Chesnara plc

Financial Statements
for the Year Ended
31 December 2007

Financial Calendar

3 April 2008	Results for the year ended 31 December 2007 announced
9 April 2008	Ex dividend date
11 April 2008	Dividend record date
11 April 2008	Published Financial Statements issued to shareholders
19 May 2008	Annual General Meeting
20 May 2008	Dividend payment date
August 2008	Interim results for the six months ending 30 June 2008 announced

Forward-looking statements

This document may contain forward-looking statements with respect to certain of the plans and current expectations relating to future financial condition, business performance and results of Chesnara plc. By their nature, all forward-looking statements involve risk and uncertainty because they relate to future events and circumstances that are beyond the control of Chesnara plc including, amongst other things, UK domestic and global economic and business conditions, market-related risks such as fluctuations in interest rates, inflation, deflation, the impact of competition, changes in customer preferences, delays in implementing proposals, the timing, impact and other uncertainties of future acquisitions or other combinations within relevant industries, the policies and actions of regulatory authorities, the impact of tax or other legislation and other regulations in the jurisdiction in which Chesnara plc and its subsidiaries operate. As a result, Chesnara plc's actual future condition, business performance and results may differ materially from the plans, goals and expectations expressed or implied in these forward-looking statements.

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Note on Terminology

On 30 June 2006 the long-term business of City of Westminster Assurance Company Limited, a Group subsidiary, acquired on 2 June 2005, was transferred, under the provisions of Part VII of the Financial Services and Markets Act 2000, to the Group's other principal operating subsidiary, Countrywide Assured plc, in which the whole of the Life operations of the Group now subsist. However, within this document reference is made to "CWA" and to "CA" to continue to identify respectively the long-term business which had been conducted within the respective companies prior to this transfer.

Financial Highlights

	Year ended 31 December	
	2007	**2006**
IFRS basis		
Operating profit	28.8	26.5
Financing costs	(1.1)	(1.2)
Loss on sale of subsidiary company	–	(0.3)
Profit before income taxes	**£27.7m**	**£25.0m**
Basic earnings per share	24.32p	18.41p
Dividend per share	15.1p	13.1p
Shareholders' net equity	**£125.8m**	**£114.3m**
European Embedded Value basis (EEV)		
Operating profit	9.7	15.0
Investment variances and economic assumption changes	(3.3)	15.6
Profit before tax	**6.4**	**30.6**
Tax	5.7	(4.4)
Profit for the period*	**£12.1m**	**£26.2m**
Covered business		
Shareholder net worth	77.6	84.5
Value of in-force business	94.0	109.9
Embedded value	171.6	194.4
Acquired embedded value financed by debt	(12.4)	(16.6)
Shareholders' equity in other Group companies	28.1	11.3
Shareholders' equity on EEV basis	**£187.3m**	**£189.1m**
Life annual premium income (AP)	£102.3m	£113.4m
Life single premium income (SP)	£32.0m	£54.8m
Life annualised premium income (AP + 1/10 SP)	£105.5m	£118.9m

In contrast with the IFRS basis of reporting, the EEV basis recognises the discounted value of the expected future cash flows, arising from the long-term business contracts in force at the year end, as a component of shareholder equity. Accordingly, the EEV result recognises, within profit, the movement in this component. Investment variances and economic assumption changes for the year ended 31 December 2006 are stated net of a £0.3m loss arising on the sale of a subsidiary company.

* Profit for the year ended 31 December 2006 includes non-replicating items of £14.2m.

I am pleased to present the fourth annual financial statements of Chesnara plc ("Chesnara").

Background

Chesnara was listed on the London Stock Exchange in May 2004. Originally formed to become the holding company of Countrywide Assured plc on its demerger from Countrywide plc, in June 2005 it acquired City of Westminster Assurance Company Limited, a further closed life assurance company, the long-term business of which was transferred to Countrywide Assured plc on 30 June 2006.

Countrywide Assured plc now manages a portfolio of some 205,000 life assurance and pension policies and is substantially closed to new business. It writes a small amount of Guaranteed Bond and protection business and accepts top-ups to existing contracts. As a substantially closed book it is expected that the embedded value of the business will decline over time as the number of policies in force reduces and as the surplus emerging in the business is distributed by way of dividends. As the portfolio runs off, the regulatory capital supporting it may also be reduced and returned to shareholders.

Chesnara continues to seek to acquire similar businesses in order to meet our primary objective of delivering a steady and attractive dividend yield.

Review of the Business

With the recent lack of acquisition opportunities in the closed life sector in our target value range of £50m to £200m, we have, during 2007, concentrated primarily on enhancing shareholder value in the existing business. However, as the business matures the opportunity for this reduces and we have therefore also invested management time in reviewing other potential value-enhancing opportunities in the financial services sector.

During the course of the year we examined a number of such opportunities. In two instances we were satisfied that, at the right price, the financial returns would complement the current business and enhance shareholder value. As such, indicative offers were made, neither of which resulted in a completed transaction.

In the core business a number of our key business drivers have continued to demonstrate positive trends over the year.

Our recent experience of mortgage endowment misselling complaints has been generally positive. The number of complaints has reduced significantly and an increasing proportion of those received are time-barred in line with FSA rules, while uphold rates on those complaints which are not time-barred have increased. Although we do not believe that this issue has fully run its course, we do feel able, however, whilst maintaining an element of conservatism, to reduce our redress provisions, by £2.8m, based on our revised expectation of future complaint activity.

Policy lapse experience has also demonstrated better trends than we had anticipated and, whilst, with a view to future economic uncertainty, we have not significantly reset our baseline assumptions, the combined lapse experience and assumption change effects for the year add £3.7m to our embedded value.

Similarly, mortality experience has also proved positive overall, leading to a net addition of £1.5m to embedded value.

As disclosed in our Interim Statement, we identified a data error in our then-existing unit pricing system. This resulted in over-deductions from our unit-linked funds for capital gains tax and we have initiated a project which has made restitution to the funds and which will recompense policyholders, in line with the principles of Treating Customers Fairly. The provision established at the half-year, net of anticipated recoveries from third parties, has been marginally increased by £0.2m to £2.5m (£1.8m net of tax) and the migration to a new unit pricing system in December has capped the compensation liability.

We have taken the opportunity to review our longer-term expense assumptions and, consequently, a further reserve has been established which has reduced our embedded value by £2.5m.

It is particularly pleasing that, in spite of the creation of the above compensation provision and future expense-related reserve, we are able to report a strong result on both the IFRS and EEV bases of reporting.

On the IFRS basis we have posted a pre-tax profit of £27.7m for the full year ended 31 December 2007 compared with £25.0m for 2006.

On the European Embedded Value ("EEV") basis of reporting, the Group recognises a pre-tax profit of £6.4m compared with £30.6m for 2006. Apart from the key influences set out above, the pre-tax result has been reduced by economic assumption changes just in excess of £4.0m. This adverse impact is almost wholly offset by the favourable impact of related changes to the estimated future liabilities for tax, which were further reduced by some £1.5m, being the effect of the prospective reduction in the rate of Corporation Tax from 30% to 28%. As a result the net-of-tax EEV profit for the period is £12.1m compared with £26.2m for 2006. The 2006 result included two non-replicating items of note: a tax gain of £10.7m arising on the merger of the Group's life businesses and the release of a reinsurer default reserve of £3.5m.

Total shareholder equity, as stated on the EEV basis, pre-dividend appropriation, has reduced, albeit not as much as one might expect from the reduction in the underlying policy base, from £189.1m (£1.81p per share) at 31 December 2006 to £187.3m (£1.79p per share) at 31 December 2007.

Countrywide Assured plc's post-dividend capital solvency ratio at 179% remains at a premium to the target set by the Board of 150%. It has reduced from 205% at the corresponding point last year due to significant dividend transfers to Chesnara. The Group's post-dividend solvency position has strengthened significantly from 225% as at 31 December 2006 to 312% as at 31 December 2007.

Based on the strength of these results, together with the improvement in the capital solvency ratios, the Board has decided, following consultation with a number of significant shareholders, to re-base the dividend and is, therefore, pleased to recommend a final dividend of 9.85p per share (2006: 8.05p per share), in respect of the year ended 31 December 2007, representing an increase of 22.4% over the final dividend for 2006. The resulting total dividend of 15.1p per share (2006: 13.1p) represents a 15.3% increase for the year.

Outlook

Experience in the key areas of mortgage endowment complaints and persistency has proved favourable with the added and welcome improvements in mortality. This leads the Board to continue to look to the future with some optimism. We remain aware of the importance of these issues, of the management of our outsourcers and of the maintenance of our clean regulatory position. During 2007 investment performance proved volatile and this has continued into 2008. Whilst we have no direct exposure to troublesome credit instruments, we are to some extent affected by stock market weakness as it reduces future projected earnings and affects policyholder sentiment.

Value-enhancing acquisition opportunities in the life assurance sector have been notable by their absence although we continue to pursue possible acquisitions, as we believe it is a matter of when, not if, companies will come to market. In addition we continue to seek other opportunities, in the wider financial services marketplace, which could leverage value from our existing capabilities. In common with many observers we expect opportunity to arise from the ongoing credit squeeze and we believe we are well placed, with our strong financial base, to be able to capitalise on this should the right opportunity arise. If there is no clearly superior investment alternative then the possibility of a return of surplus capital to shareholders will receive increasing focus.

May I take the opportunity to welcome Peter Wright to the Board of Countrywide Assured plc. Peter retired as a Principal of Towers Perrin at the start of 2008 and, up to his retirement, he carried out the roles of Actuarial Function Holder and With Profits Actuary for Countrywide Assured plc. I look forward to the market insight and technical capability which Peter will provide in his new role.

We believe we are well placed to fulfil our stated objective of continuing to deliver a reliable and progressive dividend flow and we wish to thank all our employees for their contribution to the Group in realising this aim.

Christopher Sporborg
Chairman
2 April 2008

Christopher H Sporborg CBE is the Non-executive Chairman of Chesnara plc. He is also Chairman of the Nomination Committee. He was formerly Deputy Chairman of Hambros PLC, Deputy Chairman of Hambros Bank Limited and Chairman of Hambro Insurance Services Group PLC. At Hambros he was responsible for the acquisition of Bairstow Eves PLC in 1986 and the formation of Hambro Countrywide plc and, in 1988, the creation of the life company then called Hambro Guardian Assurance plc and now part of the Chesnara plc group of companies. He is also a director of Getty Images Inc.

Graham Kettleborough is the Chief Executive of Chesnara plc. He joined Countrywide Assured plc in July 2000 with responsibility for marketing and business development and was appointed as Managing Director and to the Board in July 2002. Prior to joining Countrywide Assured plc, he was Head of Servicing and a Director of the Pension Trustee Company at Scottish Provident. He has lifetime experience in the financial services industry, primarily in customer service, marketing, product and business development, gained with Scottish Provident, Prolific Life, City of Westminster Assurance and Target Life.

Ken Romney is the Finance Director and Company Secretary of Chesnara plc. He joined Countrywide Assured plc in 1989 and became a member of the Board in 1997. He has worked in the life assurance industry for the last 24 years. He was Chief Accountant at Laurentian Life (formerly Imperial Trident) up to 1987 and was Financial Controller at Sentinel Life between 1987 and 1989. He worked for Price Waterhouse in their audit division until 1983 in both the UK and South Africa. He is a Fellow of the Institute of Chartered Accountants in England and Wales.

Frank Hughes is the Business Services Director of Chesnara plc. He joined Countrywide Assured plc in November 1992 as an IT Project Manager and was appointed to the Board as IT Director in May 2002. He has 23 years' experience in the life assurance industry gained with Royal Life, Norwich Union and CMG.

Peter Mason is the Senior Independent Non-executive Director of Chesnara plc and is Chairman of the Audit Committee. He also serves on the Remuneration and Nomination Committees. He is currently a Non-executive Director of Homeowners Friendly Society and Countrywide Assured plc. He is the Investment Director and Actuary of Neville James Group, an investment management company. He was admitted as a Fellow of the Institute of Actuaries in 1979.

Mike Gordon is an Independent Non-executive Director of Chesnara plc and is Chairman of the Remuneration Committee. He also serves on the Audit Committee and the Nomination Committee. He spent 12 years as Group Sales Director of Skandia Life Assurance Holdings. He is Chairman of Bankhall Investment Management Limited, a Skandia-owned subsidiary.

Terry Marris is a Non-executive Director of Chesnara plc and serves on the Audit Committee, the Remuneration Committee and the Nomination Committee. He joined Countrywide Assured Group plc in 1992 and was Managing Director of Countrywide Assured plc until July 2002. Previous roles included senior management positions at Lloyds Bank and General Accident.

Directors' Report

The Directors present their report and the audited consolidated accounts of Chesnara plc ("Chesnara") for the year ended 31 December 2007.

Results and dividends

The Group consolidated income statement for the year ended 31 December 2007, prepared in accordance with International Financial Reporting Standards and set out on page 42, shows:

	2007 £000	2006 £000
Profit for the year	25,439	19,256

An interim dividend of 5.25p per ordinary share was paid by Chesnara on 12 October 2007. The Board recommends payment of a final dividend of 9.85p per ordinary share on 20 May 2008 to shareholders on the register at the close of business on 11 April 2008.

Business Review

Strategic aims

Chesnara seeks to participate actively in the consolidation of the closed life business sector in the UK. In 2004, at the same time that the Company was listed on the London Stock Exchange, we acquired Countrywide Assured plc ("CA") on CA's effective demerger from the estate agency business which now forms the core of the operations of Countrywide plc, while in 2005 we acquired City of Westminster Assurance Company Limited ("CWA") from Irish Life and Permanent plc. In 2006 we merged the long-term business of the two companies in order to release significant financial and operational synergies.

As the life company is substantially closed to new business its primary focus is on the efficient run-off of its existing life and pensions portfolios. This gives rise to the emergence of surplus which supports our primary aim of delivering an attractive long-term dividend yield to our shareholders. By the very nature of the life business assets the surplus arising will deplete over time as the policies mature, expire or are the subject of a claim.

In recent years there has been significant consolidation activity in the UK closed life sector, albeit this has slowed of late. This has been driven by the realisation that closed books offer the opportunity to rationalise operations and to achieve financial and operational synergies. These may in turn be enhanced by merging the closed books into one legal entity, which also provides the opportunity for more efficient use, and potential release, of capital from the combined businesses. As a result, returns are underpinned by the prospect of a reasonably predictable emergence of surplus.

To prolong the yield delivery afforded by this emergence of surplus we continue to search for opportunities to acquire similar businesses in the small to medium sector of the life assurance market. In the absence of suitable acquisitions we seek other opportunities in the wider financial services sector that could leverage value from our existing capabilities.

Chesnara, by virtue of its market capitalisation, primarily targets acquisitions with a value of between £50m and £200m, although other opportunities are considered. All opportunities are assessed against a number of key criteria including size, risk (including actual or potential product liabilities), mix of business, and pattern and quality of predicted profit emergence. Our strategic approach, however, remains that such potential acquisitions should not detract significantly from the key aim of delivering a steady and attractive dividend yield.

How we achieve our strategic aims

The operating model of our life business is directed towards maintaining shareholder value by outsourcing all support activities to professional specialists. This typically embraces policy administration, systems, accounting and investment management and reduces the impact of potential fixed and semi-fixed cost issues which would otherwise occur as the income streams arising from a declining in-force portfolio diminish. By securing long-term contracts to support these activities we obtain a relatively fixed cost per policy per year, which ensures that the overall cost is more predictable and reduces broadly in line with the size of the policy portfolio. It also leads to the avoidance of the full weight of systems development costs, as these will, generally, be shared with other users of the outsourcers' platforms.

At the centre we maintain a small, professional corporate governance team, whose efforts are directed towards:

– Oversight of the outsourced functions;

– Maintaining regulatory compliance;

– Pursuing value-enhancing initiatives on the existing business, including the effective management of financial exposures; and

– Promoting customer retention, thereby extending the longevity of the income stream from the in-force portfolio.

The UK life assurance industry is highly regulated, in terms of both the conduct of business operations and of financial reporting. We place particular emphasis on managing our regulatory compliance through a proactive and prudent approach and maintaining a positive relationship with our principal regulator, the Financial Services Authority ("FSA"). Accordingly, a significant part of the efforts of the corporate governance team is directed towards ensuring that the operations are effectively managed in terms of conduct of business regulations and of prudential solvency requirements.

We consider the knowledge, skills and experience of the corporate governance team to be a valuable Company asset, which also has the capability of assessing acquisition opportunities in the wider UK and offshore Financial Services sector. The team is intentionally small and focussed in the interests of keeping the overall Group expense base tight, but it is supplemented from time to time by temporary resource if justified by operational or strategic demands.

In ensuring that this small team is properly incentivised we place emphasis both on retention and on reward for Company performance. Accordingly, we maintain an annual bonus scheme where half of the potential payment is guaranteed provided that the individuals remain in Company employment on a specified date, while the remaining half is related to Company performance. The three Executive Directors also have the benefit of a longer-term incentive plan, details of which are set out in the Directors' Remuneration Report on page 33. The training and competence needs of individuals are regularly assessed as an integral part of our risk management regime described below.

We take our responsibilities for social and environmental issues seriously and recognise the importance of developing and maintaining high standards. However, in view of the scope of the Group's activities and the nature and small size of the organisation we do not consider that these aspects are critical to the achievement of our strategic aims or that they should form any significant element of remuneration or reward.

Developments during 2007

During 2007 the emergence of new acquisition opportunities in the UK closed life sector slowed considerably, particularly within our £50m to £200m value target range. Whilst we do believe that more closed life and pensions books will become available in the medium term, we have continued to investigate other opportunities which could leverage value from our existing capabilities.

During the course of the year we examined a number of such opportunities. In two instances we were satisfied that, at the right price, the financial returns would complement the current business and enhance shareholder value. As such, indicative offers were made, neither of which has resulted in a completed transaction.

As to the existing life and pensions portfolios, we have made significant progress in maintaining and improving shareholder value through 2007, the most significant developments being:

Managing the Expense Base

The acquisition of CWA presented one significant issue in that its existing administration outsourcing contract was due to terminate in February 2009. Discussions with the incumbent provider identified that they were not looking to extend the contract beyond this date on terms that would be attractive to us. We therefore took steps, leveraging the outsourcing knowledge we had in both the CA and CWA operations, to procure an alternative supplier. This resulted in the signing of a contract (on 10 January 2007) with Capita Life and Pensions Regulated Services Limited ("Capita") to provide administration services for the CWA book of business with effect from 1 April 2007. While the contract has necessitated a reduction of just under £5m in the value of the in-force portfolio to reflect increased expected administration costs over the life of the portfolio, it provides certainty of base administration costs for some time to come. The arrangement is for an initial term of 15 years with the option to extend to an 'evergreen' basis, on agreed terms, within the first two years. The resultant migration project, which will transfer the business to their systems, is well under way and has enabled us to develop our plans for the closure, in Q2 2008, of the inherited Luton operation which will, as a result of the outsourcing, reduce headcount by the equivalent of 8 of the original 9 employees.

Managing Financial Exposure

The Group pays particular attention to any area in which it has a significant financial exposure. In life and pensions portfolios these typically arise in the areas of onerous policy options and guarantees and of compensation claims for past misselling of products. While the Group's portfolios have very little exposure to the impact of investment market performance on options and guarantees, it does have sizeable exposure to the misselling of policies sold in connection with an endowment mortgage. We are required to pay redress to a subset of endowment policyholders who may have been missold their product and are required to write to policyholders on a biennial basis setting out their potential returns based on specified growth rates. We have largely emerged from a period where there has been significant media attention and ever present advertising by claims management firms which generated a significant increase in the number of claims being received. Such activity has declined as policyholders have become time-barred from making a successful complaint. 69% of our in-force mortgage endowment policies are now time-barred and this proportion is expected to increase over the course of 2008 up to a maximum of around 75%. The balance of the population will not have received the requisite red letter mailings which implies that their policies are on target to reach the expected maturity value and therefore any complaint, if upheld, is likely to receive low level, if any, compensation assuming reasonable market performance. We are pleased to report that during 2007 the number of complaints we have received has reduced significantly and that, combined with the number of complaints we are able to reject under the time-barring rules, has led us to review the provision we hold for future claims. Whilst maintaining an element of conservatism, we have reduced the provisions for future redress costs by £2.8m pre-tax (£2.0m net of tax).

The Board continue to have a conservative approach to the investment of shareholder funds, which underpins our strong solvency position and future dividend capability. The benchmark of 70% cash and 30% fixed interest has been maintained and this approach has proved beneficial in the recent investment market volatility.

Promoting Customer Retention

A key determinant of our ongoing profitability and of the level and longevity of the emergence of surplus, which underpins our dividend-paying capacity, is the rate at which customers leave us. The number of policies we manage will, of course, reduce as policies mature or as claims are made. Equally, some customers' circumstances change, in some cases as a consequence of economic conditions, and their need for, or capability to fund, the relevant policy ends. We have continued to maintain a strong focus on the retention of policies where it is in the interests of customers to continue with their arrangements. We retain a qualified office-based sales team who provide advice on our key protection and endowment product lines. They offer advice on retaining the policy where appropriate or possible alternative arrangements if necessary.

An important element of our customer retention strategy is the pursuit of superior investment performance in the unit-linked funds. These underpin our unit-linked products, which account for a significant proportion of our overall policy portfolio. The CA funds are primarily managed by Schroder Investment Management Limited ("Schroders"). The CWA funds continue to be managed by Irish Life Investment Managers Limited ("ILIM"). We meet formally with both fund managers on a quarterly basis to assess past performance and future strategy. The returns on all funds are measured against relevant benchmarks.

Managing Regulatory Requirements

As ever there have been developments on the regulatory front which we continue to manage proactively. These include:

On business conduct and practice – the ongoing work we have been doing on the FSA's Treating Customers Fairly ("TCF") initiative and the migration of our two life assurance books of business to third party outsourcing firms has provided an excellent opportunity for us to undertake a thorough review of our practice and procedures. As might be expected a number of improvements to our processes have been identified. The majority of these have been rectified with little financial effect and there are only a handful of changes still to be finalised. The majority of these will be resolved as we migrate to our outsourcers' systems.

As regards the two new TCF targets announced by the FSA, we have completed the development of TCF-related Management Information, as required, by the end of March 2008 and are confident of being able to demonstrate full TCF compliance by December 2008.

One issue has, however, been identified in the pricing of our unit-linked funds, whereby, due to a data error in the indexation of the costs of our underlying investment holdings, we have overstated our estimate of capital gains chargeable to tax. As a result, we have made greater deductions from unit-linked funds than would otherwise have been the case. The effect of this has become more significant over the last two years as investment markets have recovered from the weakness in the early part of the millennium: prior to this, the effect was masked by previously accumulated capital gains tax losses. To rectify the position, we have made restitution to the linked funds and will also compensate policyholders who may have suffered loss. Accordingly, we have established a provision of £3.0m which, net of expected recoveries from third parties, gives rise to a net charge to income of £2.5m (£1.8m net of tax) as at 31 December 2007. The exposure to the compensation was capped in late December when we successfully migrated from our long-established in-house unit-pricing system to a modern, fully functional system, operated by the relevant outsourcing partner.

We have been the subject of an FSA Arrow Lite review in 2007. This was undertaken in early July and there were no requirements of significance in the resulting Risk Mitigation Programme. Furthermore, we have been informed that we will now be on a three-year cycle for future Arrow assessments. We have also submitted an updated Individual Capital Assessment to the FSA, as is required on an annual basis, and based on the feedback received our current regulatory capital resources requirement (as set out on Page 85) will continue to be adequate. We believe that these outcomes are a strong testament to our regulatory compliance ethos and our strong risk management culture and processes.

We continue to receive and review Good Practice Guides as issued by the Association of British Insurers and, where we believe it appropriate to our business, amend our practice to comply with the guidance.

On financial reporting – in contrast with the recent past there has been little requirement for changes in financial reporting. We provide financial information supplementary to our primary financial statements which are prepared in accordance with International Financial Reporting Standards. As previously, we utilise EEV principles as the basis for providing this supplementary information, as these principles provide a framework which is intended to improve the comparability and transparency of embedded value reporting across Europe.

In addition we have continued to maintain a conservative approach to our core regulatory capital and solvency requirements, targeting a minimum cover of 150% of the Long-term Insurance Capital Requirement and 100% of the Resilience Capital Requirement. The continued strong underlying emergence of surplus results in a healthy excess of regulatory capital over the target level at both a subsidiary and a group level.

Risk management

Overlaying all the day-to-day and project activity we undertake is a strong risk management culture and regime.

We maintain a process for identifying, evaluating and managing the significant risks faced by the Group which is regularly reviewed by the Board. Our risk processes have regard to the significance of risks, the likelihood of their occurrence, taking account of existing controls, and the cost of mitigating them. The process is designed to manage rather than eliminate risk and, as such, provides reasonable, but not absolute, assurance against loss.

At the subsidiary level we maintain, in accordance with the regulatory requirements of the FSA, a risk and responsibility regime. Accordingly, the identification, assessment and control of risk is firmly embedded within the organisation and the procedures for the monitoring and updating of risk are robust. As part of this we have established a CA Risk Committee which comprises solely of Non-executive Directors. This committee receives quarterly updates of the Key Risk Register, as maintained by the executive management, for review and challenge. The Risk Committee reports directly to the CA Board. These reports are also reviewed at the Chesnara Audit Committee on a quarterly basis.

The Key Risk Register has been designed to complement the production of our Individual Capital Assessment, which we are required to submit to the FSA on request and maintain on an ongoing basis. We categorise all risks against the following relevant categories – Insurance, Market, Credit, Liquidity, Operational and Group – and identify potential exposures and the necessary capital requirements accordingly. It is inherent in the operations of the life businesses that they carry significant insurance and financial risk. The nature, scope and management of these particular risks is articulated in detail in Notes 4 and 5 to the Financial Statements on pages 58 to 73.

We acknowledge that, as a consequence of our strategy of maintaining a small central corporate governance team, this does concentrate knowledge and experience in a relatively small number of people. To minimise the risk of knowledge loss we maintain a succession plan and incentivise the team with graded company performance and loyalty bonuses dependent upon their skills and knowledge. Should a skills gap appear we look to utilise external resource until such time as a permanent solution can be identified. These processes are supplemented by the maintenance of explicit procedures to assess the competence of, and training requirements for, all key individuals within the corporate governance team.

Key performance indicators

Set out below are those indicators which we consider to be key in assessing the Group's performance. They are either in the nature of lead operational indicators or are measurements which reflect outcomes. We explain the significance of each indicator and also set out the way in which it has been formulated to the extent necessary to appreciate its characteristics.

Information on the pre-tax results of the Group is presented within the Operating and Financial Review on pages 18 to 26.

Per Policy Expenses

A key area of focus for the Group is the management of expenses incurred in servicing the in-force life and pensions policy base. In particular we seek, through outsourcing arrangements, to maximise the proportion of costs which vary with policy volume. Through the assumptions we set for reporting on an EEV basis (details of which are set out on pages 109 to 121 of these financial statements), we project anticipated policy volumes in force and anticipated expenses in managing those policies over the run-off life of the policy base. Under EEV principles these expenses include, critically, the projected stream of Chesnara holding company expenses. From these projections we derive, for each period end, a projected average expense per policy per year, which is reflected in the overall value of policies in force and, therefore, in the embedded value of the life business. This measurement will have an expected variation through lapse of time as the policy base diminishes in relation to an expense base which does not diminish in the same proportion on account of expenses which do not vary with policy volume.

Following from this, the key indicators set out below show the actual EEV-based projected expense per policy per year. The variation over time comprises:

(i) The expected variation;

(ii) The extent to which the in-force policy base is higher or lower than previously anticipated; and

(iii) The extent to which projected expenses are higher or lower than previously anticipated.

Should the Group acquire further life and pension books it would usually expect to achieve economies of scale which would feed through into a reduced per policy per year cost.

		Variation due to			
	As at 31 December 2006	**Expected variation**	**Policy volume projection**	**Expenses projection**	**As at 31 December 2007**
EEV projected expense per policy per year (£'s)	65.56	6.60	(2.10)	3.50	73.56

The stated amounts are not adjusted for projected inflation rates and are therefore stated in terms of current-year pounds.

Continued favourable policy lapse experience over the year, particularly with respect to Protection policies, has led to higher projected policy volumes and this has translated into a favourable impact on per policy costs. This has been offset by revised expense projections following, principally, from a reassessment of costs which may be incurred in the longer-term.

Policy Attrition Rate

Generally, the longer that life and pensions policies remain in force the more profit accrues to the Group. Over time the value of the in-force policies is realised into surplus within CA and this is in turn distributable to Chesnara, subject to the regulatory constraints referred to in "Regulatory Resources and Requirements" below. It is important therefore that CA maximises policy retention through influencing policyholder behaviour. Different policy product types will naturally be subject to lapse, claim or surrender to varying extents and it is a detailed review and analysis of the experience of each of these types which gives rise to the projected policy in-force assumptions underpinning the projected value of policies in force within the embedded value. A globalised statement of the annual rate of attrition of policies is provided as a broad indicator of the trend in longevity of the in-force base:

Number of in-force policies (000's)

	2007	2006
Beginning of year	228	256
End of year	205	228
Rate of attrition over the year	10%	11%

The improvement in the year-on-year attrition rate reflects both our endeavours to maximise policy retention and the tendency for attrition rates to reduce, up to a point, in closed Life businesses.

Unit-linked Fund Performance

Superior performance in the unit-linked funds helps promote policy retention and increases the embedded value of the Group as future management charges received will be of a higher magnitude. The CA Managed Fund, which represents a significant proportion of CA policyholder funds under management, returned 4.1% over the year ended 31 December 2007 (31 December 2006: 9.82%), while the CWA Global Managed Fund, which represents a significant proportion of CWA policyholder funds under management, returned 4.8% over the same period (31 December 2006: 9.34%). Overall, these returns are in line with the average of 4.5% achieved by the ABI Life Balanced Managed Funds sector.

Mortgage Endowment Misselling Complaints

We continue to carry significant exposure to mortgage endowment misselling complaints, which may become the subject of redress payments to policyholders. Three of the key drivers which define and limit the extent of this exposure are set out below:

Mortgage endowment misselling complaints

	2007	2006
Number of complaints received during the year	2,234	7,300
% upheld of complaints assessed during the year	16%	26%
% time-barred at end of year	69%	63%

The % time-barred relates to those mortgage endowment policies for which a misselling complaint is potentially not admissible through the application of rules and guidance issued by the FSA and ABI and is stated as a proportion of the total number of in-force policies on which a complaint could be made. We expect the percentage of time-barred cases to peak at around 75% towards the end of 2008.

The favourable trend in these indicators underpins the release of a proportion of existing complaints redress provisions during 2007. (See comments on the IFRS result in the Operating and Financial Review on pages 18 to 26).

Regulatory Capital Resources and Requirements

The Operating and Financial Review sets out in detail a comparison between available capital resources and regulatory capital requirements for CA on pages 24 to 25. These amounts, the operation of which act as an effective constraint on distributions from CA to Chesnara, are calculated by reference to FSA prudential regulations. The following summarises the position after making allowance for dividend payments from CA to Chesnara after the respective period ends:

	31 December	
	2007 £m	2006 £m
Available capital resources (CR) represented by:		
– Share capital	40.0	40.0
– Retained earnings	5.2	21.9
– Surplus in long-term business fund	2.4	2.5
	47.6	64.4
Regulatory capital resource requirement (CRR)	26.6	31.4
Target requirement	39.1	45.8
Ratio of CR to CRR	179%	205%
Excess of CR over target requirements	£8.5m	£18.6m

The CA Board sets a minimum target of 150% of the long-term insurance capital requirement and of 100% of the resilience capital requirement components of the CRR. At each reported period end, it can be seen that CA is significantly over this target, while the year on year decline from 205% to 179% follows explicitly from pursuing a more vigorous dividend distribution from CA to Chesnara.

The target requirement as at 31 December 2007 has fallen below the amount of share capital in CA for the first time and it follows that £0.9m (being the difference between the target requirement and the amount of share capital) of the reported excess of £8.5m cannot be distributed to Chesnara other than by way of a capital reduction in CA. This constraint is now expected to increase over the next few years and the ratio of CR to CRR is, accordingly, expected to rise significantly.

Further details relating to regulatory capital resources and requirements are provided in the Operating and Financial Review on page 24.

Future trends and developments

In line with our primary aim of delivering an attractive long-term dividend yield we remain focussed on the efficient management of the emergence of surplus. We will continue to seek to maintain balance between the risks we accept and the cost of mitigating them. However, we recognise that, without further acquisitions, support for the dividend will eventually diminish and that the expense base, however well managed, will become an issue as we will have a diminishing income stream to cover fixed and semi-fixed costs. With the current lack of opportunity in the closed life book sector, we have begun to look at other propositions that would utilise the skill sets of the corporate team whilst offering value to shareholders. We remain committed to assessing any opportunities that present in the closed life sector and believe that, in time, such opportunities will arise from ongoing structural change in the marketing and distribution of life and pensions products, or from restructuring and strategic change driven by the existing owners.

As we have taken measures to de-risk the life business and to make the operational structure more efficient, we can now predict the medium-term flow of surplus from the life business with a reasonable degree of certainty. However, key uncertainties remain, particularly with respect to:

(i) The volatility of investment markets: Whilst shareholders have no direct exposure to sub-prime market issues, the volatility in equity markets since the middle of 2007 has affected fund performance, policyholder sentiment and, as fund values have fluctuated, the embedded value of the company. The sensitivity of the embedded value to investment market movements, is detailed on page 120;

(ii) Ongoing domestic- or European-driven regulatory change, e.g. the ongoing review of insurance companies under the European Solvency II initiative; and

(iii) Changes in the application or interpretation of regulatory-based rules relating to mortgage endowment misselling claims.

Provided that these areas do not adversely impact the prospects of the Group, the short- to medium-term outlook is positive for the ongoing emergence of surplus, the life business's excess over target capital requirements and, accordingly, for ongoing dividend support.

Financial risk

Disclosure with respect to financial risk is included in Note 5 to the Financial Statements.

Directors

The present Directors, all of whom served from 1 January 2006 to 31 December 2007 are listed on page 7. No other Directors served during that period and there have been no changes between that date and 2 April 2008.

The Non-executive Directors who served as Chairmen and members of the Nominations and Audit Committees of the Board are set out in the Corporate Governance Report on pages 27 to 32. Information in respect of the Chairman and members of the Remuneration Committee and in respect of Directors' service contracts is included in the Directors Remuneration Report on pages 33 to 38, which also includes details of Directors' interests in shares and share options.

On 29 January 2007 Terry Marris, whose existing term of appointment expired on 1 March 2007, was re-appointed for a further three years, so that his term of appointment now ends on 1 March 2010.

On 2 April 2008 Mike Gordon, whose existing term of appointment expires on 30 April 2008, was re-appointed for a further three years, so that his term of appointment now ends on 30 April 2011.

Pursuant to the Articles of Association, Mike Gordon and Terry Marris will retire by rotation at the Annual General Meeting and, being eligible, offer themselves for re-election. No Director seeking re-election has a service contract with the Company of more than one year's duration.

No Director had any material interest in any significant contract in the Company or in any of the subsidiary companies during the year.

The Directors benefited from qualifying third party indemnity provisions in place during the years ended 31 December 2006 and 31 December 2007 and at 2 April 2008.

The Company also provided qualifying third party indemnity provisions to certain directors of associated companies during the years ended 31 December 2006 and 31 December 2007 and at 2 April 2008.

Substantial shareholdings

The following substantial interests in the Company's ordinary share capital at 31 December 2007 have been notified to the Company:

Name of substantial shareholder	Total number of ordinary shares held	Percentage of the issued share capital as at 31 December 2007
Allianz AG	13,916,525	13.31%
New Star Asset Management	10,004,204	9.57%
Threadneedle Asset Management Holdings Limited	6,658,928	6.36%
AXA SA	4,994,951	4.78%
Lloyds TSB Group plc	4,310,619	4.12%
Witmer Asset Management LLC	3,896,173	3.72%
Legal and General Group Plc	3,381,967	3.23%
Standard Life Group	3,287,883	3.14%

Subsequent to 31 December 2007, the following changes in shareholdings have been notified to the Company:

Name of substantial shareholder	Date of Notification	Total number of ordinary shares held	Percentage of the issued share capital
Witmer Asset Management LLC	15 January 2008	–	–
Legal and General Group Plc	25 March 2008	< 5%	< 5%

The other substantial shareholder interests remained unchanged at 25 March 2008 and no other person holds a notifiable interest in the issued share capital of the Company.

There were no significant contracts with substantial shareholders during the year.

Charitable donations and political contributions

Charitable donations made by Group companies during the year ended 31 December 2007 were £nil (2006: £nil). No political contributions were made during the year ended 31 December 2007 (2006: £nil).

Employees

The average number of employees during the year was 28 (2006: 31).

Equal opportunities

Chesnara is committed to a policy of equal opportunity in employment and believes that this is essential to ensuring its success. Chesnara will continue to select, recruit, train and promote the best candidates based on suitability for the role and treat all employees and applicants fairly regardless of race, gender, marital status, ethnic origin, religious beliefs or disability. Chesnara will ensure that no employee suffers harassment or intimidation.

Disabled employees

Chesnara will provide employment for disabled persons wherever the requirements of the Group allow and if applications for employment are received from suitable applicants. If existing employees become disabled, every reasonable effort will be made to achieve continuity of employment.

Health, safety and welfare at work

Chesnara places great importance on the health, safety and welfare of its employees. Relevant policies, standards and procedures are reviewed on a regular basis to ensure that any hazards or material risks are removed or reduced to minimise or, where possible, exclude the possibility of accident or injury to employees or visitors.

The policies, standards and procedures are communicated to employees through contracts of employment, the staff handbook and employee briefings and all employees have a duty to exercise responsibility and do everything possible to prevent injury to themselves and others.

Social, environmental and ethical issues

Chesnara aims to be sensitive to the cultural, social and economic needs of our local community and endeavours to protect and preserve the environment where it operates.

We seek to be honest and fair in our relationships with our customers and provide the standards of products and services that have been agreed.

Being an office-based financial services company, the Directors believe that its activities do not materially contribute to pollution or cause material damage to the environment. However, the Company takes all practicable steps to minimise its effects on the environment and encourages its employees to conserve energy, minimise waste and recycle work materials.

Creditors payment policy

It is Chesnara's policy to pay creditors in accordance with the CBI Better Practice Payment Code (available at www.payontime.co.uk) on supplier payments. The number of creditor days outstanding at 31 December 2007, based on the consolidated financial statements, was 3 for the Group (2006: 3) and 5 for the Company (2006: 9).

Going concern statement

After making appropriate enquiries, the Directors confirm that they are satisfied that the Company and the Group have adequate resources to continue in business for the foreseeable future. Accordingly, they continue to adopt the going concern basis in the preparation of the financial statements.

Disclosure of information to Auditor

The Directors who held office at the date of approval of this Directors' Report confirm that, so far as they are each aware, there is no relevant audit information of which the Company's Auditor is unaware; and each Director has taken all the steps that they ought to have taken as a director to make themselves aware of any relevant audit information and to establish that the Company's Auditor is aware of that information.

Auditor

In accordance with section 384 of the Companies Act 1985, a resolution for the re-appointment of KPMG Audit Plc as Auditor of the Company is to be proposed at the forthcoming Annual General Meeting.

Approved by the Board on 2 April 2008 and signed on its behalf by:

Ken Romney
Director

Operating and Financial Review

The Business Review, presented in the Directors' Report on pages 8 to 14, sets out the strategic aims of the Company, how the Company meets these aims and developments and trends in realising them. This Operating and Financial Review, which should be read in conjunction with the Business Review, provides more detailed information about the characteristics and structure of the business, its operating results for 2007 under both the IFRS and EEV bases of reporting, together with further analysis of the Embedded Value and of other key financial aspects.

Characteristics and Structure of the Business

Background

Chesnara plc ("Chesnara"), which was listed on the London Stock Exchange in May 2004, was formed to become the holding company of the life assurance activities of Countrywide plc ("Countrywide"), from which they were demerged. Its principal operating subsidiary, Countrywide Assured plc ("CA"), was established in 1988 as the life assurance division of Countrywide and sold mortgage-related life assurance products through Countrywide's financial services division. As a substantially closed life business it continues to administer its in-force portfolio which comprises predominantly endowment and protection policies, this reflecting CA's history of providing mortgage-related policies to clients of an estate-agency based financial services group.

In June 2005 Chesnara acquired City of Westminster Assurance ("CWA") for a total purchase consideration of £47.8m. CWA was, on acquisition, approximately 40% of the size of the existing life business, CA, and is also substantially closed to new business. The funding for the purchase, which was settled in cash, was made by the raising of further equity of £22m from shareholders, and by the provision of a bank loan of £21m, with the balance being sourced from internal retained funds.

In common with the CA business, the policies comprising the CWA business include a mix of endowment, protection and pension policies. However, unlike CA, there is a relatively high proportion of pension policies and this helps to improve the overall mix of Chesnara's business by spreading the risk subsisting within the different policy types. On 30 June 2006, the long-term business of CWA was transferred to CA under the provisions of Part VII of the Financial Services and Markets Act 2000 (the "Part VII Transfer"). Besides reducing the reporting and regulatory burden, financial and operational synergies have been, and continue to be, recognised.

Overall CA now manages a portfolio of some 205,000 policies of which a significant proportion is unit-linked. There is a small proportion of with-profits policies (less than 2% by policy count) which are wholly reassured to Guardian Assurance plc ("Guardian"), a subsidiary of Aegon NV. CA has continued to market and sell Guaranteed Income and Guaranteed Growth Bonds resulting in a managed reduction to £12.8m of single premium income in 2007 (2006: £34.4m). CA also sells a small amount of protection business to existing customers while both the CA and CWA businesses benefit from additional inward flows on their existing life and pension contracts by way of inflation-linked increases and rebates received from the government in respect of contracted-out pension policies.

Structure of the Business

The Chesnara Group operating model is to maintain a small, centralised corporate governance team and to outsource all core operating activities. Both the administration of its life assurance and pensions books and the allied investment management functions are outsourced to professional specialists.

Our agreement with Liberata Financial Services Limited ("Liberata") to outsource back office functions for the CA business with effect from 1 February 2005 continues. The agreement, which runs for 10 years, provides Chesnara with a defined level of cost per policy during the term and mitigates the risks and significant cost inefficiencies that arise from a diminishing policy base. Whilst the transition project, which will migrate the business to Liberata's systems, is running behind expected timescales, the service levels have been in line with the agreed standards.

In January 2007, we entered into an outsourcing agreement with Capita Life and Pension Regulated Services Limited ("Capita") for them to provide back office functions for the CWA book of business from 1 April 2007 for a period of 15 years. This replaced an existing agreement with Computer Sciences Corporation that was due to expire early in 2009. As part of the new agreement a project to facilitate migration of CWA's policy administration to Capita's systems is under way and is expected to complete in mid 2008.

The agreements with our outsourcers provide the life business with a closer relationship between the size of its policy base and the level of expenses incurred in administering those policies during the terms of the agreements and this mitigates a number of risks including:

- The impact of increasing per policy costs which would affect both policy competitiveness and returns to shareholders;
- The failure to retain resource with key skills, knowledge and experience against a backdrop of reducing policy numbers and consequent headcount reductions; and
- The inevitable disparity between maintaining key resource levels and funding necessary systems developments to meet ongoing business requirements (e.g. of a legal or regulatory nature) and the reducing income with which to support them.

Chesnara Group activities are centred in Preston, Lancashire, with support for the CWA business being provided from Luton, Bedfordshire. It is expected that the Luton office will close in mid 2008 following the completion of the migration of the book to Capita's systems. On completion of the transition just one of the nine roles that existed on acquisition will be transferred to the revised corporate governance team. Chesnara has 16.5 FTE employees in its corporate governance team and this is expected to reduce to 14.5 FTE's in the second half of 2008. The team are engaged on the identification and development of business opportunities, management of the outsourcing contracts, corporate governance and the fulfilment of regulatory responsibilities.

Chesnara is a small professional knowledge-based team which is resourced to deliver known requirements. As such it will, from time to time, require external resource to facilitate new and/or unexpected developments. In the main, it aims to build on its existing relationships but will closely monitor the availability, quality and cost of suitable alternatives.

Key Dependencies

The Chesnara Group continues to rely on a number of key relationships for the successful and efficient conduct of its business:

Reinsurance – the CA and CWA businesses have transferred part of their exposure to certain risks to other insurance companies through reinsurance arrangements. Under such arrangements, other insurers have assumed a portion of the losses and expenses associated with reported and unreported losses in exchange for a portion of the policy premiums.

Outsourcing – the CA and CWA businesses have transferred most of their operational functions to third party service providers under agreements described above. Both businesses maintain a close relationship with the providers to monitor their financial and operational performance and to ensure that their performance is in accordance with agreed service standards.

Systems – Chesnara is required to maintain, and regularly test, a business continuity plan. With the transfer of the Preston-based operations to Liberata the relevant systems and the continuity plan have been transferred to them. As part of its agreement with Liberata Chesnara continues to support Liberata's plan to migrate the systems supporting CA's business to their own systems. The related agreement also provides for Liberata to manage the systems, including provision for business continuity, to support the operation of the Preston-based governance team. Similar business continuity and governance systems support arrangements exist with Capita in respect of the operations currently based in Luton. Capita are migrating the systems supporting CWA's business to their specialist administration system: this migration is due for completion in mid 2008 following which the administration functions will transfer to Capita's shared processing centre in Gloucester.

Investment management – the CA and CWA businesses have both outsourced the management of their own and policyholder investments to third party investment managers. Ongoing monitoring of their performance is maintained and is formally reviewed each month by internal management and every quarter with the Investment Managers. Schroder Investment Management Limited provides investment management services to the CA business whilst those of the CWA business are provided by Irish Life Investment Managers Limited.

Operating Review

Basis of Accounting

The Group reports primarily in accordance with International Financial Reporting Standards ("IFRS"). As IFRS essentially permits the "grandfathering" of the principles and bases used to measure profit arising on long-term insurance contracts under previously-adopted UK GAAP and, as the business of the Group predominantly relates to life contracts in run off, so the earnings profile of the Group will continue to be dominated by the underlying emergence of surplus in these businesses as measured for UK regulatory reporting purposes.

The Group continues to provide financial information supplementary to the IFRS basis. With effect from reporting periods commencing on 1 January 2006, the Group adopted European Embedded Value ("EEV") principles as the basis for providing this supplementary information in lieu of the Achieved Profit ("AP") basis of reporting. AP and EEV methodologies are similar, insofar as both aim to measure the underlying embedded value of the Group's life assurance, pensions and annuity businesses. However, EEV principles provide a framework which is intended to improve the comparability and transparency of embedded value reporting across Europe.

IFRS Result

The following summarises pre-tax earnings information reflected in the IFRS Income Statement, showing, for the year ended 31 December 2007, the contribution from the constituent businesses of the Group.

	CA business £000	CWA business £000	Parent company £000	Amortisation of AVIF £000	Total £000
Year ended 31 December 2007					
Operating profit	18,566	12,674	1,071	(3,502)	28,809
Finance costs	–	–	(1,089)	–	(1,089)
Profit before income taxes	**18,566**	**12,674**	**(18)**	**(3,502)**	**27,720**
Year ended 31 December 2006					
Operating profit	17,184	12,506	313	(3,502)	26,501
Finance costs	–	–	(1,206)	–	(1,206)
Loss on sale of subsidiary company	(248)	–	–	–	(248)
Profit before income taxes	**16,936**	**12,506**	**(893)**	**(3,502)**	**25,047**

Notes

(1) Financing costs arise in respect of a bank loan raised to part finance the acquisition of CWA.

(2) Amortisation of Acquired Value In-Force (AVIF) represents a post-acquisition charge to profits of the write down of the acquired value of CWA in-force business, as measured at the acquisition date. The pattern of amortisation is broadly intended to match the pattern of surplus arising from the run off of the underlying CWA insurance and investment contract portfolios.

Overall, the result for the year ended 31 December 2007 reflects the continuing strong emergence of surplus in both CA and CWA, as the underlying in-force insurance and investment contracts run off. Positive investment performance in shareholder funds over the year, together with continuing favourable lapse and mortality experience, have led to both principal businesses posting results in excess of those for the year ended 31 December 2006, notwithstanding that:

(i) the in-force policy base is smaller; and

(ii) statutory expense assumptions relating to insurance contracts have been strengthened to take account of additional costs which may be incurred in the longer term.

Within CA, this outcome has absorbed the net adverse pre-tax impact of £0.8m in respect of financial exposures comprising:

(i) a release of £1.7m in respect of the mortgage endowment misselling redress provision offset by

(ii) an additional provision of £3.0m for estimated redress to policyholders in respect of an error in the pricing of certain unit-linked funds which, net of estimated recoveries of £0.5m from third parties, results in a net charge to income of £2.5m.

Both of these adjustments are explained in more detail in the Business Review on page 8. The CA result has also benefited, in comparison with 2006, from the fact that the result for that year is stated after a charge of £1.1m in respect of the amortisation of deferred acquisition costs relating to insurance contracts. There is no corresponding charge for 2007 as these costs became fully amortised during 2006.

Within CWA, the result has benefited from a release of £1.1m in respect of its mortgage endowment misselling redress provision. The CWA result continues to make a significant contribution to Group earnings net of related parent company debt financing costs and of amortisation of acquired in-force value, both of which are identified in the table above. The pre-tax contribution from CWA, including the effect of these items, was £8.1m (£7.8m for the year ended 31 December 2006).

The parent company operating profit comprises the return on invested retained funds which were at a significantly higher level in 2007 compared with 2006.

EEV Result

Supplementary information prepared in accordance with EEV principles and set out in the financial statements on pages 109 to 121 is presented to provide alternative information to that presented under IFRS. EEV principles recognise profits as they are earned over the life of insurance and investment contracts and assist in identifying the value being generated by the life businesses. The result determined under this method represents principally the movement in the life businesses' embedded value, before transfers made to the Parent Company and ignoring any capital movements. As the Group's life assurance operations are now substantially closed to new business, the principal underlying components of the EEV result are the expected return from the business in force (being the yield at the risk discount rate on the related policy cash flows as they fall into surplus) together with (1) variances of actual experience from that assumed for each component of the policy in force cash flows and (2) the impact of resetting assumptions for each component of the prospective cash flows.

The following is a summarised statement of the EEV result:

	Year ended 31 December	
	2007 £000	**2006 £000**
Operating profit before tax	9,662	14,985
Variation from longer term investment return	824	6,307
Economic assumption changes	(4,043)	9,284
Profit before tax	**6,443**	**30,576**
Tax		
– current	(4,379)	(5,166)
– deferred	10,053	793
Profit for the year after tax	**12,117**	**26,203**

Profit for the year after tax is significantly lower for the year ended 31 December 2007, as compared with the prior year. The result for the year ended 31 December 2006 benefited from the following non-replicating items:

(i) a projected total saving in future tax of £10.7m arising as a result of the merger of the long-term business funds of the Group's two life assurance businesses; and

(ii) the release of £3.5m relating to a reinsurer default reserve which was no longer required.

Operating profit before tax for the year ended 31 December 2007 is some £0.5m short of the profit which would be expected from the unwind of the risk discount rate on the embedded value. The main influences underlying this variation have been:

	£m
On the favourable side:	
– new business contribution	1.3
– return on shareholder net worth	2.1
– mortality experience	1.5
– net lapse experience and assumption changes	3.7
– release of mortgage endowment redress provisions	2.8
offset on the adverse side by:	
– provision for policyholder redress in respect of unit pricing error	(2.5)
– strengthening of expense assumptions	(3.5)
– strengthening of morbidity assumptions	(2.2)
– capital gains tax deductions and assumption effects	(4.6)

The strengthening of expense assumptions follows principally from a reassessment of additional costs which may be incurred in the longer term, while adverse Capital Gains Tax effects have arisen from adverse investment market conditions and from a change in the recognition of the effects of deemed disposals relating to equity-based collective investment schemes.

At the profit before tax level, the result for the year has been further adversely affected by some £4.0m of adverse economic assumption changes. However, this amount is broadly offset by credits to the deferred tax movement for the year (reduction in liability to future tax within the value-in-force component of embedded value), so that there is a relatively insignificant impact at the net of tax level. These effects have arisen as a result of the derivation of a higher risk margin within the risk discount rate in conjunction with changes in the projected tax position as between the market consistent and traditional embedded value approaches as explained in Note 4(e) to the Supplementary Information.

The prospective reduction in the rate of Corporation Tax from 30% to 28% has given rise to a further reduction of some £1.5m in the deferred tax liability for future profits, with a consequential increase to the deferred tax credit to income for the year.

Shareholders' Equity and Embedded Value of Covered Business – EEV Basis

The consolidated balance sheet prepared in accordance with EEV principles may be summarised as:

	31 December	
	2007 £000	**2006 £000**
Value of in-force business	94,007	109,941
Other net assets	93,308	79,167
	187,315	**189,108**
Represented by:		
Embedded value ("EV") of covered business	171,639	194,401
Less: amount financed by borrowings	(12,469)	(16,574)
EV of covered business attributable to shareholders	159,170	177,827
Net equity of other Group companies	28,145	11,281
Shareholders' equity	**187,315**	**189,108**

The tables below set out the components of the value of in-force business by major product line at each period end:

Number of policies	31 December 2007 000	31 December 2006 000
Endowment	66	75
Protection	75	86
Annuities	4	4
Pensions	51	53
Other	9	10
Total	**205**	**228**

Value in-force	31 December 2007 £m	31 December 2006 £m
Endowment	58.3	70.3
Protection	63.0	73.1
Annuities	2.0	2.8
Pensions	38.1	41.7
Other	1.4	0.8
Total at product level	**162.8**	**188.7**
Valuation adjustments		
Holding company expenses	(20.7)	(21.7)
Other	(21.4)	(22.5)
Cost of capital	(5.5)	(3.4)
Value in-force pre-tax	**115.2**	**141.1**
Taxation	(21.2)	(31.2)
Value in-force post-tax	**94.0**	**109.9**

The value-in-force represents the discounted value of the future surpluses arising from the insurance and investment contracts in force at each respective period end. The future surpluses are calculated by using realistic assumptions for each component of the cash flow.

Policyholder Funds Investment Return

The CA Managed Fund, which is managed by Schroder Investment Management Limited and which represents a significant proportion of CA policyholder funds under management, returned 4.1% over the year ended 31 December 2007. The CWA Global Managed Fund, which is managed by Irish Life Investment Managers Limited and which represents a significant proportion of CWA policyholder funds under management, returned 4.8% over the same period. Overall, both funds were in line with the average of 4.5% achieved by the ABI Life Balanced Managed Fund sector.

Returns to Shareholders

Returns to shareholders are underpinned by the emergence of surplus in, and transfer of surplus from, the life business' long-term insurance fund to shareholder funds and by the return on shareholder net assets representing shareholder net equity. These realisations are utilised in the first instance for the repayment and servicing of the bank loan on the basis set out in Note 29 to the IFRS Financial Statements (on page 97). The surplus arises from the realisation of value in-force, which effectively unwinds at the risk discount rate used to discount the underlying cash flows: at 31 December 2007 this rate was reset to 7.7% (31 December 2006: 6.1%), following the methodology described in the Supplementary Information – European Embedded Value Basis. The return on shareholder net assets is determined by the Group's investment policy. Shareholder funds bear central corporate governance costs which cannot be fairly attributed to the long-term insurance funds and which arise largely in connection with the status of Chesnara as a listed company.

The Board's continuing primary aim is to provide a reliable and progressive dividend flow to shareholders within the context of the emergence of surplus in the life business. In the absence of further suitable acquisition opportunities and in view of growing retained distributable funds within Chesnara, the Board has decided to re-base the level of dividend payments such that the total dividend in respect of 2007 is some 15% higher than that in respect of 2006. Towards the end of 2006 the shares generally traded within a range of 170p to 185p. From the beginning of 2007 to the end of November 2007 the shares generally traded in a range between 165p and 185p. This reflected the fact that, in accordance with its strategy, Chesnara is essentially a yield stock which, in the absence of other acquisitions, holds out the prospect of a return of capital to shareholders. However, since the end of November 2007, the shares have generally traded within a range of 160p to 170p. With total proposed dividends in respect of the year ended 31 December 2007 at 15.1p per share this implies a yield of between 8.9% and 9.4%. In accordance with this, the shares may also be characterised as trading at a discount to Group embedded value, as reported on the EEV basis as at 31 December 2007, within a range of 5.1% to 10.7%. The recent weakening of the share price is in line with general market weakness, particularly in the financial sector which has been affected by widely reported issues in credit markets. Chesnara maintains its cash balances in deposit-based accounts and fixed interest securities. It has no direct exposure to credit derivatives or similar instruments.

Financial Review

Solvency and Regulatory Capital

Regulatory Capital Resources and Requirements

The regulatory capital of life insurance companies in the UK is calculated by reference to FSA prudential regulations. The rules are designed to ensure that companies have sufficient assets to meet their liabilities in specified adverse circumstances. As such, there is a restriction on the full transfer of surplus from the long-term business fund to shareholder funds of the life company and on the full distribution of reserves from the life company to Chesnara.

The following summarises the capital resources and requirements of the life company for regulatory purposes, before and after making provision for dividend payments from the life company to Chesnara, which were approved after the respective period ends.

	31 December	
	2007 £m	2006 £m
Pre-dividend		
Available capital resources ("CR")	77.6	84.4
Long-term insurance capital requirement ("LTICR")	25.1	28.8
Resilience capital requirement ("RCR")	1.5	2.6
Total capital resources requirement ("CRR")	26.6	31.4
Target capital requirement cover	39.1	45.8
Excess of CR over target requirement	38.5	38.6
Ratio of available CR to CRR	292%	269%
Post dividend		
Available capital resources ("CR")	47.6	64.4
Long-term insurance capital requirement ("LTICR")	25.1	28.8
Resilience capital requirement ("RCR")	1.5	2.6
Total capital resources requirement ("CRR")	26.6	31.4
Target capital requirement cover	39.1	45.8
Excess of CR over target requirement	8.5	18.6
Ratio of available CR to CRR	179%	205%

The CA Board, as a matter of policy, continues to target CR cover for total CRR at a minimum level of 150% of the LTICR and 100% of the RCR. To the extent that the target capital requirement cover of £39.1m as at 31 December 2007 falls short of the £40m share capital component of CR, so it follows that £0.9m of the reported excess of CR over target requirement is not available for distribution to shareholders except by way of a capital reduction. This constraint did not apply as at 31 December 2006.

It can be seen from this information that Chesnara, which relies on dividend distributions from its life company, is currently in a favourable position to service its loan commitments and to continue to pursue a progressive dividend policy.

Insurance Group Directive

In accordance with the EU Insurance Group Directive, the Group calculates the excess of the aggregate of regulatory capital employed over the aggregate minimum solvency requirement imposed by local regulators. The following sets out these calculations pre and post the recognition of interim and final dividends for the financial year, but approved by the Board and paid to Group shareholders after the respective dates:

	31 December	
	2007 £m	2006 £m
Pre-dividend		
Available group capital resources	93.2	79.1
Group regulatory capital requirement	(26.6)	(31.4)
Excess	66.6	47.7
Cover	350%	252%
Post-dividend		
Available group capital resources	82.9	70.7
Group regulatory capital requirement	(26.6)	(31.4)
Excess	56.3	39.3
Cover	312%	225%

The regulatory requirement is that available group capital resources should be at least 100% of the capital requirement.

Individual Capital Assessments

The FSA Prudential Sourcebooks require an insurance company to make its own assessment of its capital needs to a required standard (a 99.5% probability of being able to meet its liabilities to policyholders after one year). In the light of scrutiny of this assessment, the FSA may impose its own additional individual capital guidance. The Individual Capital Assessment is based on a realistic liability assessment, rather than on the statutory mathematical reserves, and involves stress testing the resultant realistic balance sheet for the impact of adverse events.

CA completed a further annual assessment during 2007 as a result of which it was concluded that the effective current- and medium-term capital requirement constraints on distributions to Chesnara will continue to be on the basis set out under "Regulatory capital resources and requirements" above.

FSA Policy Statement

The FSA published a policy statement, PS06/14, in December 2006 implementing various changes to the valuation of liabilities for statutory solvency purposes, effective from 31 December 2006. These changes are permissive rather than mandatory in operation and, after due consideration, the CA Board has concluded that, in view of the current financial position of CA, these changes should not be reflected in the year-end statutory valuation basis adopted by CA.

International Reporting Developments

Over the year we have continued to monitor developments on the EU Solvency II framework which, when introduced, will replace the current framework developed in the 1970s with a risk-based approach. We provided feedback to the FSA on our concerns relating to certain aspects of the proposals, which we are pleased to see have been partially addressed by subsequent developments. The final regulations will not take effect for some years, but we will continue to monitor progress in this area in the meantime.

In May 2007 the IASB released for comment a Discussion Paper on accounting for insurance and reinsurance contracts, entitled "Preliminary Views on Insurance Contracts", as part of the second phase of their insurance contracts project, which we reviewed and responded on. We will continue to monitor developments in this area.

Capital Structure, Treasury Policy and Liquidity

The Group's operations are ordinarily financed through retained earnings and through the current emergence of surplus in the life businesses. It normally does not make use of financial reinsurance or similar arrangements. There is no trading in any currencies other than sterling. Cash available for more than twelve months is normally transferred to fund managers for longer-term investment.

The Board continues to have a conservative approach to the investment of shareholder funds in the life businesses, which underpins our strong solvency position. This approach targets the investment of 100% of available funds in cash and fixed interest securities.

The profile and mix of investment asset holdings between fixed interest stocks and cash on deposit is such that realisations to support dividend distributions can be made in an orderly and efficient way.

Other factors which may place a demand on capital resources in the future include the costs of unavoidable large scale systems development such as those which may be involved with changing regulatory requirements and the requirement to finance further possible acquisitions of other closed life books and businesses in run-off. To the extent that ongoing administration of CA's life businesses is performed within the terms of its third party outsourcing agreements, the Group is sheltered, to a degree, from these development costs as they are likely to be on a shared basis, as common platforms are developed.

To the extent that the Group proposes to acquire closed life businesses in the future, it is intended that this could be done through a suitable combination of equity and debt financing and, to a lesser degree, from internal resources. This would be done, however, within the constraints of not diluting returns to shareholders and of the operation of regulatory rules regarding the level of debt finance which may be borne by Insurance Groups.

Cash flows

The Group's longer-term cash flow cycle is currently characterised by the inflow to shareholders funds of transfers from the long-term insurance funds, which are supported by the emergence of surplus within those funds. These flows are used to support dividend distributions to shareholders.

Going concern

The Group's cash flow position described above supports its ability to trade in the short term. Projections of surplus arising in the insurance funds indicate that these are at levels which should be able to continue to withstand normal business risks. In addition, Countrywide Assured plc has continued to prepare an annual Financial Condition Report. This report was based on a review of the company's ability to withstand a number of adverse scenarios and indicated that it was able to withstand, over the medium to longer term, the impact of these adverse scenarios, including a number of them in combination.

The base expectation is that, notwithstanding the existence of risks addressed in these adverse scenarios, the Group will generate surplus in its long-term business sufficient to meet its debt obligations as they fall due and to pursue a reliable and progressive dividend policy.

The Directors are committed to achieving a high standard of corporate governance including compliance with the principles and practices of the Combined Code on Corporate Governance (the "Code"), as published by the Financial Reporting Council in June 2006 and as appended to the Listing Rules.

The following statement, together with the Directors Remuneration Report on pages 33 to 38, describes how the principles set out in the Code have been applied by the Company and details the Company's compliance with the Code's provisions for the year ended 31 December 2007.

Compliance with the Combined Code

The Company has complied throughout the year with all of the provisions of the Combined Code.

The Board

The Board comprises a Non-executive Chairman, three other Non-executive Directors and three Executive Directors, each of whom served throughout the period under review.

Biographical details of all Directors are given on page 7. The Board, which plans to meet eight times during the year, has a schedule of matters reserved for its consideration and approval. These matters include:

- Setting corporate strategy
- Approving the annual budget and medium-term projections
- Reviewing operational and financial performance
- Approving major acquisitions, investments and capital expenditure
- Reviewing the Group's system of financial and business controls and risk management
- Approving appointments to the Board
- Appointment of the Company Secretary
- Approval of policies relating to Directors' remuneration

This schedule is reviewed annually. In addition, the Directors of the Company are also directors of Countrywide Assured plc (CA), the principal subsidiary company in which the life business of the Group subsists. Under FSA Prudential Regulation the directors of CA have responsibility for maintenance and projections of solvency and for assessment of capital requirements, based on risk assessments, and for establishing the level of long-term business provisions, including the adoption of appropriate assumptions.

The responsibilities that the Board has delegated to the Executive Management of the business include: the implementation of the strategies and policies of the Group as determined by the Board; monitoring of operational and financial results against plans and budget; prioritising the allocation of capital, technical and human resources and developing and managing risk management systems.

The Roles of the Chairman and Chief Executive

The division of responsibilities between the Chairman of the Board, Christopher Sporborg, and the Chief Executive, Graham Kettleborough, is clearly defined and has been approved by the Board. The Chairman leads the Board in the determination of its strategy and in the achievement of its objectives and is responsible for organising the business of the Board, ensuring its effectiveness and setting its agenda. The Chairman has no day-to-day involvement in the management of the Group. The Chief Executive has direct charge of the Group on a day-to-day basis and is accountable to the Board for the financial and operational performance of the Group.

Senior Independent Director

The Board has appointed Peter Mason as Senior Independent Director. He is available to meet shareholders on request and to ensure that the Board is aware of shareholder concerns not resolved through the existing mechanisms for shareholder communication.

Directors and Directors' Independence

The Board considers that Peter Mason, Mike Gordon and Terry Marris are independent Non-executive Directors.

In making this determination, the Board has carefully considered the following matters:

Terry Marris had, within the last five years of the period covered by this report, been an employee of a subsidiary company within the Countrywide Assured Life Holdings Limited Group ("CALH"), which was acquired by the Company on 24 May 2004. He also held the position of Managing Director of Countrywide Assured plc, the principal operating life assurance subsidiary of CALH prior to the acquisition of CALH by the Company. He resigned these positions in July 2002.

Peter Mason is also a Non-executive Director of Countrywide Assured plc, a position which he has held since 1 October 1990, and a Non-executive Director of CALH, the parent company of Countrywide Assured plc, a position which he has held since 18 November 1991.

The Board considers that the characteristics, aims and mode of operation of the relevant activities are sufficiently different from those prevailing when these Directors held the relevant positions, that the judgement and independence of mind they exercise on behalf of the Company are not adversely affected or circumscribed. The Board is of the view that the considerable specific experience and knowledge of these Directors in the business of the Group outweighs any residual risk in the historic relationships described above, while the overall balance of the Board provides significant independence of mind and judgement. The Board further considers that, taking the Board as a whole, the Independent Directors are of sufficient calibre and number that their views carry sufficient weight in the Company's decision making.

The Directors are given access to independent professional advice, at the Company's expense, when the Directors deem it necessary, in order for them to carry out their responsibilities.

Details of the Chairman's professional commitments are included in his biography on page 7. He does perform a number of pro-bono roles, but the Board is satisfied that these are not such as to interfere with his performance, which is based around a commitment of between fifty and sixty hours in any three-month period.

Professional Development

The Directors were advised, on their appointment, of their legal and other duties and obligations as Directors of a listed Company. This has been supplemented by the adoption and circulation to each Director of a written Code of Conduct, covering all aspects of the specific operation of Corporate Governance standards and of policies and procedures within the Group. Throughout their period in office, the Directors have, through the conduct of business at scheduled Board meetings, been continually updated on the Group's business and on the competitive and regulatory environment in which it operates. Through their continuing membership of the Board of the principal operating life subsidiary of the Group all of the Directors who served during the period under review continue to have considerable knowledge and experience of the business of the Chesnara plc Group, including, significantly, the wider FSA regulatory environment as to Conduct of Business and Prudential Regulation.

There have been no new appointments to the Board during the period covered by this report. A detailed induction programme will be undertaken for all such future appointments embracing the Code of Conduct referred to above and up to date information on the strategy and financial and operating performance of the Group.

Information

Regular reports and information are circulated to the Directors in a timely manner in preparation for Board and Committee meetings.

As stated above all of the Company's Directors are also members of the Board of the Company's principal operating life assurance subsidiary which holds scheduled quarterly meetings. These meetings are serviced by detailed regular reports and information, which cover all of the key areas relevant to the direction and operation of that subsidiary including:

- Earnings report
- Report from and recommendations by the Actuarial Function Holders
- Compliance report
- Investment report
- Outsourcing report

The life assurance subsidiary monitors risk management procedures, including the identification, measurement and control of risk through the offices of a Risk Management Committee. This committee is accountable to and reports to its Board on a quarterly basis.

In addition, annual reports are produced which cover an assessment of the capital requirements of the life assurance subsidiary, its financial condition and a review of its internal financial and business controls.

The quarterly meetings of the life assurance subsidiary are timed to be held immediately prior to Chesnara plc Board meetings.

On a monthly basis, the Directors receive summary high level information which enables them to maintain continuing oversight of the Group's and management's performance against objectives.

In addition to these structured processes, the papers are supplemented by information which the Directors require from time to time in connection with major events and developments, where critical views and judgements are required of Board members outside the normal reporting cycle.

Performance Evaluation

During the period under review the Chairman undertook a formal performance evaluation of the Board, individual Directors and of the Audit, Remuneration and Nomination Committees. To that end he devised a series of questionnaires to provide a framework for the evaluation process and to provide a means of making year-on-year comparisons. Individual Director assessments were supplemented by discussions between the Chairman and each Director on a one-to-one basis.

In addition, and using similar methods to those described above, the Non-executive Directors, led by the Senior Independent Director, met to conduct a performance evaluation of the Chairman.

The Company Secretariat facilitated the process to ensure that it was conducted in a timely and objective manner while the Head of Internal Audit, reporting to the Senior Independent Director, monitors the assessment and follow through of the issues arising in the evaluation process.

Company Secretary

The Company Secretary, Ken Romney, is responsible for advising the Board, through the Chairman, on all governance matters. The Directors have access to the advice and services of the Company Secretary.

Board Committees

The Board has established the committees set out below to assist in the execution of its duties. Each of these committees operates according to written terms of reference and the Chairman of each committee reports to the Board. The constitution and terms of reference of each committee are reviewed annually to ensure that the committees are operating effectively and that any changes considered necessary are recommended to the Board for approval. The terms of reference of each committee are available on the Company's website at www.chesnara.co.uk or, upon request, from the Company Secretary. There have been no changes to any of the Committees' terms of reference during the period covered by this review.

The attendance record of each of the Directors at scheduled Board and Committee meetings for the period under review is:

	Scheduled Board	Nomination Committee	Remuneration Committee	Audit Committee
Non-executive Chairman – Christopher Sporborg	7(8)	2(2)	n/a	n/a
Non-executive Director – Peter Mason	8(8)	2(2)	2(2)	5(5)
Non-executive Director – Terry Marris	8(8)	2(2)	2(2)	5(5)
Non-executive Director – Mike Gordon	7(8)	2(2)	2(2)	4(5)
Executive Director – Graham Kettleborough	8(8)	n/a	n/a	n/a
Executive Director – Ken Romney	8(8)	n/a	n/a	n/a
Executive Director – Frank Hughes	8(8)	n/a	n/a	n/a

The figures in brackets indicate the maximum number of meetings in the period during which the individual was a Board member. The information above relates to the period from 1 February 2007 to 31 January 2008.

Nomination Committee

During the period under review, the Nomination Committee comprised Christopher Sporborg (who also served as Chairman of the Committee), Peter Mason, Terry Marris and Mike Gordon. The Committee considers the mix of skills and experience that the Board requires and seeks the appointment of Directors to meet its assessment of what is required to ensure that the Board is effective in discharging its responsibilities.

During the period, the Committee met twice and considered the continuing mix of skills and experience of the Directors. There were no new appointments during the period.

Remuneration Committee

Full details of the composition and work of the Remuneration Committee are provided in the Directors' Remuneration Report on pages 33 to 38.

Audit Committee

During the period under review, the Audit Committee comprised Peter Mason (who also acted as Chairman), Mike Gordon and Terry Marris, the other independent Non-executive Directors. The Board is satisfied that Peter Mason has recent and relevant financial experience. On invitation, the Chief Executive, the Finance Director, the Head of Internal Audit and the external Auditor attend meetings to assist the Committee in fulfilment of its duties. The Committee met 5 times during the period under review.

The role of the Audit Committee is to assist the Board in discharging its duties and responsibilities for financial reporting, corporate governance and internal control. The Committee is also responsible for making recommendations to the Board in relation to the appointment, re-appointment, and removal of the external Auditor. The Committee's duties include keeping under review the scope and results of the audit work, its cost effectiveness and the independence and objectivity of the Auditor.

During the period under review, the Audit Committee discharged its responsibilities by:

- reviewing the Group's draft Financial Statements prior to Board approval and reviewing the external Auditor detailed reports thereon, in respect of the half year ended 30 June 2007 and the year ended 31 December 2007
- reviewing the appropriateness of the Group's accounting policies
- reviewing the provision of supplementary reporting of financial information in accordance with European Embedded Value principles, including the methodology undertaken and the assumptions adopted
- reviewing and approving the audit fee estimates
- reviewing the external Auditor plan for the audit of the Group's financial statements which included an assessment of key risks and confirmation of Auditor independence
- reviewing and approving the Internal Audit plan for the internal audit of the Group's internal controls, embracing operating, financial and business controls
- reviewing an annual report on the Group's systems of internal control and its effectiveness and reporting to the Board on the results of the review
- reviewing regular reports from the Head of Internal Audit
- reviewing the report on key risks by executive management
- reviewing the appointment of the external Auditor
- meeting the external Auditor without an Executive Director or a member of the Company's senior management being present
- reviewing the nature and volume of non-audit services provided by the external Auditor to ensure that a balance is maintained between objectivity and value added
- reviewing and approving the audit fee and non-audit fees
- reviewing the Group's fraud and whistle-blowing policies and procedures

Auditor Independence and Objectivity

The external Auditor, KPMG Audit Plc and its associates, provide some non-audit services primarily in the provision of taxation and regulatory advice and in relation to Corporate transactions that may arise from time to time. In order to ensure that auditor objectivity and independence are safeguarded, the following procedures have been put in place:

Audit-related services

These relate to formalities such as shareholder and other circulars, regulatory reports and work on acquisitions. This is work that the external Auditor performs in its capacity as Auditor, where the nature of the work is closely allied to that on the audit of the annual financial statements. Accordingly, this work will be undertaken by the external Auditor unless unusual circumstances apply.

Tax advice

The external Auditor will be used when particularly relevant and all other significant tax advice will be put out to tender.

General advice

All sizeable projects are put out to tender. The external Auditor will be invited to tender, provided that both parties are satisfied that the nature of the contract will not present a threat to the independence of the Auditor.

These safeguards have been approved by the Audit Committee and it is intended that they will be reviewed when required in the light of internal developments or of changes in the external circumstances of the Company. The Auditor reports to both the Directors and the Audit Committee with regard to compliance with professional and regulatory requirements and best practice.

Details of the fees paid to the Auditor, and its associates, for non-audit services during the year are provided in Note 14 to the financial statements (on page 76).

Relations with Shareholders

The Chief Executive, Graham Kettleborough, and the Finance Director, Ken Romney, meet with institutional shareholders on a regular basis and are available for additional meetings when required. Should they consider it appropriate, institutional shareholders are able to meet with the Chairman, Christopher Sporborg, the Senior Independent Director, Peter Mason and any other Director. The Chairman is responsible for ensuring that appropriate channels of communication are established between the Chief Executive and the Finance Director on the one part and the shareholders on the other and is responsible for ensuring that the views of shareholders are known to the Board. This includes twice yearly feedback prepared by the Group's brokers on meetings the Executive Directors have held with institutional shareholders.

Annual and interim reports are distributed to other parties who may have an interest in the Group's performance and those reports, together with a wide range of information of interest to existing and potential shareholders, are made available on the Company's website, www.chesnara.co.uk.

Regular meetings are also held with industry analysts and commentators so that they are better informed in formulating opinions and making judgements on the Group's performance. Private investors are encouraged to attend the Annual General Meeting ("AGM") at which the opportunity is provided to ask questions on each proposed resolution. The Chairmen of the Board Committees will be available to answer such questions as appropriate. Details of the resolutions to be proposed at the AGM on 19 May 2008 can be found in the notice of the meeting on pages 122 to 126.

Internal Control

The Board is ultimately responsible for the Group's system of internal control and for reviewing its effectiveness. In establishing the system of internal control, the Directors have regard to the significance of relevant risks, the likelihood of risks occurring and the costs of mitigating risks. It is, therefore, designed to manage rather than eliminate the risks which prevent the Company meeting its objectives and, accordingly, only provides reasonable, but not absolute, assurance against the risk of material misstatement or loss.

In accordance with "Internal Control: Guidance for Directors on the Combined Code" (The "Turnbull Guidance") the Board confirms that there is an ongoing process for identifying, evaluating and managing the significant risks faced by the Group, that this process has been in place for the year under review and up to the date of approval of the Annual Financial Statements and that the process is regularly reviewed by the Board and accords with the guidance.

In accordance with the regulatory requirements of the FSA, the Group's principal life assurance subsidiary has established and maintained a risk and responsibility regime. This ensures that the identification, assessment and control of risk is firmly embedded within the organisations and that there are procedures for monitoring and update of the same. The Compliance function of the life assurance subsidiary reviews and reports quarterly on this regime to the subsidiary's Board. This process is supplemented by the establishment and maintenance of key risk registers for both the life assurance subsidiary and for the Company, which ensure that, against various appropriate classes of risk, there is identification, assessment and control of the significant risks subsisting within these organisations. The maintenance of the key risk registers is the responsibility of the executive management, who report on them quarterly to the Risk Committee of the Board of the life assurance subsidiary and to each Chesnara Audit Committee meeting.

As stated above, all of the Company's Directors are also members of the principal life assurance subsidiary's Board and the scheduled quarterly Board Meetings of the life assurance subsidiary are immediately followed by corresponding Board meetings of the Company, which thereby has effective oversight of the maintenance and effectiveness of controls subsisting within the life assurance subsidiary. In addition, the Chesnara Board confirms that it has undertaken a formal annual review of the effectiveness of the system of internal control for the year ended 31 December 2007 and that it has taken account of material developments between that date and the date of approval of the Annual Financial Statements. The Board confirms that these reviews took account of reports by the Internal Audit Department on the operation of controls, internal financial controls, management assurance on the maintenance of controls and reports from the external Auditor on matters identified in the course of statutory audit work.

The Board also confirms the continuing appropriateness of the maintenance of an Internal Audit Function, which reports to the Senior Independent Director.

Going Concern

The Directors' Statement on Going Concern is included in the Directors' Report on page 17.

The Remuneration Committee

The Remuneration Committee (the "Committee") determines the overall pay policy and the remuneration packages and the service contracts of the Executive Directors of the Company, including the operation of bonus schemes. It also monitors the remuneration of other senior employees of Chesnara plc.

During the period under review the Committee comprised of three Non-executive Directors: Mike Gordon (who also acted as Chairman), Peter Mason and Terry Marris. The Company Secretary, Ken Romney, acts as Secretary to the Committee, and provides advice on legal and regulatory issues relating to remuneration policy. At the request of the Committee, Graham Kettleborough, the Chief Executive, also attends and makes recommendations to the Committee regarding changes to the remuneration packages of individual Directors (excluding himself) or to policy generally. Such recommendations are discussed by the Committee and adopted or amended as it sees fit. No Director is present at any part of the Committee meeting at which his own remuneration or contractual terms are being discussed. The membership and terms of reference of the Committee are reviewed annually and the terms of reference are available on the Company's website at www.chesnara.co.uk or, upon request, from the Company Secretary. Details of the number of meetings held and the attendance can be found in the Corporate Governance Report on page 29.

Remuneration Policy

The Committee aims to set remuneration at an appropriate level to attract, retain and motivate executives of the necessary calibre. An annual review of remuneration is undertaken to ensure reward levels are appropriate to the duties and responsibilities of the roles with a suitable balance between the fixed and variable elements of overall reward. In determining salary levels due regard is given to external market data relating to both financial services sector companies and listed companies of similar size. Lower quartile and market median reward levels are used when formulating and reviewing policy.

The annual bonus scheme and the long-term incentive plan are designed to incentivise and retain the Executive Directors. The plans, which are cash based, reward the achievement of corporate targets set for the year and are therefore aligned with the delivery of value to shareholders. The annual bonus plan is pensionable whilst the long-term plan is not. The Committee may award other discretionary bonuses to the Executive Directors where they consider extraordinary value has been created or significant achievement has occurred.

The Company has established frameworks for approved and unapproved discretionary Share Option Plans and a Sharesave Plan, none of which has been utilised.

Basic Salary

The Committee reviews salaries annually taking into consideration individual and Company performance, the responsibilities and accountabilities of each role, the experience of each individual and his or her marketability and future potential, and market data relating to both financial services sector companies and listed companies of similar size.

Executive Directors' remuneration also includes non-pensionable benefits in kind by way of a company car, life assurance and private medical insurance.

Bonus Schemes

The 2007 Annual Bonus Scheme was designed to incentivise the Executive Directors. The scheme consists of two elements and the overall maximum award is 50% of basic salary.

The first element is a retention measure and this becomes payable on completion of service to the end of the year. This is designed to reflect the specific nature of the business which, in the absence of further acquisitions, is a run-off proposition which requires particular skill sets and does, inherently, offer limited career opportunities.

The second element is based on Group performance and is designed to ensure that Executive Directors' awards are closely aligned to shareholders' interests on this element of the scheme. It is, therefore, based upon the level of achievement of budgeted IFRS pre-tax profit.

These arrangements can be summarised as follows:

Element	Award
Retention	25% of basic salary on completion of service to year-end.
Group performance IFRS pre-tax profit:	
– less than 90% of budget	Nil
– at 90% of budget	12.5% of basic salary and then increasing pro rata to:
– at or greater than 100% of budget	25% of basic salary

The table below sets out the details of the awards made to the Executive Directors under the scheme in 2007.

Annual Bonus Scheme – awards made in respect of year ended 31 December 2007

Graham Kettleborough	£71,312
Ken Romney	£54,856
Frank Hughes	£49,370

Awards made under the Annual Bonus Scheme are pensionable as this is considered to be a significant retention feature of such an arrangement.

The Long-term Incentive Plan was designed as a long-term cash based incentive for Executive Directors. As the business is a run-off proposition in its current form, the Remuneration Committee believes that a share based plan would be inappropriate and, therefore, the scheme continues on a cash basis. The scheme consists of two elements and there is no overall maximum award.

The first element is a retention measure and this becomes payable on completion of three years service after it is earned. This is designed to reflect the specific nature of the business as explained in the Annual Bonus section above.

The second element is based on Group performance and is designed to ensure that Executive Directors' awards are closely aligned to shareholders' interests on this element of the scheme. It is, therefore, also based upon the level of achievement of budgeted IFRS pre-tax profit.

This scheme differs from the Annual Bonus Scheme in that awards are made on a rolling half-year basis rather than on an annual basis. As an additional retention measure, payment of awards is deferred for three years.

These arrangements can be summarised as follows:

Element	Award
Retention	16.66% of basic salary on completion of service to mid-year 16.66% of basic salary on completion of service to year-end
Group performance IFRS pre-tax profit:	
– at or less than 75% of budget in first half-year	Nil
– at 100% of budget in first half-year	And then increasing pro rata to 33.3% of basic salary
– at or less than 75% of budget in second half-year	Nil
– at 100% of budget in first half-year	And then increasing pro rata to 33.3% of basic salary

Where pre-tax IFRS profit exceeds 100% of budget, the award increases on a straight-line basis.

The table below summarises the awards made to the Executive Directors under the above scheme for each of the relevant periods covered by this report.

Management Performance Incentive Plan – awards made in 2006 and 2007

	Amount awarded in respect of the half-year ended			
	31 December 2007	30 June 2007	31 December 2006	30 June 2006
Graham Kettleborough	£76,785	£55,364	£64,510	£46,670
Ken Romney	£59,066	£42,588	£49,623	£35,900
Frank Hughes	£53,159	£38,329	£44,661	£32,310

Awards made under the Long-term Incentive Plan are non-pensionable.

Share Options

The Board has established frameworks for a Sharesave Plan and approved and unapproved discretionary Share Option Plans which may, at the discretion of the Remuneration Committee, be utilised for granting options to Executive Directors and other employees. During 2007 no such options were granted.

Service Contracts

The Executive Directors, who were all appointed on 1 March 2004, have service contracts with a rolling twelve-month notice period. Compensation on termination of service contracts will be decided on a case-by-case basis having regard to the particular circumstances.

Pension Policy

Until the end of May 2005 the Executive Directors, with the permission of Countrywide Assured Group plc ("CAG"), from which Chesnara was demerged in May 2004, and of the Trustees of their pension scheme, continued membership of the defined contribution section of the CAG pension scheme. Both they, and the Company contributed to this scheme. From 1 June 2005 they became eligible to enter, and entered, the Chesnara plc Stakeholder Scheme of which they continued to be members during the period covered by this report and to which employer contributions are made at the same rate as would have been payable had their membership of the CAG scheme continued. Employer contributions were made to the respective schemes as detailed on page 38.

Non-executive Directors

The remuneration of the Non-executive Directors is determined by the Board as a whole in accordance with the Articles of Association. Non-executive Directors do not have service contracts with the Company, neither are they eligible for bonuses, pensions or participation in Company share option schemes. The date of expiry of their terms of appointment are:

	Date of expiry of term of appointment
Christopher Sporborg (Chairman)	31 December 2008
Peter Mason	31 October 2008
Mike Gordon	30 April 2011
Terry Marris	1 March 2010

On 2 April 2008 the Board agreed to re-appoint Mike Gordon for a period of three years further to the date of expiry of his current appointment, being 30 April 2008.

Mike Gordon and Terry Marris retire by rotation at the end of the forthcoming AGM, at which a resolution proposing their re-election will be tabled.

Directorate

The Directors who served during the period, all of whom were appointed on 1 March 2004, were:

Chairman

Christopher Sporborg

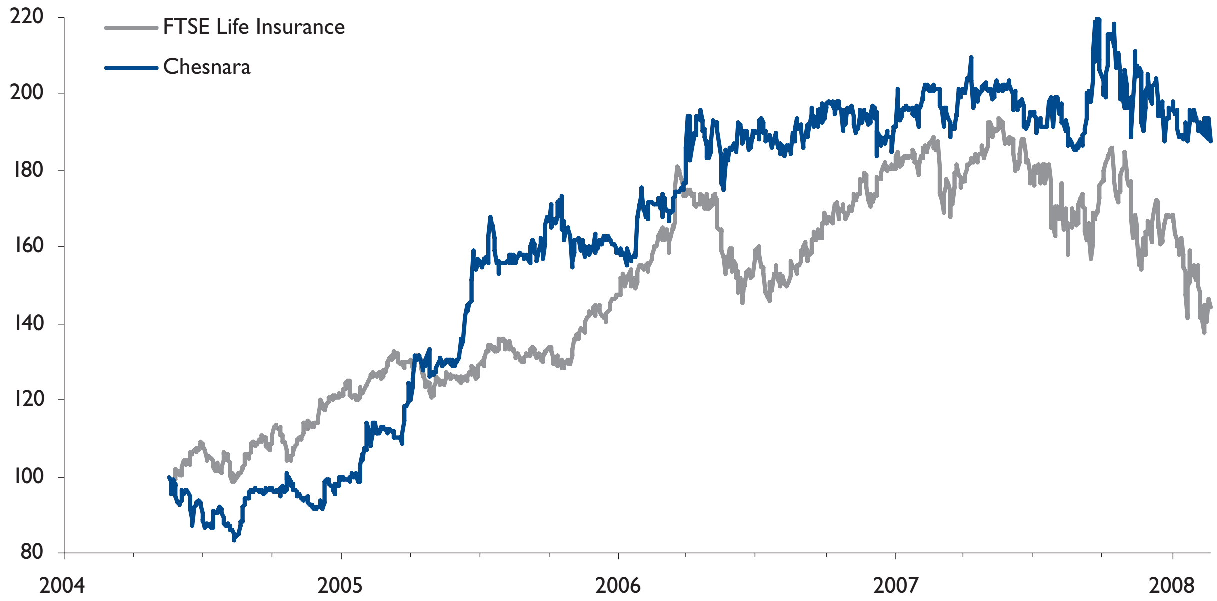
Non-executive Directors

Peter Mason
Terry Marris
Mike Gordon

Executive Directors

Graham Kettleborough
Ken Romney
Frank Hughes

Performance Graph



The above graph shows a comparison of the Company's total shareholder return ("TSR") performance against the FTSE Life Insurance sector index. The Company considers this to be the most appropriate index, given that its activities are centred on life insurance. The graph has been prepared in accordance with section 234B of the Companies Act 1985, except that it shows the TSR for the Company and the relevant index from 25 May 2004 only to 20 February 2008. The Company was first listed on the London Stock Exchange on 25 May 2004.

Directors' Interests in Shares

Directors' interests in the ordinary shares of Chesnara plc were as set out below (number of shares):

	31 December 2007		31 December 2006	
	Beneficial	Non-beneficial	Beneficial	Non-beneficial
Christopher Sporborg	75,000	–	75,000	–
Peter Mason	2,500	–	2,500	–
Terry Marris	52,708	–	52,708	–
Mike Gordon	–	–	–	–
Graham Kettleborough	26,000	–	19,659	–
Ken Romney	15,476	–	15,476	–
Frank Hughes	5,163	–	5,163	–

Graham Kettleborough purchased an additional 4,000 shares on 10 January 2008 bringing his total holding to 30,000 at 2 April 2008. There were no other changes in the Directors' shareholdings in Chesnara plc between 31 December 2007 and 2 April 2008.

Directors' Remuneration

The Auditors are required to report on this and the remaining sections of the Remuneration Report.

Total Directors' remuneration for the year ended 31 December 2007 is shown below with comparative figures for the year ended 31 December 2006.

	Year ended 31 December	
	2007 £000	2006 £000
Aggregate emoluments:		
Fees to non-executive directors	140	140
Emoluments to executive directors	865	809
Company contributions to pension schemes	84	55
Total	1,089	1,004

The following table, which has been prepared in accordance with regulatory requirements, sets out the constituents of Directors' emoluments for the year-ended 31 December 2007:

	Salaries and fees £000	Bonuses £000	Deferred bonuses £000	Benefits £000	Total 2007 £000	Total 2006 £000
Executive Directors						
Graham Kettleborough	135	71	132	13	351	325
Ken Romney	106	55	102	15	278	257
Frank Hughes	86	49	91	10	236	227
	327	175	325	38	865	809
Non-executive Directors						
Christopher Sporborg	50	–	–	–	50	50
Peter Mason	40	–	–	–	40	40
Terry Marris	25	–	–	–	25	25
Mike Gordon	25	–	–	–	25	25
	140	–	–	–	140	140
Total	**467**	**175**	**325**	**38**	**1,005**	**949**

The fees payable to Terry Marris were paid, with the addition of VAT, to his employing company, Countrywide Property Lawyers Limited, a subsidiary of Countrywide plc, until 31 December 2006. From that date payments were made directly to him.

The following table sets out each Executive Director's pension benefits for the years ended 31 December 2007 and 31 December 2006.

	Company contributions to money purchase scheme	
	2007 £000	2006 £000
Graham Kettleborough	25	16
Ken Romney	33	28
Frank Hughes	26	11
	84	55

A Salary Sacrifice scheme was introduced in July 2007. As a result, contributions formerly made by Executive Directors are now made by the Group and deducted from Directors' salaries.

The pension arrangements for the Executive Directors are set out on page 35.

No pension contributions were made by companies within the Chesnara plc Group from 1 January 2006 to 31 December 2007 in respect of any of the Non-executive Directors.

Directors' Share Options

No options were granted in respect of any Chesnara plc Share Option Scheme between 1 January 2007 and 2 April 2008, nor were there any options outstanding as at 31 December 2006, 31 December 2007 or 2 April 2008.

Approved by the Board of Directors on 2 April 2008 and signed on its behalf by:

Christopher Sporborg **Graham Kettleborough**

Statement of Directors' Responsibilities in respect of the Financial Statements and the financial statements

The Directors are responsible for preparing the Group and Parent Company financial statements in accordance with applicable law and regulations.

Company law requires the Directors to prepare Group and Parent Company financial statements for each financial year. Under that law they are required to prepare the Group financial statements in accordance with IFRSs as adopted by the EU and applicable law and have elected to prepare the Parent Company financial statements on the same basis.

The Group and Parent Company financial statements are required by law and IFRSs as adopted by the EU to present fairly the financial position of the Group and the Parent Company and the performance for the period; the Companies Act 1985 provides in relation to such financial statements that references in the relevant part of that Act to financial statements giving a true and fair view are references to their achieving a fair presentation.

In preparing each of the Group and Parent Company financial statements, the Directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgements and estimates that are reasonable and prudent;
- state they have been prepared in accordance with IFRSs as adopted by the EU; and
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the Group and Parent Company will continue in business.

The Directors are responsible for keeping proper accounting records that disclose with reasonable accuracy at any time the financial position of the Parent Company and enable them to ensure that the financial statements comply with the Companies Act 1985. They have general responsibility for taking such steps as are reasonably open to them to safeguard the assets of the Group and detect fraud and other irregularities.

Under applicable law and regulations, the Directors are also responsible for preparing a Directors' Report, Directors' Remuneration Report and the Corporate Governance Statement that comply with that law and those regulations.

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

Independent Auditor's Report to the Members of Chesnara plc

We have audited the Group and Parent Company financial statements (the "financial statements") of Chesnara plc for the year ended 31 December 2007 which comprise the Group Income Statement, the Group and Parent Company Balance Sheets, the Group and Parent Company Cash Flow Statements, the Group and Parent Company Statements of Changes in Equity, and the related notes. These financial statements have been prepared under 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 auditor's report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Company and the Company's members as a body, for our audit work, for this report, or for the opinions we have formed.

Respective responsibilities of Directors and Auditors

The Directors' responsibilities for preparing the Financial Statements, the Directors' Remuneration Report and financial statements in accordance with applicable law and International Financial Reporting Standards (IFRSs) as adopted by the EU are set out in the Statement of Directors' Responsibilities on page 39.

Our responsibility is to audit the financial statements and the part of the Directors' Remuneration Report to be audited in accordance with relevant legal and regulatory requirements and International Standards on Auditing (UK and Ireland).

We report to you our opinion as to whether the financial statements give a true and fair view and whether the financial statements and the part of the Directors' Remuneration Report to be audited have been properly prepared in accordance with the Companies Act 1985 and, as regards the Group financial statements, Article 4 of the IAS Regulation. We also report to you whether in our opinion the information given in the Directors' Report is consistent with the financial statements. The information given in the Directors' Report includes that specific information presented in the Operating and Financial Review that is cross referred from the Business Review section of the Directors' Report.

In addition we report to you if, in our opinion, the Company has not kept proper accounting records, if we have not received all the information and explanations we require for our audit, or if information specified by law regarding directors' remuneration and other transactions is not disclosed.

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

We read the other information contained in the Financial Statements and consider whether it is consistent with the audited financial statements. We consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the financial statements. Our responsibilities do not extend to any other information.

Basis of audit opinion

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

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the financial statements and the 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 financial statements and the part of the Directors' Remuneration Report to be audited.

Opinion

In our opinion:

- the Group financial statements give a true and fair view, in accordance with IFRSs as adopted by the EU, of the state of the Group's affairs as at 31 December 2007 and of its profit for the year then ended;
- the Parent Company financial statements give a true and fair view, in accordance with IFRSs as adopted by the EU as applied in accordance with the provisions of the Companies Act 1985, of the state of the Parent Company's affairs as at 31 December 2007;
- the financial statements and the part of the Directors' Remuneration Report to be audited have been properly prepared in accordance with the Companies Act 1985 and, as regards the Group financial statements, Article 4 of the IAS Regulation; and
- the information given in the Directors' Report is consistent with the financial statements.

KPMG Audit Plc 2 April 2008

Chartered Accountants and Registered Auditor
St James' Square
Manchester
M2 6DS

Consolidated Income Statement for the year ended 31 December 2007

	Note	Year ended 31 December 2007 £000	Year ended 31 December 2006 £000
Insurance premium revenue		103,554	112,800
Insurance premium ceded to reinsurers		(18,716)	(22,194)
Net insurance premium revenue	**7**	**84,838**	**90,606**
Fee and commission income			
Insurance contracts	**8**	38,032	43,519
Investment contracts	**8**	9,149	9,085
Investment income	**9**	90,210	151,470
Total revenue (net of reinsurance payable)		**222,229**	**294,680**
Other operating income	**10**	1,298	1,195
Net income		**223,527**	**295,875**
Policyholder claims and benefits incurred	**11**	(157,114)	(218,541)
Reinsurers' share of claims and benefits incurred	**11**	26,518	32,761
Net policyholder claims and benefits incurred		(130,596)	(185,780)
Change in investment contract liabilities	**12**	(50,697)	(58,905)
Reinsurers' share of investment contract liabilities	**12**	11,534	1,304
Net change in investment contract liabilities		(39,163)	(57,601)
Fees, commission and other acquisition costs	**13**	(1,546)	(2,881)
Administrative expenses	**14**	(15,955)	(17,184)
Other operating expenses			
Charge for amortisation of intangible assets	**15**	(3,734)	(3,773)
Reinsurance recapture premium	**15**	–	(1,374)
Other	**15**	(3,724)	(781)
Total expenses		**(194,718)**	**(269,374)**
Operating profit		**28,809**	**26,501**
Financing costs	**16**	(1,089)	(1,206)
Loss on sale of subsidiary company	**6**	–	(248)
Profit before income taxes		**27,720**	**25,047**
Income tax expense	**17**	(2,281)	(5,791)
Profit for the year		**25,439**	**19,256**
Basic earnings per share	**40**	24.32p	18.41p
Diluted earnings per share	**40**	24.32p	18.41p

The notes and information on pages 49 to 108 form part of these financial statements.

The Group considers that it has no product or distribution based segmentation and, as it only has significant business activity within the UK, it has no geographic segmentation. Accordingly, no segmented reporting is presented.

Consolidated Balance Sheet at 31 December 2007

	Note	31 December 2007 £000	31 December 2006 £000
Assets			
Intangible assets			
Deferred acquisition costs	**18**	9,542	10,687
Acquired value of in-force business			
Insurance contracts	**19**	19,427	22,144
Investment contracts	**19**	12,627	13,644
Reinsurers' share of insurance contract provisions	**27**	212,353	207,279
Amounts deposited with reinsurers	**28**	27,558	63,721
Investment properties	**20**	4,983	27,750
Financial assets			
Equity securities at fair value through income	**21**	743,670	738,487
Holdings in collective investment schemes at fair value through income	**21**	508,857	342,352
Debt securities at fair value through income	**21**	247,152	350,524
Loans and receivables including insurance receivables	**21/22**	15,415	17,310
Derivative financial instruments	**21/23**	9,525	30,642
Total financial assets		1,524,619	1,479,315
Reinsurers' share of accrued policyholder claims	**33**	4,661	4,191
Income taxes	**24**	–	260
Cash and cash equivalents	**25**	225,127	301,218
Total assets		**2,040,897**	**2,130,209**
Liabilities			
Bank overdrafts	**25**	1,229	–
Insurance contract provisions	**27**	1,110,848	1,115,197
Financial liabilities			
Investment contracts at fair value through income	**28**	726,503	812,979
Borrowings	**29**	12,469	16,574
Derivative financial instruments	**23**	265	1,421
Total financial liabilities		739,237	830,974
Provisions	**30**	3,575	597
Deferred tax liabilities	**31**	11,847	13,946
Reinsurance payables	**32**	1,622	3,059
Payables related to direct insurance and investment contracts	**33**	22,859	24,927
Deferred income	**34**	16,362	18,231
Income taxes	**35**	743	2,023
Other payables	**36**	6,791	7,000
Total liabilities		**1,915,113**	**2,015,954**
Net assets		**125,784**	**114,255**
Shareholders' equity			
Share capital	**37**	41,501	41,501
Share premium	**37**	20,458	20,458
Other reserves		50	50
Retained earnings	**38**	63,775	52,246
Total shareholders' equity		**125,784**	**114,255**

The notes and information on pages 49 to 108 form part of these financial statements.

Approved by the Board of Directors on 2 April 2008 and signed on its behalf by:

Christopher Sporborg **Graham Kettleborough**

Company Balance Sheet at 31 December 2007

	Note	31 December 2007 £000	2006 £000
Assets			
Non-current assets			
Financial assets			
Investment in subsidiaries	**21**	52,006	52,006
Current assets			
Loans and receivables	**22**	622	551
Income taxes	**24**	–	153
Cash and cash equivalents	**25**	28,994	11,555
Total current assets		29,616	12,259
Total assets		**81,622**	**64,265**
Current liabilities			
Borrowings	**29**	4,127	4,102
Income taxes	**35**	3	–
Other payables	**36**	1,913	1,523
Total current liabilities		6,043	5,625
Non-current liabilities			
Borrowings	**29**	8,342	12,472
Total liabilities		**14,385**	**18,097**
Net assets		**67,237**	**46,168**
Shareholders' equity			
Share capital	**37**	5,229	5,229
Share premium	**37**	20,458	20,458
Other reserves		50	50
Retained earnings	**38**	41,500	20,431
Total shareholders' equity		**67,237**	**46,168**

The notes and information on pages 49 to 108 form part of these financial statements.

Approved by the Board of Directors on 2 April 2008 and signed on its behalf by:

Christopher Sporborg **Graham Kettleborough**

Consolidated Statement of Cash Flows for the year ended 31 December 2007

	Year ended 31 December	
	2007 £000	2006 £000
Profit for the year	25,439	19,256
Adjustments for:		
Amortisation of deferred acquisition costs	1,145	2,312
Amortisation of acquired in-force value	3,734	3,772
Tax expense	2,281	5,791
Interest receivable	(26,650)	(26,331)
Dividends receivable	(35,997)	(30,266)
Interest expense	1,089	1,206
Change in fair value of investment properties	(1,873)	(2,328)
Fair value losses/(gains) on financial assets	31,768	(54,154)
Loss on sale of subsidiary company	–	248
Interest received	28,707	28,981
Dividends received	37,810	27,099
Changes in operating assets and liabilities (excluding the effect of acquisitions)		
(Increase)/decrease in financial assets	(54,327)	20,039
Increase in reinsurers share of insurance contract provisions	(5,544)	(7,097)
Decrease/(increase) in amounts deposited with reinsurers	36,163	(1,024)
(Increase)/decrease in other loans and receivables	(1,975)	2,932
(Decrease)/increase in insurance contract provisions	(4,349)	44,056
(Decrease)/increase in investment contract liabilities	(86,476)	9,833
Increase/(decrease) in provisions	2,978	(836)
(Decrease)/increase in reinsurance payables	(1,437)	1,010
(Decrease)/increase in payables related to direct insurance and investment contracts	(2,068)	1,061
Decrease in other payables	(3,060)	(1,650)
Cash (utilised by)/generated from operations	**(52,642)**	**43,910**
Income tax paid	(5,399)	(6,470)
Net cash (utilised by)/generated from operating activities	**(58,041)**	**37,440**
Cash flows from investing activities		
Disposal of subsidiary, net of cash disposed of	–	(295)
Net cash utilised by investing activities	**–**	**(295)**
Cash flows from financing activities		
Repayment of borrowings	(4,200)	(4,200)
Dividends paid	(13,910)	(13,268)
Interest paid	(1,169)	(911)
Net cash utilised by financing activities	**(19,279)**	**(18,379)**
Net (decrease)/increase in cash and cash equivalents	**(77,320)**	**18,766**
Cash and cash equivalents at beginning of period	**301,218**	**282,452**
Cash and cash equivalents at end of period	**223,898**	**301,218**

The notes and information on pages 49 to 108 form part of these financial statements.

Company Statement of Cash Flows for the year ended 31 December 2007

	Year ended 31 December	
	2007 £000	**2006 £000**
Profit for the year	**34,979**	**26,175**
Adjustments for:		
Tax expense/(recovery)	3	(182)
Interest expense	1,089	1,206
Dividends received from subsidiary company	(35,000)	(26,886)
Changes in operating assets and liabilities		
Decrease in loans and receivables	82	1,100
Increase in payables	565	424
Cash generated from operations	**1,718**	**1,837**
Cash flows from investing activities		
Dividends received from subsidiary company	35,000	26,886
Net cash generated from investing activities	**35,000**	**26,886**
Cash flows from financing activities		
Repayment of borrowings	(4,200)	(4,200)
Dividends paid	(13,910)	(13,268)
Interest paid	(1,169)	(911)
Net cash utilised by financing activities	**(19,279)**	**(18,379)**
Net increase in cash and cash equivalents	**17,439**	**10,344**
Cash and cash equivalents at beginning of period	**11,555**	**1,211**
Cash and cash equivalents at end of period	**28,994**	**11,555**

The notes and information on pages 49 to 108 form part of these financial statements.

Consolidated Statement of Changes in Equity for the year ended 31 December 2007

	Year ended 31 December 2007				
	Share capital £000	**Share premium £000**	**Capital redemption reserve £000**	**Retained earnings £000**	**Total £000**
Equity shareholders' funds at 1 January 2007	**41,501**	**20,458**	**50**	**52,246**	**114,255**
Profit for the period representing total recognised income and expenses	–	–	–	25,439	25,439
Dividends paid	–	–	–	(13,910)	(13,910)
Equity shareholders' funds at 31 December 2007	**41,501**	**20,458**	**50**	**63,775**	**125,784**

	Year ended 31 December 2006				
	Share capital £000	**Share premium £000**	**Capital redemption reserve £000**	**Retained earnings £000**	**Total £000**
Equity shareholders' funds at 1 January 2006	**41,501**	**20,458**	**50**	**46,258**	**108,267**
Profit for the period representing total recognised income and expenses	–	–	–	19,256	19,256
Dividends paid	–	–	–	(13,268)	(13,268)
Equity shareholders' funds at 31 December 2006	**41,501**	**20,458**	**50**	**52,246**	**114,255**

The notes and information on pages 49 to 108 form part of these financial statements.

Company Statement of Changes in Equity for the year ended 31 December 2007

	Year ended 31 December 2007				
	Share capital £000	**Share premium £000**	**Capital redemption reserve £000**	**Retained earnings £000**	**Total £000**
Equity shareholders' funds at 1 January 2007	**5,229**	**20,458**	**50**	**20,431**	**46,168**
Profit for the period representing total recognised income and expenses	–	–	–	34,979	34,979
Dividends paid	–	–	–	(13,910)	(13,910)
Equity shareholders' funds at 31 December 2007	**5,229**	**20,458**	**50**	**41,500**	**67,237**

	Year ended 31 December 2006				
	Share capital £000	**Share premium £000**	**Capital redemption reserve £000**	**Retained earnings £000**	**Total £000**
Equity shareholders' funds at 1 January 2006	**5,229**	**20,458**	**50**	**7,524**	**33,261**
Profit for the period representing total recognised income and expenses	–	–	–	26,175	26,175
Dividends paid	–	–	–	(13,268)	(13,268)
Equity shareholders' funds at 31 December 2006	**5,229**	**20,458**	**50**	**20,431**	**46,168**

The notes and information on pages 49 to 108 form part of these financial statements.

1 General information

Chesnara plc (the Company) is a limited liability company incorporated and domiciled in England and Wales and has primary listings on the London Stock Exchange. The address of the registered office is Harbour House, Portway, Preston PR2 2PR, UK.

The Company and its subsidiaries, together forming the Group, underwrite life risks such as those associated with death, disability and health. The Group also provides a portfolio of investment contracts for the savings and retirement needs of customers through asset management. These activities are performed entirely in the UK. The Group is substantially closed to new business, such that new insurance contracts are only issued to existing customers, dependent on their changing needs. New investment contracts relate to the sale of Guaranteed Growth and Guaranteed Income Bonds.

These financial statements were authorised for issue by the Directors on 2 April 2008.

2 Accounting policies

(a) Statement of compliance

The consolidated financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRSs") as adopted by the European Union ("Adopted IFRSs").

Both the Parent Company financial statements and the Group financial statements have been prepared and approved by the Directors in accordance with Adopted IFRSs. In publishing the Parent Company financial statements together with the Group financial statements the Company has taken advantage of the exemption in s230 of the Companies Act 1985 not to present its individual income statement and related notes that form a part of these approved financial statements.

In preparing these consolidated financial statements, the Group has adopted IFRS7 Financial Instruments: Disclosures and IAS1 Presentation of Financial Statements – Capital Disclosures. The adoption of IFRS7 and the amendment to IAS1 impacted the type and amount of disclosures made in these financial statements, but had no impact on the reported profits or financial position of the Group. In accordance with the transitional requirements of the standards, the Group has provided full comparative information.

(b) Basis of preparation

General

The Group financial statements consolidate those of the Company and its subsidiaries (together referred to as the "Group"). The Parent Company financial statements present information about the Company as a separate entity and not about its group.

The financial statements are presented in pounds sterling, rounded to the nearest thousand and are prepared on the historical cost basis except that the following assets and liabilities are stated at their fair value: derivative financial instruments, financial instruments at fair value through income, investment property and investment contract liabilities at fair value through income.

Assets and liabilities are presented on a current and non-current basis in the notes to the financial statements. If assets are expected to be recovered and liabilities expected to be settled within a year, they are classified as current. If they are expected to be recovered or settled in more than one year, they are classified as non-current.

The preparation of financial statements in conformity with IFRSs requires management to make judgements, estimates and assumptions that affect the application of policies and reported amounts of assets and liabilities, income and expenses. The estimates and associated assumptions are based on historical experience and various other factors that are believed to be reasonable under the circumstances, the results of which form the basis of making the judgements about carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates.

The estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised in the year in which the estimate is revised if the revision affects only that year, or in the year of the revision and future years if the revision affects both current and future years. Judgements made by management in the process of applying the Group's accounting policies that have a significant effect on the financial statements and estimates with a significant risk of material adjustment in the next year are set out in Note 3 (on pages 57 to 58).

The accounting policies set out below have been applied consistently to all years presented in these consolidated financial statements.

2 Accounting policies (continued)

Financial Reporting Standard 27, Life Assurance (FRS27) was issued by the Accounting Standards Board (ASB) in December 2004. A number of major insurance companies and the Association of British Insurers (ABI) signed a Memorandum of Understanding (MoU) with the ASB relating to its implementation. These financial statements have been prepared in accordance with the disclosure provisions of FRS27 and the guidance within the MoU.

Life business demerger and acquisition by Chesnara plc: reverse acquisition accounting

On 24 May 2004, Chesnara plc acquired the whole of the issued ordinary share capital of Countrywide Assured Life Holdings Limited ('CALH') from Countrywide plc ('Countrywide'), which had, itself, acquired the whole of the issued ordinary share capital of CALH on 22 May 2004 from Countrywide Assured Group plc ('CAG'). These arrangements were effected to secure the demerger from CAG of CALH, which, together with its subsidiary companies, comprised the life business of CAG.

On the acquisition of CALH, Chesnara plc issued, as fully paid, 2.5p ordinary shares to the shareholders of Countrywide ('the Countrywide shareholders') as recorded on the shareholders register on 21 May 2004, *pro rata* to their holding in Countrywide, such that they received one ordinary share in Chesnara plc for every two ordinary shares held in Countrywide. On 25 May 2004, the existing ordinary shares of 2.5p in Chesnara plc were consolidated into ordinary shares of 5p each on the basis of one new share for every two old shares, so that, in effect, the Countrywide shareholders received one ordinary 5p share in Chesnara plc for every four ordinary shares held in Countrywide.

In substance, the transactions described above represent a continuation of the business of CALH. Chesnara plc, a company with net assets of £2 prior to its acquisition of CALH, was used as a vehicle effectively to secure a listing for the business of CALH on the London Stock Exchange, and, prior to its acquisition of CALH, such net assets did not comprise an integrated set of activities and assets which were capable of generating revenue or of providing a return to investors. Chesnara plc, at the date of its acquisition of CALH, did not, therefore, comprise a business as defined in IFRS 3 Business Combinations. However the consolidated financial statements of Chesnara plc have been prepared based on the reverse acquisition method as set out in IFRS 3, as the Directors consider that this is the fairest way of presenting the financial position, results of operations and cash flows of the combined entities. Accordingly CALH is deemed to be the effective acquirer of Chesnara plc and the consolidated financial statements have been prepared as a continuation of the consolidated financial statements of CALH and its subsidiaries.

The fair value of the identifiable net assets and of the equity instruments of Chesnara plc before its deemed acquisition by CALH are negligible and the deemed consideration, based on the fair value of the equity instruments deemed to have been issued by CALH to the shareholders of Chesnara plc, is also negligible and is taken as £nil. Accordingly, the application of the purchase method of accounting for the deemed acquisition of Chesnara plc by CALH does not give rise to any goodwill or negative goodwill in the consolidated financial statements.

(c) Basis of consolidation

The consolidated financial statements incorporate the assets, liabilities and the results of the Company and of its subsidiary undertakings. Subsidiary undertakings are those entities in which the Group directly or indirectly has the power to govern the financial and operating policies in order to gain benefits from its activities. The financial statements of subsidiaries are included in the consolidated financial statements from the date that control commences until the date that control ceases.

Intragroup balances, and any income and expenses or unrealised gains or losses arising from intragroup transactions, are eliminated in preparing the consolidated financial statements.

(d) Business combinations

The Group uses the purchase method of accounting to account for the acquisition of subsidiaries. The cost of an acquisition is measured as the fair value of the assets given, equity instruments issued and liabilities incurred or assumed at the date of exchange, plus costs directly attributable to the acquisition. Identifiable assets acquired and liabilities and contingent liabilities assumed in a business combination are measured initially at their fair values at the acquisition date.

(e) Product classification

The Group's products are classified as either insurance or investment contracts for accounting purposes. Insurance contracts are contracts which transfer significant insurance risk. Contracts under which the transfer of insurance risk to the company from the policyholder is not significant are classified as investment contracts. Where contracts contain both insurance and investment components and the investment components can be measured reliably, the contracts are unbundled and the components are separately accounted for as insurance contracts and investment contracts respectively.

(f) Insurance contracts

(i) Premiums

Premiums are accounted for when due, or in the case of unit-linked insurance contracts when the liability is recognised, and exclude any taxes or duties based on premiums. Outward reinsurance premiums are accounted for when due.

(ii) Claims and benefits

Claims are accounted for in the accounting period in which they are due or notified. Surrenders are accounted for in the accounting period in which they are paid. Claims include policyholder bonuses allocated in anticipation of a bonus declaration. Reinsurance recoveries are accounted for in the same period as the related claim.

(iii) Acquisition costs

Acquisition costs comprise all direct and indirect costs arising from the conclusion of insurance contracts. An explicit deferred acquisition cost asset is established in the balance sheet to the extent that acquisition costs exceed initial fees deducted. Deferred acquisition costs are amortised at a rate based on the pattern of anticipated margins in respect of the related policies. Deferral of costs is limited to the extent that there are available future margins.

Renewal commission and other direct and indirect acquisition costs arising on enhancements to existing contracts are expensed as incurred.

(iv) Measurement of insurance contract provisions

Insurance contract provisions are measured using accounting policies having regard to the principles laid down in Council Directive 2002/83/EC.

Unit-linked provisions are measured by reference to the value of the underlying net asset value of the Group's unitised investment funds, determined on a bid value basis, at the balance sheet date. Deferred tax on unrealised capital gains is also reflected in the measurement of unit-linked provisions.

Insurance contract provisions are determined following an annual actuarial investigation of the long-term funds in accordance with regulatory requirements. The provisions are calculated on the basis of current information, using appropriate valuation methods.

For immediate annuities in payment the provision is calculated as the discounted value of the expected future annuity payments under the policies, allowing for mortality, interest rates and expenses.

For the other classes of non-linked business the provision is calculated on a net premium basis, being the level of premium consistent with a premium stream, the discounted value of which, at the outset of the policy, would be sufficient to cover exactly the discounted value of the original guaranteed benefits at maturity, or at death if earlier, on the valuation basis. The provision is then calculated by subtracting the present value of future net premiums from the present value of the benefits guaranteed at maturity, or death if earlier, as a result of events up to the balance sheet date. Negative provisions do not arise under the net premium method, which makes no allowances for voluntary discontinuances by policyholders, and which only implicitly allows for future policy maintenance costs.

Insurance contract provisions are tested for adequacy by discounting current estimates of all contractual cash flows and comparing this amount to the carrying value of the provision and any related assets: this is known as the liability adequacy test. Where a shortfall is identified, an additional provision is made and the Group recognises the deficiency in income for the year.

2 Accounting policies (continued)

For those classes of non-linked and unit-linked business where policyholders participate in profits the liability is wholly reassured to Guardian Assurance plc ("Guardian"), a subsidiary of Aegon NV. The liability is calculated on a net premium basis, but is then increased to the realistic liability as a result of the liability adequacy test.

Insurance contract provisions can never be definitive as to their timing nor the amount of claims and are therefore subject to subsequent reassessment on a regular basis.

(g) Investment contracts

(i) Amounts collected

Amounts collected on investment contracts, which primarily involve the transfer of financial risk such as long-term savings contracts, are accounted for using deposit accounting, under which the amounts collected, less any initial fees deducted, are credited directly to the balance sheet as an adjustment to the liability to the investor.

(ii) Amounts deposited with reinsurers

Amounts deposited with reinsurers under reinsurance arrangements, which primarily involve the transfer of financial risk, are entered directly to the balance sheet as amounts deposited with reinsurers. These assets are designated on initial recognition as at fair value through income.

(iii) Benefits

For investment contracts, benefits paid are not included in the income statement but are instead deducted from investment contract liabilities in the accounting period in which they are paid.

(iv) Acquisition costs

Acquisition costs relating to investment contracts comprise directly attributable incremental acquisition costs, which vary with and are related to securing new contracts, and are recognised as an asset to the extent that they represent the contractual right to benefit from the provision of investment management services. The asset is presented as a deferred acquisition cost asset and is amortised over the expected term of the contract, as the fees relating to the provision of the services are recognised. All other costs are recognised as expenses when incurred.

(v) Liabilities

All investment contract liabilities are designated on initial recognition as held at fair value through income. The financial liability in respect of unit-linked contracts is measured by reference to the value of the underlying net asset value of the Group's unitised investment funds, determined on a bid value, at the balance sheet date. Deferred tax on unrealised capital gains is also reflected in the measurement of unit-linked provisions.

The Group has designated investment contract liabilities at fair value through income as this more closely reflects the basis on which the business is managed. Guaranteed income and guaranteed growth bond liabilities and other investment contract liabilities are managed together with related investment assets on a fair value basis as part of the documented risk management strategy.

The fair value of other investment contracts is measured by discounting current estimates of all contractual cash flows that are expected to arise under contracts.

(h) Contracts with discretionary participation features (DPF)

A discretionary participation feature is a contractual right held by a policyholder to receive, as a supplement to guaranteed minimum payments, additional payments that are likely to be a significant portion of the total contractual payments. All such contracts are wholly reinsured with Guardian and the amount or timing of the additional payments are contractually at the discretion of the reinsurer and are contractually based on:

(i) the performance of a specified pool of contracts or a specified type of contract;

(ii) realised and/or unrealised investment returns on a specified pool of assets held by the reinsurer; or

(iii) the profit or loss of the reinsurer.

All contracts with discretionary participation features, whether classified as investment or insurance contracts, are accounted for as insurance contracts.

(i) Reinsurance

The Group cedes reinsurance in the normal course of business for the purpose of avoiding the retention of undue concentration of risk on any one life. Assets, liabilities and income and expense arising from ceded reinsurance contracts are presented separately from the related assets, liabilities, income and expenses from the related insurance contracts because the reinsurance arrangements do not relieve the Group from its direct obligations to its policyholders.

Only rights under contracts that give rise to a significant transfer of insurance risk are accounted for as reinsurance assets. Rights under contracts that do not transfer significant insurance risk are accounted for as financial instruments.

The net premiums payable to a reinsurer may be more or less than the reinsurance assets recognised by the Group in respect of the reinsurance cover purchased. Any gain or loss is recognised in the income statement in the period in which the reinsurance premiums are payable.

Rights under reinsurance contracts comprising the reinsurers' share of insurance contract provisions and accrued policyholder claims are estimated in a manner that is consistent with the measurement of the provisions held in respect of the related insurance contracts. Such assets are deemed impaired if there is objective evidence, as a result of an event that occurred after its initial recognition, that the Group may not recover all amounts due and the event has a reliably measurable impact on the amounts that the Group will receive from the reinsurer.

(j) Fee and commission income

Fees charged for investment management services provided in connection with investment contracts are recognised as revenue as the services are provided. Initial fees which exceed the level of recurring fees and relate to the future provision of services are deferred and amortised over the anticipated period in which services will be provided.

Initial fees charged for investment management services provided in connection with insurance contracts are recognised as revenue when earned.

For both insurance and investment contracts, initial fees on regular premiums, annual management charges and contract administration charges are recognised as revenue on an accruals basis. Surrender charges are recognised as a reduction to policyholder claims and benefits incurred when the surrender benefits are paid.

Benefit-based fees comprising charges made to unit-linked insurance and investment funds for mortality and morbidity benefits are recognised as revenue on an accruals basis.

Commissions received or receivable which do not require the Group to render further services are recognised as revenue by the Group on the effective commencement or renewal dates of the related contract. However, when it is probable that the Group will be required to render further services during the life of the contract, the commission, or part thereof, is deferred and recognised as revenue over the period in which services are rendered.

(k) Investment income

Investment income comprises income from financial assets and rental income from investment properties.

Income from financial assets comprises dividend and interest income, net fair value gains and losses (both unrealised and realised) in respect of financial assets classified as fair value through income, and realised gains on financial assets classified as loans and receivables.

Dividends are accrued on an ex-dividend basis. Interest received and receivable in respect of interest-bearing financial assets classified as fair value through income is included in net fair value gains and losses. For loans and receivables and cash and cash equivalents interest income is calculated using the effective interest method.

Rental income from investment properties under operating leases is recognised in the income statement on a straight-line basis over the term of each lease. Lease incentives are recognised in the income statement as an integral part of the total lease income.

2 Accounting policies (continued)

(l) Expenses

(i) Operating lease payments

Leases where a significant proportion of the risks and rewards of ownership is retained by the lessor are classified as operating leases. Payments made under operating leases are recognised in the income statement on a straight-line basis over the term of the lease. Lease incentives received are recognised in the income statement as an integral part of the total lease expense.

(ii) Financing costs

Financing costs comprise interest payable on borrowings calculated using the effective interest rate method.

(m) Income taxes

Income tax on the profit or loss for the year comprises current and deferred tax and is recognised in the income statement.

(i) Current tax

Current tax is the expected tax payable on the taxable income for the year, using tax rates enacted or substantively enacted at the balance sheet date, and any adjustment to tax payable in respect of previous years.

(ii) Deferred tax

Deferred tax is provided using the balance sheet liability method, providing for temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes. The amount of deferred tax provided is based on the expected manner of realisation or settlement of the carrying amount of assets and liabilities, using tax rates enacted or substantively enacted at the balance sheet date.

A deferred tax asset is recognised only to the extent that it is probable that future taxable profits will be available against which the asset can be utilised. Deferred tax assets are reduced to the extent that it is no longer probable that the related tax benefit will be realised.

(n) Acquired value of in-force business

Acquired in-force insurance and investment contracts arising from business combinations are measured at fair value at the time of acquisition.

The difference between the fair value of insurance contracts and the liability measured in accordance with the Group's accounting polices for the contracts is recorded as acquired present value of in-force business ('Acquired PVIF'). Acquired PVIF is carried gross of tax and is amortised against income on a time profile which, it is intended, will broadly match the profile of the underlying emergence of surplus as anticipated at the time of acquisition. It is tested for impairment if there are indications that recoverability of the full carrying value is in doubt.

Acquired PVIF in respect of in-force investment contracts is stated at cost less accumulated amortisation and impairment losses. The initial cost is deemed to be the fair value of the contractual customer relationships acquired. The acquired present value of the in-force investment contracts is carried gross of tax and is amortised against income on a time profile which, it is intended, will broadly match the profile of the underlying emergence of profit from the contracts. It is tested for impairment annually.

(o) Property and equipment

Items of property and equipment are stated at cost less accumulated depreciation and impairment losses.

Depreciation is charged to the income statement on a straight-line basis over the estimated useful lives of the property and equipment as follows:

Computers	5 years
Fixtures and fittings	5 years
Office equipment	5 years
Motor vehicles	4 years

(p) Investment property

Investment properties are properties which are held either to earn rental income or for capital appreciation or for both. On initial recognition investment properties are measured at cost including attributable transaction costs, and are subsequently measured at fair value. Independent external valuers, having an appropriate recognised professional qualification and recent experience in the location and category of property being valued, value the portfolio every twelve months.

The fair values reflect market values at the balance sheet date, being the estimated amount for which a property could be exchanged on the date of valuation between a willing buyer and a willing seller in an arm's length transaction after proper marketing wherein the parties had each acted knowledgeably, prudently and without compulsion.

Any gain or loss arising from a change in fair value is recognised in the income statement. Rental income from investment property is accounted for as described in accounting policy (k).

(q) Financial assets

Financial assets are classified into different categories depending on the type of asset and the purpose for which it is acquired. Currently two different categories of financial assets are used: 'financial assets at fair value through income' and 'loans and receivables'. Financial assets classified as fair value through income comprise financial assets designated as such on initial recognition and derivative financial instruments.

All financial assets held for investment purposes other than derivative financial instruments are designated as at fair value through income on initial recognition since they are managed, and their performance is evaluated, on a fair value basis in accordance with documented investment and risk management strategies. This designation is also applied to the Group's investment contracts, since the investment contract liabilities are managed together with the investment assets on a fair value basis as part of the documented risk management strategy.

Purchases and sales of 'regular way' financial assets are recognised on the trade date, which is when the Group commits to purchase, or sell the assets.

All financial assets are initially measured at fair value plus, in the case of financial assets not classified as at fair value through income, transaction costs that are directly attributable to their acquisition.

Subsequent to initial recognition, financial assets classified as at fair value through income are measured at their fair value without any deduction for transaction costs that may be incurred on their disposal.

The fair value of financial assets quoted in an active market is their bid prices at the balance sheet date.

Financial assets classified as loans and receivables are stated at amortised cost less impairment losses.

Financial assets are derecognised when contractual rights to receive cash flows from the financial assets expire, or where the financial assets have been transferred together with substantially all the risks and rewards of ownership.

Investments in subsidiaries are carried at cost less impairment in the balance sheet.

(r) Derivative financial instruments

Derivative financial instruments are recognised at fair value. The gain or loss on remeasurement to fair value is recognised immediately in profit or loss. Hedge accounting has not been applied.

The fair value of interest rate swaps is the estimated amount that the Group would receive or pay to terminate the swap at the balance sheet date, taking into account current interest rates and the current creditworthiness of the swap counterparties. The fair value of forward exchange contracts is their quoted market price at the balance sheet date, being the present value of the quoted forward price.

(s) Cash and cash equivalents

Cash and cash equivalents include cash in hand, deposits held at call with banks and other short-term highly liquid investments. Highly liquid is defined as realisable into cash within 90 days.

(t) Impairment

The carrying amounts of the Group's assets other than reinsurance assets, acquired Insurance PVIF and assets which are carried at fair value are reviewed at each balance sheet date to determine whether there is any indication of impairment. If any such indication exists, the assets' recoverable amount is estimated. An impairment loss is recognised whenever the carrying amount of an asset exceeds its recoverable amount. Impairment losses are recognised in the income statement.

2 Accounting policies (continued)

Impairment losses are reversed through the income statement if there is a change in the estimates used to determine the recoverable amount. Such losses are reversed only to the extent that the assets' carrying amount does not exceed the carrying amount that would have been determined, net of depreciation or amortisation where applicable, if no impairment loss had been recognised.

(u) Provisions

Provisions are recognised when the Group has a present, legal or constructive obligation as a result of past events such that it is probable that an outflow of economic benefits will be required to settle the obligation and a reliable estimate of the amount of the obligation can be made. Where the effect of the time value of money is material, the amount of the provision is the present value of the expenditures expected to be required to settle the obligation. The Group recognises provisions for onerous contracts when the expected benefits to be derived from a contract are less than the unavoidable costs of meeting the obligations under the contract.

(v) Borrowings

Borrowings are recognised initially at fair value, less transaction costs and are subsequently stated at amortised cost. The difference between the carrying value on initial recognition and the redemption value is recognised in the income statement over the borrowing period on an effective interest rate basis.

(w) Employee benefits

(i) Pension obligations

Group companies operate defined contribution pension schemes, which are funded through payments to insurance companies, to which Group companies pay fixed contributions. There are no legal or constructive obligations on Group companies to pay further contributions if the fund does not hold sufficient assets to pay employee benefits relating to service in current and prior periods. Accordingly, Group companies have no further payment obligations once the contributions have been paid.

Contributions to defined contribution pension schemes are recognised as employee benefit expense when they are due.

(ii) Bonus plans

The Group recognises a liability and an expense for bonuses based on a formula that takes into consideration the profit attributable to the Company's shareholders after certain adjustments. The expense is recognised in the income statement on an accruals basis.

(x) Share capital

Shares are classified as equity when there is no obligation to transfer cash or other assets. Incremental costs directly attributable to the issue of equity instruments are shown in equity as a deduction from the proceeds, net of tax. Incremental costs directly attributable to the issue of equity instruments, as consideration for the acquisition of a business, are included in the cost of acquisition.

(y) Dividends

Dividend distributions to the Company's shareholders are recognised as liabilities in the period in which the dividends are paid, and, for the final dividend, when approved by the Company's shareholders at the annual general meeting.

(z) Foreign currency transactions

Foreign currency transactions are translated into pounds sterling at the foreign exchange rate ruling at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies are translated into pounds sterling at the foreign exchange ruling at the balance sheet date. Foreign exchange differences arising on translation are recognised in the income statement.

(aa) Other payables and payables related to direct insurance and investment contracts

Insurance and investment contract payables and other payables are recognised when due and are measured on initial recognition at the fair value of the consideration paid. Subsequent to initial recognition, payables are measured at amortised cost using the effective interest rate method.

3 Accounting estimates and judgements

The Group makes estimates and assumptions that affect the reported amounts of assets and liabilities and also makes critical accounting judgements in applying the Group's accounting policies. Such estimates and judgements are continually evaluated and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable. The more critical areas where accounting estimates and judgements are made are described below.

(a) Classification of long-term contracts

The Group has exercised judgement in its classification of long-term business as between insurance and investment contracts, which fall to be accounted for differently in accordance with the policies set out in Note 2 Accounting Policies. Insurance contracts are those where significant risk is transferred to the Group under the contract and judgement is applied in assessing whether the risk so transferred is significant, especially with regard to pensions contracts, which are predominantly, but not exclusively, created for investment purposes.

(b) Estimates of future benefits payments arising from long-term insurance contracts

The Group makes estimates of the expected number of deaths for each of the years that it is exposed to risk. These estimates are based on either standard mortality tables or reinsurers' rate tables as appropriate, adjusted to reflect the Group's own experience. For contracts without fixed terms the Group has assumed that it will be able to increase charges to policyholders in future years, in line with emerging mortality experience.

The Group has offered guaranteed annuity options within certain contracts. Estimates have been made of the number of contract holders who will exercise these options, in order to measure their value. Changes in investment conditions could result in significantly more contract holders exercising their options than the Group has assumed in determining the liabilities arising from these contracts.

The Group makes estimates of future deaths, voluntary contract terminations, investment returns and administration expenses at the inception of long-term insurance contracts with fixed and guaranteed terms. These estimates, which are reconsidered annually, form the assumptions used to calculate the liabilities arising from these contracts.

The assumptions used to establish insurance contract liabilities and appropriate sensitivities relating to variations in critical assumptions are disclosed in Note 27 (on page 90).

(c) Fair value of investment contracts

Guaranteed income and guaranteed growth bonds

The fair value of investment contract liabilities, in respect of guaranteed income and guaranteed growth bonds, (which are fully described in Note 5 on page 66 to these financial statements) is established using a valuation technique, which approximates the following methodology:

(i) The fair value of the contract, measured at inception, is the purchase price paid for it. This price implies a retail market rate of interest prevailing at the inception of the contract, which is used to equate the contractual cash flows payable under the bond to the purchase price, including an allowance for expenses incurred in managing the contract; and

(ii) Subsequent measurement of the liability at fair value reflects the impact of changes in retail market interest rates for these products: this is accomplished in practice by tracking movements in the less-than-5-year gilt index as the bonds are predominantly less than 5 years in term.

This methodology has been adopted to reduce volatility in reported earnings in the income statement as the liabilities so determined are measured in a way which is consistent with the fair value of the underlying invested financial assets.

(d) Liability for future redress in respect of mortgage endowment misselling complaints

Included within insurance contract liabilities is a liability in respect of amounts anticipated to be payable as redress for upheld mortgage endowment misselling complaints. In establishing this liability the Group makes estimates about the number of future upheld complaints (taking into account the number of complaints received, the number of complaints time-barred and the number of complaints which are admitted) and about the average cost of redress per upheld complaint. These estimates are determined, taking into account historical experience and investment return projections. Variations in these estimates could result in higher or lower than expected numbers of upheld complaints and higher or lower than expected amounts of redress per upheld complaint. The impact of variations in these assumptions is disclosed in Note 27 (on page 90) to these financial statements.

3 Accounting estimates and judgements (continued)

(e) Liability for future redress in respect of unit pricing error

Included within provisions and, as disclosed in Note 30(d) on page 98, is an amount estimated to be payable to policyholders as redress in respect of loss incurred by them as a result of an error in the calculation of the unit prices relating to certain of the unit-linked funds. Judgement has been applied in establishing the estimate insofar as the amount provided has been determined by reference to:

(i) generic data relating to the amount of payments to policyholders who exited from the funds in specific periods;

(ii) the unit prices ruling in those periods; and

(iii) an estimate of the extent of the pricing error pertaining to those periods

rather than on the basis of specific individual calculations for each policyholder.

(f) Deferred acquisition costs and deferred income

The Group applies judgement in deciding the amount of direct costs that are incurred in acquiring the rights to provide investment management services in connection with the issue of investment contracts. Judgement is also applied in establishing the amortisation of the assets representing these contractual rights and the recognition of initial fees received in respect of these contracts. The assets are amortised on a straight-line basis over the lifetime of the investment management service contracts and deferred income is amortised on a straight-line basis over the period in which it is earned. Estimates are applied in determining the lifetime of the investment management service contracts and in determining the recoverability of the contractual rights assets by reference to expected future income and expense levels. This test for recoverability is performed using best estimates of future cash flows, using a market consistent estimate of future investment returns.

(g) Amortisation of acquired value of in-force business

The Group applies accounting estimates and judgement in determining the fair value, amortisation and recoverability of acquired in-force business relating to insurance and investment contracts. The acquired value of in-force business has been amortised on a basis that reflects the expected profit stream arising from the business acquired at the date of acquisition. This profit stream is estimated from the experienced termination rates, expenses of management and age of the individual contract holders as well as global estimates of investment growth, based on recent experience at the date of acquisition. Acquired value of in-force business is tested for recoverability by reference to expected future income levels, if there are indications that recoverability of the full carrying value is in doubt.

4 Management of insurance risk

Introduction

The Group's management of insurance risk is a critical aspect of the business. The primary insurance activity carried out by the Group comprises the assumption of the risk of loss from persons that are directly subject to the risk. Such risks in general relate to life, accident, health and financial perils that may arise from an insurable event, with the majority of the Group's exposure relating to mortality risk on individual lives, predominantly in the UK. As such, the Group is exposed to the uncertainty surrounding the timing and severity of claims under the related contracts.

The Group manages its insurance risk through underwriting limits, approval procedures for new products or for policies that exceed set limits, pricing guidelines, reinsurance and monitoring of emerging issues. The Group is substantially closed to new insurance business and, in practice, only sells a limited amount of new insurance business to existing policyholders: the assumption of new insurance risks is, accordingly, limited.

The principal risk is that the frequency and severity of claims is adverse to that expected. The theory of probability is applied to the pricing and provisioning for a portfolio of insurance contracts. Insured events are, by their nature, random, and the actual number and size of events during any one year may vary from those estimated using established statistical techniques. The risk under assurance policies is partly naturally hedged by risks under annuity policies where the exposure is to the risk of longevity.

Underwriting strategy

The aim of the underwriting strategy is to avoid the assumption of undue concentration of risk on any one life and there are defined underwriting procedures embracing the limits on cover for individual policies.

Reinsurance strategy

The aim of the reinsurance strategy is to reinforce the underwriting strategy by avoiding the retention of undue concentration of risk on any one life. Accordingly, there is a policy on reinsurance, which limits the total exposure on any one policy. However, there are a small number of policies which breach these limits due to historical reasons.

The Group holds a wide range of reinsurance treaties, including wholly reinsured business and risk premium reinsurance which includes original terms reinsurance and facultative reinsurance.

Ceded reinsurance contains credit risk, and such reinsurance recoverables are reported after deductions for known insolvencies and uncollectable items. The Group monitors the financial condition of reinsurers on an ongoing basis and reviews its reinsurance arrangements periodically.

The Group has a policy in place of only entering into new reinsurance contracts with reinsurers rated A and above.

Terms and conditions of insurance contracts

The terms and conditions of insurance contracts that have a material effect on the amount, timing and uncertainty of future cash flows arising from insurance contracts are set out in the product analyses below, which give an assessment of the Group's main products and the ways in which it manages the associated risks.

	Sums assured – gross and net of reinsurance			
	31 December 2007		**31 December 2006**	
	Gross £000	**Net £000**	**Gross £000**	**Net £000**
Annuities-immediate (per annum)	4,200	4,108	3,844	3,740
Long-term with DPF	75,697	204	80,133	266
Long-term without DPF	5,233,417	3,712,227	6,041,116	4,131,883
Total	**5,313,314**	**3,716,539**	**6,125,093**	**4,135,889**

Long-term insurance contracts – immediate annuities

Product features

This type of annuity is purchased with a single premium at outset, and is paid to the policyholder for the remainder of his/her lifetime. Annuities may be level or escalate at a fixed rate.

There are two types of immediate annuities: retirement and voluntary. Voluntary annuities are made at the discretion of the policyholder. Policyholders of personal pensions may have to purchase an immediate annuity on retirement. Other variations (joint life annuities) are to continue the annuity (at the same level or lower) to the surviving spouse or partner.

Payments are often guaranteed to be paid for a minimum term regardless of survival (e.g. 5 or 10 years).

Profit on existing contracts arises when mortality and investment experience are better than expected. All risks and rewards associated with this type of product accrue to shareholders.

Management of risks

The main risks associated with this product are longevity and investment risks. Longevity risks arise as the annuities are paid for the lifetime of the policyholder, and this risk is managed through the initial pricing of the annuity. Investment risk depends on the extent to which the annuity payments under the contracts have been matched by suitable assets. The Group regularly monitors the asset matching for these contracts as explained in the Market Risk Management section of Note 5 on page 64.

4 Management of insurance risk (continued)

The key risks are managed through appropriate pricing and product design. Reinsurance is not generally used for this product, although there is a small number of reinsured policies. Underwriting is not used for this product.

In respect of mortality risk (longevity), the pricing assumption is based on both historic in-house and industry available information on mortality experience for the population of policyholders, including allowances for future mortality improvements.

In respect of investment risk, with this type of product the lump sum premium is available for the Group to invest at the start of the contract. The asset mix will consist of fixed interest securities, including gilts, with varying redemption dates. The income earned on the investment will not usually be sufficient to cover the annuity and the expense outgo, so each year part of the lump sum will be disinvested, which is taken account of in the asset mix, in order to balance the fund. If annuitants die as expected the assets referred to above would be appropriate. However, in most cases annuitants will not die as expected and, therefore, the Group will need to buy and sell assets as necessary throughout the term of the policies to minimise the risk of mismatch. This position is monitored on a regular basis. Details of default risk on the fixed interest securities are set out in the Credit Risk Management section of Note 5 on page 72.

Concentration of insurance risks

The tables for immediate annuity contracts set out below illustrate the concentration of risk based on two bands of contracts grouped by the annuity payable each year for each annuity policy insured.

Annuity payable each year for each life insured	**Total annuities payable each year**			
	Before reassurance		**After reassurance**	
	£000	**%**	**£000**	**%**
As at 31 December 2007				
£0 – £25,000	4,155	98.9	4,099	99.8
More than £25,000	45	1.1	9	0.2
	4,200	100.0	4,108	100.0

	Total annuities payable each year			
	Before reassurance		**After reassurance**	
	£000	**%**	**£000**	**%**
As at 31 December 2006				
£0 – £25,000	3,799	98.8	3,731	99.8
More than £25,000	45	1.2	9	0.2
	3,844	100.0	3,740	100.0

Long-term insurance contracts – with discretionary participation features

Product features

The Group historically wrote with-profits business in the UK, where the policyholder benefits comprise a guaranteed sum assured payable on death or at maturity, to which may be added a discretionary annual bonus and a discretionary terminal bonus.

Management of risks

This business is wholly reassured to Guardian and hence the only risk retained by the Group for this business is the risk of default by the reinsurer. This risk is detailed in the Credit Risk Management section of Note 5 on page 72.

Long-term insurance contracts – without discretionary participation features

Product features

The Group has written both non-linked and unit-linked contracts, which include death and morbidity benefits on a whole life, endowment and term assurance basis.

For contracts where death is the insured risk, the most significant factors that could increase risk are epidemics (such as AIDS, SARS or a flu pandemic) or widespread changes in lifestyle, such as eating, smoking and exercise habits, resulting in earlier or more claims than expected.

Management of risks

Unit-linked insurance contracts are contracts where monthly reviewable charges are made for insurance risk and administration charges and consist mainly of regular unit-linked endowments where the primary purpose is to provide an investment return. In addition, the policyholder is insured against death and serious injury. Unit-linked contracts operate by investing the policyholders' premiums into pooled investment funds of the Group, the policyholders' share of the fund being represented by units. The benefit is payable on death, or maturity if earlier, the amount payable on death being subject to a guaranteed minimum amount. Therefore, the Group is exposed only to insurance risk insofar as the value of the unit-linked fund is lower than the guaranteed minimum death benefit. The maturity or surrender value depends on the investment performance of the underlying fund and on the level of charges levied by the Group for policy administration fees, mortality and other charges.

For contracts with fixed and guaranteed benefits and fixed future premiums, there are no mitigating terms and conditions that reduce the insurance risk accepted. This is the case for a small proportion (approximately 5% of total sums assured) of the life assurance business sold by the Group.

For the remainder of the business, operated on a quasi-linked basis, the Group charges for mortality risk on a monthly basis and has the right to alter these charges based on its mortality experience and hence minimise its exposure to mortality risk. The Group also reserves the right at regular intervals to change the premium payable in the light of charges made for insurance risk and administration services and the investment performance of the assets notionally backing these contracts. Delays in implementing increases in charges and market or regulatory restraints over the extent of the increases may reduce this mitigating effect.

A number of these contracts also include Permanent Health Insurance (PHI) benefits which have reviewable charges and the Group reserves the right to alter these charges based on its morbidity experience and hence to minimise its exposure to morbidity risk. Delays in implementing increases in charges and market or regulatory restraints over the extent of the increases may reduce this mitigating effect.

Reinsurance is used extensively on the business described above to mitigate concentrations of insurance risk. The insurance risk is further managed through pricing, product design and, for non-linked and quasi-linked contracts, appropriate investment strategy.

For units held under unit-linked contracts all of the investment risk is borne by the policyholder with the exception of a small number of contracts which provide for a minimum guaranteed rate of return, as investment performance directly affects the value of the unit fund and hence the benefits payable.

Concentration of insurance risk

The tables for long term insurance contracts set out below illustrate the concentration of risk based on five bands of contracts grouped by benefits assured for each policy assured.

Benefits assured for each life assured	**Total benefits assured**			
	Before reinsurance		**After reinsurance**	
In £000's bands	**£m**	**%**	**£m**	**%**
As at 31 December 2007				
0 – 250	5,136	96.8	3,694	99.5
250 – 500	117	2.2	17	0.4
500 – 750	33	0.6	2	0.1
750 – 1,000	12	0.2	–	–
More than 1,000	12	0.2	–	–
	5,310	100.0	3,713	100.0

4 Management of insurance risk (continued)

Benefits assured for each life assured	Total benefits assured			
	Before reinsurance		After reinsurance	
In £000's bands	£m	%	£m	%
As at 31 December 2006				
0 – 250	5,941	97.1	4,107	99.4
250 – 500	123	2.0	20	0.5
500 – 750	33	0.5	4	0.1
750 – 1,000	14	0.2	–	–
More than 1,000	10	0.2	1	–
	6,121	100.0	4,132	100.0

In addition to the above the Group has, at 31 December 2007, a total of approximately £17m per annum of retained PHI sums assured (31 December 2006: approximately £18m). The Group does not retain PHI sums assured on any one life greater than £25,000 per annum.

Long-term insurance contracts – guaranteed annuity options

Product features

There are a small number of unit-linked deferred annuity policies with guarantees regarding the rate at which the policyholder is able to convert the unit fund into an annuity at retirement, which creates an insurance liability. At retirement the fund available can either be transferred to another provider, used to purchase an annuity with a Group company at the annuity rates then applying, or used to purchase an annuity from a Group company at guaranteed annuity rates written into the policy document. The guaranteed annuity rates are only available in certain circumstances. Policyholders gain the benefit of whichever of the then-current annuity rates and guaranteed annuity rates give them the higher benefits.

Management of risks

The main risks associated with this product are longevity and market risks. These were controlled through product design and pricing. However, the guaranteed annuity rates were set during the 1960s and 1970s, when these products were sold. As these rates are no longer suitable in current conditions, appropriate technical provisions are held to reflect the risk arising from the guarantees.

The longevity assumptions underlying the technical provisions are based on both historic in-house and industry available information on mortality experience for the population of policyholders, including allowances for future mortality improvements.

Concentration of insurance risks

There are 330 such policies in force as at 31 December 2007 (as at 31 December 2006: 380). The underlying contracts have total unit funds of £4.1m (as at 31 December 2006: £4.8m), with the largest fund being less than £0.2m.

Other risks on insurance contracts

Apart from financial risks relating to the financial assets, which support life assurance contracts, as set out in Note 5 on pages 63 to 73, there are other significant types of risk pertaining to life insurance contracts, as follows:

Expense risk

The Group strategy is to outsource all operational activities to third party administrators in order to reduce the significant expense inefficiencies that would arise with fixed and semi-fixed costs on a diminishing policy base. There are, however, risks associated with the use of outsourcing. In particular, there will be a need in future to renegotiate the terms of the outsourcing arrangements as the existing agreements expire. There is also a risk that, at some point in the future, third party administrators could default on their obligations. The Group monitors the financial soundness of third party administrators and it has retained step-in rights on the more significant of these agreements. There are also contractual arrangements in place which provide for financial penalties in the event of default by the administration service providers.

Mortgage endowment misselling complaints

The life businesses have experienced a significant level of complaints from mortgage endowment policyholders since their first regulatory mailing programme in 2000. In response to this, the life businesses hold mortgage endowment complaints redress provisions. The Group continues to monitor closely, among other factors, the volume of complaints and the value of compensation paid to policyholders in order to assess the continuing adequacy of the provisions.

There remains however a residual risk that at some point in future the levels of complaints received may prove to be higher than those anticipated within the provision.

Persistency risk

Persistency risk is the risk that the investor cancels the contract or discontinues paying new premiums into the contract, thereby exposing the Group to a loss resulting from an adverse movement in the actual experience compared to that expected in the product pricing. Although changes in the levels of persistency would not adversely affect the result in the short term they would reduce future profits available from the contract.

5 Management of financial risk

Introduction

The Group's management of financial risk is a critical aspect of the business. For a significant proportion of the Group's life insurance contracts, the cash flows are linked, directly or indirectly, to the performance of the financial assets which support those contracts. This gives rise to financial risk, which also arises on the Group's investment contracts in relation to financial assets which support these contracts. The Group has procedures for setting and monitoring the Group's assets and liability position with the objective of ensuring that the Group can always meet its obligations without undue cost and in accordance with the Group's internal and regulatory capital requirements.

The Group is exposed to a range of financial risks through its life assurance contracts, financial assets, financial liabilities, including investment contracts and borrowings, and its reinsurance assets. In particular, the key financial risk is that in the long-term its investment proceeds are not sufficient to fund the obligations arising from its insurance and investment contracts. The most important components of this financial risk are market risk (interest rate risk and equity price risk), and credit risk, including the risk of reinsurer default.

The Group manages these risks within an asset liability management (ALM) framework that has been developed to achieve long-term investment returns at least equal to its obligations under insurance and investment contracts, with minimal risk. Within the ALM framework the Group periodically produces reports at legal entity and asset and liability class level, which are circulated to the Group's key management. The principal technique of the Group's ALM framework is to match assets to the liabilities arising from insurance and investment contracts by reference to the type of benefits payable to policyholders, with separate portfolios of assets being maintained for each distinct class of liability.

For unit-linked contracts the Group's objective is to match the liabilities, both insurance and investment contract liabilities, with units in the fund to which the value of the liability is linked. For other business, the Group's objective is to match the timing of cash flows from insurance and investment contract liabilities with the timing of cash flows from assets subject to identical or similar risks. By matching the cash flows of liabilities with those of suitable assets, market risk is managed effectively, whilst liquidity risk is minimised. These processes to manage the risks, which the Group has not changed from previous periods, ensure that the Group is able to meet its obligations under its contractual liabilities as they fall due.

Terms and conditions of investment contracts

The terms and conditions of insurance contracts that have a material effect on the amount, timing and uncertainty of future cash flows arising from insurance contracts are set out in Note 4 on pages 58 to 63. The terms and conditions of investment contracts that have a material effect on the amount, timing and uncertainty of future cash flows arising from investment contracts are set out in the product analyses below.

The Group provides three types of investment contract which are predominantly written in the UK.

5 Management of financial risk (continued)

(i) Unit-linked savings

These are typically single premium contracts, with the premiums invested in a pooled investment fund (usually an internal fund of the life assurance company), where the policyholder's investment in the fund is represented by units. There is a small additional benefit payable on death which does not transfer significant insurance risk to the Group for these contracts. The benefits payable at maturity or surrender of the contract are the bid value of these units.

The key variables affecting the timing and uncertainty of future cash flows are investment performance, persistency and expense inflation.

(ii) Unit-linked pensions

The contractual features are similar to unit-linked savings, except they may be single or regular premium contracts. The benefits payable on retirement purchase an open market pension annuity.

The key variables affecting the timing and uncertainty of future cash flows are investment performance, interest risks, persistency and expense inflation.

(iii) Guaranteed Income and Growth Bonds

Guaranteed Income bonds are mainly single premium contracts for a fixed term offering, either monthly or annually, fixed payments together with a return of premium at the maturity date. A guaranteed growth bond variant has also been issued which offers no income but a higher guaranteed payment at the maturity date.

The key variables affecting the timing and uncertainty of cash flows are expense inflation, interest rates, persistency and mortality.

Risks associated with investment contracts

The risks associated with investment contracts are expense risk, persistency risk and market risk. Market risk is the risk that the fair value of future cash flows will fluctuate because of a change in interest or foreign currency exchange rates or in equity prices and the consequent effect that this has on the value of charges earned by the Group and on any guarantees in the contracts. Expense risk is of the same nature as described under other risks on insurance contracts in Note 4 (see page 62). Persistency risk is the risk that the investor cancels the contract or discontinues paying new premiums into the contract, thereby exposing the Group to a loss resulting from an adverse movement in the actual experience compared to that expected in the product pricing. Although changes in the levels of persistency would not adversely affect the result in the short term they would reduce future profits available from the contract.

Market risk management

The notes below explain how market risks are managed using the categories utilised in the Group's ALM framework. In particular, the ALM framework requires the management of interest risk, equity price risk, and liquidity risk at the portfolio level, so that the appropriate risks for each portfolio may be managed in an effective way. The Group is not significantly exposed to foreign exchange risk as the only assets denominated in foreign currencies are matched by corresponding insurance contract provisions and financial liabilities. To reflect the Group risk management approach the required disclosures for interest rate, equity price and liquidity risks, as appropriate, are given separately for each portfolio of the ALM framework. The following tables reconcile the balance sheet to the classes and portfolios used in the Group's ALM framework.

31 December 2007	Total £000	Guaranteed bonds £000	Insurance contracts with DPF £000	Unit-linked contracts £000	Annuities in payment £000	Other non-linked contracts £000	Other £000
Assets							
Intangible assets							
Deferred acquisition costs	9,542	–	–	–	–	–	9,542
Acquired value of in-force business							
Insurance contracts	19,427	–	–	–	–	–	19,427
Investment contracts	12,627	–	–	–	–	–	12,627
Reinsurers' share of insurance contract provisions	212,353	–	87,279	122,327	–	2,747	–
Amounts deposited with reinsurers	27,558	–	–	27,558	–	–	–
Investment properties	4,983	–	–	4,483	–	–	500
Financial assets							
Equity securities at fair value through income	743,670	–	1,020	740,105	–	2,545	–
Holdings in collective investment schemes at fair value through income	508,857	–	2,093	467,916	–	5,224	33,624
Debt securities at fair value through income	247,152	80,844	–	84,424	59,589	18,727	3,568
Loans and receivables including insurance receivables	15,415	2,750	–	–	–	874	11,791
Derivative financial instruments	9,525	–	–	9,525	–	–	–
Total financial assets	1,524,619	83,594	3,113	1,301,970	59,589	27,370	48,983
Reinsurers' share of accrued policyholder claims	4,661	–	–	–	–	1,109	3,552
Cash and cash equivalents	225,127	2,834	399	104,291	2,965	17,107	97,531
Total assets	**2,040,897**	**86,428**	**90,791**	**1,560,629**	**62,554**	**48,333**	**192,162**
Liabilities							
Bank overdraft	1,229	–	–	–	–	–	1,229
Insurance contract provisions	1,110,848	–	90,791	922,419	62,554	35,084	–
Financial liabilities							
Investment contracts at fair value through income	726,503	85,367	–	630,844	–	10,292	–
Borrowings	12,469	–	–	–	–	–	12,469
Derivative financial instruments	265	–	–	265	–	–	–
Total financial liabilities	739,237	85,367	–	631,109	–	10,292	12,469
Provisions	3,575	–	–	–	–	159	3,416
Deferred tax liabilities	11,847	(250)	–	–	–	25	12,072
Reinsurance payables	1,622	–	–	–	–	372	1,250
Payables related to direct insurance and investment contracts	22,859	1,311	–	–	–	504	21,044
Deferred income	16,362	–	–	–	–	–	16,362
Income taxes	743	–	–	–	–	–	743
Other payables	6,791	–	–	–	–	1,897	4,894
Total liabilities	**1,915,113**	**86,428**	**90,791**	**1,553,528**	**62,554**	**48,333**	**73,479**

5 Management of financial risk (continued)

31 December 2006	Total £000	Guaranteed bonds £000	Insurance contracts with DPF £000	Unit-linked contracts £000	Annuities in payment £000	Other non-linked contracts £000	Other £000
Assets							
Intangible assets							
Deferred acquisition costs	10,687	–	–	–	–	–	10,687
Acquired value of in-force business							
Insurance contracts	22,144	–	–	–	–	–	22,144
Investment contracts	13,644	–	–	–	–	–	13,644
Reinsurers' share of insurance contract provisions	207,279	–	87,179	118,848	–	1,252	–
Amounts deposited with reinsurers	63,721	–	–	63,721	–	–	–
Investment properties	27,750	–	–	27,374	–	–	376
Financial assets							
Equity securities at fair value through income	738,487	–	1,554	732,173	–	4,760	–
Holdings in collective investment schemes at fair value through income	342,352	–	1,525	329,641	–	3,199	7,987
Debt securities at fair value through income	350,524	141,807	–	130,195	55,135	18,289	5,098
Loans and receivables including insurance receivables	17,310	4,477	–	–	–	1,257	11,576
Derivative financial instruments	30,642	–	20	30,581	–	41	–
Total financial assets	1,479,315	146,284	3,099	1,222,590	55,135	27,546	24,661
Reinsurers' share of accrued policyholder claims	4,191	–	–	–	–	432	3,759
Income taxes	260	–	–	–	–	–	260
Cash and cash equivalents	301,218	442	431	170,659	1,635	18,912	109,139
Total assets	**2,130,209**	**146,726**	**90,709**	**1,603,192**	**56,770**	**48,142**	**184,670**
Liabilities							
Insurance contract provisions	1,115,197	–	90,706	932,755	56,770	34,965	1
Financial liabilities							
Investment contracts at fair value through income	812,979	143,635	–	658,351	–	10,993	–
Borrowings	16,574	–	–	–	–	–	16,574
Derivative financial instruments	1,421	–	3	1,412	–	6	–
Total financial liabilities	830,974	143,635	3	659,763	–	10,999	16,574
Provisions	597	–	–	–	–	180	417
Deferred tax liabilities	13,946	(205)	–	–	–	26	14,125
Reinsurance payables	3,059	–	–	–	–	173	2,886
Payables related to direct insurance and investment contracts	24,927	3,296	–	–	–	538	21,093
Deferred income	18,231	–	–	–	–	–	18,231
Income taxes	2,023	–	–	–	–	–	2,023
Other payables	7,000	–	–	–	–	1,261	5,739
Total liabilities	**2,015,954**	**146,726**	**90,709**	**1,592,518**	**56,770**	**48,142**	**81,089**

Guaranteed bonds

These contracts are for a fixed term with financial benefits that are fixed and guaranteed at the inception of the contract. The Group manages its risk by matching closely contracts written with fixed interest debt securities of a suitable duration and quality, as indicated by their credit rating. The result is that, for these contracts, the Group's primary financial risk is the risk that interest income and capital redemptions from the financial assets backing the liabilities are insufficient to fund the guaranteed benefits payable. By using fixed interest debt securities, there is no exposure to equity price risk for this portfolio.

Regular monitoring of the interest rate risk is carried out by analysis of expected cash flows from the financial assets held with those for the liabilities. Cash flows for the liabilities are determined assuming all contracts continue until their expected maturity date. This analysis also enables the Group to control its liquidity risk for this portfolio.

The following tables indicate the amount and timing of the cash flows arising from the liabilities in this category of the Group's ALM framework.

31 December 2007	Contractual cash flows (undiscounted)					
Carrying values and cash flows arising from:	**Carrying amounts £000**	**0-1 year £000**	**1-2 years £000**	**2-3 years £000**	**3-4 years £000**	**4-5 years £000**
Assets backing liabilities:						
Debt securities at fair value through income	80,844	36,480	35,126	11,899	5,691	–
Loans and receivables	2,750	2,750	–	–	–	–
Cash and cash equivalents	2,834	2,834	–	–	–	–
Total	86,428	42,064	35,126	11,899	5,691	–
Liabilities	86,428	38,137	35,480	12,579	5,068	–
Difference in expected cash flows	**–**	**3,927**	**(354)**	**(680)**	**623**	**–**

31 December 2006	Contractual cash flows (undiscounted)					
Carrying values and cash flows arising from:	**Carrying amounts £000**	**0-1 year £000**	**1-2 years £000**	**2-3 years £000**	**3-4 years £000**	**4-5 years £000**
Assets backing liabilities:						
Debt securities at fair value through income	141,807	73,164	34,333	27,495	9,581	5,691
Loans and receivables	4,477	4,477	–	–	–	–
Cash and cash equivalents	442	442	–	–	–	–
Total	146,726	78,083	34,333	27,495	9,581	5,691
Liabilities	146,726	78,295	35,536	26,313	9,234	5,253
Difference in expected cash flows	**–**	**(212)**	**(1,203)**	**1,182**	**347**	**438**

These contracts can be surrendered before maturity for a cash surrender value. For these contracts the Group is not required to measure this embedded derivative at fair value. The terms are such that the surrender value will broadly change in line with changes in the market value of the matching assets, and so there is no significant risk.

Sensitivity analysis – interest rate risk

The sensitivity analysis for interest rate risk illustrates how changes in the fair value or future cash flows of a financial instrument will fluctuate because of changes in market rates at the reporting date.

The carrying amount of both the liabilities and the assets, which are fixed interest debt securities valued at fair value, will be sensitive to changes in the level of interest rates. By reviewing the matching of the cash flows by term, on a quarterly basis, management aim to minimize the impact of a change in values due to a parallel movement in all yield curves.

A 100 basis point increase or decrease in interest yields would not have a material effect on either profit for the year ended 31 December 2007 and for the year ended 31 December 2006 or shareholder equity as at those dates.

Insurance contracts with discretionary participation features

The Group historically wrote with-profits business in the UK, where the policyholder benefits comprise a discretionary annual bonus and a discretionary terminal bonus. The with-profits business is wholly reinsured to Guardian and hence the only risk retained by the Group for this business is the risk of default by the reinsurer. This risk is detailed under "Credit Risk Management" below.

With-profits business can be surrendered before maturity for a cash surrender specified in the contractual terms and conditions. For all these contracts the Group is not required to measure this embedded derivative at fair value. The impact on the Group's current year results would be minimal as any payments to policyholders are matched by payments from Guardian under the reinsurance contract.

A maturity analysis based on the earliest contractual repayment date would present all the liabilities as due in the earliest period of the table because these options can be exercised immediately by all policyholders.

5 Management of financial risk (continued)

For a small element of the with-profits business, policyholders have the option to invest in unit-linked funds as an alternative to the with-profits fund. In this case a portion of the business is retained, with the management of financial risks of this portion being the same as described under "Unit-linked Contracts" below.

Unit-linked contracts

For unit-linked contracts, which may be insurance or investment contracts, the Group matches all the financial liabilities, which are linked to units in the insurance company funds, with assets on which the unit prices are based. This approach results in the Group having no significant market risk (being interest rate, equity price and currency risks) or credit risk on these contracts. Its primary exposure to market risk is the risk of volatility in asset management fees due to the impact of interest rate and equity price movements on the fair value of the assets held in the linked funds, on which investment management fees are based.

In practice, there remains a number of areas where there is a residual risk as follows:

(i) Surplus units

Market risk arises from the existence of surplus units (over and above requirements to match policyholder unit liabilities) in the insurance company funds. Such surplus units (which effectively back surplus carried forward in the long-term insurance funds) arise because the number of units in the funds are in decline.

(ii) Mortgage endowment misselling redress provision

Market risk arises in two ways in respect of the redress provisions for mortgage endowment misselling. The first is that a fall in equity prices directly increases the cost of future redress payments. In addition it is also likely that a large fall in equity prices would increase the propensity for policyholders to make a complaint about their mortgage endowment policies. The sensitivity of the redress provision to equity price changes is disclosed in Note 27 (on page 94) to these financial statements.

(iii) Guaranteed annuity options

For a small number of unit-linked contracts guarantees exist regarding the rate at which the policyholder is able to convert the unit fund into an annuity at retirement, as described above. As the policyholders gain the benefit of whichever of the then-current annuity rates and guaranteed annuity rates give them the higher benefits, this creates an interest rate risk, in that yields available at the time the option is taken may be lower than those assumed in the guaranteed rates. A provision is held for the cost of this guarantee.

(iv) Guarantees in Timed Investment Funds

Investment guarantees have been made in respect of policies invested in the Group's Timed Investment Funds whereby the price paid to policyholders for their units on death or maturity will always be the highest price that the units have reached during their period of investment in the funds. Although there is a charge paid by policyholders for this guarantee there is a risk to shareholders that this will be insufficient to meet the full cost of this guarantee: this risk is managed within the investment strategy of the fund (see Note 26(f) (on page 88) for more details).

(v) Change in insurance contract provisions

When calculating insurance contract provisions for the non-unit component of liabilities under linked contracts, allowance is made for both future investment management charges and investment expenses as a proportion of unit funds. As investment charges are generally in excess of investment expenses this surplus is used to offset future administration expenses on the contracts. In a falling market the absolute amount of the surplus of investment charges over investment expenses would reduce and hence this might lead to an increase in insurance contract provisions.

(vi) Bonus units

Certain contracts (primarily investment contracts) contain a condition that bonus units are allocated at fixed dates in the future, essentially as a rebate of a portion of the management fees charged during the period since the last such bonus allocation. Financial assets are held to back the units that will be allocated, so as to remove the risk of adverse market price movements. This results in an apparent excess of financial assets over liabilities with an exposure to market risk.

Unit-linked contracts can be surrendered before maturity for a cash surrender specified in the contractual terms and conditions. For all these contracts the Group is not required to measure this embedded derivative at fair value. The terms are such that the surrender value will either be equal to the carrying amount of the contract liability, or in some cases lower due to surrender penalties specified in the contract terms and conditions. The impact on the Group's current year results would therefore be minimal.

A maturity analysis based on the earliest contractual repayment date would present all the liabilities as due in the earliest period of the table because these options can be exercised immediately by all policyholders.

Sensitivity analysis – equity risk

A decrease of 10% in the value of the assets would reduce asset management fees, which would result in a £0.9m decrease in profit for the year ended 31 December 2007 and to shareholder equity as at 31 December 2007 (year ended 31 December 2006 and as at 31 December 2006: £0.9m decrease).

Annuities in payment

These are contracts which pay guaranteed financial benefits, generally monthly, for the lifetime of the policyholder, and in some cases of their spouse. For certain contracts payments are guaranteed to be paid for a minimum term regardless of survival (e.g. for 5 or 10 years). The terms are guaranteed at the inception of the contract. The financial component of these contracts is a guaranteed fixed interest rate and hence the Group's primary financial risk on these contracts is the risk that interest income and capital redemptions from the financial assets backing the liabilities are insufficient to fund the benefits payable.

The Group manages the interest rate risk by matching closely new contracts written with fixed interest debt securities of a suitable duration and quality, as indicated by their credit rating. By using fixed interest debt securities, there is no exposure to equity price risk for this portfolio.

Regular monitoring of the interest rate risk is carried out by analysis of expected cash flows from the financial assets held with those for the liabilities. Cash flows for the liabilities are determined by means of projecting expected cash flows from the contracts using prudent estimates of mortality.

The following tables indicate the estimated amount and timing of the cash flows arising from the liabilities in this category of the Group's ALM framework.

31 December 2007	**Contractual cash flows (undiscounted)**					
Carrying values and cash flows arising from:	**Carrying amounts £000**	**0-5 years £000**	**5-10 years £000**	**10-15 years £000**	**15-20 years £000**	**>20 years £000**
Assets backing liabilities:						
Debt securities at fair value through income	59,589	21,176	17,538	16,929	21,677	34,469
Cash and cash equivalents	2,965	2,965	–	–	–	–
Total	62,554	24,141	17,538	16,929	21,677	34,469
Liabilities	62,554	20,434	18,611	16,541	14,258	39,078
Difference in expected cash flows	**–**	**3,707**	**(1,073)**	**388**	**7,419**	**(4,609)**

31 December 2006	**Contractual cash flows (undiscounted)**					
Carrying values and cash flows arising from:	**Carrying amounts £000**	**0-5 years £000**	**5-10 years £000**	**10-15 years £000**	**15-20 years £000**	**>20 years £000**
Assets backing liabilities:						
Debt securities at fair value through income	55,135	19,000	18,115	17,854	17,013	33,561
Cash and cash equivalents	1,635	1,635	–	–	–	–
Total	56,770	20,635	18,115	17,854	17,013	33,561
Liabilities	56,770	17,674	17,026	15,278	13,374	42,631
Difference in expected cash flows	**–**	**2,961**	**1,089**	**2,576**	**3,639**	**(9,070)**

5 Management of financial risk (continued)

Sensitivity analysis – interest rate risk

The sensitivity analysis for interest rate risk illustrates how changes in the fair value or future cash flows of a financial instrument will fluctuate because of changes in market rates at the reporting date.

The carrying amount of both the liabilities and the assets, which are debt securities valued at fair value, will be sensitive to changes in the level of interest rates. By reviewing the matching of the cash flows by term, on a quarterly basis, management aim to minimize the impact of a change in values due to a parallel movement in all yield curves.

An increase of 100 basis points in interest yields would result in a decrease of £0.4m in profit for the year ended 31 December 2007 and in shareholder equity as at 31 December 2007 (year ended 31 December 2006 and as at 31 December 2006: £0.4m decrease).

A decrease of 100 basis points in interest yields would result in a decrease of £0.5m in profit for the year ended 31 December 2007 and in shareholder equity as at 31 December 2007 (year ended 31 December 2006 and as at 31 December 2006: £0.04m decrease).

Other non-linked contracts

This category consists of two groups of contracts. The first group, representing £10.9m of liabilities out of the total of £48.3m as at 31 December 2007 (£9.5 out of the total of £48.1m as at 31 December 2006) is operated on a quasi-linked basis; these are contracts for which, while not classed as unit-linked due to the fact that there is no surrender value which depends on unit values, all other aspects of the risk management of these contracts are the same as for unit-linked contracts. As a result the Group operates the same risk management processes as described under "Unit-linked Contracts" above.

The following is a maturity analysis of the contractual liabilities for this group of contracts, prepared on an estimated basis using estimates of mortality:

	Contractual cash flows (undiscounted)				
Carrying values and cash flows arising from:	**0-5 years £000**	**5-10 years £000**	**10-15 years £000**	**15-20 years £000**	**>20 years £000**
As at 31 December 2007	24,427	28,028	27,378	15,352	6,580
As at 31 December 2006	24,712	29,407	31,528	22,592	11,245

Sensitivity analysis – equity risk

A decrease of 10% in the value of the assets which back this group of contracts would not have a material effect on either profit for the year ended 31 December 2007 and the year ended 31 December 2006 or shareholder equity as at those dates.

The second group comprises contracts which pay guaranteed benefits on death or other insurance event, the terms being guaranteed at the inception of the contract. The financial component of these contracts is a guaranteed fixed interest rate, and hence, the Group's primary financial risk on these contracts is the risk that interest income and capital redemptions from the financial assets backing the liabilities are insufficient to fund the benefits payable.

The Group manages the interest rate risk for this group by closely matching new contracts written with financial assets of a suitable duration and quality, as indicated by their credit rating. By using fixed interest debt securities there is no exposure to equity price risk. Regular monitoring of the interest rate risk is carried out by analysis of expected cash flows from the financial assets held with those for the liabilities. Cash flows for the liabilities are determined by means of projecting expected cash flows from the contracts using prudent estimates of mortality.

The following tables indicate the estimated amount and timing of the cash flows arising from the liabilities in the second group of this category of the Group's ALM framework.

31 December 2007	Contractual cash flows (undiscounted)					
Carrying values and cash flows arising from:	**Carrying amounts £000**	**0-5 years £000**	**5-10 years £000**	**10-15 years £000**	**15-20 years £000**	**>20 years £000**
Assets backing liabilities:						
Reinsurers' share of insurance contract provisions	6,784	459	849	1,256	1,596	7,248
Debt securities at fair value through income	15,970	4,811	4,819	3,322	3,908	11,508
Loans and receivables	874	874	–	–	–	–
Cash and cash equivalents	13,805	13,805	–	–	–	–
Total	37,433	19,949	5,668	4,578	5,504	18,756
Liabilities	37,433	19,688	5,572	5,151	5,253	19,617
Difference in expected cash flows	**–**	**261**	**96**	**(573)**	**251**	**(861)**

31 December 2006	Contractual cash flows (undiscounted)					
Carrying values and cash flows arising from:	**Carrying amounts £000**	**0-5 years £000**	**5-10 years £000**	**10-15 years £000**	**15-20 years £000**	**>20 years £000**
Assets backing liabilities:						
Reinsurers' share of insurance contract provisions	7,223	432	826	1,241	1,598	7,867
Equity securities at fair value through income	1,501	1,501	–	–	–	–
Debt securities at fair value through income	16,092	6,049	4,719	4,589	3,250	12,623
Loans and receivables	1,257	1,257	–	–	–	–
Reinsurers' share of accrued policyholder claims	432	432	–	–	–	–
Cash and cash equivalents	12,186	12,186	–	–	–	–
Total	38,691	21,857	5,545	5,830	4,848	20,490
Liabilities	38,691	21,837	5,593	5,533	5,542	21,983
Difference in expected cash flows	**–**	**20**	**(48)**	**297**	**(694)**	**(1,493)**

Sensitivity analysis – interest rate risk

The sensitivity analysis for interest rate risk illustrates how changes in the fair value or future cash flows of a financial instrument will fluctuate because of changes in market rates at the reporting date.

The carrying amount of both the liabilities and the assets, which include debt securities valued at fair value, will be sensitive to changes in the level of interest rates. By reviewing the matching of the cash flows by term, on a quarterly basis, management aim to minimize the impact of a change in values due to a parallel movement in all yield curves.

An increase of 100 basis points in interest yields would result in an increase of £0.2m in profit for the year ended 31 December 2007 and in shareholder equity as at 31 December 2007 (year ended 31 December 2006 and as at 31 December 2006: £0.5m increase).

A decrease of 100 basis points in interest yields would result in a decrease of £0.2m in profit for the year ended 31 December 2007 and in shareholder equity as at 31 December 2007 (year ended 31 December 2006 and as at 31 December 2006: decrease of £0.7m).

Certain of the contracts in this group are invested in the Guaranteed Growth Fund which provides a return to policyholders which is linked to the average mortgage rate. This creates a risk due to a mismatch of assets and liabilities as there are no suitable assets available to back this guarantee and hence the assets are held in cash. This means that the return on assets held is lower than the return given to policyholders. Provisions are held to meet this shortfall, on appropriate assumptions as to future levels of return on assets and return given to policyholders. There is a risk that the return given to policyholders will increase by more than the return on assets due to inability to match the guarantee – that is, that the spread between mortgage rates and cash deposit rates will increase.

5 Management of financial risk (continued)

Other

This category represents assets and liabilities other than for insurance and investment contracts, relating, principally, to surplus net assets representing shareholder equity.

Borrowings issued at variable rates of interest expose the Group to cash flow interest risk. Information on borrowings is provided in Note 29 on page 97. A 1% increase in interest rates would result in a decrease of £0.1m in profit for the year ended 31 December 2007 and in shareholder equity as at 31 December 2007 (year ended 31 December 2006 and as at 31 December 2006: £0.1m decrease).

Credit risk management

The Group has exposure to credit risk, which is the risk that a counterparty will be unable to pay amounts in full when due. Key areas where the Group is exposed to credit risk are:

- Reinsurers' share of insurance liabilities;
- Amounts deposited with reinsurer in relation to investment contracts;
- Amounts due from reinsurers in respect of claims already paid; and
- Counterparty risk with respect to corporate bond, deposits and debt securities.

In addition there will be some exposures to individual policyholders, on amounts due on insurance contracts. These are tightly controlled, with plans being terminated or benefits amended if amounts owed are for more than 3 months, so there is no significant risk to the results of the Group.

The Group structures the levels of credit risk it accepts by placing limits on its exposure to a single counterparty, or group of counterparties. Such risks are subject to at least an annual review.

By far the largest credit risk to the Group is in relation to its reinsurance assets. Although the Group holds a significant proportion of its financial assets in securities, the risk of default on these is mitigated to the extent that any losses arising in respect of unit-linked funds backing the insurance and investment contracts the Group issues, would effectively be passed on to policyholders and investors through the unit-linked funds backing the insurance and investment contracts.

The Group retains some residual risks on assets which support annuities, guaranteed investment bonds and shareholder's equity. These risks are monitored: a key aspect of this is the Group's policy of investing only in high-quality corporate bonds and government-issued debts. The Group does not currently purchase assets rated below AA by Standard and Poors.

The Group's objective is to earn competitive relative returns by investing in a diversified portfolio of securities. Watch lists are maintained for exposures requiring additional review and all credit exposures are reviewed at least annually.

The Group's exposure to credit risk in relation to its debt securities and cash balances is summarised below:

As at 31 December 2007	**Credit rating-debt securities** AAA £000	AA £000	A £000	Unrated £000	**Cash balances £000**	**Total £000**
Debt securities, deposits and cash balances with credit institutions						
Linked	3,098	647	86	–	110,146	113,977
Non-linked	50,531	36,843	3,755	151	114,981	206,261
Government or pseudo Government deposits						
Linked	62,137	–	–	–	–	62,137
Non-linked	89,904	–	–	–	–	89,904
Total debt, deposits and cash balances	**205,670**	**37,490**	**3,841**	**151**	**225,127**	**472.279**

As at 31 December 2006	**Credit rating-debt securities** AAA £000	AA £000	A £000	Unrated £000	**Cash balances £000**	**Total £000**
Debt securities, deposits and cash balances with credit institutions						
Linked	2,560	719	87	–	161,801	165,167
Non-linked	61,422	75,677	11,436	310	139,417	288,262
Government or pseudo Government deposits						
Linked	110,601	–	–	–	–	110,601
Non-linked	87,712	–	–	–	–	87,712
Total debt, deposits and cash balances	**262,295**	**76,396**	**11,523**	**310**	**301,218**	**651,742**

Reinsurance credit risk

Reinsurance is used to manage insurance risk. This does not however discharge the Group's liability as primary insurer. If a reinsurer fails to pay a claim for any reason, the Group remains liable for the payment to the policyholder. The creditworthiness of major reinsurers is considered on an annual basis by reviewing their financial strength.

It should be noted that for historical reasons the Group has a significant exposure of £236.9m as at 31 December 2007 (31 December 2006: £232.5m) to Guardian, which does not have a published credit rating. Of this amount £212.0m (31 December 2006: £208.3m) is in respect of currently guaranteed benefits. The exposure which relates to reinsured insurance contract liabilities, and which relates to amounts deposited with Guardian in respect of investment contract liabilities, was mitigated during 2006 when Guardian granted to Countrywide Assured plc a legal charge over related investment assets.

The Group also had significant exposure of £36.4m as at 31 December 2006 to Irish Life Assurance plc, which does not have a published credit rating. This exposure was removed during 2007 when the reinsurance arrangement was terminated.

In addition the Group also has an exposure on a number of its risk premium reinsurance contracts, although in general the premiums payable under these contracts in any period will be higher than the claims payments received.

6 Disposal of subsidiary

On 15 March 2006 the Group disposed of its interest in Premium Life International Limited to LCL International Life Assurance Company Limited for a consideration receivable in cash of £1, which, net of cash balances of £295,067 in the subsidiary at that date, gave rise to a net cash outflow of £295,066. This amount is reflected as a cash outflow from investing activities in the Consolidated Statement of Cash Flows.

The contribution of the subsidiary to the net profit for the year ended 31 December 2006 was not material and a loss of £248,000 arising on the disposal was recognised in the Consolidated Income Statement for that period.

Following the disposal there was a reduction of £2,030,000 in the regulatory capital resource requirements of Countrywide Assured plc, which are disclosed in Note 26 (c) (on page 85) and there was a reduction in available capital resources of £248,000.

7 Insurance premium revenue

	Year ended 31 December 2007				Year ended 31 December 2006			
	Unit linked-without DPF £000	Other-without DPF £000	With DPF £000	Total £000	Unit linked-without DPF £000	Other-without DPF £000	With DPF £000	Total £000
Insurance premium revenue	77,812	23,015	2,727	103,554	84,755	24,711	3,334	112,800
Insurance premium ceded to reinsurers	(11,046)	(5,013)	(2,657)	(18,716)	(12,468)	(6,622)	(3,104)	(22,194)
Net insurance premium revenue	**66,766**	**18,002**	**70**	**84,838**	**72,287**	**18,089**	**230**	**90,606**

8 Fees and commission income

	Year ended 31 December 2007		Year ended 31 December 2006	
Fee income	Insurance contracts £000	Investment contracts £000	Insurance contracts £000	Investment contracts £000
Policy-based fees	7,949	3,771	10,598	3,906
Fund management-based fees	2,486	3,317	3,336	3,021
Benefit-based fees	27,110	241	29,053	252
Change in deferred income – gross	–	1,869	–	1,964
Change in deferred income – reinsurer share	–	(56)	–	(58)
Total fee income	37,545	9,142	42,987	9,085
Commission income	487	7	532	–
Total fee and commission income	**38,032**	**9,149**	**43,519**	**9,085**

9 Investment income

	Year ended 31 December	
	2007 £000	2006 £000
Dividend income	35,997	34,271
Interest income	26,650	28,767
Rental income from investment properties	1,268	1,610
Net fair value gains and losses		
Equity securities designated as at fair value through income on initial recognition	12,674	83,802
Debt securities designated as at fair value through income on initial recognition	1,418	(13,733)
Derivative financial instruments	10,330	14,425
Investment properties	1,873	2,328
Total investment income	**90,210**	**151,470**

Net fair value gains and losses in respect of holdings in collective investment schemes are included in the line that is most appropriate taking into account the nature of the underlying investments.

No amounts included in net fair value gains and losses of financial instruments were estimated using a valuation technique (2006: £nil).

10 Other operating income

	Year ended 31 December	
	2007 £000	2006 £000
Release of unused provisions	28	8
Recharge of shared property services to tenants	504	453
Administration fees charged to reinsurers	189	248
Professional indemnity insurance recoveries	104	254
Other	473	232
Total other operating income	**1,298**	**1,195**

11 Policyholder claims and benefits

	Year ended 31 December 2007				Year ended 31 December 2006			
	Unit linked-without DPF £000	Other-without DPF £000	With DPF £000	Total £000	Unit linked-without DPF £000	Other-without DPF £000	With DPF £000	Total £000
Claims and benefits paid to policyholders	128,991	20,283	5,383	154,657	134,578	24,297	6,858	165,733
Net increase/(decrease) in insurance contract provisions	(2,404)	4,776	85	2,457	44,297	6,551	1,960	52,808
Total policyholder claims and benefits	126,587	25,059	5,468	157,114	178,875	30,848	8,818	218,541
Recoveries from reinsurers	(17,523)	(3,806)	(5,189)	(26,518)	(21,266)	(3,116)	(8,379)	(32,761)
Net policyholder claims and benefits incurred	**109,064**	**21,253**	**279**	**130,596**	**157,609**	**27,732**	**439**	**185,780**

12 Change in investment contract liabilities

	Year ended 31 December	
	2007 £000	2006 £000
Net changes in the fair value of investment contracts designated on initial recognition as fair value through income	50,697	58,905
Reinsurer's share	(11,534)	(1,304)
Net change in investment contract liabilities	**39,163**	**57,601**

Investment contract benefits comprise benefits accruing to holders of investment contracts issued by the Group.

The total amount included in net changes in the fair value of investment contracts, which were estimated using a valuation technique was £50,697,000 (2006: £58,905,000).

13 Fees, commission and other acquisition costs

	Year ended 31 December	
	2007 £000	**2006 £000**
Directly expensed costs		
Insurance contracts		
Commission	140	65
New business and renewal costs	157	139
Investment contracts		
Commission	83	344
New business and renewal costs	53	53
Amortisation of deferred acquisition costs		
Insurance contracts	–	1,114
Investment contracts-gross	1,145	1,199
Investment contracts-reinsurance	(32)	(33)
Total	**1,546**	**2,881**

14 Administrative expenses

	Year ended 31 December	
	2007 £000	**2006 £000**
Personnel-related costs	2,627	2,450
Costs paid to third-party administrators	5,268	6,650
Other goods and services	8,060	8,084
Total	**15,955**	**17,184**

Included in Other Goods and Services above are the following amounts payable to the Auditor and its associates, exclusive of VAT.

	Year ended 31 December	
	2007 £000	**2006 £000**
Fees payable to the Company's Auditor for the audit of the company's annual accounts	25	17
Fees payable to the Company's Auditor and its associates for other services:		
The audit of the Company's subsidiaries pursuant to legislation	252	223
Other services pursuant to legislation	107	136
Tax services	72	49
Services related to information technology	5	21
All other services	10	15
	471	**461**

15 Other operating expenses

Charge for amortisation of intangible assets	Year ended 31 December 2007 £000	Year ended 31 December 2006 £000
Amortisation of acquired value of in-force business		
Insurance contracts	2,717	2,756
Investment contracts	1,017	1,017
Total	**3,734**	**3,773**
Reinsurance recapture premium	**–**	**1,374**

With effect from 31 December 2006 a reinsurance arrangement with Munich Re was terminated. This resulted in a recapture premium payable to them of the amount shown above.

Other	Year ended 31 December 2007 £000	Year ended 31 December 2006 £000
Increase in provisions	3,138	8
Direct operating expenses of investment properties		
Revenue-generating properties	524	680
Non revenue-generating properties	–	38
Other	62	55
Total	**3,724**	**781**

16 Financing costs

	Year ended 31 December 2007 £000	Year ended 31 December 2006 £000
Interest expense on bank borrowings	**1,089**	**1,206**

Interest expense on bank borrowings is calculated using the effective interest method and is the total interest expense for financial liabilities that are not designated at fair value through income.

17 Income tax expense

	Year ended 31 December	
	2007 £000	**2006 £000**
Current tax expense		
Current year	4,883	4,212
Adjustment to prior years	(503)	626
Overseas tax	–	334
	4,380	5,172
Deferred tax expense		
Origination and reversal of temporary differences	(2,099)	619
Total income tax expense	**2,281**	**5,791**

Reconciliation of effective tax rate on profit before tax

	Year ended 31 December	
	2007 £000	**2006 £000**
Profit before tax	**27,720**	**25,047**
Income tax using the domestic corporation tax rate of 30% (2006: 30%)	8,316	7,514
Impact of small companies rate for subsidiaries	(2)	–
Permanent differences	66	163
Effect of UK taxing bases on insurance profits		
Offset of franked investment income	(5,115)	(3,463)
Variation in rate of tax on amortisation of acquired in-force value	(467)	127
Other	(14)	824
(Over)/under provided in prior years	(503)	626
Total income tax expense	**2,281**	**5,791**

18 Deferred acquisition costs

	Insurance contracts		Investment contracts		Total	
	2007 £000	**2006 £000**	**2007 £000**	**2006 £000**	**2007 £000**	**2006 £000**
Balance at 1 January	**–**	**1,114**	**10,687**	**11,886**	**10,687**	**13,000**
Amortisation charged to income	–	(1,114)	(1,145)	(1,199)	(1,145)	(2,313)
Impairment losses	–	–	–	–	–	–
Balance at 31 December	**–**	**–**	**9,542**	**10,687**	**9,542**	**10,687**
Current	–	–	1,614	1,093	1,614	1,093
Non-current	–	–	7,928	9,594	7,928	9,594
Total	**–**	**–**	**9,542**	**10,687**	**9,542**	**10,687**

The amortisation charged to income is recognised in Fees, Commission and Other Acquisition Costs (see Note 13 on page 76).

19 Acquired value of in-force business (AVIF)

	AVIF on insurance contracts £000	AVIF on investment contracts £000	Total £000
Cost			
Balance at 1 January 2006	**33,278**	**15,254**	**48,532**
Additions	–	–	–
Balance at 31 December 2006	**33,278**	**15,254**	**48,532**
Additions	–	–	–
Balance at 31 December 2007	**33,278**	**15,254**	**48,532**
Amortisation and impairment losses			
Balance at 1 January 2006	**8,378**	**593**	**8,971**
Amortisation for the year	2,756	1,017	3,773
Impairment charge	–	–	–
Balance at 31 December 2006	**11,134**	**1,610**	**12,744**
Amortisation for the year	2,717	1,017	3,734
Impairment charge	–	–	–
Balance at 31 December 2007	**13,851**	**2,627**	**16,478**
Carrying amounts			
At 31 December 2006	**22,144**	**13,644**	**35,788**
At 31 December 2007	**19,427**	**12,627**	**32,054**
31 December 2006			
Current	2,716	1,017	3,733
Non-current	19,428	12,627	32,055
Total	**22,144**	**13,644**	**35,788**
31 December 2007			
Current	2,678	1,016	3,694
Non-current	16,749	11,611	28,360
Total	**19,427**	**12,627**	**32,054**

The amortisation period of AVIF on insurance contracts is 13 years and the amortisation period for AVIF on investment contracts is 15 years.

The amortisation is charged to income and is recognised in Other Operating Expenses (see Note 15 on page 77).

20 Investment properties

	2007 £000	2006 £000
Balance at 1 January	**27,750**	**25,422**
Disposals	(24,640)	–
Fair value adjustments	1,873	2,328
Impairment losses	–	–
Balance at 31 December	**4,983**	**27,750**
Current	1,415	24,241
Non-current	3,568	3,509
Total	**4,983**	**27,750**

Investment properties were bought for investment purposes in line with the investment strategy of the Group. The properties are independently valued in accordance with International Valuation Standards on the basis of determining the open market value of the investment properties on an annual basis. The latest valuations were conducted as at 31 December 2007.

Income arises from investment properties in two streams:

(i) Fair value gains arising as a result of market appreciation in the value of the properties and

(ii) Rental income arising from leases granted on the properties.

Both of these amounts are disclosed in Investment Income (see Note 9 on page 74). Expenses incurred in the operation and maintenance of investment properties are disclosed in Other Operating Expenses (see Note 15 on page 77).

During the year ended 31 December 2007 the Group decided to dispose of directly held properties in favour of indirect property investments through holdings in collective investment schemes.

21 Financial assets

	31 December	
Group	**2007 £000**	**2006 £000**
Financial assets by measurement category		
Fair value through income		
Designated at fair-value through income on initial recognition	1,499,679	1,431,363
Derivative financial instruments	9,525	30,642
Loans and receivables	15,415	17,310
Total	**1,524,619**	**1,479,315**

	31 December	
	2007 £000	2006 £000
Financial assets at fair value through income		
Equities		
Listed	743,670	738,487
Debt securities – fixed rate		
Government Bonds	152,041	198,314
Listed	95,111	149,993
Debt securities – floating rate		
Listed	–	2,217
Total debt securities	247,152	350,524
Holdings in collective investment schemes	508,857	342,352
Derivative financial instruments	9,525	30,642
Total	**1,509,204**	**1,462,005**
Current	255,189	339,091
Non-current	1,254,015	1,122,914
Total	**1,509,204**	**1,462,005**

	31 December	
Company	2007 £000	2006 £000
Investment in subsidiaries	**52,006**	**52,006**
Current	–	–
Non-current	52,006	52,006
Total	**52,006**	**52,006**

22 Loans and receivables, including insurance receivables

	31 December	
Group	2007 £000	2006 £000
Receivables arising from insurance contracts		
Policyholders	2,082	2,258
Receivables arising from investment contracts		
Policyholders	11	13
Reinsurance receivables	300	716
Commission receivables	628	508
Debtor for professional indemnity insurance	17	80
Other receivables		
Accrued interest income	10,726	12,259
Related party receivables	79	77
Recoveries relating to unit pricing redress	494	–
Other	1,078	1,399
Total loans and receivables	**15,415**	**17,310**
Current	15,415	17,310
Non-current	–	–
Total	**15,415**	**17,310**

Unit pricing redress is explained in Note 30(d) on page 98

22 Loans and receivables, including insurance receivables (continued)

The fair value of loans and receivables is £15,415,000 (2006: £17,310,000).

	31 December	
Company	**2007 £000**	**2006 £000**
Amounts due from subsidiary companies	279	473
Other	343	78
Total loans and receivables	**622**	**551**
Current	622	551
Non-current	–	–
Total	**622**	**551**

The fair value of loans and receivables is £622,000 (2006: £551,000).

23 Derivative financial instruments

The Group does not use derivatives as part of any hedging strategies to mitigate risk.

Non-hedge derivatives within unit-linked funds

As part of its Investment management strategy, the Group purchases derivative financial instruments comprising part of its investment portfolio for unit-linked investment funds, which match the liabilities arising on its unit-linked insurance and investment business.

A variety of equity futures are part of the portfolio matching the unit-linked investment and insurance liabilities. Derivatives are used to facilitate more efficient portfolio management allowing changes in investment strategy to be reflected by futures transactions rather than a high volume of transactions in the underlying assets.

All the contracts are exchange-traded futures, with their fair value being the bid price at the balance sheet date.

	31 December 2007		31 December 2006	
	Asset £000	**Liability £000**	**Asset £000**	**Liability £000**
Exchange-traded futures (by geographical investment market)				
Australia	77	(23)	808	(108)
Switzerland	199	(5)	1,777	(85)
Europe	1,016	–	7,394	(85)
UK	1,588	(2)	1,067	(28)
Hong Kong	2,059	–	1,755	(203)
Japan	331	(74)	2,869	(809)
South Korea	2,012	(129)	3,208	(10)
Sweden	28	–	596	(3)
Singapore	329	–	568	(11)
USA	1,886	(32)	10,600	(79)
Total	**9,525**	**(265)**	**30,642**	**(1,421)**
Current	9,525	(265)	30,642	(1,421)
Non-current	–	–	–	–
Total	**9,525**	**(265)**	**30,642**	**(1,421)**

24 Income tax assets

	31 December	
	2007 £000	2006 £000
Income tax assets, which are all current, comprise:		
Group		
Corporation tax recoverable	–	260
Company		
Corporation tax recoverable	–	153

25 Cash and cash equivalents

	31 December	
	2007 £000	2006 £000
Group		
Bank and cash balances	30,416	48,392
Call deposits due within 1 month	115,068	62,773
Call deposits due after 1 month	79,643	190,053
Total cash and cash equivalents	**225,127**	**301,218**
Bank overdrafts	(1,229)	–
Cash and cash equivalents in the statement of cash flows	**223,898**	**301,218**

The effective interest rate on short term bank deposits was 5.91% (2006: 5.11%), with an average maturity of 53 days. All deposits included in cash and cash equivalents are capable of being realised as cash within 90 days.

Included in cash and cash equivalents held by the Group are balances totalling £110,146,000 (2006: £155,482,000) held in unit-linked policyholders' funds.

	31 December	
	2007 £000	2006 £000
Company		
Bank and cash balances	18	297
Call deposits due within 1 month	26,976	11,258
Short term deposits due within 1 year	2,000	–
Total	**28,994**	**11,555**

26 Capital Management

(a) Objective

The Group's objective when managing capital is to maintain a strong capital base to protect policyholders' and creditors' interests and to satisfy regulators, while continuing to maintain shareholder value. This is achieved through:

(i) safeguarding the Group's ability to continue as a going concern so that it can continue to provide returns to shareholders and benefits for other stakeholders;

(ii) providing an adequate return to shareholders by pricing insurance and investment contracts commensurately with the level of risk; and

(iii) complying with the insurance capital requirements established by the regulators of the insurance markets where the Group operates. As at 31 December 2006 and 31 December 2007 the Group operated exclusively in the UK and the Group's regulatory capital requirements are, accordingly, determined by the regulations established by the FSA.

(b) Operation of the UK and EU regulatory regimes

The operation of FSA regulation with respect to the Group's life assurance business is such as to specify the minimum amount of capital that must be held in addition to the insurance liabilities as determined for regulatory purposes. This is established by reference to two calculations, being:

(i) the Pillar 1 calculation, which compares regulatory capital based on the characteristics of the in-force life assurance business with a concomitant measure of capital as prescribed by regulation and

(ii) the Pillar 2 calculation, which compares a risk-based assessment of economic capital with a concomitant measure of capital based on a realistic assessment of insurance liabilities.

For the whole of the period covered by these financial statements the minimum regulatory capital requirement is determined by the first calculation, as this gives rise to the lesser measure of surplus capital. This calculation is set out below in Section (c) Regulatory Capital Resources and Requirements, together with the Board's policy in targeting regulatory capital resource cover for total regulatory capital resource requirements.

The Group's regulated life assurance business, which falls outside the scope of the FSA's "realistic capital" regime, is mainly non-profit business, comprising both unit-linked and non-linked business. The with-profits liabilities of the life assurance business are wholly reassured to Guardian. Therefore, notwithstanding the existence of with-profits business, there is no with-profits fund and a Fund for Future Appropriations is not maintained. The relevant capital requirement for the long-term business fund is therefore the minimum solvency requirement determined in accordance with FSA regulations, as described above.

The Group's life assurance business, up to 30 June 2006, as determined for UK regulatory purposes, comprised Countrywide Assured plc ("CA") and City of Westminster Company Limited ("CWA"), which was acquired on 2 June 2005. On 30 June 2006, under the provisions of Part VII of the Financial Services and Markets Act 2000 (the "Part VII Transfer"), the long-term business of CWA was transferred to CA. As a result, the whole of the FSA regulated activity of the Group effectively subsists within CA from that date. CWA was de-authorised by the FSA as a regulated life company during September 2006. The transfer gives rise to a number of recognised and prospective benefits within the combined entity, including the determination of the capital resources and capital resource requirements, savings in operational expenses and relief of some accumulated tax losses in CA.

Notwithstanding these changes, the assumptions underlying the calculation of technical provisions are, where appropriate, determined separately for the ongoing portions of the long-term business conducted separately within CA and CWA prior to the Part VII Transfer. In the information which follows the designations "CA" and "CWA" relate to the separately regulated life companies, while the designations "CA business" and "CWA business" relate to the separate long-term businesses which were conducted within CA and CWA prior to the Part VII Transfer and which now continue within CA alone.

In addition to the UK solvency requirements the Group is subject to the requirements of the EU Insurance Group Directive, in accordance with which the Group calculates the excess of the aggregate of regulatory capital resources determined on a Group-wide basis over the aggregate minimum regulatory capital requirement imposed by local regulators. The requirement is that available Group capital resources, as set out in Section (d) Group Capital Position Statement below, should be at least 100% of capital requirements.

There has been no material change in the Group's management of capital in the period.

The Group and its individually regulated life assurance business have complied with all externally and internally imposed capital requirements during the period.

(c) Regulatory capital resources and requirements

The following summarises the capital resources and requirements of CA, as determined for UK regulatory purposes:

	31 December	
	2007 £m	**2006 £m**
Available capital resources (CR)	47.6	84.4
Long-term insurance capital requirement (LTICR)	25.1	28.8
Resilience capital requirement (RCR)	1.5	2.6
Total capital resource requirements (CRR)	26.6	31.4
Target capital requirement cover	39.1	45.8
Excess of CR over target requirement	8.5	38.6
Ratio of available CR to CRR	179%	269%

Available capital resources as at 31 December 2007 are stated after provision for a dividend of £30m which was approved by the CA Board subsequent to 31 December 2007. This represents a change in treatment compared with the corresponding position as at 31 December 2006 when available capital resources, as reflected above, are stated before provision for a dividend of £20m, which was approved by the CA Board subsequent to 31 December 2006. This change in treatment follows a change to regulatory rules which now require that capital resources should be stated after making provision for dividends which are reasonably foreseeable. Had provision been made at 31 December 2006 for the dividend of £20m which was reasonably foreseeable at that time, CA's ratio of available CR to CRR would have been 205%. Similarly, had provision not been made at 31 December 2007 for the dividend of £30m which was reasonably foreseeable at that time, CA's ratio of available CR to CRR would have been 292%.

CA's Board, as a matter of policy, will continue to target CR cover for total CRR at a minimum level of 150% of the LTICR plus 100% of the RCR.

26 Capital Management (continued)

(d) *Group capital position statement*

The following summarises the regulatory capital resources arising in both life and non-life entities, together with a statement of capital resources on a consolidated basis and with a reconciliation to shareholders' net equity established on the IFRS basis:

As at 31 December 2007:	Life business UK non-participating £000	Life business shareholder £000	Total life business £000	Other activities £000	Consolidation adjustments £000	Group total £000	Adjustment for dividend £000	Group total – IFRS basis £000
Shareholder funds outside long-term insurance funds	–	54,086	54,086	87,305	(29,109)	112,282	10,302	122,584
Shareholder funds in long-term insurance funds	3,200	–	3,200	–	–	3,200	–	3,200
Total shareholder funds	3,200	54,086	57,286	87,305	(29,109)	115,482	10,302	125,784
Adjustment onto regulatory basis								
Adjustments to assets	(888)	(8,848)	(9,736)	(51,988)	29,109	(32,615)		
Other	80	–	80	–	–	80		
Total available capital resources	**2,392**	**45,238**	**47,630**	**35,317**	**–**	**82,947**		

As at 31 December 2006:	Life business UK non-participating £000	Life business shareholder £000	Total life business £000	Other activities £000	Consolidation adjustments £000	Group total £000
Shareholder funds outside long-term insurance funds	–	91,274	91,274	46,635	(27,168)	110,741
Shareholder funds in long-term insurance funds	3,514	–	3,514	–	–	3,514
Total shareholder funds	3,514	91,274	94,788	46,635	(27,168)	114,255
Adjustment onto regulatory basis						
Adjustments to assets	(1,094)	(9,304)	(10,398)	(52,085)	27,168	(35,315)
Other	74	–	74	–	–	74
Total available capital resources	**2,494**	**81,970**	**84,464**	**(5,450)**	**–**	**79,014**

The tables presented above illustrate Group total available capital resources as measured for the purposes of inclusion in the related regulatory returns. As at 31 December 2007 they are stated after provision of a dividend of £10.3m which was approved by the Chesnara plc Board subsequent to 31 December 2007. This represents a change in treatment when compared with the corresponding position as at 31 December 2006 when Group total available capital resources are stated before provision of a dividend of £8.4m, which was approved by the Chesnara plc Board subsequent to 31 December 2006. This change in treatment follows a change to regulatory rules which now require that capital resources should be stated after making provision for dividends which are reasonably foreseeable. Provision is not made for such dividends on the IFRS basis: accordingly, it is necessary to make adjustment to shareholder funds outside long-term insurance funds as at 31 December 2007, as reflected above, in order to illustrate the relationship with the total shareholder equity included in the consolidated balance sheet prepared on the IFRS basis.

The following table summarises the movement in the available capital resources of the constituent funds of the life business for the year ended 31 December 2007:

	Life business UK non-participating £000	Life business shareholder £000	Total life business £000
At beginning of period	**2,494**	**81,970**	**84,464**
Surplus arising in the year	28,898	–	28,898
Net loss arising in shareholder fund	–	(732)	(732)
Transfer from long-term business fund to shareholder fund	(29,000)	29,000	–
Dividends			
– paid to shareholders	–	(35,000)	(35,000)
– proposed	–	(30,000)	(30,000)
At end of period	**2,392**	**45,238**	**47,630**

There were no changes in available capital resources for the year ended 31 December 2007 due to changes in management policy, regulatory changes or external factors. The effect of new business written in the period on available capital resources is not considered to be significant.

Subject to the capital management policy of the Group as set out above, capital resources are available for use elsewhere in the Group.

The Group has no formal intragroup funding arrangements.

(e) Technical provisions net of reassurance

(i) The technical provisions established to determine the regulatory capital resources as set out above are:

	31 December	
	2007 £000	2006 £000
Technical provisions		
Unit-linked		
Unit		
– Insurance contracts	771,818	774,023
– Investment contracts	613,913	604,380
Non-unit (sterling)		
– Insurance contracts	32,386	42,039
– Investment contracts	7,919	9,770
Non-participating		
– Insurance contracts	94,891	92,792
– Investment contracts	95,763	155,196
Total	**1,616,690**	**1,678,200**

(ii) The principal assumptions underlying the calculation of the technical provisions are:

Mortality

A base mortality table is selected which is most appropriate for each type of contract taking into account rates charged to the Group by reinsurers. The mortality rates reflected in these tables are periodically adjusted, allowing for emerging experience and changes in reinsurer rates.

Morbidity

Morbidity tables are derived based on reinsurer tables. These are periodically adjusted to take into account emerging experience where appropriate.

26 Capital Management (continued)

Persistency

In general, no allowance is made for lapses or surrenders within the valuation of insurance contract liabilities. This is a prudent assumption.

Discount rates

The Group has used the following rates of interest in discounting the projected liabilities:

	31 December 2007		31 December 2006	
Rate of interest	CA business	CWA business	CA business	CWA business
Assurances				
Without profit: non linked business	3.90%	2.60%	3.95%	2.40%
Without profit: annual premium	3.90%	2.60%	3.95%	2.40%
Without profit: guaranteed income bonds	4.80%	–	5.20%	–
Annuities				
Without profit: deferred	3.90%	3.20%	3.95%	3.20%
Without profit: vested	4.40%	4.40%	4.50%	4.70%

For many of the life insurance products the interest rate risk is managed through asset/liability management strategies that seek to match the interest rate sensitivity of the assets to that of the underlying liabilities. The overall objective of these strategies is to limit the net change in value of assets and liabilities arising from interest rate movements. While it is more difficult to measure the interest sensitivity of the Group's insurance liabilities than those of the related assets, to the extent that the Group can measure such sensitivities, it believes that interest rate movements will generate asset changes that substantially offset changes in value of the liabilities relating to the underlying products.

Under the gross premium method of valuation and, to a lesser extent, the net premium method of valuation, technical provisions are sensitive to the interest rate used when discounting. For annuities in payment and assurances the provision is sensitive to the assumed future mortality experience of policyholders.

Renewal expenses and inflation

The renewal expenses assumed are based on the charges made to CA by its two third party insurance administration services providers, with appropriate margins. These are assumed to inflate at a mix of current inflation rates in the UK, being the Retail Price Index and the National Average Earnings Index. Explicit allowance is also made for those Governance expenses which are charged to the long-term funds.

Taxation

The Group has assumed that current tax legislation and tax rates will not change.

The sensitivities of technical provisions and of components of capital to changes in assumptions are materially the same as those detailed in Note 27(c) (iii) on page 93.

(f) Valuation of options and guarantees

(i) Stochastically-valued options and guarantees

The Group has a small number of guaranteed annuity options, considered in Note 4, which are valued stochastically.

(ii) Deterministically-valued options and guarantees

Timed Investment Funds

Certain investment funds, the "Timed Investment Funds", carry a guarantee that the price at maturity date or death will not be less than the highest price attained between commencement and contract cessation. The cost of the guarantee can be managed by changing the investment policy adopted by each fund.

In respect of this guarantee:

(i) a monthly charge of $^{1}/_{48}$ % of the fund value is made; and

(ii) investment conditions were such as to require the establishment of a reserve of £100,000 as at 31 December 2007 (31 December 2006: £100,000).

The reserve for a given fund is derived as the discounted exposure at fund maturity date, the exposure being the difference between the guaranteed Timed Investment Fund value and the projected fund maturity value, with the latter projected value being derived assuming an immediate fall in value of equities within the fund of 26% and allowing for future investment returns, including presumed future equity investment return of 4.9% per annum.

Guaranteed Growth Fund

The Guaranteed Growth Fund (GGF) is a deposit-based contract which provides a return to policyholders that is linked to the average residential mortgage rate. However, the assets backing the contract are largely held as cash on deposit. There is, therefore, likely to be a shortfall between the return given to policyholders and the return earned on assets, and the value of this shortfall is reserved for.

Other reserves for this product are a "unit" reserve of the current value of the benefits held and a non-unit reserve for expenses.

The underlying fund at 31 December 2007 was £9.0m (31 December 2006: £9.7m). 995 policies invested in the fund (31 December 2006: 1077), of which 141 (31 December 2006: 157) were paying premiums (for a total of approximately £47,000 per annum (31 December 2006: £53,000)).

For the valuation of contract liabilities CWA projects for each future year:

– the benefit outgo from the fund;

– the investment return from the assets backing the fund; and

– the difference between these items.

These differences are then discounted and summed to establish the GGF loss reserve.

The following assumptions are used for calculating the loss reserve:

Rate of growth of liability:	5.85% pa
Rate of return on cash:	4.55% pa
Discount rate:	3.90% pa
Retirement age:	90% of business with policyholders retiring at age 65 10% of business with policyholders retiring at age 70
Terminations before retirement:	3% pa

The reserve for the guarantee as at 31 December 2007 was £1.0m. (31 December 2006: £1.3m).

(g) Management of risk

The Group's approach to the management of risk which may have an impact on the measurement of capital resources and requirements, as measured on a regulatory basis, is set out in Notes 4 and 5 to these financial statements.

27 Insurance contract provisions

(a) Analysis of insurance contract provisions by type

	31 December 2007			31 December 2006		
	Gross £000	Reinsurance £000	Net £000	Gross £000	Reinsurance £000	Net £000
Long-term business						
Unit-linked without DPF	922,183	122,092	800,091	932,496	118,588	813,908
Non-linked without DPF	97,874	2,983	94,891	91,995	1,512	90,483
With DPF	90,791	87,278	3,513	90,706	87,179	3,527
Total insurance contract provisions	**1,110,848**	**212,353**	**898,495**	**1,115,197**	**207,279**	**907,918**
Current	41,961	4,541	37,420	55,034	8,293	46,741
Non-current	1,068,887	207,812	861,075	1,060,163	198,986	861,177
Total	**1,110,848**	**212,353**	**898,495**	**1,115,197**	**207,279**	**907,918**

(b) Analysis of movement in insurance contract provisions

Unit-linked without DPF

	2007			2006		
	Gross £000	Reinsurance £000	Net £000	Gross £000	Reinsurance £000	Net £000
Balance at 1 January	**932,496**	**118,588**	**813,908**	**896,110**	**113,565**	**782,545**
Premiums received	77,195	9,812	67,383	84,357	10,574	73,783
Fees deducted	(21,892)	(1,293)	(20,599)	(23,423)	(1,413)	(22,010)
Reserves released in respect of benefits paid	(109,510)	(10,518)	(98,992)	(98,080)	(12,486)	(85,594)
Investment return	47,540	5,739	41,801	77,251	8,499	68,752
Other movements	(3,646)	(236)	(3,410)	(3,719)	(151)	(3,568)
Balance at 31 December	**922,183**	**122,092**	**800,091**	**932,496**	**118,588**	**813,908**

Non-linked without DPF

	2007			2006		
	Gross £000	Reinsurance £000	Net £000	Gross £000	Reinsurance £000	Net £000
Balance at 1 January	**91,995**	**1,512**	**90,483**	**87,208**	**589**	**86,619**
Premiums received	22,797	4,343	18,454	24,363	6,034	18,329
Fees deducted	(11,317)	(3,925)	(7,392)	(14,670)	(5,549)	(9,121)
Reserves released in respect of benefits paid	(6,665)	705	(7,370)	(5,374)	1,565	(6,939)
Investment return	1,871	(198)	2,069	4,348	587	3,761
Other movements	(807)	546	(1,353)	(3,880)	(1,714)	(2,166)
Balance at 31 December	**97,874**	**2,983**	**94,891**	**91,995**	**1,512**	**90,483**

With DPF

	2007			2006		
	Gross £000	Reinsurance £000	Net £000	Gross £000	Reinsurance £000	Net £000
Balance at 1 January	**90,706**	**87,179**	**3,527**	**88,746**	**85,409**	**3,337**
Premiums received	3,070	2,951	119	3,334	3,203	131
Fees deducted	(959)	(944)	(15)	(1,009)	(994)	(15)
Reserves released in respect of benefits paid	(4,179)	(3,974)	(205)	(5,358)	(5,203)	(155)
Investment return	1,925	1,838	87	1,819	1,590	229
Other movements	228	228	–	3,174	3,174	–
Balance at 31 December	**90,791**	**87,278**	**3,513**	**90,706**	**87,179**	**3,527**

The residual net liability of £3,513,000 as at 31 December 2007 (31 December 2006: £3,527,000) relates to unit-linked holdings within policies which have been classified as "With DPF".

(c) Assumptions and sensitivities for insurance contract provisions

(i) Process used to determine the assumptions

The process used to determine the assumptions is intended to result in conservative estimates of the most likely, or expected, outcome. The assumptions are checked to ensure that they are consistent with observed market prices or other published information.

For insurance contracts the Group regularly considers whether the current liabilities are adequate. The assumptions that are considered include the expected number and timing of deaths, other claims and investment returns, over the period of risk exposure. A reasonable allowance is made for the level of uncertainty within the contracts.

For those classes of non-linked and unit-linked business where policyholders participate in profits, the liability is wholly reinsured to Guardian. When performing the gross liability adequacy test, allowance is made for expected future bonuses paid by Guardian. This is based on the realistic liabilities of the underlying policies reinsured, as provided to the Group by Guardian.

For all the other classes of linked and quasi-linked business, the insurance contract provision is calculated on a gross premium basis, by subtracting the present value of future premiums from the present value of future benefits payable under the policy, until it ceases at maturity, or death if earlier. The gross premium method makes explicit allowance for future policy maintenance costs. If the net present value of the future discounted cash flows is positive, no asset is recognised.

For immediate annuities in payment the provision is calculated as the discounted value of the expected future annuity payments under the policies, allowing for mortality, interest rates and expenses.

27 Insurance contract provisions (continued)

For the other classes of non-linked business the provision is calculated on a net premium basis, being the level of premium consistent with a premium stream, the discounted value of which, at the outset of the policy, would be sufficient to cover exactly the discounted value of the original guaranteed benefits at maturity, or at death if earlier, on the valuation basis. The provision is then calculated by subtracting the present value of future net premiums from the present value of the benefits guaranteed at maturity, or death if earlier, as a result of events up to the balance sheet date. Negative provisions do not arise under the net premium method, which makes no allowances for voluntary discontinuances by policyholders, and which only implicitly allows for future policy maintenance costs.

(ii) Assumptions

The principal assumptions underlying the calculation of the insurance contract provisions are:

Mortality

A base mortality table is selected which is most appropriate for each type of contract taking into account rates charged to the Group by reinsurers. The mortality rates reflected in these tables are periodically adjusted, allowing for emerging experience and changes in reinsurer rates.

Morbidity

Morbidity tables are derived based on reinsurer tables. These are periodically adjusted to take into account emerging experience where appropriate.

Persistency

In general, no allowance is made for lapses or surrenders within the valuation of insurance contract liabilities.

Discount rates

The Group has used the following rates of interest in discounting the projected liabilities:

	31 December 2007		31 December 2006	
Rate of interest	**CA business**	**CWA business**	**CA business**	**CWA business**
Assurances				
– without profit: non linked business	3.90%	2.60%	3.95%	2.40%
– without profit: annual premium	3.90%	2.60%	3.95%	2.40%
Annuities				
– without profit: deferred	3.90%	3.20%	3.95%	3.20%
– without profit: vested	4.40%	4.40%	4.50%	4.70%

For many of the life insurance products the interest rate risk is managed through asset/liability management strategies that seek to match the interest rate sensitivity of the assets to that of the underlying liabilities. The overall objectives of these strategies is to limit the net change in value of assets and liabilities arising from interest rate movements. While it is more difficult to measure the interest sensitivity of the Group's insurance liabilities than those of the related assets, to the extent that the Group can measure such sensitivities, it believes that interest rate movements will generate asset changes that substantially offset changes in value of the liabilities relating to the underlying products.

Under the gross premium method and to a lesser extent the net premium method, the insurance contract provision is sensitive to the interest rate used when discounting. For annuities in payment and assurances, the provision is sensitive to the assumed future mortality experience of policyholders.

Renewal expenses and inflation

The renewal expenses assumed are based on the charges made to the Group by its two third party insurance administration services providers, with appropriate margins. These are assumed to inflate at a mix of current inflation rates in the UK, being the Retail Price Index and the National Average Earnings Index. Explicit allowance is also made for Governance expenses incurred by the Group.

Taxation

The Group has assumed that current tax legislation and tax rates will not change.

(iii) Changes in assumptions and sensitivity to changes in assumptions

Assumptions are adjusted for changes in mortality, investment return, policy maintenance expenses and expense inflation to reflect anticipated changes in market conditions and market experience and price inflation.

The major changes to the bases used for the calculation of the provisions were as follows.

As a consequence of the fact that the valuation basis makes no allowance for lapses, when lapses occur it is necessary to allocate fixed expenses across a small number of in-force policies. Consequently the per policy expense reserve has increased. This increased the reserves by £0.7m as at 31 December 2007 (31 December 2006: £5.7m).

The reserve held in respect of the CWA business for guaranteed annuity rates was reduced by £0.3m, making allowance principally for the vesting of policies with the guarantee, changes in unit values and interest rates.

Annuitant mortality assumptions in respect of the CWA business were weakened as a result of a reappraisal of mortality experience leading to release of £1.9m of reserves.

The basis for the calculation of the reserve held for complaints, principally mortgage endowment complaints, is given below.

The Group re-runs its valuation models on various bases. An analysis of sensitivity around various scenarios provides an indication of the sensitivity of the estimates to changes in assumptions in respect of its life assurance contracts. The table presented below demonstrates the sensitivity of assets and insured liability estimates to particular movements in assumptions used in the estimation process. Certain variables can be expected to impact on life assurance liabilities more than others, and consequently a greater degree of sensitivity to these variables may be expected.

Impact on reported net of tax profits and equity to changes in key variables:

	Change in variable %	Change in net of tax profits and equity 2007 £m
Investment return	+1	(1.2)
Investment return	-1	0.6
Mortality/morbidity	+10	–
Policy maintenance expenses	+10	(2.2)

The above sensitivities are calculated as an expected impact on IFRS-based profits, net of reinsurance and tax and the analysis has been prepared for a change in the stated variable, with all other assumptions remaining constant.

The sensitivities to the changes in investment returns are calculated taking into account the consequential changes to valuation assumptions.

The sensitivities to mortality and morbidity (critical illness) rates shown above are calculated on the assumption that there would be no consequential change in rates to policyholders. In practice, Group policy is to pass costs on to policyholders where it considers that the impact of the change is significant (see Note 4 for further information).

An increase in mortality rates would have a negative impact on the CA business due to the preponderance of assurance business. In contrast, there would be a positive impact occurring in the CWA business due to its preponderance of annuity business. On a consolidated Group basis the impacts are closely balanced. A decrease in mortality rates would have the contrary effect in each business but the Group results would remain closely balanced.

27 Insurance contract provisions (continued)

Changes in mortality and morbidity rates are not correlated: one may increase whilst the other remains unchanged or reduces. The figure shown above assumes both rates increase by 10%. The effects of separate 10% increases would be an increase in consolidated net of tax profits and equity by £0.7m for increased mortality rates and a reduction in consolidated net of tax profits and equity by £0.7m for increased morbidity rates.

Increases in expenses due to inflation would predominantly be passed on to policyholders through higher policy fees.

The main expense risk is that of unforeseen changes to third party administration expenses, as discussed in Note 4. The impact shown above quantifies a 10% increase in those expenses.

(iv) Provisions for redress in respect of pension transfers and opt-outs and in respect of endowment misselling complaints

Pension transfers and opt-outs

The investment liabilities include an amount of £0.1m in respect of potential compensation payments and associated costs arising from a review of advice provided to customers who were sold personal pension policies by Group representatives between 25 May 1988 and 30 June 1994. This comprises £0.1m for CA policies (31 December 2006: £0.3m) and £nil for CWA policies (31 December 2006: £0.1m). The reviews, which were conducted in accordance with guidelines issued by the FSA and which are now complete, relate to small numbers of unsettled cases where the Group does not have primary responsibility for compensation under the regulatory rules. The Directors are of the opinion that suitable provision has been made for these cases at 31 December 2007.

Endowment misselling complaints

The insurance liabilities include an amount of £6.7m (31 December 2006: £11.62m) in respect of potential compensation payments arising from endowment misselling complaints. This comprises £6.2m for CA policies (31 December 2006: £9.7m) and £0.5m for CWA policies (31 December 2006: £1.92m). The provision for the costs of redress has been estimated on the basis of the Group's experience in respect of policyholders' propensity to complain, complaint uphold rates and average cost of settlement. It is also based on estimation of the in-force endowment policy population exposed to complaint, taking account of estimated future policy cessation, and of the rate at which policies are expected to become time-barred in accordance with FSA rules.

As the setting of the provision for the rate of redress of endowment misselling complaints relies on estimates of factors which may be materially affected by unanticipated or unforeseen events, it is not possible to determine precisely the level of redress. The Directors are of the opinion that suitable provision has been made taking account of known circumstances.

The liability for mortgage endowment misselling claims would increase if there were an increase in the number of complaints received, a decrease in the number of policies time-barred, an increase in the complaint uphold rate or an increase in the average amount of redress per settled complaint compared with current assumptions. A decrease in the fund value of the assumed unit growth rate would tend to increase the average redress amount per policy. A 10% increase in assumed propensity to complain would increase insurance contract provisions by £0.3m. A 10% increase in assumed cost of redress to settle each complaint would increase insurance contract provisions by £0.6m.

28 Investment contracts at fair value through income and amounts deposited with reinsurer

(a) *Analysis by contract type*

	31 December 2007			31 December 2006		
Long-term business	**Investment contract liability £000**	**Amount deposited with reinsurer £000**	**Net £000**	**Investment contract liability £000**	**Amount deposited with reinsurer £000**	**Net £000**
Unit-linked	630,843	27,128	603,715	658,352	63,229	595,123
Non-linked	10,293	–	10,293	10,992	–	10,992
Guaranteed income and guaranteed growth bonds	85,367	–	85,367	143,635	–	143,635
Other	–	430	(430)	–	492	(492)
Total	**726,503**	**27,558**	**698,945**	**812,979**	**63,721**	**749,258**
Current	65,818	–	65,818	46,887	1,612	45,275
Non-current	660,685	27,558	633,127	766,092	62,109	703,983
Total	**726,503**	**27,558**	**698,945**	**812,979**	**63,721**	**749,258**

(b) *Analysis of movements in investment contract liability and amounts deposited with reinsurer*

	31 December 2007			31 December 2006		
Unit-linked	**Investment contract liability £000**	**Amount deposited with reinsurer £000**	**Net £000**	**Investment contract liability £000**	**Amount deposited with reinsurer £000**	**Net £000**
Balance at 1 January	**658,352**	**63,229**	**595,123**	**629,111**	**62,184**	**566,927**
Deposits received	18,340	902	17,438	20,922	2,969	17,953
Fees deducted from account balances	(4,227)	(2)	(4,225)	(4,569)	(21)	(4,548)
Account balances paid on terminations in the year	(45,689)	(1,449)	(44,240)	(66,291)	(8,777)	(57,514)
Investment yield	29,127	893	28,234	82,316	7,835	74,481
Other movements	(25,060)	(36,445)	11,385	(3,137)	(961)	(2,176)
Balance at 31 December	**630,843**	**27,128**	**603,715**	**658,352**	**63,229**	**595,123**

28 Investment contracts at fair value through income and amounts deposited with reinsurer (continued)

	31 December 2007			31 December 2006		
Non-linked	**Investment contract liability £000**	**Amount deposited with reinsurer £000**	**Net £000**	**Investment contract liability £000**	**Amount deposited with reinsurer £000**	**Net £000**
Balance at 1 January	**10,992**	–	**10,992**	**12,258**	–	**12,258**
Deposits received	75	–	75	75	–	75
Account balances paid on terminations in the year	(1,549)	–	(1,549)	(1,799)	–	(1,799)
Investment yield	617	–	617	560	–	560
Other movements	158	–	158	(102)	–	(102)
Balance at 31 December	**10,293**	–	**10,293**	**10,992**	–	**10,992**

	31 December 2007			31 December 2006		
Guaranteed income and guaranteed growth bonds	**Investment contract liability £000**	**Amount deposited with reinsurer £000**	**Net £000**	**Investment contract liability £000**	**Amount deposited with reinsurer £000**	**Net £000**
Balance at 1 January	**143,635**	–	**143,635**	**161,777**	–	**161,777**
Deposits received	12,645	–	12,645	34,552	–	34,552
Account balances paid on terminations in the year	(76,696)	–	(76,696)	(57,395)	–	(57,395)
Investment yield	5,221	–	5,221	6,093	–	6,093
Other movements	562	–	562	(1,392)	–	(1,392)
Balance at 31 December	**85,367**	–	**85,367**	**143,635**	–	**143,635**

29 Borrowings

Group and Company

	31 December	
	2007 **£000**	**2006** **£000**
Bank loan	12,469	16,574
Current	4,127	4,102
Non-current	8,342	12,472
Total	12,469	16,574

The bank loan which was drawn down on 2 June 2005 under a facility made available on 4 May 2005 is unsecured and is repayable in five equal annual instalments on the anniversary of the draw down date. Accordingly the current portion as at 31 December 2007, being that payable within one year, is £4,127,294 and the non-current portion is £8,341,962. The outstanding principal on the loan bears interest at a rate based on the London Inter-bank Offer Rate, payable in arrears over a period which varies between one and six months at the option of the borrower.

The fair value of the bank loan at 31 December 2007 was £12,600,000 (31 December 2006: £16,800,000).

30 Provisions

	MECR **£000**	**Other complaints redress** **£000**	**Onerous contracts** **£000**	**Unit pricing redress** **£000**	**Total** **£000**
Balance at 1 January 2006	**718**	**277**	**438**	–	**1,433**
Provisions made during the year	83	(2)	24	–	105
Provisions used during the year	(337)	(70)	(42)	–	(449)
Provisions reversed during the year	(338)	(151)	(3)	–	(492)
Balance at 31 December 2006	**126**	**54**	**417**	–	**597**
Provisions made during the year	61	16	67	2,994	3,138
Provisions used during the year	(67)	(4)	(61)	–	(132)
Provisions reversed during the year	(18)	(9)	(1)	–	(28)
Balance at 31 December 2007	**102**	**57**	**422**	**2,994**	**3,575**
31 December 2006					
Current	126	54	44	–	224
Non-current	–	–	373	–	373
Total	**126**	**54**	**417**	**–**	**597**
31 December 2007					
Current	102	57	61	2,994	3,214
Non-current	–	–	361	–	361
Total	**102**	**57**	**422**	**2,994**	**3,575**

The initial provisions for MECR (see (a) below) and Other Complaints Redress (see (b) below) were established by way of a transfer from Other Balances within Other Payables as this was considered to more properly reflect the nature of the related liability.

30 Provisions (continued)

(a) Mortgage endowment complaints redress (MECR)

As part of the mortgage endowment complaint redress process (refer to Note 27 Insurance Contract Provisions on page 90), if the complaint is upheld an offer of redress is made to the customer where a loss has occurred. These offers are classified as payables for the first 6 months after they are made, subsequent to which they are reclassified as provisions, as the customer loses the right of redress at the level offered, but continues to have a right to enforce a claim, which the Group has the right to reassess. The provision is established at the original offer level as a prudent estimate of future liabilities.

(b) Other complaints redress

Offers of redress on complaints other than mortgage endowment related are classified in a manner similar to that detailed for MECR above.

(c) Onerous contracts

The Group has a number of onerous operating lease contracts that had been entered into historically, whose activity and current status is described in Note 41 Operating Leases on page 105. Given the terms of the contracts the Group has created an onerous contract provision for anticipated future net costs. Over the terms of the contracts this provision takes account of the contract terms, future payments and future mitigating income from sublets, contract by contract, to create a view as to the Group's exposure.

This provision comprises three components: provision for vacant properties, provision for properties due to become empty at the end of their subleases, and provision for future under-recoveries of costs on subleases entered into.

Within the provision calculation two estimates or judgements are made:

(a) The provision model assumes that if the rent is reduced to 75% of the Group contract, the Group will have 82% sublet occupancy of the properties.

(b) Future cash flows are discounted within the provision model at 4.5%, this being the difference between a cost of capital of 8.5% and a presumed rent review and inflation increase of 4%.

Sensitivities

	Provision at 31 December 2007 £000	Post sensitivity provision £000	Change in provision £000	%
Discount rate – decreased by 1% to 3.5%	422	439	17	+4%
Sublease rent mitigation – from 75% to 65%	422	478	56	+13%
Occupancy mitigation – from 82% to 72%	422	474	52	+12%

(d) Unit pricing redress

A data error in the indexation of the costs of underlying financial assets in certain of the unit-linked funds was identified during 2007. As a result, the amount of capital gains chargeable to tax had been overestimated for unit pricing purposes and greater deductions were made from these funds than would otherwise have been the case. The effect of this became more significant during 2006 and 2007 as investment markets recovered from their previous lows. Restitution has been made to the relevant unit-linked funds, thus correcting the position for continuing policyholders. An exercise is under way to review payments to policyholders who exited the funds prior to the restitution and who may have suffered loss. A provision of £2,994,000 has been established at 31 December 2007 to cover the estimated cost of redress and the administration costs of performing the review. Associated recoveries from third parties have been established at £494,000 as at the same date and these have been included in "Loans and Receivables" as set out in Note 22 on page 81. The net charge to the income statement for the year ended 31 December 2007 in establishing the provision and associated recoveries is, accordingly, £2,500,000.

The provision is estimated insofar as it is not based on specific individual calculations for each policyholder, but has been established on the basis of generic data relating to the amount of payments to policyholders who exited from the funds in specific periods, of the unit prices ruling in those periods and of an estimate of the extent of the pricing error pertaining to those periods. The Directors consider this methodology to be prudent.

31 Deferred tax liabilities

(a) Recognised deferred tax assets and liabilities

As at 31 December 2007	Assets £000	Liabilities £000	Net £000
Insurance contract provisions	–	5,476	(5,476)
Intangible assets			
Deferred acquisition costs	–	2,509	(2,509)
Acquired value of in-force business	–	8,269	(8,269)
Deferred income	4,319	–	4,319
Property and equipment	88	–	88
Total	4,407	16,254	(11,847)
Current	–	–	–
Non-current	4,407	16,254	(11,847)
Total	**4,407**	**16,254**	**(11,847)**

As at 31 December 2006	Assets £000	Liabilities £000	Net £000
Insurance contract provisions	–	6,147	(6,147)
Contingency reserves	120	–	120
Intangible assets			
Deferred acquisition costs	–	3,357	(3,357)
Acquired value of in-force business	–	9,856	(9,856)
Deferred income	5,172	–	5,172
Property and equipment	122	–	122
Total	**5,414**	**19,360**	**(13,946)**
Current	–	–	–
Non-current	5,414	19,360	(13,946)
Total	**5,414**	**19,360**	**(13,946)**

(b) Unecognised deferred tax assets

	31 December	
	2007 £000	2006 £000
Tax losses arising in pensions business	49,157	45,557
Unrelieved expenses	123,582	125,985
Total	**172,739**	**171,542**

(i) A deferred tax asset has not been recognised in respect of tax losses arising on pension business, because it is uncertain whether future taxable profit arising on pensions business will be available against which the Group can utilise the benefits therefrom.

(ii) A deferred tax asset has not been recognised in respect of unrelieved expenses, because it is not probable that there will be a sufficient level of taxable income arising from income and gains on financial assets, so that the Group can utilise the benefits therefrom.

31 Deferred tax liabilities (continued)

(c) Movement in temporary differences during the year

	Year ended 31 December 2007			Year ended 31 December 2006		
	Balance at 1 January £000	Recognised in income £000	Balance at 31 December £000	Balance at 1 January £000	Recognised in income £000	Balance at 31 December £000
Insurance contract provisions	(6,147)	671	(5,476)	(5,104)	(1,043)	(6,147)
Contingency reserves	120	(120)	–	120	–	120
Intangible assets						
Deferred acquisition costs	(3,356)	848	(2,508)	(3,705)	349	(3,356)
Acquired value of in-force business	(9,856)	1,586	(8,270)	(10,860)	1,004	(9,856)
Deferred income	5,171	(852)	4,319	5,743	(572)	5,171
Property and equipment	122	(34)	88	122	–	122
Realised losses on financial assets	–	–	–	4,349	(4,349)	–
Unrealised gains on financial assets	–	–	–	(3,992)	3,992	–
Total	**(13,946)**	**2,099**	**(11,847)**	**(13,327)**	**(619)**	**(13,946)**

32 Reinsurance payables

	31 December	
Payable to reinsurance	**2007 £000**	**2006 £000**
Payables in respect of insurance contracts	1,557	3,032
Payables in respect of investment contracts	65	27
Total	**1,622**	**3,059**
Current	1,622	3,059
Non-current	–	–
Total	**1,622**	**3,059**

33 Payables related to direct insurance and investment contracts

	31 December 2007			31 December 2006		
	Gross £000	Reinsurance £000	Net £000	Gross £000	Reinsurance £000	Net £000
Accrued claims	20,854	4,661	16,193	22,721	4,191	18,530
Policyholder premium liabilities	2,005	–	2,005	2,206	–	2,206
Total	**22,859**	**4,661**	**18,198**	**24,927**	**4,191**	**20,736**
Current	22,859	4,661	18,198	24,927	4,191	20,736
Non-current	–	–	–	–	–	–
Total	**22,859**	**4,661**	**18,198**	**24,927**	**4,191**	**20,736**

The fair value of payables related to the direct insurance and investment contracts is not materially different from the carrying value.

34 Deferred income

	31 December	
	2007 £000	2006 £000
Balance at 1 January	**18,231**	**20,195**
Release to income	(1,869)	(1,964)
Balance at 31 December	**16,362**	**18,231**
Current	1,876	1,934
Non-current	14,486	16,297
Total	**16,362**	**18,231**

The release to income is included in Fee and Commission Income (see Note 8 on page 74).

35 Income tax liabilities

	31 December	
	2007 £000	2006 £000
Group		
Income tax liabilities, which are all current, comprise:		
Corporation tax	**743**	**2,023**
Company		
Income tax liabilities, which are all current, comprise:		
Corporation tax	**3**	–

36 Other payables

	31 December	
	2007 £000	2006 £000
Group		
Accrued expenses	3,720	4,141
Other	3,071	2,859
Total	**6,791**	**7,000**
Current	6,791	6,412
Non-current	–	588
Total	**6,791**	**7,000**
Company		
Accrued expenses	1,630	1,135
Other	283	388
Total	**1,913**	**1,523**
Current	1,913	935
Non-current	–	588
Total	**1,913**	**1,523**

The fair value of other payables is not materially different from the carrying value.

37 Share capital and share premium

Group

	31 December 2007		31 December 2006	
	Number of shares	Share capital £000	Number of shares	Share capital £000
Share capital	104,588,785	41,501	104,588,785	41,501

There have been no changes in Group share capital and share premium during the year ended 31 December 2007.

Under the reverse acquisition basis of accounting referred to in Note 2 on page 50, at the date of acquisition of Chesnara plc (the legal parent) the amount of issued share capital in the consolidated balance sheet represents the amount of issued share capital of Countrywide Assured Life Holdings Limited (the legal subsidiary) immediately before the acquisition and the deemed cost of acquisition, which as explained in Note 2, is taken as £nil. The number of shares, representing the equity structure, reflects the equity structure of Chesnara plc as set out below.

Company

The share capital of Chesnara plc comprises:

	31 December 2007 £	31 December 2006 £
Authorised 201,000,000 Ordinary shares of 5p each	10,050,000	10,050,000

	Number of Shares	Share Capital £	Share Capital £
Issued Ordinary shares of 5p each	104,588,785	5,229,439	5,229,439

There have been no changes in Company share capital and share premium during the year ended 31 December 2007.

38 Retained earnings

Group

Retained earnings attributable to equity holders of the parent company comprise

	Year ended 31 December	
	2007 £000	2006 £000
Balance at 1 January	**52,246**	**46,258**
Profit for the year	25,439	19,256
Dividends		
Final approved and paid for 2005	–	(7,986)
Interim approved and paid for 2006	–	(5,282)
Final approved and paid for 2006	(8,419)	–
Interim approved and paid for 2007	(5,491)	–
Balance at 31 December	**63,775**	**52,246**

The interim dividend in respect of 2006, approved and paid in 2006, was paid at the rate of 5.05p per share. The final dividend in respect of 2006, approved and paid in 2007, was paid at the rate of 8.05p per share so that the total dividend paid to the equity shareholders of the Parent Company in respect of the year ended 31 December 2006 was made at the rate of 13.10p per share.

The interim dividend in respect of 2007, approved and paid in 2007, was paid at the rate of 5.25p per share to equity shareholders of the Parent Company registered at the close of business on 14 September 2007, the dividend record date.

A final dividend of 9.85p per share in respect of the year ended 31 December 2007 payable on 20 May 2008 to equity shareholders of the Parent Company registered at the close of business on 11 April 2008, the dividend record date, was approved by the Directors after the balance sheet date. The resulting total dividend of £10.3m has not been provided for in these financial statements and there are no income tax consequences.

The following summarises dividends per share in respect of the year ended 31 December 2006 and 31 December 2007:

	2007 P	2006 P
Interim – approved and paid	5.25	5.05
Final – proposed	9.85	8.05
Total	**15.10**	**13.10**

Company

	Year ended 31 December	
	2007 £000	**2006 £000**
Balance at 1 January	**20,431**	**7,524**
Profit for the year	34,979	26,175
Dividends paid		
Final approved and paid for 2005	–	(7,986)
Interim approved and paid for 2006	–	(5,282)
Final approved and paid for 2006	(8,419)	–
Interim approved and paid for 2007	(5,491)	–
Balance at 31 December	**41,500**	**20,431**

Details of dividends approved and paid are set out in the "Group" section above.

39 Employee benefit expense

	Year ended 31 December	
	2007 £000	**2006 £000**
Wages and salaries	2,134	2,038
Social security costs	252	253
Pension costs-defined contribution plans	241	160
Total	**2,627**	**2,451**
Average number of employees		
Company	20	19
Subsidiaries	10	14
Total	**30**	**33**

Between 1 January 2004 and 31 May 2005 the Group offered membership of the Countrywide Assured Group plc (CAG) Pension Scheme to eligible employees. Under a Deed of Settlement dated 18 March 2004 CAG and the Scheme Trustees had given permission for the Company to participate in the CAG Pension Scheme for a period of 12 months following the demerger described in Note 2 above. Accordingly employees of the Group became deferred members of the CAG Scheme at the end of May 2005. At that time the Group allowed eligible employees to enter the Chesnara plc Stakeholder Scheme, on a basis where employer contributions are made to the scheme at the same rate as would be payable had their membership of the Countrywide Assured Group Pension Scheme continued, provided that employee contributions also continue to be made at the same rate. The employee may opt to request the Company to pay employer contributions into a personal pension plan, in which instance, employer contributions will be made on the same terms as for the Chesnara plc Stakeholder Scheme.

Employees who joined the Group as a result of the acquisition of CWA Life Holdings plc continue to be members of the pre-existing defined contribution Group Personal Pension scheme, to which employer and employee contributions are made.

The Group has for the period covered by these financial statements, only made contributions to defined contribution plans to provide pension benefits for employees upon retirement.

The Group has established frameworks for a sharesave plan and for discretionary share option plans which may, at the discretion of the Remuneration Committee, be utilised for granting options to Executive Directors and to other Group employees. No options have been granted in relation to these plans.

40 Earnings per share

Earnings per share is based on the following:

	Year ended 31 December	
	2007	**2006**
Profit for the year (£000)	25,439	19,256
Weighted average number of ordinary shares	104,588,785	104,588,785
Basic earnings per share	24.32p	18.41p
Diluted earnings per share	24.32p	18.41p

The weighted average number of ordinary shares in respect of the years ended 31 December 2007 and 31 December 2006 is based on 104,588,785 shares in issue at the beginning and end of those periods.

There were no share options outstanding during the year ended 31 December 2006 or during the year ended 31 December 2007. Accordingly, there is no dilution of the average number of ordinary shares in issue in respect of these periods.

41 Operating leases

Leases as lessee

Non-cancellable operating lease rentals are payable as follows:

	31 December 2007				31 December 2006			
	Investment properties £000	Non-investment properties £000	Motor vehicles £000	Total £000	Investment properties £000	Non-investment properties £000	Motor vehicles £000	Total £000
Operating lease rentals								
Less than one year	20	670	37	727	58	670	32	760
Between one and two years	–	670	27	697	44	670	18	732
Between two and five years	–	2,010	16	2,026	–	2,010	8	2,018
More than five years	–	3,817	–	3,817	–	4,236	–	4,236
Expenses recognised in the year in respect of operating leases	–	452	35	487	–	647	31	678

The Group's investment property portfolio is typically freehold. However it has short-term leasehold interests in two properties, which will both have expired by 2008.

The Group leases a property under an operating lease which it occupies in the course of its day to day business. The lease expires on 22 July 2019, with an option to renew the lease after that date. Lease payments are reviewed every five years to reflect market rentals. The lease does not include any contingent rentals.

The Group leases a number of office premises which are no longer used for Group purposes. The leases typically run for approximately a further 8 years after the balance sheet date. Lease payments are reviewed every five years to reflect market rentals. None of the leases includes contingent rentals. These leased properties are sublet by the Group. Sublease payments as detailed below are expected to be received during the following years. The Group has recognised a provision of £422k at 31 December 2007 (31 December 2006: £417k) in respect of these leases (see Note 30 Provisions on page 97).

Leases as lessor

The Group subleases out both its investment properties from its investment portfolio and the office premises which are no longer used for Group purposes. The future minimum lease payments under non-cancellable leases are as follows:

	31 December 2007			31 December 2006		
	Investment properties £000	Non-investment properties £000	Total £000	Investment properties £000	Non-investment properties £000	Total £000
Sub lease rentals						
Less than one year	–	312	312	–	461	461
Between one and two years	–	314	314	–	930	930
Between two and five years	–	941	941	–	1,400	1,400
More than five years	–	1,757	1,757	–	2,453	2,453
Rental income recognised in the year	–	207	207	–	286	286
Repairs and maintenance costs recognised in the year	–	10	10	–	118	118

42 Contingencies

The Group is subject to insurance solvency regulations and it has complied with all solvency regulations, either in accordance with the EU Directives or with UK regulations framed by the Financial Services Authority. There are no contingencies associated with the Group's compliance with these regulations.

There are otherwise no contingencies.

43 Capital commitments

There were no capital commitments as at 31 December 2007.

44 Related party transactions

(a) Identity of related parties

The shares of the Company were widely held and no single shareholder exercised significant influence or control over the Company.

The Company has related party relationships with:

(i) key management personnel who comprise only the directors of the company;

(ii) its subsidiary companies; and

(iii) other companies over which its directors have significant influence.

(b) Related party transactions

(i) Transactions with key management personnel

Key management personnel comprise of the Directors of the company. There are no executive officers other than certain of the Directors. Key management compensation is as follows:

	Year ended 31 December	
	2007 £000	2006 £000
Short-term employee benefits	680	675
Post-employment benefits	84	55
Long-term employment benefits	325	274
Total	**1,089**	**1,004**

Until 31 December 2006, fees of £25,000 payable to Terry Marris, Non-executive Director, which are included in short-term employment benefits, were paid with the addition of VAT to his employing company, Countrywide Property Services Limited, of which he was a Director and which is a subsidiary of Countrywide plc. From 1 January 2007 fees have been paid directly to him with no addition of VAT.

In addition to their salaries the Group also provides non-cash benefits to Directors, and contributes to a post employment defined contribution pension plan on their behalf.

The following amounts were payable to Directors in respect of bonuses and incentives:

	31 December	
	2007 £000	2006 £000
Annual bonus scheme	176	166
Long-term incentive plan	983	658
Total	**1,159**	**824**

These amounts have been included in Group and Company Accrued Expenses as disclosed in Note 36 on page 101.

The amounts payable under the annual bonus scheme were payable within one year. At 31 December 2007, £251,000 of the amount payable under the long-term incentive plan was payable within one year (2006: nil).

(ii) Transactions with subsidiaries

The Company undertakes centralised administration functions, the costs of which it charges back to its operating subsidiaries. The following amounts which effectively comprised a recovery of expenses at no mark up were credited to the income statement of the Company for the respective periods.

	Year ended 31 December	
	2007 £000	2006 £000
	1,964	2,489

(iii) Transactions with companies over which Chesnara plc directors have significant influence

The following transactions are disclosed for the periods covered by these financial statements because they were with companies within the Countrywide plc Group, which is or was controlled or significantly influenced by Directors of the Company.

	Year ended 31 December	
	2007 £000	2006 £000
Amounts payable/(receivable)		
Commission payable in respect of arrangement of the Groups' insurance and investment contracts (Included in Fees, Commission and Other Acquisition Costs: see Note 13 on page 76	221	238
Administration services (Included in Other Operating Income: see Note 10 on page 75)	(80)	(107)
Property services	(15)	(15)
Total	**126**	**116**

Amounts outstanding in respect of the above transactions at each period end were:

	31 December	
	2007 £000	2006 £000
Payables (included in Other Payables: see Note 36 on page 101)	7	7
Receivables (included in Other Receivables see Note 22 on page 81)	1	5

45 Group entities

Control of the Group

The issued share capital of Chesnara plc the Group parent company is widely held, with no single party able to control 20% or more of such capital or of the rights which such ownership confers.

Group subsidiary companies

Name	Country of incorporation or registration	Ownership interest 31 December	
		2007	2006
Countrywide Assured plc	England & Wales	100% of all share capital(4)	100% of all share capital(4)
Countrywide Assured Life Holdings Limited	England & Wales	100% of all share capital	100% of all share capital
Countrywide Assured Services Limited	England & Wales	100% of all share capital(4)	100% of all share capital(4)
Countrywide Assured Trustee Company Limited	England & Wales	100% of all share capital(4)	100% of all share capital(4)
Premium Life Assurance Holdings Limited	England & Wales	Applied to be dissolved (Dissolved 05/02/08)	100% of all share capital(1)
Reefwise Limited	England & Wales	Applied to be dissolved (Dissolved 08/01/08)	100% of all share capital(2)
Countrywide Assured Commission Services Limited	England & Wales	Applied to be dissolved (Dissolved 18/02/08)	100% of all share capital (3)
The Greenways Management Company (Deepcar) Limited	England & Wales	Applied to be dissolved (Dissolved 19/02/08)	100% of all share capital(3)
CWA Trustee Company Limited	England & Wales	100% of all share capital(5)	100% of all share capital(5)
CWA Life Holdings plc	England & Wales	100% of all share capital	100% of all share capital
City of Westminster Assurance Company Limited	England & Wales	Applied to be dissolved	100% of all share capital(5)

(1) Held indirectly through Countrywide Assured plc

(2) Held indirectly through Premium Life Assurance Holdings Limited

(3) Held indirectly through Reefwise Limited

(4) Held indirectly through Countrywide Assured Life Holdings Limited

(5) Held indirectly through CWA Life Holdings plc

Statement of Directors' Responsibilities in respect of the EEV Basis Supplementary Information

The Directors have chosen to prepare supplementary information in accordance with the EEV Principles issued in May 2004 by the CFO Forum of European Insurance Companies and expanded by the Additional Guidance on European Embedded Value Disclosures issued in October 2005.

When compliance with the EEV Principles is stated, those principles require the Directors to prepare supplementary information in accordance with the Embedded Value Methodology ("EVM") contained in the EEV Principles and to disclose and explain any non-compliance with the EEV guidance included in the EEV Principles.

In preparing the EEV supplementary information, the Directors have:

- Prepared the supplementary information in accordance with the EEV Principles;
- Identified and described the business covered by the EVM;
- Applied the EVM consistently to the covered business;
- Determined assumptions on a realistic basis, having regard to past, current and expected future experience and to any relevant external data, and then applied them consistently;
- Made estimates that are reasonable and consistent; and
- Described the basis on which business that is not covered business has been included in the supplementary information, including any material departures from the accounting framework applicable to the Group's financial statements.

Independent Auditor's Report to Chesnara plc on the EEV Basis Supplementary Information

We have audited the EEV basis supplementary information (the supplementary information) on pages 111 to 121 in respect of the year ended 31 December 2007. The supplementary information has been prepared in accordance with the EEV Principles issued in May 2004 by the CFO Forum as supplemented by the Additional Guidance on European Embedded Value Disclosures issued in October 2005 (together 'the EEV Principles') using the methodology and assumptions set out on pages 114 to 118. The EEV supplementary information should be read in conjunction with the Group's financial statements which are on pages 42 to 108.

This report is made solely to the Company in accordance with the terms of our engagement. Our audit work has been undertaken so that we might state to the Company those matters we have been engaged to state in this 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 for our audit work, for this report, or for the opinions we have formed.

Respective responsibilities of directors and auditor

As described in the Statement of Directors' Responsibilities on page 109, the Directors' responsibilities include preparing the supplementary information on the EEV basis in accordance with the EEV Principles. Our responsibilities, as Independent Auditor, in relation to the supplementary information are established in the UK by the Auditing Practices Board, by our profession's ethical guidance and the terms of our engagement.

Under the terms of engagement we are required to report to the Company our opinion as to whether the supplementary information has been properly prepared in accordance with the EEV Principles using the methodology and assumptions set out on pages 114 to 118. We also report if we have not received all the information and explanations we require for this audit.

Basis of audit opinion

We conducted our audit having regard to International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the 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 applied in the preparation of the supplementary information 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 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 EEV basis supplementary information for the year ended 31 December 2007 has been properly prepared in accordance with the EEV Principles using the methodology and assumptions set out on pages 114 to 118.

KPMG Audit Plc 2 April 2008
Chartered Accountants and Registered Auditor
St James' Square
Manchester
M2 6DS

Summarised consolidated income statement

	Note	Year ended 31 December 2007 £000	2006 £000
Operating profit of covered business	6	9,678	15,684
Other operational result		(16)	(699)
Operating profit		**9,662**	**14,985**
Variation from longer-term investment return		824	6,307
Effect of economic assumption changes		(4,043)	9,284
Profit before tax		**6,443**	**30,576**
Tax		5,674	(4,373)
Profit for the period		**12,117**	**26,203**
Earnings per share			
Based on profit for the period		11.59p	25.05p
Diluted earnings per share			
Based on profit for the period		11.59p	25.05p

The notes and information on pages 114 to 121 form part of this supplementary information.

Supplementary Information – European Embedded Value Basis (continued)

Summarised consolidated balance sheet

	Note	31 December 2007 £000	31 December 2006 £000
Assets			
Value of in force business	5,8	94,007	109,941
Reinsurers' share of insurance contract provisions		187,486	183,033
Amounts deposited with reinsurers		26,702	62,794
Investment properties		4,983	27,750
Deferred tax assets		88	121
Financial assets			
Equity securities at fair value through income		743,670	738,487
Holdings in collective investment schemes at fair value through income		508,857	342,352
Debt securities at fair value through income		247,152	350,524
Loans and receivables including insurance receivables		15,415	17,310
Derivative financial instruments		9,525	30,642
Total financial assets		1,524,619	1,479,315
Reinsurers' share of accrued policy claims		4,660	4,191
Income taxes		–	260
Cash and cash equivalents		225,127	301,218
Total assets		**2,067,672**	**2,168,623**
Liabilities			
Bank Overdraft		1,229	–
Insurance contract provisions		1,086,581	1,091,889
Financial liabilities			
Investment contracts at fair value through income		744,222	832,025
Borrowings		12,469	16,574
Derivative financial instruments		265	1,421
Total financial liabilities		756,956	850,020
Provisions		3,575	597
Reinsurance payables		1,622	3,059
Payables related to direct insurance and investment contracts		22,859	24,927
Income taxes		743	2,023
Other payables		6,792	7,000
Total liabilities		**1,880,357**	**1,979,515**
Net assets		**187,315**	**189,108**
Shareholders' equity			
Share capital		41,501	41,501
Share premium		20,458	20,458
Other reserves		50	50
Retained earnings		125,306	127,099
Total shareholders' equity	5,8	**187,315**	**189,108**

The notes and information on pages 114 to 121 form part of this supplementary information.

Approved by the Board of Directors on 2 April 2008 and signed on its behalf by:

Ken Romney **Graham Kettleborough**

Summarised consolidated statement of changes in equity

	Year ended 31 December	
	2007 £000	2006 £000
Shareholders' equity at 1 January	**189,108**	**176,173**
Profit for the period representing total recognised income and expense	12,117	26,203
Dividends paid	(13,910)	(13,268)
Shareholders' equity at 31 December	**187,315**	**189,108**

The notes and information on pages 114 to 121 form part of this supplementary information.

Notes to the Supplementary Information

1 Basis of preparation

This section sets out the detailed methodology followed for producing these Group financial statements which are supplementary to the Group's primary financial statements which have been prepared in accordance with International Financial Reporting Standards ("IFRS"). These financial statements have been prepared in accordance with the European Embedded Value ("EEV") principles issued in May 2004 by the European CFO Forum and supplemented by Additional Guidance on EEV Disclosures issued by the same body in October 2005. The principles provide a framework intended to improve comparability and transparency in embedded value reporting across Europe.

2 Covered business

The Group uses EEV methodology to value its individual life assurance, pension and annuity business, which has been written, with only insignificant exceptions, in the UK ("covered business"). This business comprises the Group's long-term business operations, being those contracts falling under the definition of long-term insurance business for UK regulatory purposes.

The Group has no business activities other than those relating to the covered business. In particular, the operating activities of the holding company, Chesnara plc, are treated as an integral part of the covered business. Under EEV principles no distinction is made between insurance and investment contracts, as there is under IFRS, which accords these classes of contracts different accounting treatments.

On 30 June 2006, under the provisions of Part VII of the Financial Services and Markets Act 2000, the long-term business of City of Westminster Assurance Company Limited, the principal operating subsidiary of CWA Life Holdings plc, was transferred to Countrywide Assured plc ("CA"), the primary operating subsidiary company of the Group. As a result, the whole of the covered business of the Group effectively subsists within CA with effect from that date. The transfer gives rise to benefits which have been recognised within the covered business, including determination of the capital requirement of the covered business on a combined basis and reduced costs relating largely to audit and consultancy fees. The impact of these, together with the consequential relief of tax losses in CA, which had not hitherto been recognised in the cashflow projections relating to the value of business in force, was recognised in these financial statements as at 31 December 2006 and for year then ended.

3 Methodology

(a) Embedded Value

Overview

Shareholders' equity comprises the embedded value of the covered business, together with the net equity of other Group companies, including that of the holding company which is stated after writing down fully the carrying value of the covered business.

The embedded value of the covered business is the aggregate of the shareholder net worth (SNW) and the present value of future shareholder cash flows from in-force covered business (value of in-force business) less any deduction for the cost of required capital. It is stated after allowance has been made for aggregate risks in the business. SNW comprises those amounts in the long-term business, which are either regarded as required capital or which represent surplus assets within that business.

New business

Much of the covered business is in run-off and is, accordingly, substantially closed to new business. The Group does still sell guaranteed bonds but, overall, the contribution from new business to the results established using EEV methodology is not material. Accordingly, not all of those items related to new business values, which are recommended by the EEV guidelines, are reported in this supplementary financial information.

Value of in-force business

The cash flows attributable to shareholders arising from in-force business are projected using best estimate assumptions for each component of cashflow.

The present value of the projected cash flows is established by using a discount rate which reflects the time value of money and the risks associated with the cash flows which are not otherwise allowed for. There is a deduction for the cost of holding the required capital, as set out below.

Taxation

The present value of the projected cash flows arising from in-force business takes into account all tax which is expected to be paid under current legislation, including tax which would arise if surplus assets within the covered business were eventually to be distributed.

The value of the in-force business has been calculated on an after-tax basis and is grossed up to the pre-tax level for presentation in the income statement. The amount used for the grossing up is the amount of shareholder tax payable in the policyholder fund plus any direct tax charge within the shareholder fund.

Cost of capital

The cost of holding the required capital to support the covered business (see 3b below) is reflected as a deduction from the value of in-force business and is determined as the difference between the amount of the required capital and the projected release of capital and investment income.

Financial options and guarantees

The principal financial options and guarantees are (i) guaranteed annuity rates offered on some unit-linked pension contracts and (ii) a guarantee offered under Timed Investment Funds that the unit price available at the selected maturity date (or at death, if earlier) will be the highest price attained over the policy's life. The cost of these options and guarantees has been assessed, in principle, on a market-consistent basis, but, in practice, this has been carried out on approximate bases, which are appropriate to the level of materiality of the results.

Allowance for risk

Allowance for risk within the covered business is made by:

1) setting required capital levels by reference to the Directors' assessment of capital needs;

2) setting the risk discount rate, which is applied to the projected cash flows arising on the in-force business, at a level which includes an appropriate risk margin; and

3) explicit allowance for the cost of financial options and guarantees and, where appropriate, for reinsurer default

(b) Level of Required Capital

The level of required capital of the covered business reflects the amount of capital that the Directors consider necessary and appropriate to manage the business. In forming their policy the Directors have regard to the minimum statutory requirements and an internal assessment of the market, insurance and operational risks inherent in the underlying products and business operations. The capital requirement resulting from this assessment represents 150% of the long-term insurance capital requirement ("LTICR") together with 100% of the resilience capital requirement ("RCR"), as set out in FSA regulations.

The required capital is provided by the retained surplus in the long-term business fund and the retained earnings and issued share capital in the shareholder fund.

(c) Risk Discount Rate

The risk discount rate ("RDR") is a combination of the risk-free rate and a risk margin. The risk-free rate reflects the time value of money and the risk margin reflects any residual risks inherent in the covered business and makes allowance for the risk that future experience will differ from that assumed. In order to reduce the subjectivity when setting the RDR, the Board has decided to adopt a 'bottom up' market-consistent approach to allow explicitly for market risk.

Using the market-consistent approach each cash flow is valued at a discount rate consistent with that used in the capital markets: in accordance with this, equity-based cash flows are discounted at an equity RDR and bond-based cash flows at a bond RDR. In practice a short-cut method known as the "certainty equivalent" approach has been adopted. This method assumes that all cash flows earn the risk-free rate of return and are discounted at the risk-free rate. In general, and consistent with the market's approach to valuing financial instruments for hedging purposes, the risk-free rate is based on swap yields. Where, however, non-linked business is substantially backed by government bonds, the yields on these assets have been taken.

Within the risk margin allowance also needs to be made for non-market risks. For some of these risks e.g. mortality and expense risk it is assumed that the shareholder can diversify away any uncertainty where the impact of variations in experience on future cashflows is symmetrical. For those risks that are assumed to be diversifiable no adjustment to the risk margin has been made. For any remaining risks that are considered to be non-diversifiable risks there is no risk premium observable in the market and therefore a constant margin of 50 basis points has been added to the risk margin. The RDR is determined by equating the results from the traditional embedded value approach, including the assumed actual investment returns and traditional cost of capital, to that derived using the market-consistent method, this process being known as calibration of the RDR. The risk margin is then the difference between the derived RDR and the risk-free rate. The selection of the assumed actual investment returns and the reported cost of capital will have no impact on the reported result, as changes in these produce corresponding changes in the RDR.

A market-consistent valuation approach also generally requires consideration of 'frictional' costs of holding shareholder capital: in particular, the cost of tax on investment returns and the impact of investment management fees can reduce the face value of shareholder funds. In the Group's case, the expenses relating to corporate governance functions eliminate any taxable investment return in shareholder funds, while investment management fees are not material.

(d) Analysis of Profit

The contribution to operating profit, which is identified at a level which reflects an assumed longer-term level of investment return, arises from three sources:

(i) new business;

(ii) return from in-force business; and

(iii) return from shareholder net worth.

Additional contributions to profit arise from:

(i) variances between the actual investment return in the period and the assumed long-term investment return; and

(ii) the effect of economic assumption changes.

The contribution from new business represents the value recognised at the end of each period in respect of new business written in that period, after allowing for the cost of acquiring the business, the cost of establishing the required technical provisions and after making allowance for the cost of capital.

The return from in-force business is calculated using closing assumptions and comprises:

(i) the expected return, being the unwind of the discount rate over the period applied to establish the value of in-force business at the beginning of the period;

(ii) variances between the actual experience over the period and the assumptions made to establish the value of business in force at the beginning of the period; and

(iii) the net effect of changes in future assumptions, made prospectively at the end of the period, from those used in establishing the value of business in force at the beginning of the period, other than changes in economic assumptions.

The contribution from shareholder net worth comprises the actual investment return on residual assets in excess of the required capital.

(e) Assumption Setting

There is a requirement under EEV methodology to use best estimate demographic assumptions and to review these at least annually with the economic assumptions being reported at each reporting date. The current practice is detailed below.

Each year the demographic assumptions are reviewed as part of year-end processes and hence were reviewed in December 2007.

The detailed projection assumptions, including mortality, morbidity, persistency and expenses reflect recent operating experience. Allowance is made for future improvement in annuitant mortality based on experience and externally published data. Favourable changes in operating experience, particularly in relation to expenses and persistency, are not anticipated until the improvement in experience has been observed. Holding company expenses (for the Chesnara Group such expenses relate largely to listed company functions) are allocated to the covered business as the whole business of the Chesnara Group is the transaction of life assurance business through the subsidiary companies. Hence the expense assumptions used for the cash flow projections include the full cost of servicing this business.

The economic assumptions are reviewed and updated at each reporting date based on underlying investment conditions at the reporting date. The assumed discount rate and inflation rates are consistent with the investment return assumptions.

The assumptions required in the calculation of the value of the annuity rate guarantee on pension business have been set equal to best-estimate assumptions.

4 Assumptions

(a) Investment Returns (pre- tax)

The assumed future pre-tax returns on fixed interest and RPI linked securities are set by reference to redemption yields available in the market at the end of the reporting period. The corresponding return on equities and property is equal to the fixed interest gilt assumptions plus an appropriate risk margin. For linked business the aggregate return has been determined by reference to the benchmark asset mix within the Managed Funds.

	31 December	
	2007	**2006**
Equity risk premium	2.7%	2.7%
Property risk premium	2.7%	2.7%
Investment return		
Fixed Interest	4.6%	4.6%
Equities	7.3%	7.3%
Property	7.3%	7.3%
Inflation		
RPI	3.1%	3.1%

(b) Actuarial Assumptions

The demographic assumptions used to determine the value of the in-force business have been set at levels commensurate with the underlying operating experience identified in the periodic actuarial investigations.

(c) Taxation

Projected tax has been determined assuming current tax legislation and rates continue unaltered, except where future tax rates or practices have been announced.

(d) Expenses

The expense levels are based on internal expense analysis investigations and are appropriately allocated to the new business and policy maintenance functions. These have been determined by reference to:

(i) the outsourcing agreements in place with our third-party business process administrators;

(ii) anticipated revisions to the terms of such agreements as they fall due for renewal; and

(iii) corporate governance costs relating to the covered business.

The expense assumptions also include the expected future holding company expenses which will be recharged to the covered business.

No allowance has been made for future productivity improvements in the expense assumptions.

(e) Risk Discount Rate

The risk-free rate is set by reference to the sterling bid swap rates available in the market at the end of the reporting period. Where, however, non-linked business is substantially backed by government bonds, the yields on these assets have been used.

An explicit constant margin of 50 basis points is added to the risk-free rate to cover any remaining risks that are considered to be non-market, non-diversifiable risks, as there is no risk premium observable in the market. This margin gives due recognition to the fact that:

(i) the covered business is substantially closed to new business;

(ii) there is no significant exposure in the with profits business, which is wholly reinsured;

(iii) expense risk is limited as a result of the outsourcing of substantially all policy administration and related functions to third-party business process administrators; and

(iv) for much of the life business the Group has the ability to vary risk charges made to policyholders.

	31 December	
	2007	2006
Risk-free rate	5.0%	4.8%
Non-diversifiable risk	0.5%	0.5%
Risk margin	2.2%	0.8%
Risk discount rate	7.7%	6.1%

The risk margin is derived as a result of the calibration of the RDR, as explained in Note 3c above. The significant increase between 31 December 2006 and 31 December 2007 reflects a change in the projected long-term tax position of the covered business. As at 31 December 2006, there were differences in the projected tax basis and, hence, in the absolute level of projected tax as between the market-consistent approach and the traditional embedded value approach: these differences were, effectively, eliminated by the calibration process and this resulted in an apparently lower level of derived risk margin. As at 31 December 2007, the projected tax position between the two approaches is consistent so that there are no differences which are eliminated by the calibration process and this results in a higher level of derived risk margin.

5 Analysis of shareholders' equity

	31 December	
	2007 £000	2006 £000
Covered business		
Required capital	39,149	45,792
Free surplus	38,483	38,668
Shareholder net worth	77,632	84,460
Value of in-force business	94,007	109,941
Embedded value of covered business	**171,639**	**194,401**
Less: amount financed by borrowings	(12,469)	(16,574)
Embedded value of covered business attributable to shareholders	159,170	177,827
Net equity of other Group companies	28,145	11,281
Total shareholders' equity	**187,315**	**189,108**
The movement in the value of in-force business comprises:		
Value at beginning of period	**109,941**	**109,961**
Amount charged to operating profit	(15,934)	(20)
Value at end of period	**94,007**	**109,941**

On 2 June 2005, the Group drew down £21m on a bank loan facility, in order to part fund the acquisition of CWA Life Holdings plc. This effectively represented a purchase of part of the underlying value in force of CWA by way of debt finance and it follows that the embedded value of the covered business is not attributable to equity shareholders of the Group to the extent of the outstanding balance on the loan account at each balance sheet date. The loan is repayable in five equal annual instalments on the anniversary of the draw down date, the funds for the repayment effectively being provided by way of the realisation of the underlying value of in-force business of the covered business. In accordance with this, £4.2m of the loan was repaid on 2 June 2006 and a further £4.2m was repaid on 2 June 2007, leaving principal outstanding at that date of £12.6m.

6 Analysis of profit of covered business

	Year ended 31 December	
	2007 £000	2006 £000
New business contribution	1,261	1,599
Return from in-force business		
Expected return	10,206	10,386
Experience variances	394	7,459
Operating assumption changes	(4,236)	(5,072)
Return on shareholder net worth	2,053	1,312
Operating profit	**9,678**	**15,684**
Variation from longer-term investment return	824	6,307
Effect of economic assumption changes	(4,043)	9,284
Profit on covered business before tax	**6,459**	**31,275**
Tax	5,677	(4,496)
Profit on covered business after tax	**12,136**	**26,779**

The profit of covered business varies from amounts presented in the summarised consolidated income statement in respect of the pre-tax result of the holding company presented as "other operational result", and in respect of any tax pertaining thereto, which is included in "other tax". The variation from longer-term investment return for the year ended 31 December 2006 is stated net of a loss of £248,000 arising on the sale of a subsidiary company.

7 Sensitivities to alternative assumptions

The following table shows the sensitivity of the embedded value of the covered business as reported at 31 December 2007 to variations in the assumptions adopted in the calculation of the embedded value. Sensitivity analysis is not provided in respect of the new business contribution for the year ended 31 December 2007 as the reported level of new business contribution is not considered to be material (see Note 3a above). It largely relates to guaranteed bond business, where a close asset/liability matching approach leaves values largely insensitive to changes in experience.

Embedded Value ("EV") of covered business as at 31 December 2007	**£171.6m**

	Change in EV (£m)
Economic sensitivities	
100 basis point increase in risk discount rate	-4.7
100 basis point reduction in yield curve	2.9
10% decrease in equity and property values	-5.2
Operating sensitivities	
10% decrease in maintenance expenses	1.9
10% decrease in lapse rates	3.7
5% decrease in mortality/morbidity rates	
Assurances	1.8
Annuities	-0.8
Reduction in the required capital to statutory minimum	1.8

The key assumption changes represented by each of these sensitivities are as follows:

Economic sensitivities

i) 100 basis point increase in the risk discount rate. The 7.7% RDR increases to 8.7%;

ii) 100 basis point reduction in the yield curve. The fixed interest return is reduced by 1% and the equity/ property returns are also reduced by 1%, thus maintaining constant equity/property risk premiums. The rate of future inflation has also been reduced by 1% so that real yields remain constant. In addition the risk discount rate has also reduced by 1%; and

iii) 10% decrease in the equity and property values. This gives rise to a situation where, for example, a Managed Fund unit liability with a 60% equity holding would reduce by 6% in value.

Operating sensitivities

i) 10% decrease in maintenance expenses, giving rise to, for example, a base assumption of £20 per policy pa reducing to £18 per policy pa;

ii) 10% decrease in persistency rates giving rise to, for example, a base assumption of 10% of policy base lapsing pa reducing to 9% pa;

iii) 5% decrease in mortality/morbidity rates giving rise to, for example, a base assumption of 100% of the parameters in a selected mortality/morbidity table reducing to 95% of the parameters in the same table; and

iv) the sensitivity to the reduction in the required capital to the statutory minimum shows the effect of reducing the required capital from 150% of the LTICR plus 100% RCR to the amounts of 100% LTICR plus 100% RCR, being the minimum requirement prescribed by FSA regulation.

In each sensitivity calculation all other assumptions remain unchanged except where they are directly affected by the revised economic conditions: for example, as stated, changes in interest rates will directly affect the risk discount rate.

The sensitivities to changes in the assumptions in the opposite direction will result in changes of similar magnitude to those shown in the above table but in the opposite direction.

8 Reconciliation of shareholders' equity on the IFRS basis to shareholder equity on the EEV basis

	31 December	
	2007 £000	2006 £000
Shareholders' equity on the IFRS basis	**125,784**	**114,255**
Adjustments		
Deferred acquisition costs		
Investment contracts	(8,961)	(10,074)
Deferred income	15,426	17,239
Adjustment to provisions on investment contracts, net of amounts deposited with reinsurers	(18,220)	(19,596)
Adjustments to provisions on insurance contracts, net of reinsurers' share	(600)	(936)
Acquired in-force value	(23,785)	(25,933)
Deferred tax	3,664	4,212
Group shareholder net worth	**93,308**	**79,167**
Value of inforce business	94,007	109,941
Shareholders' equity on the EEV basis	**187,315**	**189,108**
Group shareholder net worth comprises:		
Shareholder net worth in covered business	77,632	84,460
Shareholder's equity in other Group companies	28,145	11,281
Debt finance	(12,469)	(16,574)
Total	**93,308**	**79,167**

Chesnara plc

Notice is hereby given that the Annual General Meeting of the Company will be held at the offices of Panmure Gordon (UK) Limited, Moorgate Hall, 155 Moorgate, London, EC2M 6XB on 19 May 2008 at 11am for the following purposes:

Ordinary Business

To consider and if thought fit, to pass the following resolutions which will be proposed as ordinary resolutions:

Resolution 1

To receive and adopt the Financial Statements for the financial year ended 31 December 2007 together with the Reports of the Directors and Auditor thereon.

Resolution 2

To declare a final dividend for the financial year ended 31 December 2007.

Resolution 3

To approve the Directors' Remuneration Report set out in the Financial Statements for the financial year ended 31 December 2007.

Resolution 4

To re-elect Michael Gordon as a Director who retires by rotation in accordance with the Company's Articles of Association.

Resolution 5

To re-elect Terry Marris as a Director who retires by rotation in accordance with the Company's Articles of Association.

Resolution 6

To reappoint KPMG Audit Plc as Auditor of the Company to hold office from the conclusion of this meeting until the conclusion of the next General Meeting at which the Financial Statements are laid before the Company at a remuneration to be determined by the Directors.

Special Business

To consider and, if thought fit, pass the following resolutions of which Resolution 7 will be proposed as an ordinary resolution and resolutions 8 and 9 will be proposed as special resolutions.

Resolution 7

That the Directors be and they are generally and unconditionally authorised, pursuant to Section 80 of the Companies Act 1985 ("the Act") to exercise all the powers of the Company to allot relevant securities (as defined in Section 80 of the Act) provided that:-

(i) The aggregate nominal value of relevant securities allotted pursuant to this authority shall not exceed £1,742,972 representing 33.33% of the issued ordinary shares of 5p each;

(ii) This authority shall expire on the date of the Annual General Meeting to be held in 2009 or fifteen months after the passing of this resolution whichever occurs first; and

(iii) The company may make an offer or agreement before the expiry of this authority which would or might require relevant securities to be allotted after this authority has expired and the Directors may allot relevant securities in pursuance of any such offer or agreements as if this authority has not expired.

This authority is to replace the existing like authority which is hereby revoked with immediate effect.

Resolution 8

That, subject to the passing of Resolution 7, the Directors be and they are empowered, pursuant to Section 95 of the Act, to allot equity securities (as defined in Section 94 of the Act) pursuant to the authority contained in the foregoing Resolution numbered 8 as if Section 89(1) of the Act did not apply to such allotment, provided that this power shall be limited to:

(i) The allotment of equity securities in connection with a rights issue or other pre-emptive offer in favour of holders of ordinary shares where the equity securities respectively attributable to the interests of all holders of ordinary shares are proportionate (as nearly as may be) to the respective numbers of ordinary shares held by them subject to such exclusions or arrangements as the Directors may deem necessary or desirable to deal with fractional entitlements otherwise arising or legal or practical problems under the laws or regulations of any regulatory authority in any territory;

(ii) The allotment of equity securities pursuant to the terms of any share scheme for employees approved by the members in General Meetings; and

(iii) The allotment of equity securities for cash (otherwise than as mentioned in sub-paragraphs (i) and (ii) above) provided that the maximum aggregate nominal value of equity securities allotted does not exceed £261,471 representing approximately 5% of the issued share capital of the Company; and shall expire on the date of the Annual General Meeting of the Company to be held in 2009 or fifteen months after the passing of this resolution whichever occurs first except to the extent that the same is renewed or extended prior to or at such Meeting save that the Company may make an offer or agreement before the expiry of this power which would or might require securities to be allotted after it has expired and the Directors may allot equity securities in pursuance of any such offer or agreement as if the power conferred hereby had not expired.

Resolution 9

That the Company be and is generally and unconditionally authorised for the purposes of Section 166 of the Act to make one or more market purchases (within the meaning of Section 163(3) of the Companies Act 1985) on the London Stock Exchange of ordinary shares of 5p each in the capital of the Company provided that:

(i) The maximum aggregate number of ordinary shares hereby authorised to be purchased is 10,458,878 (representing 10% of the Company's issued share capital);

(ii) The minimum price which may be paid for such ordinary shares is 5p per share;

(iii) The maximum price (exclusive of expenses) which may be paid for such ordinary shares is not more than 5% above the average of the middle market quotations for the ordinary shares derived from the Daily Official List of the London Stock Exchange for the five business days before the purchase is made;

(iv) The authority hereby conferred shall expire at the conclusion of the next Annual General Meeting of the Company held in 2009 or, if earlier, the date 15 months after the date on which the resolution is passed; and

(v) The Company may make a contract or contracts to purchase ordinary shares under the authority hereby conferred prior to the expiry of such authority which will or may be executed wholly or partly after the expiry of such authority, and may make a purchase of ordinary shares in pursuance of any such contract or contracts.

Notes

1. Any Member entitled to attend and vote at this Meeting may appoint a proxy or proxies to attend and vote instead of him. A Member may appoint more than one proxy in relation to the Annual General Meeting provided that each proxy is appointed to exercise the rights attached to a different share or shares held by that Member. A proxy need not be a Member of the Company. A form of proxy for this Meeting is enclosed, and in order to be valid, any form of proxy and power of attorney or other authority under which it is signed, or a notarially certified or office copy of such power of attorney, must reach the Company's Registrars, Capita Registrars at 34 Beckenham Road, Beckenham, Kent R3 4TU or by post to Business Reply Licence No MB122, Capita Registrars (Proxies), PO Box 25, Beckenham, Kent, BR3 4BR not less than 48 hours excluding any part of a day which is a non-working day before the time appointed for the holding of the meeting. The appointment of a proxy will not preclude a shareholder from attending and voting at the meeting.

2. To appoint a proxy or give or amend an instruction to a previously appointed proxy via the CREST system, the CREST message must be received by the issuer's agent RA10 not less than 48 hours excluding any part of a day which is a non-working day before the time appointed for the holding of the meeting or of any adjournment of the meeting. For this purpose, the time of receipt will be taken to be the time (as determined by the timestamp applied to the message by the CREST Applications Host) from which the issuer's agent is able to retrieve the message. After this time any change of instructions to a proxy appointed through CREST should be communicated to the proxy by other means. CREST Personal Members or other CREST sponsored members, and those CREST Members who have appointed voting service provider(s) should contact their CREST sponsor or voting service provider(s) for assistance with appointing proxies via CREST. For further information on CREST procedures, limitations and system timings please refer to the CREST Manual. We may treat as invalid a proxy appointment sent by CREST in the circumstances set out in Regulation 35(5) (a) of the Uncertificated Securities Regulations 2001. In any case your proxy form must be received by the company's registrars not less than 48 hours excluding any part of a day which is a non-working day before the time appointed for the holding of the meeting to be valid.

3. There is no Directors' service contract of more than one year's duration with any Director. Biographical details of each Director who is being proposed for re-appointment or re-election by shareholders including such membership of Board committees, are set out in the attached document hereto.

4. The Register of Directors' shareholdings and transactions and copies of Directors' service contracts and letters of appointment will be available for inspection at the registered office of the Company during normal business hours each business day and at the place of the Annual General Meeting for at least 15 minutes prior to and during the Meeting.

5. Pursuant to Regulation 41 of the Uncertificated Securities Regulations 2001, the time by which a person must be entered on the register of members in order to have the right to attend and vote at the Annual General Meeting (and for the purpose of the determination by the Company of the votes they may cast) is 11am on 17 May 2008 or, if the Meeting is adjourned, such time being not more than 48 hours prior to the time fixed for the adjourned meeting. Changes to entries on the register of members after that time will be disregarded in determining the right of any person to attend or vote at the meeting.

6. In accordance with Section 325 of the Companies Act 2006, the right to appoint proxies does not apply to persons nominated to receive information rights under section 146 of the Companies Act 2006. Persons nominated to receive information rights under section 146 of the Companies Act 2006 who have been sent a copy of this notice of meeting are hereby informed, in accordance with Section 149 (2) of the Companies Act 2006, that they may have a right under an agreement with the registered member by whom they were nominated to be appointed, or to have someone else appointed, as a proxy for this meeting. If they have no such right, or do not wish to exercise it, they may have a right under such an agreement to give instructions to the member as to the exercise of voting rights. Nominated persons should contact the registered member by whom they were nominated in respect of these arrangements.

7. As at 2nd April 2008 (being the last business day prior to the publication of this Notice) the Company's issued share capital consists of 104,588,785 ordinary shares, carrying one vote each. Therefore, the total voting rights in the Company as at 2nd April 2008 are 104,588,785.

8. Members should note that it is possible that, pursuant to requests made by Members of the Company under section 527 of the Companies Act 2006, the Company may be required to publish on a website a statement setting out any matter relating to: (i) the audit of the Company's accounts (including the auditor's report and

the conduct of the audit) that are to be laid before the Annual General Meeting; or (ii) any circumstance connected with an auditor of the Company ceasing to hold office since the previous meeting at which annual accounts and reports were laid in accordance with section 437 of the Companies Act 2006. The Company may not require the Members requesting any such website publication to pay its expenses in complying with sections 527 or 528 of the Companies Act 2006. Where the Company is required to place a statement on a website under section 527 of the Companies Act 2006, it must forward the statement to the Company's auditor not later than the time when it makes the statement available on the website. The business which may be dealt with at the Annual General Meeting includes any statement that the Company has been required under section 527 of the Companies Act 2006 to publish on a website.

9. In order to facilitate voting by corporate representatives at the meeting, arrangements will be put in place at the meeting so that (i) if a corporate Member has appointed the chairman of the meeting as its corporate representative to vote on a poll in accordance with the directions of all of the other corporate representatives for that Member at the meeting, then on a poll those corporate representatives will give voting directions to the chairman and the chairman will vote (or withhold a vote) as corporate representative in accordance with those directions; and (ii) if more than one corporate representative for the same corporate Member attends the meeting but the corporate Member has not appointed the chairman of the meeting as its corporate representative, a designated corporate representative will be nominated, from those corporate representatives who attend, who will vote on a poll and the other corporate representatives will give voting directions to that designated corporate representative. Corporate Members are referred to the guidance issued by the Institute of Chartered Secretaries and Administrators on proxies and corporate representatives (www.icsa.org.uk) for further details of this procedure.

Additional Information

Approval of the Directors Remuneration Report set out in the Financial Statements (Resolution 3)

The Directors' Remuneration Report Regulations 2002, which came into force on 1 August 2002, stipulates the form of the Report. The Report is set out on pages 33 to 38 of the Financial Statements. Shareholders will be asked to approve this Remuneration Report under Resolution 3.

Authority to Allot Relevant Securities (Resolution 7)

The Company will be asking shareholders to renew the existing authority which the Directors have to allot shares in respect of the authorised but unissued ordinary share capital. Resolution 7 seeks to renew this authority to issue shares up to an aggregate nominal amount of £1,742,972 representing approximately 33.33% of the issued share capital of the Company.

Disapplication of Pre-emption Rights (Resolution 8)

Resolution 8 will be proposed as a Special Resolution, renewing the Directors' authority to allot shares for cash other than to existing shareholders in proportion to their shareholding up to an aggregate nominal value of £261,471, representing 5% of the Company's issued share capital.

Both these authorities (Resolutions 7 and 8), if given, will expire at the conclusion of the next Annual General Meeting or 15 months after the passing of the resolution, whichever occurs first.

Power to purchase own shares (Resolution 9)

The Companies Act 1985 permits a public company to purchase its own shares in accordance with powers contained in its Articles of Association with the authority of a resolution of shareholders. Such a power would expire at the conclusion of the next Annual General Meeting. With effect from 1 December 2003, listed companies are able to buy their own shares and, instead of cancelling them, hold them in treasury and either sell them for cash or use them for cash or use them for an employee share scheme under the Companies (Acquisition of Own Shares) (Treasury Shares) Regulations 2003. The aggregate nominal value of shares of any class held as treasury shares must not at any time exceed 10% of the nominal value of the issued share capital of the shares in that class at that time. Your Directors believe that the Company should continue to have the authority to purchase its own shares. However, this authority will only be exercised when the result would be an increase in earnings per share and in the best interests of the Company. Your Directors have no present intention to make use of this authority. Resolution 9 will be proposed as a special resolution at the Annual General Meeting to give the necessary authority.

By Order of the Board

Ken Romney
Company Secretary

Date 2nd April 2008

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