Chesnara plc

Financial Statements
for the Year Ended
31 December 2009

Financial Calendar

31 March 2010	Results for the year ended 31 December 2009 announced
14 April 2010	Published Financial Statements issued to shareholders
14 April 2010	Ex dividend date
16 April 2010	Dividend record date
13 May 2010	Annual General Meeting
19 May 2010	Interim Management Statement for the quarter ending 31 March 2010
20 May 2010	Dividend payment date
August 2010	Interim results for the six months ending 30 June 2010 announced
November 2010	Interim Management Statement for the quarter ending 30 September 2010

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, Swedish 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 jurisdictions 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 UK operating subsidiary, Countrywide Assured plc, in which the whole of the UK-based 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.

This document refers throughout to the 'UK Business' and the 'Swedish Business'. As explained in Note 8 to the IFRS financial statements, these are the business segments of the Group, comprising, for the UK Business, Countrywide Assured Life Assurance Holdings Limited and its subsidiary companies and, for the Swedish Business, Moderna Försäkringar Liv AB and its subsidiary and associated companies.

Financial Highlights

	Year ended 31 December	
	2009	2008
IFRS basis		
Operating profit/(loss)		
UK Business	24.7	23.6
Swedish Business	(2.1)	–
Other group activities	(2.3)	(0.1)
Profit arising on acquisition of Swedish Business	25.1	–
	45.4	**23.5**
Financing costs	(0.7)	(0.8)
Profit before income taxes	**£44.7m**	**£22.7m**
Basic earnings per share	45.26p	19.24p
Dividend per share	15.95p	15.55p
Shareholders' net equity	**£159.8m**	**£126.4m**
European Embedded Value basis (EEV)		
Operating profit		
UK Business	22.0	25.5
Swedish Business	(2.9)	–
Other group activities	0.9	0.4
	20.0	**25.9**
Investment variances and economic assumption changes		
UK Business	(6.1)	(9.9)
Swedish Business	10.1	–
Profit before tax and before exceptional item	**24.0**	**16.0**
Exceptional item		
Profit on acquisition of Swedish Business	54.2	–
Profit before tax	78.2	16.0
Tax	12.1	(1.2)
Profit for the year	**£90.3m**	**£14.8m**
Shareholders' equity on EEV basis		
Embedded value		
UK Business	157.8	154.3
Swedish Business	91.5	–
Embedded value of covered business	249.3	154.3
Acquired embedded value financed by debt	(4.2)	(8.4)
Shareholders' equity in other Group companies	17.5	36.8
	£262.6m	**£182.7m**
EEV per share	258.7p	180.0p
UK business		
Life annual premium income (AP)	£85.5m	£92.6m
Life single premium income (SP)	£23.3m	£23.9m
Life annualised premium income (AP + 1/10 SP)	£87.8m	£95.0m
Swedish business		
New business premium income (AP + 1/10 SP)	£49.9m	£77.7m
Total premium income (AP + SP)	£269.4m	£245.3m

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.

The Swedish Business was acquired on 23 July 2009. Accordingly, certain of the premium income amounts shown above relate to the pre-acquisition period and are presented here for illustrative purposes.

I am pleased to present the sixth annual financial statements of Chesnara plc ('Chesnara'). With recovery in global investment markets and the acquisition of Moderna Försäkringar Liv AB ('Moderna') mid way through the year, 2009 has seen two major developments in the current and future trading prospects and in the financial strength of the Group. In the light of continuing economic uncertainty, it is pleasing that our results continue to show a high degree of resilience, allowing us to maintain a reliable and progressive dividend policy, while being in a good position to pursue further value-enhancing acquisitions as they arise.

Review of the Business

On 23 July 2009, Chesnara completed the acquisition of Moderna, an open Swedish life assurance and pensions company specialising in unit-linked pensions business written predominantly through independent financial advisers. It currently manages a portfolio of some 85,000 life assurance and pensions policies and it is expected that its embedded value will increase over time as further new business is written. Moderna's prospects were subsequently enhanced by the acquisition of a further 42% share in AkademikerRådgivning i Sverige AB (leading to 91% ownership), an IFA trading in a specialist area of the market. In early 2010, we also completed the acquisition of the operations and certain assets of Aspis Försäkrings Liv AB, a Swedish life risk and health insurer. These acquisitions widen the scope of Moderna's activities and underpin its ability to offer a fully-rounded proposition to the Swedish market.

Moderna was acquired for £20m, from existing cash resources, at a significant discount of 73% to its embedded value, which gave rise to an accretion to Group embedded value of £54.2m. On the IFRS basis of reporting, we have recognised a profit on acquisition of £25.1m.

Global investment market influences have also had a significant impact on the Group's results with the leading UK market indices, for example, posting gains of between 22% and 24% over the whole of 2009. While the low interest rate environment dampened returns on the Group's shareholder funds, this was more than offset by the favourable impact of rising equity markets on the Group's embedded value. This leads to higher current and prospective deductions from unit-linked funds under management, with the UK Business's embedded value benefiting to the extent of £6.0m and the Swedish Business's embedded value benefiting to the extent of £7.5m in the post-acquisition period.

On the EEV basis of reporting, excluding the profit of £54.2m arising on the acquisition of Moderna, we have made pre-tax profits of £24.0m for the year ended 31 December 2009, including £8.8m post-acquisition pre-tax profits attributable to Moderna, compared with £16.0m for the year ended 31 December 2008. Apart from the impact of rising equity markets, other key factors underlying the EEV result are:

In respect of the UK Business:

(i) £7.4m expected return from the unwind of the discount rate;

(ii) £6.8m benefit from continuing favourable persistency experience; and

(iii) £1.3m release from a unit pricing remedial provision no longer required,

offset by

(iv) a £5.6m reduction in pre-tax embedded value earnings arising from a change in the basis of tax on overseas dividends: while this gives rise to lower deductions from policyholder unit-linked funds, there is a broadly offsetting release from the estimate of future tax payable, resulting in a credit to tax.

The EEV tax movement also benefited from a writeback, in excess of £4m, in respect of a tax provision relating to 2007 within the UK Business. As to the underlying persistency assumptions for the UK Business, we have been cautious in the extent to which we have adjusted these while the prospects for the UK economy and household budgets remain uncertain.

In respect of the Swedish Business:

(i) a £0.7m contribution from new business;

(ii) £1.7m expected return from the unwind of the discount rate;

(iii) a £2.6m favourable investment mix effect, driven also by rising equity markets;

(iv) £1.5m profit arising from life, risk and health insurance business and from other business activities; and

(v) other experience effects, including mortality profits, in excess of £2.5m,

offset by

(vi) a £7.8m adverse persistency effect, largely arising from the resetting of the assumptions relating to future persistency rates: this cautious approach reflects the continuing uncertain state of the Swedish economy and its impact on the savings market.

On the IFRS basis, we have posted a pre-tax profit of £44.7m for the year ended 31 December 2009. Adjusting for the effects of the Swedish Business, including the profit of £25.1m arising on acquisition, the profit before tax from continuing UK Business and Group activities was £23.8m, compared with £22.7m in respect of the year ended 31 December 2008. Besides favourable investment market effects, this result also includes, with respect to the UK Business, net mortality and morbidity profits of some £2.1m and the impact of the release to income of £1.3m from the unit-pricing remedial provision, the establishment of which we first reported in respect of the results for the year ended 31 December 2007. The Swedish Business posted a post-acquisition loss of £2.6m, which is in line with expectations as the business continues to build scale and, when profits from an increasing base of in-force investment contracts outweighs the front-end strain of writing new business, it is expected to be profitable, on the IFRS basis within two to three years.

Shareholder Value and Returns to Shareholders

Total shareholder equity on the EEV basis, pre appropriation of £10.5m for the final 2009 dividend, is £262.6m (258.7p per share), compared with £182.7m (180.0p per share) as at 31 December 2008. The significant uplift reflects principally the positive impact of acquiring the Swedish Business at a discount of 73% to its embedded value, together with a strong core trading result in both the UK and Swedish Businesses, driven by the recovery in global investment markets. In addition, the weakening of sterling against the Swedish Krona, between the acquisition date and the end of 2009, gave rise to a further £5.5m accretion in embedded value through the recognition of foreign exchange translation gains.

The capacity of the Group to pursue its dividend policy relies on the continuing emergence of surplus in the UK Business and in the ability to distribute that surplus which, in turn, depends on the regulatory solvency position of the UK Business. I am pleased to report that the UK Business's solvency ratio, post proposed dividends, at 197% (177% as at 31 December 2008) remains in excess of the target of 150% set by the Board of the Life subsidiary.

The Group's dividend policy now has to take account of the competing need for funds of the developing Swedish Business which, in turn, depends on the underlying regulatory solvency ratio of the Swedish Life Business. This was 302% as at 31 December 2009 which is comfortably in excess of the target of 150% set by the Moderna Board. The combined Group post dividend solvency ratio remains at a healthy 316% as at 31 December 2009 (31 December 2008: 358%).

Based on the strength of our results and of our capital solvency ratios, the Board has decided to recommend a final dividend of 10.3p per share (2008 final dividend: 10.05p per share), giving rise to total dividends of 15.95p per share for 2009, which represents a 2.6% increase over total dividends of 15.55p per share for 2008. At the recent trading range of 200p and 220p per share, this represents a yield to shareholders of between 7.3% and 8.0%.

Outlook

We enter 2010 with a somewhat different shape to our business than we entered 2009. The purchase of Moderna and subsequent investments in Sweden have brought a new dimension to the Group. We fully expect that these investments will deliver further value to shareholders in excess of the significant value the acquisition has already delivered.

The fall-out from the credit crunch and the prospect of Solvency II in 2012 have led to an increase in the flow of available acquisition opportunities. However, we continue to be selective and will only pursue opportunities which demonstrate the capability of prolonging our dividend and/or of delivering a significant value uplift for shareholders.

We wish to welcome our new colleagues in Sweden to the Group and thank all our employees for the dedication and commitment they continue to demonstrate.

Peter Mason
Chairman
30 March 2010

Peter Mason was the Senior Independent Non-executive Director of Chesnara plc and Chairman of the Audit Committee during 2008. He was appointed as Chairman of Chesnara plc and Chairman of the Nomination Committee on 1 January 2009. He was re-appointed as a member of the Remuneration and Audit Committees with effect from 22 December 2009 and was appointed as Chairman of Moderna Försäkringar Liv AB with effect from 23 July 2009. He is currently a Non-executive Director of Homeowners Friendly Society and 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.

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. He was appointed as a Non-executive Director of Moderna Försäkringar Liv AB and as Chairman of Moderna Fonder & Analys AB with effect from 23 July 2009. 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 26 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 25 years' experience in the life assurance industry gained with Royal Life, Norwich Union and CMG.

Mike Gordon is an Independent Non-executive Director of Chesnara plc and is Chairman of the Remuneration Committee. He was appointed as Senior Independent Non-executive Director of Chesnara plc on 1 January 2009. He also serves on the Audit Committee and the Nomination Committee and was appointed as a Non-executive Director of Moderna Försäkringar Liv AB with effect from 23 July 2009. He spent 12 years as Group Sales Director of Skandia Life Assurance Holdings.

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.

Peter Wright is an Independent Non-executive Director who was appointed to the Chesnara plc Board on 1 January 2009. At the same date he was appointed as Chairman of the Audit Committee and as a member of the Remuneration Committee. He was appointed as a member of the Nomination Committee with effect from 9 July 2009. He retired as a Principal of Towers Perrin on 1 January 2008 and is a former Vice President of the Institute of Actuaries, having been admitted as a Fellow in 1979.

Directors' Report

Chesnara plc – Company No. 4947166

The Directors present their report and the audited consolidated accounts of Chesnara plc ('Chesnara') for the year ended 31 December 2009. The Corporate Governance Report on pages 36 to 42 forms part of the Directors' Report.

Results and Dividends

The Group consolidated statement of comprehensive income for the year ended 31 December 2009, prepared in accordance with International Financial Reporting Standards and set out on page 53, shows:

	2009 £000	2008 £000
Profit for the year attributable to shareholders	45,940	20,017

An interim dividend of 5.65p per ordinary share was paid by Chesnara on 12 October 2009. The Board recommends payment of a final dividend of 10.3p per ordinary share on 20 May 2010 to shareholders on the register at the close of business on 16 April 2010.

Business Review

Strategic aims

Chesnara continues to seek to participate in the consolidation of life assurance and pensions businesses in the UK and Western Europe. When the Company was listed on the London Stock Exchange in 2004, we acquired Countrywide Assured plc ('CA') on its demerger from Countrywide plc. In 2005 we acquired City of Westminster Assurance Company Limited ('CWA') from Irish Life and Permanent plc and in 2006 we merged the long-term business of the two companies. In the following years opportunities for further similar acquisitions were limited as valuations increased to levels which would not provide attractive returns. This was followed by uncertainty arising from disruption to financial markets and from a recessionary environment and this prevented any significant acquisition activity.

However, in early 2009 an opportunity arose to acquire an open Swedish life assurance and pensions company – Moderna Försäkringar Liv AB ('Moderna') – at a very attractive discount to its embedded value. The announcement regarding the proposed acquisition was made on 17 April 2009 with shareholder approval obtained at an EGM on 20 July 2009, with completion taking place three days later. On 11 December 2009 we announced that Moderna had agreed to take over the in-force business, personnel, expertise and systems of Aspis Försäkings Liv AB ('Aspis'), a small Swedish life and health risk insurer, which complements Moderna's focus on pensions and savings contracts. Completion of the acquisition of Aspis took place on 17 February 2010. The acquisitions of Moderna and Aspis add a growth element to Chesnara's proposition to shareholders. Whilst requiring additional capital in the early years, the prospect for the creation of value for shareholders in the medium to longer term is significant.

The UK Business is substantially closed to new business and its primary focus remains 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.

The Swedish Business is open to new business and its primary aim is to regain market share in the company-paid and individual pensions market, whilst developing profitable business in other areas. Writing new business requires funding to support the initial costs incurred: this is provided either by way of financial reinsurance or by way of cash contributions from Chesnara. As the in-force business portfolio grows in scale the income generated by it eventually allows the business to self fund and become a net generator of cash. Moderna is targeted to reach this pivotal point in the next three to four years.

Following the acquisition of Moderna, and in order to prolong the yield delivery to investors, we continue to examine opportunities to acquire businesses, primarily in the small to medium sector of the life assurance and pensions market in the UK and Western Europe. The experience gained from the acquisition of Moderna and Aspis leads us to believe that we can leverage further value from our existing, and newly-acquired, capabilities. As a consequence of changes in the wider financial market environment sellers' expectations of value have

reduced to levels where transactions may provide the returns we are seeking. Whilst the environment is now more challenging, due to market uncertainty and potentially higher solvency capital requirements, it is apparent that further consolidation is likely to occur.

Consolidation is driven by the opportunity to rationalise operations and to achieve financial and operational synergies from the life assurance and pensions books. These may be enhanced by merging them, where possible, into one legal entity, which also provides the opportunity for more efficient use, and potential release, of capital from the combined businesses.

We primarily target 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 and financial liabilities), discount to embedded value, capital requirements and the pattern and quality of predicted profit emergence. Our strategic approach, however, remains that such potential acquisitions should not detract significantly from the primary aim of delivering a steady and attractive dividend yield although opportunities which present a significant value uplift or growth opportunity will also be evaluated.

How we achieve our strategic aims

In the UK we maintain a small professional corporate governance team who are responsible for both the regulatory and operational requirements of the listed entity – Chesnara – and those of the UK closed book subsidiary – CA. In Sweden, as the book is open and in a growth phase, we retain a broader-based management and operational team.

We maintain a strong internal risk management culture and regime throughout the Group and we maintain systems and controls which satisfy regulatory requirements at all levels. Details of the processes we utilise to identify, evaluate and manage the risks within the Group can be found on page 13.

The UK and Swedish life assurance and pensions industries are both 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 on maintaining a positive relationship with our principal regulators, the Financial Services Authority ('FSA') and the Finansinspektionen ('FI'). Accordingly, a significant effort is directed towards ensuring that the operations are effectively managed in terms of conduct of business regulations and of prudential solvency requirements.

Our team in the UK is intentionally small and focussed in the interests of keeping the overall expense base tight. It has the capability to manage the UK businesses and to assess acquisition opportunities, but it is supplemented from time to time by temporary resource if justified by operational or strategic demands.

We consider the skills, knowledge and experience of the corporate governance team to be a valuable company asset and to ensure continuity we utilise incentivisation schemes which provide reward for both loyalty and company performance. Accordingly, we maintain an annual bonus scheme where half of the potential payment is guaranteed provided that the individuals remain in 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 44. The training and competence needs of individuals are regularly assessed as an integral part of our risk management regime as described below on page 13.

The operating model of our UK 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. Oversight of the outsourced functions forms a significant part of the workload of the UK team. In addition they focus on management of risk, including management of financial exposures; maintaining regulatory compliance; pursuing value-enhancing initiatives on the existing business; and promoting customer retention, thereby extending the longevity of the income stream from the in-force portfolio.

The operating model in Sweden is different from that in the UK as the business is, and will remain, open to new business. Rather than outsource core functions, we believe that it is important that the drive and team ethic of

Moderna is preserved whilst they rebuild following the disruption caused by the sale process during late 2008 and the first half of 2009. The focus in Sweden is to re-establish market share in our target markets, whilst maximising the strategic and organisational opportunities presented by the acquisition of Aspis. We do, however, outsource the provision of IT infrastructure as this mitigates operational risk and, whilst Moderna manages the selection of appropriate investment funds, investment decisions are made solely by the fund managers. Moderna has effective compliance systems and maintains a good relationship with its regulator. It has also focussed on developing its risk and reporting systems to meet the requirements of Chesnara. As well as receiving basic salary, senior managers are incentivised through the receipt of a share of the embedded value created, the majority of which is deferred for three years to engender loyalty, whilst other staff participate in an annual flat rate reward scheme, which is linked to a number of business performance measures.

Chesnara takes its responsibilities for social and environmental issues seriously and recognises the importance of developing and maintaining high standards. We do not, however, 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 2009

The key development in 2009 was the acquisition of Moderna, which we announced on 17 April 2009 and which was completed on 23 July 2009 following shareholder approval at an EGM three days earlier. The purchase price of £20m represented a 73% discount to Moderna's Embedded Value on acquisition.

Moderna is a Stockholm-based Swedish life assurance and pensions company which entered the market less than ten years ago. It established a strong presence in the Swedish unit-linked market as a result of an innovative approach to the funds that it offers, by distributing its products predominantly through independent financial advisers and by developing bespoke IT systems designed around the needs of IFA's and their clients. Prior to the hiatus caused by uncertainty surrounding its ownership, Moderna had grown from nil to around a 14% share of its key target company-paid pensions market. In addition, the company had developed a small number of other products in profitable niches to support or complement its primary market.

Shortly after our purchase, Moderna received approval from Finansinspektionen ("FI") the Swedish Regulator, for the commencement of operations of Moderna Fonder & Analys AB, a subsidiary company established to separate out the fund selection and fund management activities of the Swedish Business. As well as providing focus on this key part of Moderna's market offering, it provides less volatility in income flow to the life company, some taxation advantages to the company and clients and provides a platform, at some future stage, to market its capabilities beyond the life company.

On acquisition, Moderna owned 49% of the share capital of two associated companies, AkademikerRådgivning i Sverige AB ('AkademikerRådgivning') and Modernac SA ('Modernac'). The former is an IFA which was jointly owned in association with Akademikertjänst I.A.S. AB ('the Akademics'). A strategic review of the operation and its ownership resulted in Moderna acquiring a further 42% of the shares, resulting in 91% ownership. In our view, AkademikerRådgivning was underperforming and we therefore injected new management and are expanding the sales resource in order to maximise the opportunity presented by its unrivalled access to an affluent sector of the Swedish population. As part of the arrangement with the Akademics, Moderna also secured a five-year contract to continue providing members of the Akademics with group life cover. Modernac SA is a reinsurer established in Luxembourg on an associated basis with the Akademics, with business from the group life scheme being 90% reinsured into Modernac which provides a profit-sharing mechanism to Moderna and the Akademics.

Late in 2009 the FI announced that Aspis Försäkrings Liv AB ('Aspis'), a Swedish-based life and health risk insurer was to have its operating licence revoked due to solvency concerns. We took the opportunity to acquire the in-force portfolio, personnel, intellectual property and systems of Aspis but not the liabilities for existing claims, although we will be undertaking administration of these claims on a commercial basis for the Administrator of Aspis. We announced this acquisition on 11 December 2009 and completion of the transaction occurred on 17 February 2010. Aspis, which has focussed on life and health risk insurance, provides an extremely good fit with the existing Moderna business which has focussed on pensions and savings. Moderna will now be able to offer a full solution to corporate pension scheme customers as well as separately marketing a strong range of risk products where appropriate. In addition to the opportunities presented on the product side there are synergies which can be obtained through the rationalisation of the capabilities of Moderna and Aspis and management is tasked to realise these in the near term.

Besides these developments and refocusing of the Swedish business with respect to its market presence and product offering, the management of Moderna has continued to ensure that compliance with regulatory

requirements remains robust. During 2009, this has involved a re-assessment of the compliance, internal audit and risk control functions with regard to independence, resourcing and scope of work performed.

In the UK market there were some signs of acquisition opportunity, as owners reflected on the effects of the financial crisis, particularly in terms of stock market performance and its effect on their profits, and also looked forward to the potential effects of the implementation of the Solvency II regime in late 2012.

We have also identified a number of opportunities in Western Europe and remain interested in acquiring further overseas assets. Whilst we do not expect to be able to repeat the significant value uplift achieved on the Moderna transaction we are aware of an increase in the number of potentially attractive opportunities.

The availability of capital to support acquisitions is a potentially constraining factor. However, we are beginning to see some signs of improved credit availability, albeit margins remain at historically high levels and the term of financing is restricted. Therefore, should further financing for an attractive opportunity be required, we would consider raising funding from shareholders via the issue of further equity in appropriate circumstances.

We will continue to investigate acquisition opportunities as they arise as we continue to believe that we can leverage further value from our existing, and newly acquired, capabilities.

As to the existing, and newly acquired, life and pensions portfolios, we have continued to protect shareholders' interests through the active management of the following areas:

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. The Group's portfolios have very little exposure to the impact of investment market performance on options and guarantees. However, it does have exposure to market falls by way of policyholders' linked funds, which have expanded significantly following the purchase of Moderna, and from which surplus is generated. Whilst there is no discernable misselling risk in Sweden we do have ongoing exposure to the misselling of policies sold in connection with an endowment mortgage in the UK. In this regard 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. Such exposure to redress payments has declined as policyholders have become time-barred from making a successful complaint. Over 80% of our in-force mortgage endowment policies are time-barred and this proportion is increasing slightly as time progresses. 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 result in low level, if any, compensation, assuming reasonable long-term market performance. During 2009 the number of complaints we have received and the percentage of those we have upheld has remained relatively stable. The percentage of complaints time-barred has increased and investment market gains have led to a reduction of the average amount of compensation paid. The current provision for future redress costs is, based on current knowledge and expectation, believed to be adequate. However, it is not set in the expectation of any change in rules or interpretation of the existing rules by the FSA or by the Financial Ombudsman Service ('FOS') who are responsible for mediating between the company and policyholders on disputed complaints.

The Board continues to have a conservative approach to the investment of shareholder funds, which underpin our strong solvency position and future dividend capability. The benchmark of 70% cash and 30% fixed interest securities has been maintained and, whilst this approach may have proved disadvantageous in terms of potential returns during the market recovery, the Board is not minded to expose shareholder capital to the volatility of investment markets to any significant extent.

In our last financial statements we reported that we had suffered a loss as Kaupthing Singer and Friedlander had entered administration and we had, therefore, fully written down the £1.1m deposit we had with them. During the course of 2009 we have received £0.3m from the administrators and further distributions may be expected in 2010 and beyond, although we are not expecting full recovery.

Managing the expense base

We continue to maintain strong management of our expense base. In the UK our team of 16 people manages the demands of the listed entity, Chesnara, and of CA. A much larger workforce is in place in Sweden. Moderna's staff complement at the end of 2009 was 78 and Aspis brought a further 51 to the Group. We have begun a

process where synergies will be realised and we expect to reduce costs through selective headcount reductions and through relocating support functions to Aspis's lower cost centre in Norköpping in the south of Sweden.

Within the Group we continue to maintain a rigorous budgeting and approval process. Budgets are prepared by the relevant subsidiary and reviewed, challenged, amended and approved by the relevant Boards before submission to the Group Board for overall approval. Budgets are monitored and reported against on a monthly basis, with explanations provided for significant variances.

In order to provide greater certainty of expenses relating to the outsourcing of the CWA book of business in the UK, the Board approved the take-up of the option we had to extend the administration element of the contract with Capita Life and Pensions Regulated Services Ltd ('Capita') to an evergreen basis with effect from 1 January 2010. The existing contract provided services until 2022 and we now have the advantage of fixed terms for the administration of this book until the last policy ends. We did not take up the option to extend the supporting financial and actuarial services and are keeping this area under review.

Promoting customer retention

A key determinant of our future 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. This is true for both the UK and Swedish Businesses. In the UK 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 continue 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, and who offer advice on retaining the policy where appropriate or possible alternative arrangements, if necessary. To date, despite the challenging economic environment, we have yet to see any significant deterioration in retention rates. As a result of this continued positive experience, our expectation of future retention rates on this business has improved.

With regard to the Swedish Business, while the overall number of policies in force has risen, the rate at which policyholders leave has increased due to a number of influences. First, the uncertainty around future ownership unsettled IFA's and their clients and some took the opportunity to move their arrangements to other suppliers. In addition, Moderna's funds suffered a period of relatively poor performance in late 2008 and early 2009 as a result of their value-focussed approach to investing. The investment market recovery has reversed this, but the economic climate in Sweden has deteriorated and this has led to higher levels of unemployment and contract discontinuance. Further, a recent regulatory change in Sweden has enabled the transfer of pension investments away from the original supplier – a new initiative. The experience to date has been that of heavy marketing by bank-owned life assurance subsidiaries which has led to Moderna being a net loser in this market. We believe that, in the near term, Moderna's strategy, as regards a differentiated fund approach and recent improved performance, will enable them to compete more strongly in this market. Moderna have a policy of proactively contacting IFA's and, where appropriate, clients directly, to ascertain the reason for cancellation or transfer. This information is utilised in the development of the marketing and sales effort.

An important element of our customer retention strategy is the pursuit of good relative investment performance in the unit-linked funds. The CA funds are primarily managed by Schroder Investment Management Limited ('Schroders') while 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 Moderna funds are managed by a carefully selected range of fund managers who have strong performance records in the relevant sector. Performance is monitored very closely and regular meetings are held with fund managers. Should underperformance continue then an alternative manager is sourced and appointed to manage the relevant assets. Further details of fund performance are provided in the Key Performance Indicators on pages 14 and 19.

Managing regulatory requirements

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

Business conduct and practice – through the year we have continued the development of Treating Customers Fairly ('TCF') measures in the UK business. We believe we have successfully embedded TCF in the business and that the outsourcers have achieved the same.

In previous reports we stated that we had identified a data error in the UK Business whilst migrating from an aged unit pricing system to a modern system. The project to rectify the consequences of this data error is all but complete and with the experience we now have we have, during 2009, released back to income £1.3m (£0.9m net of tax) from the original provision of £3.0m (£2.2m net of tax) established in 2007.

In the UK we have not been the subject of any formal FSA review as our next Arrow assessment is not due until 2011. Originally this had been set for 2010. However, the FSA advised us in January 2010 that they would postpone this for a year and we believe that this is a reflection of our continued good compliance record. We will continue to keep our FSA supervisory team informed and discuss matters with them on a regular basis. As an example of this, we have submitted an updated Individual Capital Assessment to the FSA although we are not strictly required to do so. We believe our current regulatory capital resources requirement (as set out on page 16) will continue to be adequate. We will continue our strong risk management culture and processes which complement our regulatory compliance ethos.

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 UK Business, amend our practice to comply with the guidance.

In Sweden the FI have not undertaken any significant review of Moderna. However, we were subject to an approval process as part of the acquisition and have since received approval for Moderna Fonder & Analys AB to commence operations and for the acquisition of the majority of shares in, and the assumption of management control of, AkademikerRådgivning. Furthermore we have worked closely with the FI in the acquisition of Aspis and take their approval of this acquisition as a positive sign of our standing with them.

Financial reporting – our primary financial statements are prepared on an IFRS basis: a key development during 2009 has been application of the requirements of IFRS 8 Operating Segments. This standard helps to promote transparency of trading performance and financial position of the Group as the UK and Swedish businesses are subject to sharply contrasting business dynamics. During the second quarter of 2010 the International Accounting Standards Board are due to issue an Exposure Draft on Insurance Contracts and it is expected that this will have a significant impact on financial reporting for both our UK and Swedish businesses.

We continue to employ EEV principles as the basis for providing information supplementary to the IFRS financial statements, as these principles provide a framework which is intended to improve the comparability and transparency of embedded value reporting on a pan European basis: there has been no fundamental change in our application of the principles during 2009.

Solvency II – we have initiated processes in both the UK and Swedish businesses to ensure compliance with the requirements of the EU Solvency II Directive by the scheduled implementation date of 31 October 2012. These requirements involve far-reaching changes, not only in terms of the conduct of the operations, by way of enhancing risk management processes, but also in terms of the calculation of the technical provisions and of the risk-based determinants of capital adequacy, and reporting of the same.

Risk management

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

In both the UK and Swedish businesses we maintain processes for identifying, evaluating and managing the significant risks faced by the Group which are regularly reviewed by the Audit Committee. 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 processes are designed to manage rather than eliminate risk and, as such, provide reasonable, but not absolute, assurance against loss.

At the subsidiary CA level in the UK Business we maintain, in accordance with the regulatory requirements of the FSA, a risk and responsibility regime. Accordingly, the identification, assessment and control of risk are 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 Risk Committee in CA, 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 CA's 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.

At the subsidiary Moderna level in the Swedish Business, there is full compliance with the regulatory requirement that its Board and Managing Director have responsibility for ensuring that the management of the organisation is characterised by sound internal control, which is responsive to internal and external risks and changes in them. The Board has responsibility for ensuring that there is an internal control risk function, which is charged with (i) ensuring that there is information which provides a comprehensive and objective representation of the risks within the organisation and (ii) proposing changes in processes and documentation regarding risk management. These obligations are evidenced by regular compliance, internal audit, general risk and financial risk reports to the Moderna Board. The latter is supplemented by quarterly returns to the FI, which set out estimated capital requirements in respect of Insurance, Market, Credit, Liquidity, Currency and Operational risks.

It is inherent in the operations of both the UK and Swedish life and pensions businesses that they carry significant insurance and financial risk. Further, the Group, as a result of the acquisition of an overseas business, now incurs currency exchange risk. The nature, scope and management of these particular risks are articulated in detail in Notes 5 and 6 to the Financial Statements on pages 76 to 101.

We acknowledge that, as a consequence of our strategy of maintaining a small UK-based 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 retention bonuses dependent upon their skills and knowledge. Should a skills gap appear we would 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 23 to 35.

UK Business

(1) Per policy expenses

A key area of focus for the UK Business 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 169 to 171 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 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 at the same rate, as not all expenses vary in line 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.

	As at 31 December 2008	Variation due to			As at 31 December 2009
		Expected variation	Policy volume projection	Expenses projection	
EEV projected expense per policy per year (£'s)	72.08	2.93	(4.70)	(5.41)	64.90

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

An improving rate of continuing policy lapse experience over the year has led to higher projected policy volumes and this has translated into a favourable impact on per policy costs as fixed costs are spread over a larger policy base. This has been enhanced by revised expense projections following, principally, from a reassessment of costs which may be incurred in the longer-term with respect to corporate governance activity.

(2) Policy attrition rate

Generally, the longer that life and pensions policies remain in force the more profit accrues to the UK Business. 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 providing an advice service to customers. 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)

	2009	2008
Beginning of year	192	210
End of year	176	192
Rate of attrition over the year	8.3%	8.6%

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.

(3) Unit-linked fund performance

Relative outperformance in the unit-linked funds helps promote policy retention and, when positive, increases the embedded value of the Group as future management charges received will be of a higher magnitude. The CA Pension Managed Fund, which represents a significant proportion of CA policyholder funds under management, provided a return of 22.9% over the year ended 31 December 2009 (31 December 2008: -17.3%), while the CWA Balanced Managed Pension Fund, which represents a significant proportion of CWA policyholder funds under management, provided a return of 21.16% over the same period (31 December 2008: -19.9%). These returns compare favourably with the ABI UK Pension Balanced Managed benchmark return of 20.47% (31 December 2008: -20.6%).

(4) Mortgage endowment misselling complaints

We continue to carry potentially 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:

	2009	2008
Number of complaints received during the year	1,210	1,206
% upheld of complaints assessed during the year	27%	28%
% time barred of complaints assessed during the year	62%	50%

The percentage of in-force policies which are time-barred remains above 80% but has increased only slightly during 2009 as investment markets have had a beneficial effect on policy values. Time-barred policies are 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 the ABI. We do not expect the percentage of time-barred cases to increase significantly in future years.

The number of complaints we have received has marginally increased with the percentage of claims upheld reducing slightly. The percentage of complaints we have time-barrred has increased but remains below the percentage of policies which are actually time-barred. This is a consequence of customers who already recognise they are time-barred not submitting a misselling complaint. Where misselling has occurred, the average amount of compensation we are required to pay has fallen as investment markets have recovered. The current provision is, based on current knowledge and expectation, believed to be adequate. However, it is not set in the expectation of any change in rules or interpretation of the existing rules by the regulatory authority or by the Financial Ombudsman Service ('FOS') who are responsible for mediating between the company and policyholders on disputed complaints.

(5) 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 31 to 32. 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	
	2009 £m	2008 £m
Available capital resources (CR) represented by:		
– Share capital	40.0	40.0
– Retained earnings	1.1	1.0
– Surplus in long-term business fund	2.5	2.0
	43.6	43.0
Regulatory capital resource requirement (CRR)	22.1	24.3
Target requirement	32.0	35.6
Ratio of CR to CRR	197%	177%
Excess of CR over target requirements	£11.6m	£7.4m

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.

The target requirement as at 31 December 2009 continues to fall below the amount of share capital in CA and it follows that £8.0m (being the difference between the target requirement and the amount of share capital) of the reported excess of £11.6m cannot be distributed to Chesnara other than by way of a capital reduction in CA.

This constraint is expected to increase over the next few years and the ratio of CR to CRR is, accordingly, expected to rise significantly.

It is our intention that, in the medium-term, and provided that there are no unforeseen demands on the CRR, that it will be reduced by way of a formal capital reduction through the courts, thus making funds available for transfer to the parent company.

Swedish Business

The Swedish Business was acquired on 23 July 2009. Accordingly, certain of the key performance indicator information set out below relates to the pre-acquisition period and are provided here to illustrate the underlying trends in the business.

(1) Premium income

The writing of profitable new business and the continuing flow of premium income are key to the success of the Swedish Business, which focuses primarily on the pensions and savings market, but which also writes risk business where the opportunity exists.

	Year ended 31 December	
	2009 **£m**	**2008** **£m**
New Business Premium Income*		
Pension and savings	46.8	72.5
Risk insurance	3.1	5.2
Total	**49.9**	**77.7**

*Basis: annualised premium plus 1/10 single premium denominated in SEK and translated into sterling at a constant rate of SEK11.5 = £1.

	Year ended 31 December	
	2009 **£m**	**2008** **£m**
Total Premium Income*		
Pension and savings	244.2	221.7
Risk insurance	25.2	23.6
Total	**269.4**	**245.3**

*Basis: total premiums paid denominated in SEK and translated into sterling at a constant rate of SEK11.5 = £1.

The deterioration in new business premiums was caused by the hiatus resulting from the process of selling Moderna into new ownership in the early part of 2009. Not surprisingly, financial advisers, who are the primary source of distribution for Moderna, were reluctant to place larger business contracts with it whilst its ownership was subject to uncertainty. However, total premiums held up well and strategies are now in place to facilitate a recovery in the levels of new business being written.

(2) Market share

The Swedish Business's primary target market is that of unit-linked pension business and, within that, company-paid contributions business.

Share of unit-linked pensions market by quarter

	Q4 08	Q1 09	Q2 09	Q3 09	Q4 09
Total business	10.6%	6.6%	5.5%	4.0%	5.4%
Company-paid contributions business	14.1%	8.2%	6.4%	7.8%	7.8%

As a consequence of new business volumes falling, as shown above, market share also fell. As the above figures demonstrate there has been some recovery in market share of the company-paid contributions business as the effect of marketing the revised ownership has improved sentiment towards Moderna.

(3) Policy attrition

The longer that insurance and investment contracts remain in force, the more profit accrues to the business. Different policy product types will be subject to surrender, transfer or lapse to varying extents.

	Year ended 31 December	
	2009	2008
Surrenders (Endowments)	11.4%	7.7%
Transfers (Pensions)	3.2%	1.5%
Lapses (Pensions and Endowments)	17.9%	19.8%

The above percentages are, for surrenders and transfers, based on the capital amount surrendered or transferred, divided by the amount of capital potentially transferable. For lapses, it is the annual premium of lapsed policies, divided by the total annual premium in force at the start of the year. Rates of loss were also affected by the uncertainty surrounding the ownership of Moderna in the early part of 2009. Moderna's record on fund performance during 2009 and Chesnara's ownership have helped stem the losses but, on the reverse side, economic conditions in Sweden have had a negative impact. Moderna continues with its policy of contacting financial advisers and their clients where a termination occurs to ensure that any underlying trends are countered.

New regulations allowing the transfer of pension funds were confirmed at the end of March 2009 and, whilst in the near term, we expect this to be an attractive market opportunity for Moderna, we have, to date, suffered more outgoing transfers than incoming ones as large banks have targeted this market.

(4) Assets under management

The value of assets under management is a key reference point for establishing the ongoing profit-earning capacity of the business, as fees are received based on those values.

	Year ended 31 December	
	2009 £m	2008 £m
Assets under management*	962.3	576.9

*Denominated in SEK and translated into sterling at a constant rate of SEK11.5 = £1.

Assets under management increased by £385.4m during the year ended 31 December 2009. Adjusting for premiums paid and for the withdrawal of funds resulting from transfers, surrenders and natural pension payouts, policyholders experienced average growth, across the fund range, of approximately 25% due to improved fund performance.

(5) Fund performance

Relative fund performance is key to obtaining new business and to supporting business retention.

Number of funds

	Year ended 31 December	
	2009	2008
Outperformed against relevant index	19	8
Underperformed against relevant index	14	21
No relevant index	2	4

One of Moderna's key differentiators is its approach to selecting the funds available to investors. Rather than adopt mainstream funds, which, in Sweden, are those predominantly managed by subsidiaries of banks which also have life assurance subsidiaries, they select a limited number of funds from a wide range of independent fund managers. The funds selected are, in general, actively managed funds with a value approach, but in markets which are considered efficient, Moderna focuses on index-linked funds. The performance of all funds is closely monitored and regular contact is undertaken with managers to ensure that the underlying reason for the performance, whether positive or negative, is fully understood. Funds that do not perform favourably compared to the relevant index are wholly replaced if there are no acceptable strategies for improvement in the returns. During the market volatility in 2008 the managed funds underperformed as, in general, the managers utilised a value approach to the underlying investment strategies and, therefore, the fund returns suffered as a result. The reverse has generally been true in 2009, resulting in a number of funds gaining ground and therefore outperforming the relevant benchmark.

(6) 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 Moderna on pages 32 to 33. These amounts are set according to regulations established by the Swedish regulator and their ratio is a key indicator of the capital health of the business as it expands and provides the context in which further capital contributions are made by the parent company to finance that expansion in a predictable and orderly manner.

	31 December	
	2009 £m	2008 £m
Available capital resources (CR) represented by:		
– Share capital	1.1	1.1
– Additional equity contributions	33.6	24.2
– Accumulated deficit	(10.2)	(12.6)
	24.5	12.7
Regulatory capital resource requirement (CRR)	8.1	7.7
Target requirement	12.1	11.5
Ratio of CR to CRR	302%	165%
Excess of CR over target requirements	£12.4m	£1.2m

The information as at 31 December 2008 relates to the pre-acquisition period and is provided for illustrative purposes. The fall in the accumulated deficit over the year was impacted by a pre-acquisition restatement of the period for the straight-line amortisation of deferred acquisition costs from 10 to 17 years, such costs being an admissible asset for Swedish regulatory purposes. Equity contributions were enhanced by additional £2.1m funding by Chesnara in the post-acquisition period.

The Moderna Board sets a minimum target of 150% of the regulatory capital requirement. Swedish solvency regulation requires that a certain proportion of assets, to be fully admissible, are to be held in the form of cash. The operation of this requirement may, from time to time, act as the operative constraint in determining the

level of additional funding requirements, thereby causing the solvency ratio to rise above what it would otherwise have been, had the form of assets matching capital resources not been a constraint.

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 our businesses. Whilst the acquisition of Moderna, and its substantial accretion to embedded value, is welcome and it will, in time, begin to contribute to future dividend payments, support for dividends from the UK run-off business will diminish as the book inevitably runs down. Therefore, we recognise that, without further acquisitions, providing dividend growth in the medium term will become challenging. In order to overcome this potential issue we continue to seek further acquisition opportunities which have income generating capability. We have seen an increase in the number of opportunities as the effect of recent financial market difficulties is recognised and as the potential implications of the EU Solvency II Directive become ever more apparent. Solvency II brings challenges both in terms of capital requirements and, not least, in terms of implementation. We believe we are in relatively good shape and, at this time, are not expecting any significant adverse capital effects. However, evaluating opportunities, in a still uncertain market and regulatory background and taking on implementation across a wider group does, and will, bring challenges.

That said, both businesses remain exposed to macroeconomic and industry-related factors including:

(i) volatility in investment markets which will have an effect on surplus generation and embedded value as these are, in part, linked to investment values. The sensitivity of the embedded value to investment market movements, is detailed on page 174;

(ii) the adverse impact of low interest rates as the return on the significant cash deposit balances we hold is significantly diminished;

(iii) the effect of the economic downturn on policy continuation rates. Whilst reductions in interest rates and low inflation will help affordability, the likely increase in unemployment will have an inevitable effect, albeit we have factored in these considerations in setting our discontinuance rates;

(iv) ongoing domestic- or European-driven regulatory change, e.g. the impact of Solvency II or changes in the application or interpretation of other regulatory-based rules;

(v) changes in the taxation regime of life assurance companies, particularly in the UK following the publication of the HMRC's consultation paper of 10 March 2010; and

(vi) exchange rate fluctuations where any cost of funding Moderna or the effect on the reported embedded value of the Swedish Business could be negatively affected.

Provided that these areas do not adversely impact the prospects of the Group significantly, the short- to medium-term outlook is positive for the ongoing emergence of surplus and, accordingly, for dividend support.

Financial risk

Disclosure with respect to financial risk is included in Note 6 to the Financial Statements.

Directors

The present Directors of the Company and their biographical details are set out on page 7. All of those Directors served for the period from 1 January 2008 to 31 December 2009, with the exception of Peter Wright, who served as Non-executive Director from 1 January 2009, his appointment date, to 31 December 2009. There have been no changes in the Directorate between 31 December 2009 and 30 March 2010.

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 36 to 42. 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 43 to 49, which also includes details of Directors' interests in shares and share options.

Pursuant to the Articles of Association, Ken Romney and Frank Hughes 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. In addition, no Director had any material interest in any significant contract with 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 2008 and 31 December 2009 and the period to 30 March 2010.

Substantial shareholdings

The following substantial interests in the Company's ordinary share capital at 31 December 2009 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 2009
Amerprise Financial, Inc. (Threadneedle Asset Management)	10,163,397	10.01%
Henderson Global Investors Limited	4,566,866	4.37%
Legal and General Group	4,130,698	4.06%
Standard Life Investments Limited	3,864,029	3.80%

The substantial shareholder interests remained unchanged at 25 March 2010 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 2009 were £nil (2008: £nil). No political contributions were made during the year ended 31 December 2009 (2008: £nil).

Employees

The average number of employees during the year was 51 (2008: 24).

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, age, gender, marital status, ethnic origin, religious beliefs, sexual orientation 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 business 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. To support this we allow each of our UK employees two days release on full pay each year where they can support a local charity project of their choice.

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 primarily office-based financial services companies, the Directors believe that the Group's activities do not materially contribute to pollution or cause material damage to the environment. However, the Group 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 2009, based on the consolidated financial statements, was for the Group 1 (2008: 4) and for the Company 3 (2008: 13).

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 as stated in Note 2(c) to the financial statements on page 62. Detailed analysis of relevant risks and other factors is included within the sections headed 'Going Concern', 'Capital Structure, Treasury Policy and Liquidity' and 'Cash Flows' in the Operating and Financial Review and within Notes 5 and 6 to these 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. This information is given and should be interpreted in accordance with the provisions of section 418 of the Companies Act 2006.

Auditor

A resolution for the re-appointment of Deloitte LLP as Auditor of the Company is to be proposed at the forthcoming Annual General Meeting.

Approved by the Board on 30 March 2010 and signed on its behalf by:

Ken Romney
Director

The Business Review, presented in the Directors' Report on pages 8 to 20 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 2009 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 Countrywide Assured plc ('CA'), a life assurance company, on its demerger from Countrywide plc ('Countrywide'). CA was established in 1988 as the life assurance division of Countrywide and, predominantly, 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 mainly comprises 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 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, of which £4.2m remains outstanding as at 31 December 2009, 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 has helped to improve the overall mix of Chesnara's UK 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 resulted.

In April 2009 Chesnara announced the proposed acquisition of Moderna Försäkringar Liv AB at an attractive discount to its embedded value. The transaction completed on 23 July 2009 following shareholder approval at an EGM three days earlier. Moderna is an open unit-linked life and pensions business based in Sweden. It started writing business in 2002 and had achieved a market share of 14% of the company-paid pensions market by 2008. This market penetration fell as issues surrounding its then ownership, by an Icelandic financial services organisation, and its proposed sale became a concern to its key distributors – Swedish Independent Financial Advisers – and their clients. Following Chesnara's purchase of Moderna market share is again beginning to grow from somewhat reduced levels. Shortly after the acquisition, the Swedish regulator, Finansinspektionen ('FI'), approved the commencement of operation of a subsidiary company Moderna Fonder & Analys AB ('MFA') which was established to separate out the fund selection and management activities from the life company and to potentially, develop these activities in the wider market. On acquisition, Moderna owned 49% of the share capital in two associated companies, AkademikerRådgivning I Sverige AB ('AkademikerRådgivning') and Modernac SA ('Modernac'). The former is an IFA which was jointly owned by Akademikerjänst I.A.S. AB ('the Akademics') and a strategic review led to Modena acquiring a further 42% of the shares resulting in 91% ownership. Subsequently we have installed new management and are expanding the sales capabilities. Modernac is a reinsurer based in Luxembourg and was established to reinsure business resulting from a group life cover arrangement with the Akademics which has recently been extended for a further five years.

In December 2009 we announced that Moderna was to acquire the in-force portfolio, personnel, intellectual property and systems of Aspis Försäkrings Liv AB ('Aspis') – a Swedish based risk insurer which was to have its operating licence revoked by the FI due to solvency concerns. The transaction was finalised on 17 February 2010 and we also entered into a commercial agreement to administer pre-existing claims where we have accepted no liability. As a result of this transaction Moderna is able to complement its existing strength in the pensions and savings market with a range of risk and health products whilst realising operational synergies which will arise by combining the capabilities of the two businesses.

In the UK CA now manages a portfolio of some 176,000 life assurance and pension 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 sells a small amount of protection business to existing customers while it also benefits from additional inward flows on its existing life

and pension contracts by way of inflation-linked increases and rebates received from the government in respect of contracted-out pension policies.

As the UK Business is substantially closed to new business, it is expected that its embedded value 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.

At the end of 2009 Moderna had a portfolio of some 85,000 policies of which the vast majority are unit-linked. Writing new business requires funding to support the initial costs incurred and this is provided either by cash contributions from Chesnara or by way of financial reinsurance. As the business grows it will reach the point where the surplus it generates outstrips the costs of writing new business and therefore it becomes a generator of cash rather than a consumer. Moderna is expected to reach this pivotal point in the next three to four years.

Chesnara continues to seek to acquire similar life assurance businesses which provide initial valuation uplift but which also demonstrate characteristics which will provide support for our primary objective of delivering an attractive dividend yield.

Structure of the Business

The Chesnara Group operating model in the UK 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. In Sweden, we only outsource the provision of IT infrastructure and the management of investment funds. We believe that it is important that the drive and team ethic of Moderna is preserved whilst they rebuild market share and maximise the strategic and operational synergies and opportunities offered by the launch of MFA, assumption of control of AkademikerRådgivning and the acquisition of Aspis.

In the UK our agreement with HCL Insurance Business Services Limited (formerly Liberata Financial Services Limited) to outsource back office functions for the CA business with effect from 1 February 2005 continues. The agreement, which runs for 10 years from that date, 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.

The outsourcing agreement with Capita Life and Pension Regulated Services Limited ('Capita') initially provided for the supply of administration and financial functions for the CWA book of business from 1 April 2007 for a period of 15 years. As of 31 December 2009 the service in respect of the administration was extended to an 'evergreen' basis such that the contract will remain in force until the last CWA policy ends.

The agreements with our outsourcers provide the UK 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 and UK Business activities are based in Preston, Lancashire. Moderna is based in Stockholm in Sweden and following the acquisition of Aspis has acquired a further administration capability in Norköpping in southern Sweden. Chesnara has 16 FTE employees in its corporate governance team in the UK. The team are engaged in the management of the outsourcing contracts, corporate governance, the fulfilment of regulatory responsibilities and identification and development of business opportunities. In Sweden, following the planned expansion of AkademikerRådgivning and the acquisition of Aspis, a maximum post-rationalisation headcount in the order of 140 is being targeted. The management team in Moderna is primarily engaged on regaining profitable market share and on exploiting the strategic opportunities presented by MFA, AkademikerRådgivning and Aspis.

Chesnara's approach to resourcing is to maintain a focussed, professional, knowledge-based management team which is sized to deliver known requirements. As such it does, 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 – both the UK and Swedish 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. In addition Moderna have entered into contracts which provide funding for the financial strain associated with writing new business. Relations with the providers of these contracts is closely managed to ensure continuity of these arrangements on commercially acceptable terms.

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. Moderna's outsourced IT infrastructure service is monitored under similar arrangements.

Systems – All Chesnara's subsidiaries are required to maintain, and regularly test, a business continuity plan. Within the outsourcing contracts we have, in both the UK and Sweden, terms which require the operator to undertake annual Business Continuity Plan tests and ensure that systems can be promptly recovered in the event of failure. With HCL this extends to the provision of systems which support the UK governance team.

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. In Sweden, MFA has been established to provide focussed management of the investment operations. One of Moderna's key differentiators in their market is that they offer the funds of independent fund managers and regularly assess the performance they deliver. Should performance deteriorate, Moderna will appraise the likelihood of recovery and, if appropriate, reallocate funds to new managers.

Operating Review

Basis of Accounting

The Group reports in accordance with International Financial Reporting Standards ('IFRS'). IFRS essentially permits the 'grandfathering' of the principles and bases used to measure profit arising on long-term insurance contracts under previously-adopted UK and Swedish GAAP, where the contracts contain significant insurance risk. Profits on contracts where no significant insurance risk subsists are measured using the principles of IAS 39 Financial Instruments: Recognition and Measurement.

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. EEV methodology aims to measure the underlying embedded value of the Group's life assurance, pensions and annuity businesses and provides a framework which is intended to improve the comparability and transparency of embedded value reporting across Europe. As stated in the 'International Reporting Developments' section of the Financial Review on page 34, we have decided to defer compliance with the European Insurance CFO Forum Market Consistent Embedded Value (MCEV) Principles (copyright © Stichting CFO Forum Foundation 2008) until 2011.

IFRS Result

The IFRS result for the year ended 31 December 2009 comprises:

	Year ended 31 December 2009			Year ended 31 December 2008		
	Pre-tax £000	**Tax £000**	**Post-tax £000**	**Pre-tax £000**	**Tax £000**	**Post-tax £000**
Profit arising on acquisition of Swedish Business	25,056	–	25,056	–	–	–
UK Business result	24,784	948	25,732	23,614	(2,856)	20,758
Swedish Business result	(2,626)	(148)	(2,774)	–	–	–
Other group activities	(2,473)	392	(2,081)	(887)	146	(741)
Total result	**44,741**	**1,192**	**45,933**	**22,727**	**(2,710)**	**20,017**
Non-controlling interest			7			–
Total result attributable to shareholders			**45,940**			**20,017**
Total result excluding Swedish Business items*	**23,757**	**1,340**	**25,097**	**22,727**	**(2,710)**	**20,017**

*Includes adjustment for £1,446,000 expenses, included in Other Group Activities, incurred during 2009 in connection with the acquisition of the Swedish Business.

The profit of £25.1m arising on the acquisition of the Swedish Business represents the excess of the £45.1m fair value of net assets acquired over the purchase consideration of £20.0m, as disclosed in Note 7 of the IFRS financial statements.

The result for the UK Business continues to be dominated by the strong emergence of surplus from the underlying life and pensions contracts, which are in run off. Key influences which have maintained the pre-tax result above the 2008 level are:

(i) the impact of a significant appreciation in the value of fixed interest securities over the year, which has contributed some £2.4m;

(ii) favourable net mortality/ morbidity experience of £2.1m; and

(iii) the release back to income of £1.3m from a unit-pricing provision, based on experience of redress and complaints levels during the year.

The effect of these positive influences was dampened somewhat by lower returns on shareholder funds due to the low interest rate environment.

The Swedish Business incurred a small, but expected, loss over the 23-week post-acquisition period. It is expected to incur trading losses for a further three years, as it continues to build scale and until realised profits from an increasing base of in-force investment contracts outweigh the front-end strain of writing new business.

The result of other group activities, which principally relates to the operations of the parent company, include £1.4m of expenses incurred in connection with the acquisition of the Swedish Business: this accounts for the increase in the level of loss over 2008. Other significant factors were a recovery of £0.3m in respect of a cash deposit with Kaupthing, Singer & Friedlander, previously written off, and financing costs on bank borrowings which were £0.2m lower than expected, both offset by lower returns on invested cash deposits.

The recognition for total tax in the Group for the year ended 31 December 2009 is, unusually, a credit of £1.2m, whereas a net charge would normally be expected. This situation arises from the writeback, in excess of £4m, of a provision for current tax in the UK Business in respect of 2007. The provision had been established, because of uncertainty surrounding the interpretation of tax legislation pertaining to that year, which was clarified as a result of the 2007 tax computation being submitted to, and accepted, by HMRC.

EEV Result

Supplementary information prepared in accordance with EEV principles and set out in the financial statements on pages 162 to 177 is presented to provide alternative information to that presented under IFRS. EEV principles assist in identifying the value being generated by the UK and Swedish Life Businesses. The result determined under this method represents principally the movement in the UK and Swedish Businesses' embedded value, before transfers made to the parent company and ignoring any capital movements. Through including the in-force value of insurance and investment contracts, EEV recognises the discounted profit stream expected to arise from those contracts. The principal underlying components of the EEV result are the expected return from existing business, in both the UK and Swedish businesses, being the unwind of the rate used to discount the related cash flows, and the value added by the writing of new business in the Swedish Business. Adjustments are made to the result for variations in actual experience from that assumed for each component of policy cash flows arising in the period and for the impact of restating assumptions for each component of the prospective cash flows.

The following is a summarised statement of the EEV result:

	Year ended 31 December 2009			**Year ended 31 December 2008**		
	UK business £000	**Swedish business £000**	**Total £000**	**UK business £000**	**Swedish business £000**	**Total £000**
Operating profit	**22,000**	**(2,880)**	**19,120**	**25,521**	**–**	**25,521**
Variation from longer-term investment return	6,206	7,544	13,750	(16,831)	–	(16,831)
Economic assumption changes	(12,286)	2,556	(9,730)	6,951	–	6,951
Profit on covered business before tax	15,920	7,220	23,140	15,641	–	15,641
Tax thereon	11,893	–	11,893	(1,376)	–	(1,376)
Profit on covered business after tax	27,813	7,220	35,033	14,265	–	14,265
Results of non-covered business and of other Group companies profit before tax and exceptional items			868			385
Exceptional profit arising on acquisition of the Swedish Business			54,187			–
Tax			177			176
Profit after tax			**90,265**			**14,826**
Non-controlling interest			7			–
Profit after tax attributable to shareholders			**90,272**			**14,826**

The profit of £54.2m arising on the acquisition of the Swedish Business is the excess of the embedded value of Moderna at the acquisition date over the purchase consideration of £20m. This represents a discount of 73% to Moderna's embedded value at the acquisition date.

The dominating feature underlying the EEV result of both the UK Business and of the Swedish Business for the 23-week post-acquisition period was the recovery in global investment markets. The leading UK equity indices, for example, posted gains of between 22% and 24% over 2009. The favourable impact of global investment market growth is reflected through higher current and prospective deductions from unit-linked funds under management, with the UK and Swedish Businesses benefiting to the extent of £6m and £7.5m respectively. Other significant influences underlying EEV earnings for the year are:

In respect of the UK Business:

(i) £7.4m expected return from the unwind of the discount rate;

(ii) £6.8m continuing favourable persistency experience; and

(iii) £1.3m release from a unit-pricing remedial provision no longer required,

offset by

(iv) £5.6m reduction to income arising from a lower estimate of future deductions from policyholder linked funds in respect of tax on overseas dividends.

The treatment of tax on overseas dividends follows legislative change and is offset by a corresponding credit to tax in the overall prospective future tax charge, so that the effect on net-of-tax EEV is, broadly, neutral. Other items which have contributed to the significant tax credit attributed to the UK Business are (i) the writeback of an amount in excess of £4m in respect of the 2007 current tax provision, as explained under 'IFRS Result' above and (ii) improvements to the underlying modelling processes.

In respect of the Swedish Business:

(i) £0.7m contribution from new business;

(ii) £1.7m expected return from the unwind of the discount rate;

(iii) £2.6m favourable investment mix effects, also driven by the recovery in equity markets;

(iv) £1.5m profit in respect of business not modelled for EEV purposes and in respect of other activities of the Swedish Business: this relates principally to the life risk and health insurance business, which is not modelled; and

(v) underlying experience effects, including mortality profits, in excess of £2.5m,

offset by

(vi) £7.8m adverse persistency effects: this reflects deteriorating experience over the second half of 2009 and includes £7.1m in respect of the assumption for future lapses. It has been decided to adopt a prudent approach in view of the uncertain state of the Swedish economy and its impact on the savings market.

Overall, the embedded value has proved resilient in the face of a difficult trading environment. As this is likely to be subject to continuing volatility, attention is drawn to the sensitivity of the EEV to various factors as set out on page 174.

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 2009			
	UK business £000	Swedish business £000	Other group activities £000	Total £000
Value of in-force business	85,559	112,753	–	198,312
Other net assets	68,098	(22,323)	18,498	64,273
	153,657	**90,430**	**18,498**	**262,585**
Represented by:				
Embedded value ('EV') of regulated entities	157,854	91,478	–	249,332
Less: amount financed by borrowings	(4,197)	–	–	(4,197)
EV of regulated entities attributable to shareholders	153,657	91,478	–	245,135
Net equity of other Group companies	–	(1,048)	18,498	17,450
Shareholders' equity	**153,657**	**90,430**	**18,498**	**262,585**

	31 December 2008			
	UK business £000	Swedish business £000	Other group activities £000	Total £000
Value of in-force business	84,940	–	–	84,940
Other net assets	61,031	–	36,737	97,768
	145,971	**–**	**36,737**	**182,708**
Represented by:				
Embedded value ('EV') of regulated entities	154,329	–	–	154,329
Less: amount financed by borrowings	(8,358)	–	–	(8,358)
EV of regulated entities attributable to shareholders	145,971	–	–	145,971
Net equity of other Group companies	–	–	36,737	36,737
Shareholders' equity	**145,971**	**–**	**36,737**	**182,708**

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

	Year ended 31 December 2009			Year ended 31 December 2008		
Number of policies	UK business 000	Swedish business 000	Total 000	UK business 000	Swedish business 000	Total 000
Endowment	55	15	70	62	–	62
Protection	58	–	58	64	–	64
Annuities	5	–	5	5	–	5
Pensions	51	70	121	53	–	53
Other	7	–	7	8	–	8
Total	**176**	**85**	**261**	**192**	**–**	**192**

Value of in-force	Year ended 31 December 2009 UK business £m	Swedish business £m	Total £m	Year ended 31 December 2008 UK business £m	Swedish business £m	Total £m
Endowment	40.2	15.2	55.4	53.8	–	53.8
Protection	48.1	–	48.1	51.2	–	51.2
Annuities	3.9	–	3.9	4.5	–	4.5
Pensions	36.2	98.6	134.8	33.5	–	33.5
Other	0.7	–	0.7	–	–	–
Total at product level	**129.1**	**113.8**	**242.9**	**143.0**	**–**	**143.0**
Valuation adjustments						
Holding company expenses	(9.8)	–	(9.8)	(8.7)	–	(8.7)
Other	(26.5)	–	(26.5)	(26.3)	–	(26.3)
Cost of capital	(0.8)	(1.0)	(1.8)	(5.1)	–	(5.1)
Value in-force pre-tax	**92.0**	**112.8**	**204.8**	**102.9**	**–**	**102.9**
Taxation	(6.4)	–	(6.4)	(18.0)	–	(18.0)
Value in-force post-tax	**85.6**	**112.8**	**198.4**	**84.9**	**–**	**84.9**

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.

'Other' valuation adjustments in the UK Business principally comprise expenses of managing policies which are not attributed at product level.

The movement on Group EEV in respect of the year ended 31 December 2009, before recognition of the final dividend of £10.5m in respect of 2009 (year ended 31 December 2008: £10.2m) may be summarised as:

	Year ended 31 December 2009		Year ended 31 December 2008	
	£000	£000	£000	£000
Beginning of year		**182,708**		**187,315**
Profit arising on acquisition of Swedish Business		54,187		–
UK Business result				
Pre-tax	16,257		15,641	
Tax	11,799		(1,376)	
Post-tax		28,056		14,265
Other group operations		(653)		561
Swedish Business result				
Pre-tax	8,836		–	
Tax	(161)		–	
Post-tax		8,675		–
Foreign exchange gain		5,539		–
Dividends paid during the year		(15,934)		(16,054)
Reduction in equity following share buy-back operation		–		(3,379)
Non-controlling interest		7		–
End of year		**262,585**		**182,708**

The results attributable to the UK and Swedish Businesses shown above comprise the results of the covered business, non-covered business and of other Group companies within the respective business, whereas the results attributed to the UK Business and Swedish Business in the 'EEV Result' section shown above relate solely to the covered business.

Returns to Shareholders

Returns to shareholders are underpinned by the emergence of surplus in, and transfer of surplus from, the UK 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 36 to the financial statements (on page 142). The surplus arises from the realisation of in-force value of the UK Business, which is in run-off. 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 Chesnara's obligations as a listed company.

The acquisition of the Swedish Business in July 2009 has had a twofold impact on the prospect for shareholder returns. First, as the business was acquired at a significant discount of 73% to its embedded value, there was an immediate accretion of £54.2m to shareholder net equity as measured on the European Embedded Value basis. Secondly, in contrast to the UK Business, which is in run-off, the Swedish Business is open and now offers a growth element to total shareholder return. The Swedish Business is expected to become cash generative and, therefore, to have the ability to support the Group's dividend capacity within three to four years.

The Board's primary aim is to continue to provide a reliable and progressive dividend flow to shareholders within the context of the emergence of surplus in the UK life business: in the absence of further acquisitions there is also the prospect of a return of capital to shareholders.

Between the beginning of 2009 up until the acquisition of the Swedish Business towards the end of July 2009, the shares generally traded in a range of between 120p and 150p per share. With total proposed dividends in respect of the year ended 31 December 2009 at 15.95p per share, this implied a yield of between 10.6% and 13.3%. The shares may also be characterised as having traded at a discount to Group embedded value of £182.7m, as reported on the EEV basis as at 31 December 2008, within a range of 16.7% to 33%.The share price performance over this period is largely attributable to an overhang from the investment market turbulence experienced towards the end of 2008, in combination with adverse market sentiment towards financial institutions.

Following the acquisition of the Swedish Business up until mid November 2009, the share price strengthened, generally trading in a range of between 150p and 185p per share: this improving trend was helped, in part, by general investment market recovery. Notwithstanding this, the shares traded in this period at a discount of between 20% and 35% of embedded value, as adjusted for the extent of value accretion we had signalled to the market arising on the acquisition of the Swedish Business.

Between mid November 2009 and early March 2010, the share price has strengthened considerably, generally trading in a range of between 185p and 210p per share. This implies a yield, based on total 2009 proposed dividends, of between 7.6% and 8.6%, with the shares trading at a discount of between 19% and 28% to embedded value of £262.6m, as now reported at 31 December 2009**.** The improvement follows our interim management statement issued on 19 November 2009, which set out the full extent of the accretive impact of the acquisition of the Swedish Business, while also pointing to an improvement in the fundamentals underpinning the UK Business. It is also worthy of note that, through 2009, our share price performance has consistently outperformed the Life sector as a whole, as illustrated by the performance graph set out in the Directors' Remuneration Report on page 47.

Financial Review

Solvency and Regulatory Capital

Regulatory Capital Resources and Requirements

The regulatory capital of both the UK and Swedish Businesses is calculated by reference to regulations established and amended from time to time by the FSA in the UK and by Finansinspektionen in Sweden. The rules are designed to ensure that companies have sufficient assets to meet their liabilities in specified adverse circumstances. As such, there is, in the UK a restriction on the full transfer of surplus from the long-term business fund to shareholder funds of CA, and on the full distribution of reserves from CA to Chesnara and, in Sweden, on distributions from shareholder funds.

Within the UK, the regulations include minimum standards for assessing the value of liabilities, including making an appropriate allowance for default risk on corporate bonds held to match liabilities when assessing the valuation discount rates used for valuing these liabilities. Market turmoil in 2008 led to significant widening of spreads on corporate bonds above gilts, through changed assessment of default risk and liquidity issues, and therefore, with the widening spreads, this issue was of concern to the industry. CA continues to maintain a prudent approach of limiting the assumed liquidity premium in corporate bonds to a maximum of 50bps as at 31 December 2009 (31 December 2008: 50bps). Additionally, the CA Board continues to maintain their stance that permissive changes to regulations introduced in 2006, in FSA policy statement PS06/14, that would allow a reduction in liabilities are not appropriate for CA at this time.

The following summarises the capital resources and requirements of CA for UK regulatory purposes, after making provision for dividend payments from CA to Chesnara, which were approved after the respective period ends:

	31 December	
	2009 £m	**2008 £m**
Available capital resources ('CR')	43.6	43.0
Long-term insurance capital requirement ('LTICR')	19.8	22.5
Resilience capital requirement ('RCR')	2.3	1.8
Total capital resources requirement ('CRR')	22.1	24.3
Target capital requirement cover	32.0	35.6
Ratio of available CR to CRR	197%	177%
Excess of CR over target requirement	£11.6m	£7.4m

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 £32.0m as at 31 December 2009 falls short of the £40m share capital component of CR, so it follows that £8.0m of the reported excess of CR over target requirement is not available for distribution to shareholders except by way of a capital reduction.

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.

The Swedish Business, in contrast to the UK Business, and being open to new business, is, in the short to medium term, a net consumer of capital. The ratio of capital resources to capital resource requirements is a key indicator of the capital health of the business as it expands and provides the context in which further capital contributions are made by the parent company to finance that expansion in a predictable and orderly manner.

The following summarises the capital resources and requirements of Moderna for Swedish regulatory purposes:

	31 December	
	2009 £m	2008 £m
Available capital resources (CR) represented by:		
– Share capital	1.1	1.1
– Additional equity contributions	33.6	24.2
– Accumulated deficit	(10.2)	(12.6)
	24.5	12.7
Regulatory capital resource requirement (CRR)	8.1	7.7
Target requirement	12.1	11.5
Ratio of CR to CRR	302%	165%
Excess of CR over target requirements	£12.4m	£1.2m

The information as at 31 December 2008 relates to the pre-acquisition period and is provided for illustrative purposes. The fall in the accumulated deficit over the year was impacted by a pre-acquisition restatement of the period for the straight-line amortisation of deferred acquisition costs from 10 to 17 years, such costs being an admissible asset for Swedish regulatory purposes. Equity contributions were enhanced by an additional £2.1m funding by the parent company in the post-acquisition period.

The Moderna Board sets a minimum target of 150% of the regulatory capital requirement. Swedish solvency regulation requires that a certain proportion of assets, to be fully admissible, is to be held in the form of cash. The operation of this requirement may, from time to time, act as the operative constraint in determining the level of additional funding requirements, thereby causing the solvency ratio to rise above what it would otherwise have been, had the form of assets matching capital resources not been a constraint.

Insurance Groups Directive

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

	31 December	
	2009 £m	2008 £m
Available group capital resources	99.7	86.9
Group regulatory capital requirement	(31.6)	(24.3)
Excess	**68.1**	**62.6**
Cover	**316%**	**358%**

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 UK insurance companies to make their own assessment of their capital needs to a required standard (a 99.5% probability of being able to meet 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, including such market effects as significant falls in equity values, interest rate increases and decreases, bond defaults and further widening of bond spreads.

CA completed a further full annual assessment during 2009 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. This assessment is subject to quarterly high-level updates until the next full annual assessment.

We are currently developing the Swedish Business's ability to produce similar assessments, so that the determination of risk-based capital is more clearly aligned with UK best practice. In the meantime, the Swedish Business, in accordance with local regulatory requirements, continues to make quarterly assessments of the risk-based capital requirements of its business: these indicate that capital resources currently provide a comfortable margin over capital resource requirements.

International Reporting Developments

Over the year, we have continued to monitor developments in the EU Solvency II framework which will impact both the UK and Swedish Businesses. We have established a Steering Group to oversee our implementation of the regulations, which are due to become effective on 31 October 2012. Besides ensuring that there are robust processes for the calculation of technical reserves and solvency capital, the implementation will embrace wide-ranging changes in risk management processes on a Group-wide basis. In the meantime, we have continued internal quantitative analysis and begun to assess the impact on the Group of the content of the numerous Consultation Papers which have been issued by the Committee of European Insurance and Occupational Pensions Supervisors ('CEIOPS').

The IASB is due to issue an Exposure Draft relating to Insurance Contracts during the second quarter of 2010 and we will continue to monitor this significant IFRS development.

In June 2008, the European Insurance CFO Forum ('CFO Forum') issued the European Insurance CFO Forum Market Consistent Embedded Value ('MCEV') Principles. These principles, with which we had intended to comply with effect from our interim financial statements for the six months ended 30 June 2009, represent a development of the existing European Embedded Value ('EEV') principles issued by the same Forum, which form the current basis of preparation of our Supplementary Information – European Embedded Value Basis as set out in Note 1 to the Supplementary Information on page 165. However, on 22 May 2009, the CFO Forum announced that the mandatory MCEV reporting date for all its member firms would be deferred until 2011, in light of developments arising from the recent financial crisis. In accordance with this, we have also decided to defer compliance with the MCEV Principles, and any amendment thereto, until 2011.

Capital Structure, Treasury Policy and Liquidity

The Group's UK operations are ordinarily financed through retained earnings and through the current emergence of surplus in the UK Life Business. The Swedish Business is financed by a combination of financial reinsurance arrangements and capital contributions from Chesnara. There is, otherwise, no further reliance on debt financing within the Group, with the last tranche of our borrowings, to part finance the acquisition of CWA in 2005, due to be repaid in June 2010. Cash available for more than twelve months in the UK is normally transferred to fund managers for longer-term investment.

The Board continues to have a conservative approach to the investment of shareholders' funds in the Life businesses, which underpins our strong solvency position. For the UK Business, where the greater part of shareholders' funds subsist, this approach targets the investment of 100% of available funds in cash and fixed interest securities. In the light of recent volatility in financial markets, particular attention is given to the mix and spread of these investments to ensure that we are not unduly exposed to particular sectors and that our counterparty limits are strictly adhered to. Current economic conditions heighten the risk of corporate bond default and observations on this are made in the 'Going Concern' section below.

The profile and mix of investment asset holdings between fixed interest stocks and cash on deposit in the UK 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. To the extent that ongoing administration of the UK Life Business 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.

To the extent that the Group proposes to acquire 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 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 continues to be characterised by the strong inflow to shareholders' funds of transfers from the long-term insurance fund of the UK Business, which are supported by the emergence of surplus within that fund. These flows are used (i) to support dividend distributions to shareholders; (ii) to repay our debt obligations as set out in Note 36 of these financial statements on page 142 and (iii) to support the medium-term requirements of the Swedish Business to meet regulatory solvency capital requirements as it expands.

Going Concern

The Group's cash flow position described above, together with the return on financial assets in the parent company, supports the ability to trade in the short-term. Accordingly, the underlying solvency position of the UK Life Business and its ongoing ability to generate surpluses which support cash transfers to shareholders' funds is critical to the ongoing ability of the Group to continue trading and to meet its obligations as they fall due.

The information set out in 'Solvency and Regulatory Capital' above indicates a strong solvency position as at 31 December 2009 as measured at both the individual regulated life company levels in both the UK and Sweden and at the Group level. In addition, in respect of the UK Life Business, a Financial Condition Report and a detailed annual Individual Capital Assessment have been prepared, as also set out above. These include assessments of the ability of the business to withstand key events, including those which may now become more significantly adverse in the current financial and economic environment, being an increased rate of policy lapse, expense overruns and unfavourable investment market conditions. The assessments indicate that the UK Business is able to withstand the impact of these adverse scenarios, including the effect of continuing significant investment market falls, while the business's outsourcing arrangements protect it from significant expense overruns. As also indicated above, the current assessment of the risk-based capital requirements of the Swedish Business indicates a comfortable excess of capital resources over those requirements.

Notwithstanding that the Group is well capitalised, the current financial and economic environment presents some specific threats to its short-term cash flow position and it is appropriate to assess these. In the first instance, the Group does not rely on the renewal or extension of bank facilities to continue trading – indeed, as indicated, its normal operations are cash generative. The Group does, however, rely on cash flow from the maturity or sale of fixed interest securities which match its obligations to its Guaranteed Bond policyholders: in the current economic environment there is clearly a continuing higher risk of bond default, particularly in respect of financial institutions. In order to manage this risk we ensure that our bond portfolio is actively monitored and well diversified. Further, this risk abated through 2009 as our underlying bond obligations to policyholders continued to mature. Other significant counterparty default risk relates to our principal reassurer Guardian Assurance ('Guardian'). We monitor Guardian's financial position and are satisfied that any associated credit default risk is low.

Our expectation is that, notwithstanding the risks set out above, the Group will continue to generate surplus in its UK long-term business sufficient to meet its debt obligations as they fall due, to continue to pursue a reliable and progressive dividend policy and to meet the medium-term financing requirements of the Swedish Business, which is expected to become cash-generative within three to four years.

Corporate Governance Report

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 2008 and as appended to the Listing Rules.

The following statement, together with the Directors' Remuneration Report on pages 43 to 49, 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 2009.

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, which it reviews annually, 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 acquisitions, investments and capital expenditure;
- Reviewing the Group's system of financial and business controls and risk management;
- Approving appointments to the Board and to its Committees;
- Appointment of the Company Secretary; and
- Approval of policies relating to Directors' remuneration.

In addition:

(i) the Directors of the Company are also Directors of Countrywide Assured plc (CA), the principal subsidiary company in which the UK-based life and pensions 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; and

(ii) three Directors of the Company, being Messrs Mason, Kettleborough and Gordon, are also Directors of Moderna Försäkringar Liv AB (Moderna), the principal subsidiary company in which the Swedish-based life and pensions business of the Group subsists. Under regulation by Finansinspektionen, the Directors of Moderna have responsibility for ensuring that Moderna complies with regulatory solvency requirements.

The responsibilities that the Board has delegated to the respective Executive Managements of the UK and Swedish businesses 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, Peter Mason, 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 designated Mike Gordon 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 was independent on his appointment as Chairman on 1 January 2009. In making this determination, the Board has carefully considered the fact that he 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 Countrywide Assured Life Holdings Limited ('CALHL'), the parent company of Countrywide Assured plc, a position he has held since 18 November 1991.

The Board considers that Mike Gordon, Terry Marris and Peter Wright are independent Non-executive Directors. In making this determination, the Board has carefully considered the following matters:

(i) Terry Marris had, within five years of his appointment, been an employee of a subsidiary company within the CALHL Group, 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; and

(ii) Peter Wright had, within the last three years prior to his appointment, served as Head of Actuarial Function of Countrywide Assured plc and has otherwise provided actuarially-based consultancy advice, the relevant services being provided under an agreement with his employer at the time, Tillinghast Towers Perrin.

There were no comparable matters to consider in respect of Mike Gordon.

With regard to Peter Mason and Terry Marris, the Board considers that the characteristics, aims and mode of operation of the relevant activities of the Company are sufficiently different from those prevailing when they held the relevant positions, that the judgement and independence of mind exercised on behalf of the Company are not adversely affected or circumscribed. The Board is of the view that their considerable specific experience and knowledge in the business of the Group outweighs any residual risk in the historical relationships described above. With regard to Peter Wright, the nature of the services he provided, being subject either to FSA regulation or to professional standards and guidance prescribed or issued variously by the Institute of Actuaries or by the Financial Reporting Council Board of Actuarial Standards, was such that he was required to maintain a vigorous independence of mind and to prepare recommendations in accordance with the highest professional standards.

The Board is satisfied that the overall balance of the Board continues to provide significant independence of mind and judgement and further considers that, taking the Board as a whole, the Independent Directors are of sufficient calibre and number that their views carry significant 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. 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 membership of the CA Board all of the Directors who served during the period under review have considerable knowledge and experience of the UK-based business of the Chesnara plc Group. Similarly, Messrs Mason, Kettleborough and Gordon, through their membership of the Moderna Board, have considerable knowledge and experience of the Swedish-based business 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, the Company's Directors are also variously members of the Boards of CA and Moderna. These Boards hold scheduled quarterly meetings, which 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:

For CA:

- Earnings report;
- Report from the Actuarial Function Holders and With-profits Actuary;
- Compliance report;
- Investment report; and
- Outsourcing reports.

CA 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.

For Moderna:

- Earnings report;
- Operating reports, including sales and fund performance;
- Financial risk report;
- General risk report, including an estimate of risk-based capital, in accordance with Swedish regulatory requirements;
- Compliance report; and
- Report on subsidiaries and associated company.

In addition, Moderna is required to submit to the Chesnara Audit Committee a quarterly risk report, an annual report on internal financial and business controls and all internal audit reports.

On a monthly basis, the Directors receive summary high level information, relating to total Group operations, prepared by the Group Chief Executive, 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, of 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 the performance evaluations were 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. During the year the terms of reference of the Audit Committee were amended to (i) permit the Chairman of the Company to be a member of the Audit Committee and (ii) remove references to review of annual financial statements of pension funds, as this item is not applicable to the Company. There have been no changes to any of the other Committees' terms of reference during the period covered by this review. 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.

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
Peter Mason – Non-executive Chairman	7(8)	2(2)	n/a	1(1)
Terry Marris – Non-executive Director	7(8)	1(2)	1(2)	4(5)
Mike Gordon – Non-executive Director	5(8)	2(2)	2(2)	4(5)
Peter Wright – Non-executive Director (from 1 January 2009)	8(8)	1(1)	2(2)	5(5)
Graham Kettleborough – Executive Director	8(8)	n/a	n/a	n/a
Ken Romney – Executive Director	8(8)	n/a	n/a	n/a
Frank Hughes – Executive Director	7(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 or Committee member. The information above relates to the period from 1 February 2009 to 31 January 2010.

Nomination Committee

During the whole of the period under review, the Nomination Committee comprised Peter Mason who also served as Chairman of the Committee, Terry Marris and Mike Gordon. In addition, Peter Wright was appointed to the Committee on 9 July 2009.

The Committee considers the mix of skills and experience that the Board requires and seeks the appointment of Directors 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.

Remuneration Committee

Full details of the composition and work of the Remuneration Committee are provided in the Directors' Remuneration Report on pages 43 to 49.

Audit Committee

During the period under review, the Audit Committee comprised Peter Wright (Chairman), Mike Gordon and Terry Marris, as independent Non-executive Directors. Peter Mason was re-appointed as a member of the Committee on 22 December 2009. The Board is satisfied that Peter Wright 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 the fulfilment of its duties. The Committee met five 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 external 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 2009 and the year ended 31 December 2009;
- 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 and reviewing and approving the audit and non-audit fees;
- 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 internal audit plans 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 internal audit functions;
- meeting the Head of Internal Audit without an Executive Director or a member of the Company's senior management being present;
- reviewing the report on key risks by Executive Management ;
- 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; and
- reviewing the Group's anti-fraud and whistle-blowing policies and procedures.

In addition, the Committee oversaw the competitive tendering process, conducted in July 2009, which resulted in the appointment of Messrs Deloitte LLP as external Auditor, with effect from 1 October 2009.

Auditor Independence and Objectivity

The external Auditor of Chesnara plc, up to and including 29 September 2009, was Messrs KPMG Audit plc: Messrs Deloitte LLP were appointed with effect from 1 October 2009 as a result of the competitive tendering process referred to above.

The external Auditor, Deloitte LLP 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

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 external Auditor, and its associates, for both audit and non-audit services during the year are provided in Note 16 to the financial statements (on page 111).

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, the Senior Independent Director 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 13 May 2010 can be found in the notice of the meeting on pages 178 to 186.

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 might 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, CA has established and maintained a risk and responsibility regime. This ensures that the identification, assessment and control of risk are firmly embedded within the organisation and that there are procedures for monitoring and update of the same. The CA Risk Management function reviews and reports quarterly on this regime to the CA Board. This process is supplemented by the establishment and maintenance of key risk registers for both CA 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 executive management, who respectively report on them quarterly to the CA Risk Committee and to each Chesnara Audit Committee meeting.

In accordance with the requirements of the Swedish regulator, Finansinspektionen, Moderna has also established and maintained a risk and responsibility regime, which requires *inter alia* that:

- the Moderna Board and Managing Director have responsibility for ensuring that the organisation and management of the operation are characterised by sound internal control, which is responsive to internal and external risks and to changes in them;
- the Moderna Board has responsibility for the satisfactory management and control of risks through the specification of internal procedures; and
- there is an explicit risk control function, which is supported by compliance and internal control functions.

As an integral part of this regime Moderna also maintains a detailed high-level risk register, which identifies, monitors and assesses risk by appropriate classification of risk.

As stated above, all of the Chesnara Directors are also members of the CA Board and the Company thereby has effective oversight of the maintenance and effectiveness of controls subsisting within CA. As to Moderna, such oversight is exercised by way of the membership of three of the Company's Directors of the Moderna Board, together with quarterly reporting by Moderna to the Chesnara Audit Committee.

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 2009 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 functions 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 a Group Internal Audit Function, which reports to the Chairman of the Audit Committee.

Going Concern

The Directors' Statement on Going Concern is included in the Directors' Report on page 22.

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 within the Chesnara Group.

During the period under review the Committee comprised of the Non-executive Directors: Mike Gordon (who also acted as Chairman), Peter Wright and Terry Marris, with Peter Mason, who is Chairman of the Group, being re-appointed on 22 December 2009. 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 39.

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. In mid-2009, the Remuneration Committee engaged Towers Perrin to undertake a review of Executive Director compensation and concluded, following consideration of their findings, that compensation arrangements remained appropriate.

The Annual Bonus Scheme and the Long-term Incentive Plan are designed to incentivise and retain the Executive Directors. The Scheme and Plan, 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. Neither the Annual Bonus Scheme nor the Long-term Incentive Plan is pensionable. The Committee may award other discretionary bonuses to the Executive Directors where they consider extraordinary value has been created or significant achievement has occurred.

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

The Company notes recent commentary and recommendations regarding the reward structures for Executive Directors of financial institutions and, as a result, the Remuneration Committee continues its ongoing review of the suitability of the Group's current remuneration policy and practice.

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 fully-expensed company car, life assurance and private medical insurance.

Bonus Schemes

Annual Bonus Scheme

The 2009 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 was designed to reflect the specific nature of the business which, prior to the acquisition of Moderna, was a run-off proposition which required particular skill sets and did, 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. For the period under review the exceptional profit arising from the acquisition of Moderna has been excluded from the calculation of the Annual Bonus. For future periods the budget for IFRS pre-tax profit includes the budgeted result of Moderna.

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 2009.

Annual Bonus Scheme – awards made in respect of year ended 31 December 2009

Graham Kettleborough	£82,226
Ken Romney	£59,405
Frank Hughes	£53,464

Long-term Incentive Plan

The Long-term Incentive Plan was designed as a long-term cash based incentive for Executive Directors. As the business was a run-off proposition prior to its acquisition of Moderna, the Remuneration Committee believed that a cash-based plan would be the most appropriate form of reward. 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. For the period under review the exceptional profit arising from the acquisition of Moderna has been excluded from the calculation of the Long term Incentive Plan.

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. However, following the announcement of a significant rise in the rate of individual income tax for earnings above £150,000 per year from 6 April 2010 in the Pre-Budget Report of 9 December 2009, the Remuneration Committee have agreed to advance payment of the deferred bonuses to the Executive Directors in order to avoid the increased tax rate. Payment is subject to an agreement that should an Executive Director voluntarily leave, or be dismissed from the service of the Group for performance reasons, then any bonus that would not have been due at the relevant date will be repayable net of any tax and National Insurance deductions. The agreement therefore maintains the retention element of the Long-term Incentive Plan.

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 16.66% of basic salary
– at or less than 75% of budget in second half-year	Nil
– at 100% of budget in second half-year	And then increasing pro rata to 16.66% 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.

Long-term Incentive Plan – awards made in 2008 and 2009

	Amount awarded in respect of the half-year ended			
	31 December 2009	30 June 2009	31 December 2008	30 June 2008
Graham Kettleborough	£69,430	£71,201	£47,268	£37,656
Ken Romney	£47,285	£54,770	£36,360	£28,966
Frank Hughes	£42,556	£49,293	£32,724	£26,070

The performance element of the Long-term Incentive Plan will be amended for 2010 such that each Executive Director will forego a percentage of their entitlement to Group IFRS pre-tax related bonus in exchange for a share of the increase in Embedded Value achieved by Moderna during the year. Graham Kettleborough will forego 50% of his entitlement of Group IFRS pre-tax related bonus and receive 0.65% of the increase in the embedded value of Moderna. The increase will be measured in Swedish Kronor and be converted to Pounds Sterling at the rate applying at the close of business on 31 December 2010. The relevant percentages for Ken Romney and Frank Hughes are 25%/0.235% and 10%/0.0825% respectively. The awards have been set at a level which will reflect the Directors' responsibilities and involvement with Moderna and marginally increase reward should Moderna achieve its budgeted increase in Embedded Value. Bonus resulting from this element of reward will be paid 40% after the end of the year in which it is earned with 60% being deferred for three years.

A scheme based on the same measure and with the same payment profile has been implemented for a limited number of senior managers within Moderna. The total pool will be no greater than 2.5% of the increase in Embedded Value with 40% paid at the end of the year in which it is earned with 60% deferred for three years.

Discretionary Bonus

The exceptional profit arising from the purchase of Moderna was excluded from the calculation of bonus awarded in both the Annual Bonus Scheme and the Long-term Incentive Plan. However, the Remuneration Committee decided that extraordinary value had been created as a result of the transaction and awarded non-pensionable discretionary bonuses to the Executive Directors as shown below.

	Bonus payable 31 December 2009	Bonus payable 31 December 2012
Graham Kettleborough	£75,000	£75,000
Ken Romney	£50,000	£50,000
Frank Hughes	£25,000	£25,000

Unlike awards made under the Long-term Incentive Plan the deferred element of these bonuses is not being advanced.

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 2009 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

The Executive Directors are members of the Chesnara plc Stakeholder Scheme to which employer contributions are made at rates agreed by the Remuneration Committee. Employer contributions to the respective schemes are detailed on page 48.

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 dates of expiry of their terms of appointment are:

	Date of expiry of term of appointment
Peter Mason (Chairman from 1 January 2009)	31 October 2011
Mike Gordon	30 April 2011
Terry Marris	1 March 2013
Peter Wright	1 January 2012

On 21 January 2010 the Board agreed to re-appoint Terry Marris for a period of three years further to the date of expiry of his current contract, being 1 March 2010.

Christopher Sporborg served as Chairman to 31 December 2008, at which date he retired on the expiry of his term of appointment.

Ken Romney and Frank Hughes 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 were:

Chairman

Peter Mason

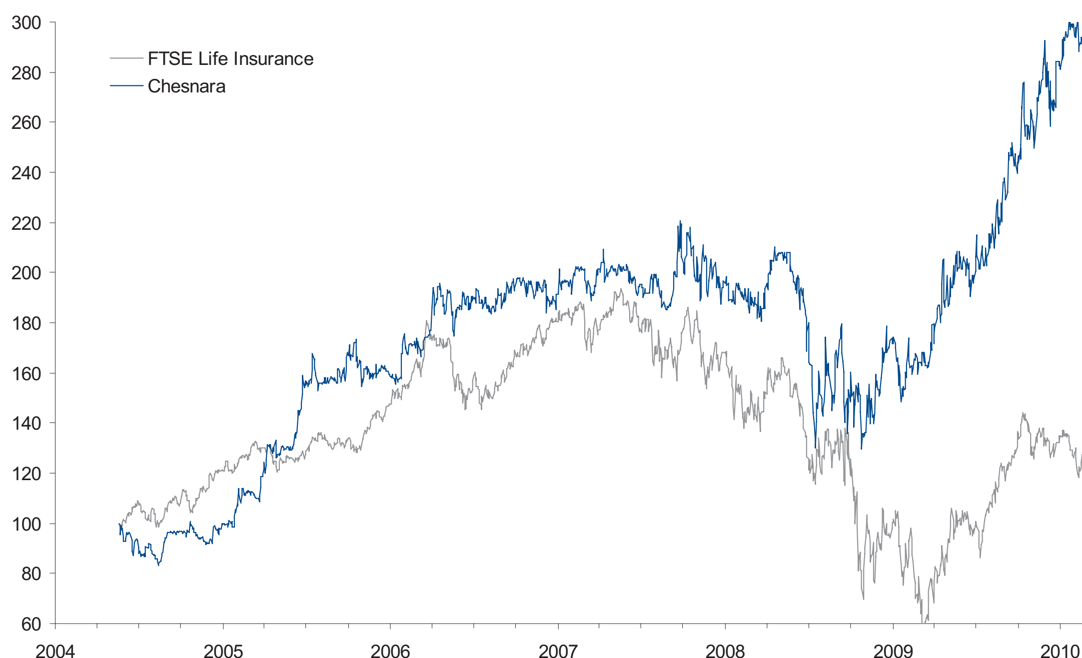
Non-executive Directors

Terry Marris
Mike Gordon
Peter Wright

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 421(2) of the Companies Act 2006.

Directors' Interests in Shares

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

	31 December 2009		31 December 2008	
	Beneficial	Non-beneficial	Beneficial	Non-beneficial
Christopher Sporborg	n/a	n/a	75,000	–
Peter Mason	17,500	–	17,500	–
Terry Marris	52,708	–	52,708	–
Mike Gordon	–	–	–	–
Peter Wright	20,000	–	20,000	–
Graham Kettleborough	42,600	–	42,600	–
Ken Romney	50,476	–	15,476	–
Frank Hughes	5,163	–	5,163	–

There were no changes in the Directors' shareholdings in Chesnara plc between 31 December 2009 and 30 March 2010.

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 2009 is shown below with comparative figures for the year ended 31 December 2008.

	Year ended 31 December	
	2009 £000	2008 £000
Aggregate emoluments:		
Fees to Non-executive Directors	171	140
Compensation to a Non-executive Director for loss of office (ex gratia)	–	30
Emoluments to Executive Directors	1,207	723
Company contributions to pension schemes	124	160
Total	**1,502**	**1,053**

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 2009:

	Salaries and fees £000	Bonuses £000	Deferred bonuses £000	Benefits £000	Total 2009 £000	Total 2008 £000
Executive Directors						
Graham Kettleborough	148	157	216	15	536	296
Ken Romney	112	109	152	12	385	237
Frank Hughes	80	78	117	11	286	190
	340	344	485	38	1,207	723
Non-executive Directors						
Christopher Sporborg	–	–	–	–	–	80
Peter Mason	68	–	–	–	68	40
Terry Marris	30	–	–	–	30	25
Mike Gordon	40	–	–	–	40	25
Peter Wright	33	–	–	–	33	–
	171	–	–	–	171	170
Total	**511**	**344**	**485**	**38**	**1,378**	**893**

Peter Wright, who was appointed to the Chesnara plc Board on 1 January 2009, was paid fees of £20,000 for the year ended 31 December 2008 in respect of his services as Non-executive Director of Countrywide Assured plc, a subsidiary company. He was appointed to this latter position on 2 January 2008.

The following table sets out each Executive Director's pension benefits for the years ended 31 December 2009 and 31 December 2008.

	Company contributions to money purchase scheme	
	2009 £000	2008 £000
Graham Kettleborough	41	49
Ken Romney	40	52
Frank Hughes	43	59
	124	160

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 46.

No pension contributions were made by companies within the Chesnara plc Group from 1 January 2008 to 31 December 2009 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 2009 and 30 March 2010, nor were there any options outstanding as at 31 December 2008, 31 December 2009 or 30 March 2010.

Approved by the Board of Directors on 30 March 2010 and signed on its behalf by:

Peter Mason **Graham Kettleborough**

Statement of Directors' Responsibilities in respect of the Financial Statements

The directors are responsible for preparing the Annual Report and the financial statements in accordance with applicable law and regulations.

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

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

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

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

Responsibility statement

We confirm that to the best of our knowledge:

- the financial statements, prepared in accordance with International Financial Reporting Standards, give a true and fair view of the assets, liabilities, financial position and profit or loss of the company and the undertakings included in the consolidation taken as a whole; and
- the management report, which is incorporated into the directors' report, includes a fair review of the development and performance of the business and the position of the company and the undertakings included in the consolidation taken as a whole, together with a description of the principal risks and uncertainties that they face.

By order of the Board

Peter Mason	**Graham Kettleborough**
Chairman	Chief Executive Officer
30 March 2010	30 March 2010

Independent Auditor's Report to the Members of Chesnara plc

We have audited the financial statements of Chesnara plc for the year ended 31 December 2009 which comprise the Consolidated Statement of Comprehensive Income, the Consolidated and Company Balance Sheets, the Consolidated and Company Statements of Cash Flows and the Consolidated and Company Statements of Changes in Equity and the related Notes 1 to 55. The financial reporting framework that has been applied in their preparation is applicable law and International Financial Reporting Standards (IFRSs) as adopted by the European Union and as regards the parent company financial statements, as applied in accordance with the provisions of the Companies Act 2006.

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

Respective responsibilities of directors and auditors

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

Scope of the audit of the financial statements

An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of: whether the accounting policies are appropriate to the group's and the parent company's circumstances and have been consistently applied and adequately disclosed; the reasonableness of significant accounting estimates made by the directors; and the overall presentation of the financial statements.

Opinion on financial statements

In our opinion:

- the financial statements give a true and fair view of the state of the group's and of the parent company's affairs as at 31 December 2009 and of the group's profit for the year then ended;
- the group financial statements have been properly prepared in accordance with IFRSs as adopted by the European Union;
- the parent company financial statements have been properly prepared in accordance with IFRSs as adopted by the European Union and as applied in accordance with the provisions of the Companies Act 2006; and
- the financial statements have been prepared in accordance with the requirements of the Companies Act 2006 and, as regards the group financial statements, Article 4 of the IAS Regulation.

Opinion on other matters prescribed by the Companies Act 2006

In our opinion:

- the part of the Directors' Remuneration Report to be audited has been properly prepared in accordance with the Companies Act 2006; and
- the information given in the Directors' Report for the financial year for which the financial statements are prepared is consistent with the financial statements.

Matters on which we are required to report by exception

We have nothing to report in respect of the following:

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

- adequate accounting records have not been kept by the parent company, or returns adequate for our audit have not been received from branches not visited by us; or
- the parent company financial statements and the part of the Directors' Remuneration Report to be audited are not in agreement with the accounting records and returns; or
- certain disclosures of directors' remuneration specified by law are not made; or
- we have not received all the information and explanations we require for our audit.

Under the Listing Rules we are required to review:

- the directors' statement in relation to going concern contained within the Directors' Report; and
- the part of the Corporate Governance Statement relating to the company's compliance with the nine provisions of the June 2008 Combined Code specified for our review.

Alexander Arterton (Senior Statutory Auditor) 30 March 2010
for and on behalf of Deloitte LLP
Chartered Accountants and Statutory Auditors
Manchester, United Kingdom

Consolidated Statement of Comprehensive Income for the year ended 31 December 2009

	Note	Year ended 31 December 2009 £000	Year ended 31 December 2008 £000
Insurance premium revenue		100,105	94,274
Insurance premium ceded to reinsurers		(24,997)	(17,193)
Net insurance premium revenue	9	**75,108**	**77,081**
Fee and commission income			
Insurance contracts	10	35,864	35,289
Investment contracts	10	15,256	9,305
Net investment return	11	326,680	(222,742)
Total revenue (net of reinsurance payable)		**452,908**	**(101,067)**
Other operating income	12	4,689	1,314
Total income		**457,597**	**(99,753)**
Insurance contract claims and benefits incurred			
Claims and benefits paid to insurance contract holders	13	(129,557)	(131,829)
Net (increase)/decrease in insurance contract provisions	13	(127,840)	180,265
Reinsurers' share of claims and benefits	13	47,897	(8,736)
Net insurance contract claims and benefits		(209,500)	39,700
Change in investment contract liabilities	14	(199,748)	108,516
Reinsurers' share of investment contract liabilities	14	4,710	(4,743)
Net change in investment contract liabilities		(195,038)	103,773
Fees, commission and other acquisition costs	15	(5,167)	(1,377)
Administrative expenses	16	(18,245)	(13,633)
Other operating expenses			
Charge for amortisation of acquired value of in-force business	17	(6,953)	(3,578)
Charge for amortisation of acquired value of customer relationships	17	(188)	–
Other	17	(2,195)	(1,653)
Total expenses		**(437,286)**	**123,232**
Total income less expenses		**20,311**	**23,479**
Share of profit from associates	25	39	–
Profit recognised on acquisition of subsidiary	7	25,056	–
Operating profit		**45,406**	**23,479**
Financing costs	18	(665)	(752)
Profit before income taxes		**44,741**	**22,727**
Income tax credit/(expense)	19	1,192	(2,710)
Profit for the year		**45,933**	**20,017**
Attributable to:			
Shareholders	8	45,940	20,017
Non-controlling interest		(7)	–
		45,933	**20,017**
Foreign exchange translation differences arising on the revaluation of foreign operations		3,381	–
Total comprehensive income for the year		**49,314**	**20,017**
Attributable to:			
Shareholders		49,321	20,017
Non-controlling interest		(7)	–
		49,314	**20,017**
Basic earnings per share (based on profit for the year attributable to shareholders)	49	45.26p	19.24p
Diluted earnings per share (based on profit for the year attributable to shareholders)	49	45.26p	19.24p

The notes and information on pages 61 to 159 form part of these financial statements.

Consolidated Balance Sheet at 31 December 2009

	Note	31 December 2009 £000	31 December 2008 £000
Assets			
Intangible assets			
Deferred acquisition costs	**20**	9,327	8,590
Acquired value of in-force business			
Insurance contracts	**21**	14,937	16,866
Investment contracts	**21**	71,526	11,610
Acquired value of customer relationships	**22**	2,682	–
Internally-developed software	**23**	4,060	–
Property and equipment	**24**	491	–
Investment in associates	**25**	1,051	–
Investment properties	**26**	3,355	3,432
Reinsurers' share of insurance contract provisions	**33**	236,866	182,693
Amounts deposited with reinsurers	**34**	27,056	22,181
Financial assets			
Equity securities at fair value through income	**27**	454,970	363,879
Holdings in collective investment schemes at fair value through income	**27**	1,612,861	576,502
Debt securities at fair value through income	**27**	247,836	279,104
Policyholders' funds held by the Group	**27**	41,107	–
Insurance and other receivables	**27/28**	19,822	11,056
Prepayments	**27/28**	3,784	1,600
Derivative financial instruments	**27/29**	7,964	5,570
Total financial assets		2,388,344	1,237,711
Reinsurers' share of accrued policyholder claims	**40**	4,728	4,100
Income taxes	**30**	395	–
Cash and cash equivalents	**31**	155,241	192,381
Total assets		**2,920,059**	**1,679,564**

	Note	31 December	
		2009 £000	2008 £000
Liabilities			
Bank overdrafts	**31**	2,312	1,094
Insurance contract provisions	**33**	1,077,033	923,506
Financial liabilities			
Investment contracts at fair value through income	**34**	1,529,221	558,542
Liabilities relating to policyholders' funds held by the Group	**35**	41,107	–
Borrowings	**36**	28,996	8,358
Derivative financial instruments	**29**	54	70
Total financial liabilities		1,599,378	566,970
Provisions	**37**	1,452	3,397
Deferred tax liabilities	**38**	10,366	10,798
Reinsurance payables	**39**	15,039	1,397
Payables related to direct insurance and investment contracts	**40**	30,433	23,891
Deferred income	**41**	13,132	14,575
Income taxes	**42**	1,313	1,074
Other payables	**43**	9,833	6,494
Total liabilities		**2,760,291**	**1,553,196**
Net assets		**159,768**	**126,368**
Shareholders' equity			
Share capital	**44**	41,501	41,501
Share premium		20,458	20,458
Treasury shares	**45**	(3,379)	(3,379)
Other reserves	**46**	3,431	50
Retained earnings	**47**	97,744	67,738
Total shareholders' equity		**159,755**	**126,368**
Non-controlling interest		13	–
Total equity		**159,768**	**126,368**

The notes and information on pages 61 to 159 form part of these financial statements.

Approved by the Board of Directors on 30 March 2010 and signed on its behalf by:

Peter Mason **Graham Kettleborough**

Company Balance Sheet at 31 December 2009

	Note	31 December 2009 £000	31 December 2008 £000
Assets			
Non-current assets			
Financial assets			
Investment in subsidiaries	**27**	74,029	52,006
Current assets			
Loans and receivables	**28**	199	1,120
Prepayments	**28**	63	57
Income taxes	**30**	395	139
Cash and cash equivalents	**31**	19,635	37,372
Total current assets		20,292	38,688
Total assets		**94,321**	**90,694**
Current liabilities			
Bank overdrafts	**31**	–	8
Borrowings	**36**	4,197	4,168
Other payables	**43**	2,211	2,287
Total current liabilities		6,408	6,463
Non-current liabilities			
Borrowings	**36**	–	4,190
Total liabilities		**6,408**	**10,653**
Net assets		**87,913**	**80,041**
Shareholders' equity			
Share capital	**44**	5,229	5,229
Share premium		20,458	20,458
Treasury shares	**45**	(3,379)	(3,379)
Other reserves	**46**	50	50
Retained earnings	**47**	65,555	57,683
Total shareholders' equity		**87,913**	**80,041**

The notes and information on pages 61 to 159 form part of these financial statements.

Approved by the Board of Directors on 30 March 2010 and signed on its behalf by:

Peter Mason **Graham Kettleborough**

Consolidated Statement of Cash Flows for the year ended 31 December 2009

	Year ended 31 December	
	2009 £000	2008 £000
Profit for the year	45,940	20,017
Adjustments for:		
Depreciation of property and equipment	65	–
Amortisation of deferred acquisition costs	2,080	952
Amortisation of acquired value of in-force business	6,953	3,577
Amortisation of acquired value of customer relationships	188	–
Amortisation of internally-developed software	414	–
Tax (recovery)/expense	(1,192)	2,710
Interest receivable	(17,959)	(24,398)
Dividends receivable	(24,048)	(35,781)
Interest expense	665	752
Change in fair value of investment properties	77	324
Fair value (gains)/ losses on financial assets	(284,739)	247,210
Loss on sale of property and equipment	21	–
Profit arising on acquisition of subsidiary company	(25,056)	–
Share of profit of associate net of impairment	122	–
Interest received	20,893	22,150
Dividends received	23,304	39,278
Increase in intangible assets related to insurance and investment contracts	(3,157)	–
Changes in operating assets and liabilities		
(Increase)/decrease in financial assets	(58,028)	38,166
(Increase)/decrease in reinsurers share of insurance contract provisions	(27,211)	30,221
(Increase)/decrease in amounts deposited with reinsurers	(4,875)	5,377
(Increase)/decrease in insurance and other receivables	(4,671)	194
(Increase)/decrease in prepayments	(1,293)	1,316
Increase/(decrease) in insurance contract provisions	120,648	(187,342)
Increase/(decrease) in investment contract liabilities	219,609	(167,961)
Decrease in provisions	(2,229)	(178)
Increase/(decrease) in reinsurance payables	3,629	(225)
Increase in payables related to direct insurance and investment contracts	3,604	1,032
Decrease in other payables	(970)	(2,728)
Cash utilised by operations	**(7,216)**	**(5,337)**
Income tax paid	(2,371)	(2,921)
Net cash utilised by operating activities	**(9,587)**	**(8,258)**
Cash flows from investing activities		
Acquisition of subsidiary net of cash acquired	(5,944)	–
Investment in associates	(334)	–
Development of software	(918)	–
Purchases of property and equipment	(180)	–
Net cash utilised by investing activities	**(7,376)**	**–**
Cash flows from financing activities		
Repayment of borrowings	(5,759)	(4,200)
Dividends paid	(15,934)	(16,054)
Interest paid	(821)	(720)
Purchase of treasury shares	–	(3,379)
Net cash utilised by financing activities	**(22,514)**	**(24,353)**
Net decrease in cash and cash equivalents	**(39,477)**	**(32,611)**
Cash and cash equivalents at beginning of the year	191,287	223,898
Effect of exchange rate changes on cash and cash equivalents	1,119	–
Cash and cash equivalents at end of the year	**152,929**	**191,287**

The notes and information on pages 61 to 159 form part of these financial statements.

Company Statement of Cash Flows for the year ended 31 December 2009

	Year ended 31 December	
	2009 £000	2008 £000
Profit for the year	**23,809**	**32,237**
Adjustments for:		
Tax recovery	(392)	(124)
Interest expense	154	752
Dividends received from subsidiary company	(25,890)	(33,000)
Changes in operating assets and liabilities		
Decrease/(increase) in loans and receivables	921	(559)
(Increase)/decrease in prepayments	(6)	6
(Decrease)/increase in other payables	(55)	411
Tax received	133	–
Cash utilised by operations	**(1,326)**	**(277)**
Cash flows from investing activities		
Acquisition of subsidiary company	(19,956)	–
Capital contributions paid to subsidiary	(2,067)	–
Dividends received from subsidiary company	25,890	33,000
Net cash generated from investing activities	**3,867**	**33,000**
Cash flows from financing activities		
Repayment of borrowings	(4,200)	(4,200)
Dividends paid	(15,934)	(16,054)
Interest paid	(136)	(720)
Purchase of treasury shares	–	(3,379)
Net cash utilised by financing activities	**(20,270)**	**(24,353)**
Net (decrease)/increase in cash and cash equivalents	**(17,729)**	**8,370**
Cash and cash equivalents at beginning of the year	37,364	28,994
Cash and cash equivalents at end of the year	**19,635**	**37,364**

The notes and information on pages 61 to 159 form part of these financial statements.

Consolidated Statement of Changes in Equity for the year ended 31 December 2009

	Year ended 31 December 2009					
	Share capital £000	Share premium £000	Other reserves £000	Treasury shares £000	Retained earnings £000	Total £000
Equity shareholders' funds at 1 January 2009	**41,501**	**20,458**	**50**	**(3,379)**	**67,738**	**126,368**
Purchase of treasury shares	–	–	–	–	–	–
Profit for the year attributable to shareholders	–	–	–	–	45,940	45,940
Dividends paid	–	–	–	–	(15,934)	(15,934)
Foreign exchange translation reserve	–	–	3,381	–	–	3,381
Equity shareholders' funds at 31 December 2009	**41,501**	**20,458**	**3,431**	**(3,379)**	**97,744**	**159,755**

	Year ended 31 December 2008					
	Share capital £000	Share premium £000	Other reserves £000	Treasury shares £000	Retained earnings £000	Total £000
Equity shareholders' funds at 1 January 2008	**41,501**	**20,458**	**50**	–	**63,775**	**125,784**
Purchase of treasury shares	–	–	–	(3,379)	–	(3,379)
Profit for the year attributable to shareholders	–	–	–	–	20,017	20,017
Dividends paid	–	–	–	–	(16,054)	(16,054)
Equity shareholders' funds at 31 December 2008	**41,501**	**20,458**	**50**	**(3,379)**	**67,738**	**126,368**

The notes and information on pages 61 to 159 form part of these financial statements.

Company Statement of Changes in Equity for the year ended 31 December 2009

	Year ended 31 December 2009					
	Share capital £000	**Share premium £000**	**Other reserves £000**	**Treasury shares £000**	**Retained earnings £000**	**Total £000**
Equity shareholders' funds at 1 January 2009	**5,229**	**20,458**	**50**	**(3,379)**	**57,683**	**80,041**
Profit for the year representing total recognised income and expenses	–	–	–	–	23,806	23,806
Dividends paid	–	–	–	–	(15,934)	(15,934)
Equity shareholders' funds at 31 December 2009	**5,229**	**20,458**	**50**	**(3,379)**	**65,555**	**87,913**

	Year ended 31 December 2008					
	Share capital £000	**Share premium £000**	**Other reserves £000**	**Treasury shares £000**	**Retained earnings £000**	**Total £000**
Equity shareholders' funds at 1 January 2008	**5,229**	**20,458**	**50**	–	**41,500**	**67,237**
Purchase of treasury shares	–	–	–	(3,379)	–	(3,379)
Profit for the year representing total recognised income and expenses	–	–	–	–	32,237	32,237
Dividends paid	–	–	–	–	(16,054)	(16,054)
Equity shareholders' funds at 31 December 2008	**5,229**	**20,458**	**50**	**(3,379)**	**57,683**	**80,041**

The notes and information on pages 61 to 159 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, comprise UK and Swedish life and pensions businesses, which correspond with the operating segments of the Group.

The UK business, the activities of which are performed entirely in the UK, underwrites life risks such as those associated with death, disability and health and provides a portfolio of investment contracts for the savings and retirement needs of customers through asset management. It 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.

The Swedish business, the activities of which are performed predominantly in Sweden, underwrites life, accident and health risks and provides a portfolio of investment contracts. It is open to new business, securing distribution of its products principally through independent financial advisers, one of which is a subsidiary company, which services a specialist sector of the market.

These financial statements are presented in pounds sterling, which is the functional currency of the Parent Company. Foreign operations are included in accordance with the policies set out in Note 2. The financial statements were authorised for issue by the Directors on 30 March 2010.

2 Significant 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.

The Group has applied, for the first time, IFRS 8 Operating Segments, Amendments to IFRS 7 Financial Instruments: Disclosures and Amendments to IAS 1 Presentation of Financial Statements: A Revised Presentation, which became effective during the reporting period. The Group has also elected to early adopt IFRS 3 (revised 2008): Business Combinations and IAS 27 (revised 2008) Consolidated and Separate Financial Statements which came into effect for accounting periods beginning after 1 July 2009. Their application has not led to any changes in group accounting policies, but has given rise to extensive additional disclosures.

At the date of authorisation of these financial statements, the following Standards, which are applicable to the Group and which have not been applied in these financial statements, were in issue, but were not yet effective, and in some cases had not yet been adopted by the EU:

- IFRS 9 Financial Instruments;
- IAS 24 (revised) Related Party Disclosures; and
- Improvements to IFRSs 2009.

The Directors anticipate that the application of these Standards in future periods will have no material impact on the financial statements of the Group.

In publishing the Parent Company financial statements together with the Group financial statements the Company has taken advantage of the exemption in s408 of the Companies Act 2006 not to present its individual income statement and related notes that form a part of these approved financial statements.

(b) Basis of consolidation

The consolidated financial statements incorporate the financial statements of the Company and of entities controlled by the company (its subsidiaries), made up to 31 December each year. Control is achieved where the Company has the power to govern the financial and operating policies of an investee entity so as to obtain benefits from its activities. The Parent Company financial statements present information about the Company as a separate entity and not about its group.

2 Significant accounting policies (continued)

Non-controlling interests in the net assets of consolidated subsidiaries are identified separately from the Group's equity therein. Non-controlling interests consist of the amount of those interests at the date of the original business combination (see below) and the non-controlling interest's share of changes in equity since the date of the combination. Losses applicable to the non-controlling interest in excess of the non-controlling interest's interest in the subsidiary's equity are allocated against the interests of the Group except to the extent that the non-controlling interest has a binding obligation and is able to make an additional investment to cover the losses.

The results of subsidiaries acquired or disposed of during the year are included in the consolidated statement of comprehensive income from the effective date of acquisition or up to the effective date of disposal. Where necessary, adjustments are made to the financial statements of subsidiaries to bring the accounting policies used into line with those used by the Group.

All intra-group transactions, balances, income and expenses are eliminated on consolidation.

(c) Basis of preparation

General

The Consolidated and Parent Company financial statements have been prepared on a going concern basis. The Directors believe that they have a reasonable expectation that the Group has adequate resources to continue in operational existence for the foreseeable future. In making this assessment, the Directors have taken into consideration the points as set out in the Operating and Financial Review in the section headed 'Going Concern'.

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.

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

These financial statements have also been prepared in accordance with the disclosure provisions of FRS 27 'Life Assurance'.

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.

(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. Expenses directly attributable to the acquisition are expensed as incurred. The acquiree's identifiable assets, liabilities, and contingent liabilities, which meet the conditions for recognition under IFRS 3 are measured initially at their fair values at the acquisition date. Gains arising on a bargain purchase, where the net fair value of the identifiable assets, liabilities and contingent liabilities of the acquiree exceeds the cost of acquisition, is recognised in profit or loss at the acquisition date.

The non-controlling interest in the acquiree is initially measured at the non-controlling interest's proportion of the net fair value of the assets, liabilities and contingent liabilities recognised.

(e) Investments in associates

An associate is an entity over which the Group is in a position to exercise significant influence, but not control or joint control, through participation in the financial and operating policy decisions of the investee. Significant influence is the power to participate in the financial and operating policy decisions of the investee, but is not control or joint control over those policies.

The results and assets and liabilities of associates are incorporated in these financial statements using the equity method of accounting. Investments in associates are carried in the balance sheet at cost as adjusted by post-acquisition changes in the Group's share of the net assets of the associate, less any impairment in the value of individual investments. Losses of an associate in excess of the Group's interest in that associate are recognised only to the extent that the Group has incurred legal or constructive obligations or made payments on behalf of the associate.

Where a Group company transacts with an associate of the Group, profits and losses are eliminated to the extent of the Group's interest in the associate. Losses may provide evidence of an impairment of assets transferred, in which case appropriate provision is made for impairment.

2 Significant accounting policies (continued)

(f) Foreign currencies

The individual financial statements of each Group company are presented in the currency of the primary economic environment in which it operates, being its functional currency. For the purpose of these consolidated financial statements, the results and financial position of each Group company are expressed in pounds sterling, which is the functional currency of the Parent Company and the presentation currency of the consolidated financial statements.

In preparing the financial statements of the individual companies, transactions in currencies other than the entity's functional currency, being foreign currencies, are recorded at the rates of exchange prevailing on the dates of the transactions. At each balance sheet date, monetary assets and liabilities which are denominated in foreign currencies are retranslated at the rates prevailing on the balance sheet date. Non-monetary items carried at fair value, which are denominated in foreign currencies are translated at the rates prevailing when the fair value was determined. Non-monetary items, which are measured in terms of historical cost in a foreign currency, are not retranslated. Exchange differences are recognised in profit or loss in the period in which they arise, except when they relate to items for which gains and losses are recognised in equity.

For the purpose of presenting consolidated financial statements, the assets and liabilities of the Group's foreign operations are translated at exchange rates prevailing on the balance sheet date. Income and expense items are translated at the average exchange rates for the period, unless exchange rates fluctuate significantly during the period, in which case the exchange rates at the dates of transactions are used. Exchange differences arising are classified as equity and are recognised in the Group's foreign currency translation reserve. Such translation differences are recognised as income or as expense in the period in which the operation is disposed of.

Transactions relating to Business Combinations denominated in foreign currencies are translated into sterling at the exchange rates prevailing on the transaction date.

(g) Product classification

The Group's products are classified at inception as either insurance or investment contracts for accounting purposes. Insurance contracts are contracts which transfer significant insurance risk and remain as insurance contracts until all rights and obligations are extinguished or expire. They may also transfer financial risk. Investment contracts are contracts which carry financial risk, with no significant insurance risk. 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.

In some insurance contracts and investment contracts the financial risk is borne by the policyholders. Such contracts are usually unit-linked contracts.

(h) Insurance contracts

There are fundamental differences as between the nature of the insurance contracts subsisting in the UK and Swedish businesses, including *inter alia* contract longevity: the related product characteristics are set out in detail for the separate UK and Swedish businesses in Note 5. As a consequence, the alignment of income and expense recognition with the underlying assumption of risk leads to the adoption of separate accounting policies appropriate to each business, as follows:

UK Business

(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. They are initial fees amortised at a rate based on the pattern of anticipated margins in respect of the related policies. An explicit deferred acquisition cost asset is established in the balance sheet to the extent that acquisition costs exceed initial fees deducted. At 31 December each year, such costs that are deferred to future years are reviewed to ensure they do not exceed 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 and is not discounted.

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 as set out below.

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, including projected improvements in future 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.

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 or the amount of claims and are therefore subject to subsequent reassessment on a regular basis.

Swedish Business – Life

(i) Premiums

Premiums are accounted for when received, 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. Reinsurance recoveries are accounted for in the same period as the related claim.

2 Significant accounting policies (continued)

(iii) Acquisition costs

Acquisition costs comprise expenditure incurred arising from the completion of insurance contracts. They are initial fees amortised at a rate based on the pattern of anticipated margins in respect of the related policies. An explicit deferred acquisition cost asset is established in the balance sheet to the extent that acquisition costs exceed initial fees deducted. At the end of each year, such costs that are deferred to future years are reviewed to ensure they do not exceed 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

Provision is made at the year-end for the estimated cost of claims incurred but not settled at the balance sheet date, including the cost of claims incurred but not yet reported. The estimated cost of claims includes expenses to be incurred in settling claims. Outstanding claim provisions are not discounted other than for income protection and waiver of premium benefits, where payments may be made for a considerable period of time.

All reasonable steps are taken to ensure that there is appropriate information regarding claims exposures. However, given the uncertainty in establishing claims provisions, it is likely that the final outcome will prove to be different from the original liability established.

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 deficiency in income for the year is recognised.

Swedish Business – Non-life

(i) Premiums

Written premiums for non-life (general) insurance business comprise the premiums on contracts incepting in the financial year. Written premiums are stated gross of commission payable to intermediaries and exclusive of taxes and duties paid on premiums.

Unearned premiums are those proportions of the premium which relate to periods of risk after the balance sheet date. Unearned premiums are calculated on a straight-line basis according to the duration of the policy underwritten.

(ii) Acquisition costs

Acquisition costs, which represent commission payable, incurred in writing written premiums, are deferred and amortised over the period in which the related premiums are earned.

(iii) Claims

Claims incurred

Claims incurred comprise claims and related expenses paid in the year and changes in provisions for outstanding claims, including provisions for claims incurred but not yet reported and related expenses, together with any adjustments to claims from previous years.

Outstanding claims provisions

Provision is made at the year-end for the estimated cost of claims incurred but not settled at the balance sheet date, including the cost of claims incurred but not yet reported. The estimated cost of claims includes expenses to be incurred in settling claims. Outstanding claims provisions are not discounted. Provisions are calculated gross of any reinsurance recoveries.

All reasonable steps are taken to ensure that there is appropriate information regarding claims exposures. However, given the uncertainty in establishing claims provisions, it is likely that the final outcome will prove to be different from the original liability established.

The estimation of outstanding claims provisions is described in Note 5.

(i) 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 Group has designated investment contract liabilities at fair value through income as this more closely reflects the basis on which the businesses are managed.

The financial liability in respect of unit-linked contracts is measured by reference to the value of the underlying net asset value of the unitised investment funds, determined on a bid value, at the balance sheet date. For UK business, deferred tax on unrealised capital gains and for Swedish business a yield tax in respect of an estimate of the investment return on the underlying investments in the unitised funds are also reflected in the measurement of the respective unit-linked liabilities.

In respect of UK business 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.

(j) 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, which exist only within the UK business, 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.

2 Significant accounting policies (continued)

(k) 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, policyholder or loss event (for example multiple losses under a Group Life contract). 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, which comprise amounts due from insurance companies for paid and unpaid losses and ceded life policy benefits. Rights under contracts that do not transfer significant insurance risk are accounted for as financial instruments and are presented as amounts deposited with reinsurers.

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 and in accordance with the terms of the reinsurance contract. 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. Impairment losses reduce the carrying value of the related reinsurance assets to their recoverable amount and are recognised as an expense in the income statement.

The Group enters into certain financing arrangements, which are established in the form of a reinsurance contract, but which are substantively in the form of a financial instrument. Such arrangements are classified and presented as borrowings within financial liabilities.

(l) 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, 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.

For insurance and investment contracts, 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.

(m) 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 at 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.

(n) 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 and on reinsurance claims deposits included within reinsurance payables, calculated using the effective interest rate method.

(o) Income taxes

Income tax on the profit or loss for the year comprises current and deferred tax and is recognised in the income statement. Tax that relates directly to transactions reflected within equity is also presented within equity.

(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.

(iii) Policyholders' fund yield tax

Certain of the Group's policyholders within the Swedish Business are subject to a Swedish yield tax which is calculated based on an estimate of the investment return on underlying investments within their unitised funds. The Group is under an obligation to deduct the yield tax from the policyholders' unitised funds and to remit these deductions to the tax authorities. The deduction from policyholders' unitised funds is presented as management fee income with an equal charge reflected in the current tax charge.

(p) 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. Present value of in-force business 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. The present value of in-force insurance contracts is tested for recoverability/impairment as part of the liability adequacy test.

2 Significant accounting policies (continued)

The present value 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. The recoverable amount is estimated at each balance sheet date. If the recoverable amount is less than the carrying amount, an impairment loss is recognised in the income statement and the carrying amount is reduced to its recoverable amount.

(q) Acquired value of customer relationships

The acquired value of customer relationships arising from business combinations is measured at fair value at the time of acquisition.

This comprises the discounted cashflows relating to new insurance and investment contracts which are expected to arise from existing customer relationships. These are carried gross of tax, are amortised in accordance with the expected emergence of profit from the new contracts and are tested periodically for recoverability.

(r) Internally-developed software

An intangible asset in respect of internal development software costs is only recognised if all of the following conditions are met:

(i) an asset is created that can be identified;

(ii) it is probable that the asset created will generate future economic benefits; and

(iii) the development costs of the asset can be measured reliably.

Software development costs are amortised on a straight-line basis over their estimated useful life, which typically varies between 3 and 5 years. Where no internally-generated intangible asset can be recognised, development expenditure is recognised as an expense in the period in which it is incurred.

(s) 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 economic lives of the property and equipment on the following basis:

Computers and similar equipment	3 years
Fixtures and other equipment	5 years

Assets held under finance leases are depreciated over their useful economic lives on the same basis as owned assets, or where shorter, over the term of the relevant lease.

(t) 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 (m).

(u) 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 at 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 values of financial assets quoted in an active market are their bid prices at the balance sheet date.

Financial assets classified as loans and receivables are stated at amortised cost less impairment losses. A provision for the impairment of loans and receivables is established when there is objective evidence that the Group will not be able to collect all the amounts due according to the original contract terms after the date of the initial recognition of the asset and when the impact on the estimated cash flows of the financial asset can be reliably measured.

Financial assets classified as prepayments are held at cost and are amortised over the relevant time period.

Financial assets at fair value through income are regularly reviewed for objective evidence of impairment. In determining whether objective evidence exists, the Group considers, among other factors, the financial stability of the counterparty, current market conditions and fair value volatility.

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 in the Company balance sheet at cost less impairment.

(v) 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.

Embedded derivatives which are not closely related to their host contracts and which meet the definition of a derivative are separated and fair valued through income.

(w) Policyholders' funds held by the group and liabilities relating to policyholders' funds held by the group

Policyholders' funds held by the Group and liabilities relating to policyholders' funds held by the Group are recognised at fair value.

Policyholders' funds held by the Group

The policyholders' funds held by the Group represent the assets associated with an Investment product in the Swedish Business, where the assets are held on behalf of the policyholder and where all the risks and rewards associated with the assets are the policyholders' not the Group's.

The policyholders' funds held by the Group are held for investment purposes on behalf of the policyholders and are designated as at fair value through income. The fair values of the policyholders' funds held by the Group are the accumulation of the bid prices of the underlying assets at the balance sheet date. Transactions in these financial assets are recognised on the trade date, which is when the Group commits (on behalf of the policyholder) to purchase, or sell the assets.

2 Significant accounting policies (continued)

Liabilities relating to policyholders' funds held by the Group

The liability relating to policyholders' funds held by the Group represents the liability that matches the asset policyholders' funds held by the Group. As stated previously, the risk and rewards associated with the investment product (and its underlying assets and matching liability) lie with the policyholders not the Group.

(x) 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.

(y) Impairment

The carrying amounts of the Group's assets other than reinsurance assets (refer to (k) above) 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 in order to determine the extent of the impairment loss, if any. An impairment loss is recognised whenever the carrying amount of an asset exceeds its recoverable amount and impairment losses are recognised in the income statement. The recoverable amount is the higher of fair value less costs to sell and value in use. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money.

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.

(z) 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.

(aa) Borrowings

Borrowings are recognised initially at fair value, less transaction costs, and are subsequently measured at amortised cost using the effective interest method, with interest expense recognised in the income statement on an effective yield basis. The effective interest method is a method of calculating the amortised cost of a financial liability and of allocating interest expense over the relevant period. The effective interest rate is the rate that exactly discounts future cash payments through the expected life of the financial liability.

(bb) Employee benefits

(i) Pension obligations

UK Business

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 in the income statement when due.

Swedish Business

The Group participates in a combined defined benefit and defined contribution scheme for the benefit of its employees. However, the scheme is a multi-employer scheme, with the associated assets and liabilities maintained on a pooled basis. There is limited information available to the Group to allow it to account for the scheme as a defined benefit scheme and, in accordance with IAS19 Employee Benefits, it is, therefore, accounted

for as a defined contribution scheme. Contributions paid to the scheme are recognised in the income statement when 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.

(cc) Share capital and shares held in treasury

(i) 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.

(ii) Shares held in treasury

Where the Company purchases its own equity share capital, the consideration paid, including directly attributable costs, is deducted from total shareholders' equity and shown separately as 'treasury shares' until they are cancelled. Where such shares are subsequently sold, any consideration received is included within shareholders' equity.

(dd) Dividends

Dividend distributions to the Company's shareholders are recognised 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.

(ee) 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, and which relate variously to the UK and Swedish businesses together, or to each separately, are described below.

UK and Swedish Businesses

(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 Significant 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) Deferred acquisition costs and deferred income – investment contracts

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 over the expected lifetime of the investment management service contracts and deferred income, where applicable, is amortised over the expected period over 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.

3 Accounting estimates and judgements (continued)

As at 31 December 2009, the carrying values of deferred acquisition costs, net of amortisation, and of deferred income, in respect of the UK Business, were £7.7m and £13.1m respectively (as at 31 December 2008 £8.6m and £14.6m respectively). An increase in the estimate of the lifetime of the investment management service contract by one year in respect of deferred acquisition costs would have increased profit before tax for the year ended 31 December 2009 by £0.1m and shareholders' equity as at 31 December 2009 by £0.1m and an increase of one year in the length of the amortisation period in respect of deferred income would have reduced profit before tax for the year ended 31 December 2009 by £0.1m and shareholders' equity as at 31 December 2009 by £0.1m.

As at 31 December 2009, the carrying values of deferred acquisition costs, net of amortisation, in respect of the Swedish Business, was £1.6m (as at 31 December 2008 £nil). An increase in the length of the amortisation period by one year would have increased profit before tax for the year ended 31 December 2009 by £0.1m and shareholders' equity as at 31 December 2009 by £0.1m.

(c) 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 and expense levels.

As at 31 December 2009, the carrying value of acquired in-force business, net of amortisation, was £24.8m in respect of the UK Business (as at 31 December 2008 £28.5m) and £61.7m in respect of the Swedish Business (as at 31 December 2008 £nil).

(d) Fair value of financial assets and unit-linked investments

Fair value measurement 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.

Fair value is the amount for which an asset could be exchanged, or a liability settled, between willing, knowledgeable parties in an arm's length transaction. Fair values are determined by reference to observable market prices where available and reliable.

UK Business

(a) 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 33.

As at 31 December 2009, the carrying value of insurance contract liabilities was £1,044m (as at 31 December 2008 £923.5m).

(b) 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 34 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.

Fair value measurement 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.

As at 31 December 2009, the carrying value of investment contract liabilities in respect of guaranteed income and guaranteed growth bonds was £22.9m (as at 31 December 2008 £55.1m).

(c) 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 33 to these financial statements.

As at 31 December 2009, the liability for future redress in respect of mortgage endowment misselling complaints was £2.9m (as at 31 December 2008 £4.2m).

Swedish Business

(a) Insurance claim reserves

Provisions are determined by management based on experience of claims settled and on statistical models which require certain assumptions to be made regarding the timing, incidence and amount of claims. In order to calculate the total provision required, the historical development of claims is analysed using statistical methodology to extrapolate, within acceptable parameters, the value of outstanding claims.

For more recent underwriting years the provisions will make more use of techniques that incorporate expected loss ratios. As underwriting years mature, the reserves are increasingly driven by methods based on actual claims experience. The data used for statistical modelling is internally generated. Actual claims experience may differ from the historical pattern on which the estimate is based and the cost of individual claims may exceed that assumed.

Liabilities carried in respect of waiver of premium and income protection policies are sensitive to the Group's assessment of the length of period in which benefits will be paid to policyholders (which can be significant). Estimates are made based on the sex, age and occupation of the claimant as well as the length of time the claimant has been claiming on the policy.

As at 31 December 2009, the carrying value of the insurance claim reserves, gross of reinsurance, was £32.4m (as at 31 December 2008 £nil). The key sensitivities in respect of insurance claim reserves are considered in Note 5.

(b) Insurance claim reserves – reinsurance recoverable

A significant proportion of the insurance claims arising within the Swedish Business are ceded to reinsurers. In preparing the financial statements the Directors have made an assessment as to whether claims ceded to reinsurers are recoverable. As at 31 December 2009, such claims ceded to reinsurers and reflected on the balance sheet were £27.3m (31 December 2008 £nil). The application of a 10 per cent bad debt provision on the reinsurance balance would reduce 2009 profit before tax by £2.7m and shareholders' equity by £2.0m.

3 Accounting estimates and judgements (continued)

(c) Accounting for pension plans

The Group participates in a defined benefit pension scheme on behalf of its Swedish employees. The scheme is a multi-employer plan to which a number of third party employers also contribute. The underlying assets and liabilities of the scheme are pooled and are not allocated between the contributing employers. As a result, information is not available to account for the scheme as a defined benefit scheme and the Group has accounted for the scheme as a defined contribution scheme.

(d) Income tax expense

Commissions payable and receivable from fund managers in respect of the unit-linked business have been included as part of the unit-linked funds and subject to fund yield tax (see accounting policy o). Management is aware that the Swedish tax authority has questioned, in respect of another unit-linked business, whether such commissions receivable from fund managers should be part of the Group's income and be subject to corporation tax of 26.3 per cent (being the Swedish corporation tax for the year 2009). Management consider that the current accounting treatment remains appropriate.

4 Exchange rates

The Group's principal overseas operations during the year were located within Sweden.

The results and cash flows of these operations have been translated into sterling at an average rate for the year of £1 = SEK 11.5594.

Assets and liabilities have been translated at the year end rate of £1 = SEK11.5305, the acquisition of Moderna Försäkringar Liv AB, at the 23 July 2009 acquisition balance sheet date rate of £1 = SEK12.3728 and the acquisition of AkademikerRådgivning i Sverige AB, at the 23 November 2009 acquisition balance sheet date rate of £1 = SEK11.4030.

Total foreign currency exchange rate movements during 2009 resulted in a gain recognised in the Consolidated Statement of Comprehensive Income of £3,381,000.

5 Management of insurance risk

The Group's management of insurance risk is a critical aspect of the business. Notwithstanding that the Group pursues common overarching objectives and employs similar techniques in managing this risk, the disparate characteristics of the products and of the market and regulatory environments of the UK and Swedish businesses are such that this risk is managed separately for the respective businesses, as follows:

UK Business

The primary insurance activity carried out by the Group's UK Business 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 UK Business's exposure relating to mortality risk on individual lives, predominantly in the UK. As such, the UK Business is exposed to the uncertainty surrounding the timing and severity of claims under the related contracts.

The UK Business 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 UK Business is substantially closed to new insurance business in the UK 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 UK Business 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 UK Business monitors the financial condition of reinsurers on an ongoing basis and reviews its reinsurance arrangements periodically.

The UK Business 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 main products of the UK Business and of the ways in which the associated risks are managed.

	Sums assured – gross and net of reinsurance			
	31 December 2009		31 December 2008	
	Gross £000	Net £000	Gross £000	Net £000
Annuities-immediate (per annum)	4,899	4,812	4,568	4,514
Long-term with DPF	68,633	204	72,728	204
Long-term without DPF	4,488,927	3,280,348	5,024,349	3,632,144
Total	**4,562,459**	**3,285,364**	**5,101,645**	**3,636,862**

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 UK Business regularly monitors the asset matching for these contracts as explained in the Market Risk Management section of Note 6.

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.

5 Management of insurance risk (continued)

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 UK Business 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 UK Business 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 6.

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 2009				
£0 – £25,000	4,854	99.1	4,803	99.8
More than £25,000	45	0.9	9	0.2
	4,899	100.0	4,812	100.0
As at 31 December 2008				
£0 – £25,000	4,523	99.0	4,505	99.8
More than £25,000	45	1.0	9	0.2
	4,568	100.0	4,514	100.0

Long-term insurance contracts – with discretionary participation features

Product features

The UK Business 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 6.

Long-term insurance contracts – without discretionary participation features

Product features

The UK Business 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 UK Business, 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 UK Business 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 UK Business 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 UK Business.

For the remainder of the business, operated on a quasi-linked basis, the UK Business 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 UK Business 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 UK Business 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**	
	£m	**%**	**£m**	**%**
In £000's bands				
As at 31 December 2009				
0 – 250	4,407	96.7	3,259	99.3
250 – 500	102	2.3	20	0.6
500 – 750	27	0.6	2	0.1
750 – 1,000	13	0.2	–	–
More than 1,000	8	0.2	–	–
	4,557	100.0	3,281	100.0

5 Management of insurance risk (continued)

Benefits assured for each life assured	Total benefits assured			
	Before reinsurance		After reinsurance	
	£m	%	£m	%
In £000's bands				
As at 31 December 2008				
0 – 250	4,930	96.8	3,611	99.4
250 – 500	116	2.3	20	0.6
500 – 750	27	0.5	1	–
750 – 1,000	12	0.2	–	–
More than 1,000	12	0.2	–	–
	5,097	100.0	3,632	100.0

In addition to the above the UK Business has, at 31 December 2009, a total of approximately £13.8m per annum of retained PHI sums assured (31 December 2008: approximately £15.5m). The UK Business 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 251 such policies in force as at 31 December 2009 (as at 31 December 2008: 292). The underlying contracts have total unit funds of £2.4m (as at 31 December 2008: £2.6m), 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 6, there are other significant types of risk pertaining to life insurance contracts, as follows:

Expense risk

The strategy of the UK Business 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 UK Business 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 UK Business 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 UK Business 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.

Assumptions and sensitivities

The assumptions and sensitivities relating to insurance contract provisions for the UK Business are set out in Note 33 Insurance Contract Provisions.

Swedish Business

The terms and conditions of insurance contracts which 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 main products of the Swedish Business and of the ways in which the associated risks are managed. The breakdown of the insurance products of the Swedish Business, by gross and net premiums written and by claims outstanding, which reflects the scale of business written, is as follows. Certain of the information includes amounts and balances relating to the pre-acquisition period and is provided for illustrative purposes.

Premiums	**Before reinsurance Year ended 31 December**		**After reinsurance Year ended 31 December**	
	2009 £000	**2008 £000**	**2009 £000**	**2008 £000**
Group				
Sweden	11,312	8,625	2,652	2,181
Norway	5,291	7,524	978	1,256
Individual				
Death	471	450	53	56
Waiver of premium	4,344	4,155	850	892
Income protection	3,213	3,073	623	654
	24,631	23,827	5,156	5,039

5 Management of insurance risk (continued)

Claims outstanding	Before reinsurance Year ended 31 December		After reinsurance Year ended 31 December	
	2009 £000	2008 £000	2009 £000	2008 £000
Group				
Sweden	12,131	9,920	1,377	1,135
Norway	8,869	7,996	1,450	1,234
Individual				
Death	422	333	75	66
Waiver of premium	5,931	5,276	1,110	1,047
Income protection	5,000	4,414	1,079	872
	32,353	29,739	5,091	4,354

Terms and conditions

Product features – Group Contracts

Group Contracts insure policyholders in respect of death with the option to include additional accident and disability benefits. Policyholders may also include their spouse and children (up to the age of 25) on the policy.

The Swedish product provides a maximum coverage of insured benefits up to 40 times a base amount (as at 31 December 2009 SEK 42,700, being approximately £3,700) although most policies are between 7.5 to 20 times the base amount.

The Norwegian product provides a maximum coverage of insured benefits up to 80 times a base amount (as at 31 December 2009 NOK 70,256, being approximately £7,580) although most policies are around 40 times the base amount.

Policies are sold in both Sweden and Norway and all sales are intermediated. Group Contracts sold in Sweden allow the policyholder to choose the sum assured level. Contracts sold in Norway have sum assured levels that are normally determined by the policyholders' employer and apply to all members of that company scheme.

All contracts are for an annual period and premium payments are made usually on either an annual or quarterly basis.

Product features – Individual Contracts

In relation to Individual Contracts, the Swedish Business writes contracts, which include death and morbidity benefits on term assurance with disability, waiver of premium and income protection options. Policies are sold in Sweden and all sales are intermediated.

In relation to the income protection and the waiver of premium benefits within the Individual Contracts, the monthly benefits upon a claim may be payable to the policyholders over a long period up to their retirement.

The contracts have been unbundled as between insurance and investment contracts. Risk in respect of investment contracts is described in Note 6. All insurance contracts are for an annual period and payments are made on a monthly basis.

Management of risk

The main risk associated with the Group and Individual Contracts is the frequency of claims (for either death or accident or sickness). Claims experience can be variable, with the main factors being the age, sex and occupation of the policyholder.

In addition, for the Group Contracts, the Swedish Business is exposed to a single loss event that covers a number of employees of an organisation.

The key risks are managed through appropriate product design and pricing of the policies to ensure that the potential cost to the Swedish Business of these events (and associated expenses of underwriting and

administration) are reflected in the price charged to the policyholder. Key controls implemented include a defined pricing structure based on the characteristics of the policyholder and the regular review of management information on the type and frequency of accidents.

Group Contracts are issued on an annual basis which means that the Swedish Business's exposure runs for a period of 12 months, after which the Swedish Business has the option to decline to renew or can increase the price on renewal.

Individual Contracts are long-term contracts but the Swedish Business has the option to review the premiums on an annual basis.

For both the Group and Individual Contracts, between 80 per cent to 90 per cent of the premiums and claims relating to this product are ceded to a reinsurer which reduces the overall insurance risk exposure to the Swedish Business.

In addition, for Group Contracts, the loss arising from a single event to multiple employees is reinsured. The reinsurance provides indemnity for a single loss between SEK 5m (approximately £0.4m) and SEK 100m (approximately £8.7m).

Concentration of insurance risk

Concentration of insurance risk is determined by reference to benefits assured for Individual Contracts and by estimated maximum loss for Group Contracts.

The following tables highlight the maximum exposure to the Swedish Business arising from Individual Contracts, grouped by sums assured, at each balance sheet date.

Total benefits assured	**31 December 2009**	
	Before reinsurance £000	**After reinsurance £000**
Benefit in £000 bands		
0-250	439,948	68,259
250-500	1,254	251
500-750	117	23
750-1000	70	14
Over 1,000	–	–
	441,389	68,547

In respect of Group Contracts, the business is exposed to multiple employees of the same organisation being involved in a single loss event. The Swedish Business estimates that its largest such exposures arise in Norway, where the Group Contracts sold tend to cover all employees within that organisation (whereas in Sweden employees may opt in to the Group Contract). The Swedish Business forecasts that its maximum loss would be approximately SEK 27 million (approximately £2.3m) gross of reinsurance and SEK 5 million (approximately £0.4m) after reinsurance.

Assumptions and sensitivities for Group Contract and Individual Contract insurance provisions

Group Contracts are sold on an annual basis and the Individual Contracts include an option for the Group to increase the premium on an ongoing basis. Therefore, for both Group and Individual Contracts, the Group adopts a reserving approach that is similar to that of a non-life insurance business, with claim reserves projected using an estimated loss ratio with reference to previous loss development for earlier years.

The insurance contract provisions comprise unearned premium provisions, outstanding claims and associated reinsurance recoveries. Except for the income protection and the waiver of premium benefits within the Individual Contracts, provisions for the insurance contracts are not discounted because of the short term nature of the liabilities, which are generally paid by the fourth year of development for a single accident year. Income protection and waiver of premium contracts are discounted at a rate equivalent to a high quality (i.e. AA rated) corporate bond.

5 Management of insurance risk (continued)

Unearned premiums

Unearned premiums represent a proportion of the premium relating to policies that expire after the balance sheet date. Unearned premiums are calculated automatically by the underwriting system on a straight-line basis over the period of the policy.

Outstanding claims

Outstanding claims include notified claims, claims incurred as at the balance sheet date but not reported and an estimate of the external cost of handling the claims.

The key risk in respect of notified claims is that they are paid or handled inappropriately (for example invalid or fraudulent claims are paid). All claims handling is outsourced, although physical payment of the claims is performed by the Swedish Business. The Swedish Business also inspects companies performing outsourced claims handling services on at least an annual basis. Management information is also reviewed on a regular basis to identify unusual trends in the payment of claims.

The estimation of claims incurred but not reported ('IBNR') is generally subject to a greater degree of uncertainty than the estimation of costs of settling claims already notified to the Swedish Business, where more information about the claim event is generally available. In calculating the estimated cost of claims which have not been notified, the Swedish Business uses a variety of estimation techniques, generally based upon statistical analyses of historical experience, which assumes that the development pattern of the current claims will be consistent with past experience.

The most common methods that are used are the chain ladder method and the Bornhuetter-Ferguson method. Chain ladder methods involve the analysis of historical claims development factors and the selection of estimated development factors based on this historical pattern. The selected factors are applied to cumulative claims data for each accident year that is not fully developed to provide an estimated ultimate claims cost. The Bornhuetter-Ferguson method uses a combination of an initial estimate of the expected loss ratio and an estimate based on observed claims experience. The two estimates are combined using a formula that gives more weight to the experience-based estimate as time passes.

The use of different approaches assists in giving greater understanding of the trends inherent in the data being projected and also assists in setting the range of possible outcomes. The most appropriate estimation technique is selected taking into account the characteristics of the policies sold. Where deemed appropriate, an allowance is made for changes or uncertainties which may create distortions in the underlying statistics or which might cause the cost of unsettled claims to increase or reduce when compared with the cost of previously settled claims. Although claim reserves are considered reasonable, on the basis of information available to the Swedish Business, the ultimate liabilities will vary as a result of subsequent information and events.

Income protection and waiver of premium benefits within Individual Contracts

For reported claims, the liabilities are reviewed on a case by case basis. A discounted cash flow model is used to determine the liabilities and the key factors used are:

- the probability of 'recovery' (i.e. return to work). The recovery rates depend on age, sex and length of time the claimant has been claiming the benefits;
- the mortality rate; and
- the discount rate.

For unreported claims, the claims development table (as described below) is used.

Sensitivity analysis

The key sensitivities in the measurement of the Group and Individual Contracts insurance claim reserves are a movement in the loss ratio applied to earned premium and the foreign exchange risk arising on business written in Norway. In addition, for the income protection and the waiver of premium benefits within the Individual Contracts, the claims reserves are impacted by the discount rate used. The impact of these sensitivities is shown below: the information includes pre-acquisition amounts and is presented for illustrative purposes.

	Pre-tax profit		Shareholders' equity	
	2009 £000	2008 £000	2009 £000	2008 £000
5% increase in loss ratio				
Gross before reinsurance	(1,193)	(1,096)	(910)	(839)
Net after reinsurance	(174)	(330)	(132)	(252)
5% decrease in loss ratio				
Gross before reinsurance	1,193	1,096	910	839
Net after reinsurance	174	330	132	252
10% increase in the Norwegian Krone				
Gross before reinsurance	(857)	(752)	(654)	(576)
Net after reinsurance	(140)	(41)	(107)	(31)
10% decrease in the Norwegian Krone				
Gross before reinsurance	857	752	654	576
Net after reinsurance	140	41	107	31
1% increase in discount rate				
Gross before reinsurance	788	751	601	575
Net after reinsurance	156	141	119	108
1% decrease in discount rate				
Gross before reinsurance	(896)	(860)	(683)	(658)
Net after reinsurance	(178)	(180)	(136)	(138)

In addition to the scenario testing above, the development of insurance liabilities provides a measure of the Swedish Business's ability to estimate the ultimate value of claims. The top half of the table below illustrates how the Swedish Business's estimate of total claims outstanding for each accident year has changed at successive year-ends. The bottom half of the table reconciles the cumulative claims to the amount appearing in the balance sheet. An accident-year basis is considered to be the most appropriate for the business written by the Swedish Business. The information is presented on both a gross and net of reinsurance basis.

5 Management of insurance risk (continued)

Analysis of claims development – gross

	2004 £000	2005 £000	2006 £000	2007 £000	2008 £000	2009 £000
Estimate of ultimates						
End of accident year	4,556	7,102	10,031	15,902	17,908	18,501
One year later	4,749	7,140	8,822	12,052	14,089	–
Two years later	4,888	6,319	7,125	10,335	–	–
Three years later	4,938	5,440	6,954	–	–	–
Four years later	4,887	4,744	–	–	–	–
Five years later	4,828	–	–	–	–	–
Current estimate of ultimate claims	4,828	4,744	6,954	10,335	14,089	18,501
Cumulative payments	(3,725)	(3,864)	(4,845)	(5,744)	(6,641)	(3,214)
In balance sheet	1,103	880	2,109	4,591	7,448	15,287
Provision for prior years						935
Liability in balance sheet						32,353

Analysis of claims development – net

	2004 £000	2005 £000	2006 £000	2007 £000	2008 £000	2009 £000
Estimate of ultimates						
End of accident year	493	787	1,220	2,474	2,469	3,162
One year later	547	769	988	1,567	2,144	–
Two years later	550	675	700	1,499	–	–
Three years later	550	495	695	–	–	–
Four years later	501	474	–	–	–	–
Five years later	483	–	–	–	–	–
Current estimate of ultimate claims	483	474	695	1,499	2,144	3,162
Cumulative payments	(373)	(386)	(485)	(784)	(991)	(442)
In balance sheet	110	88	210	715	1,153	2,720
Provision for prior years						95
Liability in balance sheet						5,091

6 Management of financial risk

The Group is exposed to a range of financial risks through its insurance contracts, financial assets, including assets representing shareholder assets, financial liabilities, including investment contracts and borrowings, and its reinsurance assets: accordingly, 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, equity price risk and foreign currency exchange risk), and credit risk, including the risk of reinsurer default. These risks arise from open positions in interest rate, equity and currency products, all of which are exposed to general and specific market movements.

For unit-linked contracts the Group's objective is to match the liabilities, both insurance and investment contract liabilities, with units in the assets of the funds to which the value of the liabilities is linked, such that the policyholder bears the market risk. This minimises the impact of market risks and of credit risk on these contracts, such that the primary exposure to market risk is the risk of volatility in asset management fees due to the impact of interest rate, equity price and foreign currency movements on the fair value of the unit-linked assets, on which management fees are based. For the UK Business, however, there is residual market risk, which

arises generally from the specific terms and conditions of the related insurance and investment contracts, as described below.

For non unit-linked 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.

Notwithstanding that the Group pursues common overarching objectives and employs similar techniques in managing financial risk, the disparate characteristics of the products and of the market and regulatory environment of the UK and Swedish Businesses are such that the operation of the Group's overall management of financial risk is devolved as between the UK and Swedish Businesses. In addition, there is specific foreign currency exchange risk, which arises at the Group Corporate level. Accordingly, the description of the specific management of financial risk is set out separately below at the UK Business, Swedish Business and Corporate levels.

UK Business

The UK Business manages its market 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 business periodically produces reports at legal entity and asset and liability class level, which are circulated to the UK Business's key management. The principal technique of the 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.

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 5. 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 UK Business provides three types of investment contract which are predominantly written in the UK.

(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 business for these contracts. The benefits payable at maturity or surrender of the contract are the bid value of these units less surrender penalties, where applicable. 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.

6 Management of financial risk (continued)

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 business and on any guarantees in the contracts. Expense risk is of the same nature as described under other risks on insurance contracts in Note 5. Persistency risk is the risk that the investor cancels the contract or discontinues paying new premiums into the contract, thereby exposing the business 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 UK Business'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 business 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 business's 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 business's ALM framework.

31 December 2009	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	7,683	–	–	–	–	–	7,683
Acquired value of in-force business							
Insurance contracts	14,195	–	–	–	–	–	14,195
Investment contracts	10,593	–	–	–	–	–	10,593
Reinsurers' share of insurance contract provisions	209,604	–	88,880	117,918	–	2,806	–
Amounts deposited with reinsurers	27,056	–	–	26,192	–	–	864
Investment properties	3,355	–	–	2,880	–	–	475
Financial assets							
Equity securities at fair value through income	454,970	–	2	454,961	–	7	–
Holdings in collective investment schemes at fair value through income	697,259	–	3,116	663,148	–	10,247	20,748
Debt securities at fair value through income	245,928	18,026	–	118,239	80,478	23,960	5,225
Insurance and other receivables	9,593	532	–	–	–	3,237	5,824
Prepayments	1,628	–	–	–	–	–	1,628
Derivative financial instruments	4,420	–	–	4,420	–	–	–
Total financial assets	1,413,798	18,558	3,118	1,240,768	80,478	37,451	33,425
Reinsurers' share of accrued policyholder claims	4,728	–	–	–	–	900	3,828
Cash and cash equivalents	120,830	5,757	395	32,889	449	8,912	72,428
Total assets	**1,811,842**	**24,315**	**92,393**	**1,420,647**	**80,927**	**50,069**	**143,491**
Liabilities							
Bank overdraft	2,312	–	–	235	–	1,593	484
Insurance contract provisions	1,044,680	–	92,393	835,884	80,927	35,476	–
Financial liabilities							
Investment contracts	610,930	22,923	–	578,523	–	9,484	–
Borrowings	–	–	–	–	–	–	–
Derivative financial instruments	54	–	–	54	–	–	–
Total financial liabilities	610,984	22,923	–	578,577	–	9,484	–
Provisions	1,452	–	–	–	–	203	1,249
Deferred tax liabilities	9,613	30	–	–	–	19	9,564
Reinsurance payables	2,064	–	–	–	–	225	1,839
Payables related to direct insurance and investment contracts	24,751	1,362	–	–	–	964	22,425
Deferred income	13,132	–	–	–	–	–	13,132
Income taxes	854	–	–	–	–	–	854
Other payables	3,825	–	–	–	–	2,105	1,720
Total liabilities	**1,713,667**	**24,315**	**92,393**	**1,414,696**	**80,927**	**50,069**	**51,267**

31 December 2008	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	8,590	–	–	–	–	–	8,590
Acquired value of in-force business							
Insurance contracts	16,866	–	–	–	–	–	16,866
Investment contracts	11,610	–	–	–	–	–	11,610
Reinsurers' share of insurance contract provisions	182,693	–	79,484	100,093	–	3,116	–
Amounts deposited with reinsurers	22,181	–	–	22,181	–	–	–
Investment properties	3,432	–	–	2,932	–	–	500
Financial assets							
Equity securities at fair value through income	363,879	–	2	363,872	–	5	–
Holdings in collective investment schemes at fair value through income	576,502	–	2,578	554,817	–	8,041	11,066
Debt securities at fair value through income	279,104	51,360	–	129,517	70,957	21,392	5,878
Insurance and other receivables	9,879	2,127	–	–	–	1,423	6,329
Prepayments	1,600	–	–	–	–	–	1,600
Derivative financial instruments	5,570	–	–	5,570	–	–	–
Total financial assets	1,236,534	53,487	2,580	1,053,776	70,957	30,861	24,873
Reinsurers' share of accrued policyholder claims	4,100	–	–	–	–	1,192	2,908
Cash and cash equivalents	155,009	3,031	368	50,257	7,260	13,135	80,958
Total assets	**1,641,015**	**56,518**	**82,432**	**1,229,239**	**78,217**	**48,304**	**146,305**
Liabilities							
Bank overdraft	1,086	–	–	38	–	822	226
Insurance contract provisions	923,506	–	82,432	728,179	78,217	34,678	–
Financial liabilities							
Investment contracts	558,542	55,119	–	494,449	–	8,974	–
Borrowings	–	–	–	–	–	–	–
Derivative financial instruments	70	–	–	70	–	–	–
Total financial liabilities	558,612	55,119	–	494,519	–	8,974	–
Provisions	3,397	–	–	–	–	179	3,218
Deferred tax liabilities	10,798	90	–	–	–	147	10,561
Reinsurance payables	1,397	–	–	–	–	253	1,144
Payables related to direct insurance and investment contracts	23,891	1,309	–	–	–	942	21,640
Deferred income	14,575	–	–	–	–	–	14,575
Income taxes	1,213	–	–	–	–	–	1,213
Other payables	4,207	–	–	–	–	2,309	1,898
Total liabilities	**1,542,682**	**56,518**	**82,432**	**1,222,736**	**78,217**	**48,304**	**54,475**

Guaranteed bonds

These contracts are for a fixed term with financial benefits that are fixed and guaranteed at the inception of the contract. The business manages its market risk, its only material risk on these products, 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 business'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 business to control its liquidity risk for this portfolio.

6 Management of financial risk (continued)

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

31 December 2009	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**
Assets backing liabilities:				
Debt securities at fair value through income	18,026	14,258	7,914	1,248
Insurance and other receivables	532	532	–	–
Cash and cash equivalents	5,757	5,757	–	–
Total	24,315	20,547	7,914	1,248
Liabilities	24,315	15,617	7,938	1,075
Difference in expected cash flows	**–**	**4,930**	**(24)**	**173**

31 December 2008	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**
Assets backing liabilities:				
Debt securities at fair value through income	51,360	35,498	12,455	6,907
Insurance and other receivables	2,127	2,127	–	–
Cash and cash equivalents	3,031	3,031	–	–
Total	56,518	40,656	12,455	6,907
Liabilities	56,518	36,628	13,982	7,135
Difference in expected cash flows	**–**	**4,028**	**(1,527)**	**(228)**

These contracts can be surrendered before maturity for a cash surrender value. For these contracts the business is not required to separately 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 of mismatch.

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 aims to minimise 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 2009 and for the year ended 31 December 2008 or shareholder equity as at those dates.

Insurance contracts with discretionary participation features

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

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.

For a small element of the with-profits business, policyholders have the option to invest a portion of their investment 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 business 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 business 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 remain 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 33 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 of £0.6 m is held for the cost of this guarantee (31 December 2008: £0.7m).

(iv) Guarantees in Timed Investment Funds

Investment guarantees have been made in respect of policies invested in the business'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 32 for more details). A provision of £0.1m is held to meet the full cost of this guarantee (31 December 2008: £1.2m).

The key assumption underlying the provision is the level of potential future falls in equities and the sensitivity of the provision to the assumption changes depending on whether, at the valuation date, the guarantee is 'in the money'. An increase in this assumption, from 24% to 34%, would result in a £1.6m decrease in profit for the year ended 31 December 2009 and in shareholder equity as at 31 December 2009 (an increase in the assumption from 25% to 35% would have resulted in a decrease of £0.4m in profit for the year ended 31 December 2008 and in shareholder equity as at 31 December 2008).

(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.

6 Management of financial risk (continued)

(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 cash surrender specified in the contractual terms and conditions. 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 business's current year results would therefore be minimal. For all these contracts the business is not required to separately measure this embedded derivative at fair value.

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 £0.8 m decrease in profit for the year ended 31 December 2009 and to shareholder equity as at 31 December 2009 (year ended 31 December 2008 and as at 31 December 2008: £0.8m 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 UK Business'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 UK Business 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 ALM framework:

31 December 2009		**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	80,478	26,342	23,738	17,508	28,962	52,216
Cash and cash equivalents	449	449	–	–	–	–
Total	80,927	26,791	23,738	17,508	28,962	52,216
Liabilities	80,927	24,339	22,417	20,177	17,610	52,027
Difference in expected cash flows	**–**	**2,452**	**1,321**	**(2,669)**	**11,352**	**189**

31 December 2008	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	70,957	21,085	19,958	16,581	22,341	41,035
Cash and cash equivalents	7,260	7,260	–	–	–	–
Total	78,217	28,345	19,958	16,581	22,341	41,035
Liabilities	78,217	22,488	20,513	18,228	15,705	45,216
Difference in expected cash flows	–	**5,857**	**(555)**	**(1,647)**	**6,636**	**(4,181)**

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 minimise 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 of the matching assets would result in a decrease of £0.1m in profit for the year ended 31 December 2009 and in shareholder equity as at 31 December 2009 (year ended 31 December 2008 and as at 31 December 2008: £0.3m decrease).

A decrease of 100 basis points in interest yields would result in an increase of £0.1m in profit for the year ended 31 December 2009 and in shareholder equity as at 31 December 2009 (year ended 31 December 2008 and as at 31 December 2008: £1.7m decrease).

Other non-linked contracts

This category consists of two groups of contracts. The first group, representing £12.1m of liabilities out of the total of £50.1m as at 31 December 2009 (£10.1m out of the total of £48.3m as at 31 December 2008) 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 business 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. The analysis represents the gross liabilities, before taking into account offsetting linked assets that are scheduled to mature in a similar profile.

	Contractual cash flows (undiscounted)				
	0-5 years £000	**5-10 years £000**	**10-15 years £000**	**15-20 years £000**	**>20 years £000**
As at 31 December 2009	20,796	22,314	18,148	6,655	2,904
As at 31 December 2008	22,686	24,813	21,543	10,105	4,080

Sensitivity analysis – equity risk

An increase or 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 2009 and the year ended 31 December 2008 or shareholder equity as at those dates.

The second group of contracts comprises contracts which pay guaranteed benefits on death or other insurance events, 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.

6 Management of financial risk (continued)

The business 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 ALM framework:

31 December 2009	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	5,701	375	694	1,027	1,305	5,926
Debt securities at fair value through income	20,102	5,563	5,583	2,857	5,081	12,392
Insurance and other receivables	3,237	3,237	–	–	–	–
Cash and cash equivalents	8,919	8,919	–	–	–	–
Total	37,959	18,094	6,277	3,884	6,386	18,318
Liabilities	37,959	16,502	7,140	6,283	6,198	19,514
Difference in expected cash flows	**–**	**1,592**	**(863)**	**(2,399)**	**188**	**(1,196)**

31 December 2008	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	6,072	411	760	1,124	1,429	6,487
Debt securities at fair value through income	17,724	4,929	4,300	2,702	3,126	9,953
Insurance and other receivables	1,423	1,423	–	–	–	–
Cash and cash equivalents	12,967	12,967	–	–	–	–
Total	38,186	19,730	5,060	3,826	4,555	16,440
Liabilities	38,186	15,022	7,048	6,211	6,182	20,601
Difference in expected cash flows	**–**	**4,708**	**(1,988)**	**(2,385)**	**(1,627)**	**(4,161)**

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 minimise 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 £0.2m in profit for the year ended 31 December 2009 and in shareholder equity as at 31 December 2009 (year ended 31 December 2008 and as at 31 December 2008: £0.6m decrease).

A decrease of 100 basis points in interest yields would result in an increase of £0.1m in profit for the year ended 31 December 2009 and in shareholder equity as at 31 December 2009 (year ended 31 December 2008 and as at 31 December 2008: increase of £0.5m).

Certain of the contracts in this second group of contracts 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.

Other

This category comprises two groups of assets and liabilities which have different risk characteristics.

(i) Intangible assets and deferred income

These comprise acquired value of in-force business, deferred acquisition cost and deferred income which are non-monetary items. There is, therefore, no financial risk associated with these assets and liabilities which are amortised in line with the related accounting policies.

(ii) Other assets and liabilities

These primarily comprise tradeable collective investment scheme assets, cash and debt securities and, as such, are exposed to limited counterparty credit risk as explained below in 'Credit Risk Management'.

Net of associated liabilities, the items broadly match the shareholder equity of the UK Business and, therefore, contribute to the return on the Group's investment in the UK Business.

UK Business and Other Group Activities

Credit risk management

The UK Business 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 business 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 business.

The business 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 UK Business is in relation to its reinsurance assets. Although the business 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 which the business issues, would effectively be passed on to policyholders and investors through the unit-linked funds backing the insurance and investment contracts.

The UK Business 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 business's current policy of investing new monies only in high-quality bonds of supra-national corporations and in government-backed debt. The business has never purchased assets rated below AA by Standard & Poors.

The UK Business'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 monthly.

6 Management of financial risk (continued)

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

As at 31 December 2009	Credit rating-debt securities				Cash balances £000	Total £000
	AAA £000	AA £000	A £000	Unrated £000		
Debt securities, deposits and cash balances with credit institutions						
Linked	41,284	51	410	–	41,630	83,375
Non-linked	25,959	4,748	4,026	–	98,835	133,568
Government or pseudo Government deposits						
Linked	63,475	–	–	–	–	63,475
Non-linked	105,975	–	–	–	–	105,975
Total debt, deposits and cash balances	**236,693**	**4,799**	**4,436**	**–**	**140,465**	**386,393**

As at 31 December 2008	Credit rating-debt securities				Cash balances £000	Total £000
	AAA £000	AA £000	A £000	Unrated £000		
Debt securities, deposits and cash balances with credit institutions						
Linked	40,507	137	–	–	45,046	85,690
Non-linked	44,937	15,385	3,520	–	147,335	211,177
Government or pseudo Government deposits						
Linked	72,999	–	–	–	–	72,999
Non-linked	101,619	–	–	–	–	101,619
Total debt, deposits and cash balances	**260,062**	**15,522**	**3,520**	**–**	**192,381**	**471,485**

Reinsurance credit risk

Reinsurance is used to manage insurance risk in the UK Business. This does not however discharge the business's liability as primary insurer. If a reinsurer fails to pay a claim for any reason, the business 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 UK Business has a significant exposure of £232.9m as at 31 December 2009 (31 December 2008: £200.6m) to Guardian, which does not have a published credit rating. Of this amount £204.1m (31 December 2008: £182.5m) 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 floating charge over related investment assets, which ranks that company equally with Guardian policyholders. In order to monitor the ongoing creditworthiness of Guardian, the UK Business reviews the financial statements and regulatory returns submitted by Guardian to the FSA on an annual basis.

In addition the business 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.

Financial assets that are past due or impaired

In 2008, a cash deposit with Kaupthing Singer and Friedlander ('KSF') was written down by its full amount of £1,091,000 as a result of KSF entering administration.

During 2009, interim distributions totalling £326,000 were made from the administrators in respect of the deposit.

There are no other Group financial assets that are impaired, would otherwise be past due, or impaired, whose terms have been negotiated, or past due but not impaired.

Swedish Business

Terms and conditions of unit-linked investment contracts

The insurance and investment elements of unit-linked contracts provided by the Swedish Business have been unbundled. The principal risks associated with the insurance contracts are disclosed in Note 5. The terms and conditions of investment contracts that could 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 Swedish Business provides two types of investment contract:

(i) Unit-linked savings

These are single premium or regular premium contracts, with the premiums invested in unit-linked funds or trust accounts where the policyholder decides where to invest. On certain contracts there is a small additional benefit payable on death which is deemed not to transfer significant insurance risk to the business for these contracts. The benefits payable at maturity or surrender of the contracts are the underlying value of the investment in the unit-linked funds or trust accounts.

(ii) Unit-linked pensions

The contractual features are similar to unit-linked savings. The savings can be transferred to another pension provider or can be cashed on retirement over a period of least five years. There is no annuity linked to the unit-linked pensions.

As the business matches all the financial liabilities with assets on which the unit liabilities are based, this approach results in the business having no significant market risk (being interest rate, equity price and currency risks) or credit risk on these contracts.

Contractual maturity analysis

The liquidity risk within the Swedish Business is limited, since the premiums are collected in advance and any large claims payments are usually known within a short period of their occurrence. To reduce the remaining liquidity risk, the business's cash flow is analysed continuously. The main part of the business's assets is placed in securities which can be sold with short notice, without the price being greatly affected. Investments are also made into listed securities where the liquidity risk is deemed to be limited.

The following table sets out the contractual maturity analysis of the financial assets and financial liabilities of the Swedish Business: the information as at 31 December 2008 is in respect of the pre-acquisition period and is provided for illustrative purposes.

6 Management of financial risk (continued)

31 December 2009

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 years £000	Unit linked* £000
Assets							
Equity securities at fair value through income	–	–	–	–	–	–	–
Collective investment schemes	915,602	5,963	–	–	–	–	909,639
Policyholders' funds held by the group	41,107	–	–	–	–	–	41,107
Debt securities at fair value through income	1,908	1,908	–	–	–	–	–
Reinsurers' share of insurance contract provisions	27,262	15,359	3,733	2,328	922	4,920	–
Insurance and other receivables	10,208	9,548	660	–	–	–	–
Accrued income and prepayments	2,093	2,093	–	–	–	–	–
Derivative financial instruments	3,544	1,051	1,437	863	183	10	–
Cash and cash equivalents	14,776	14,776	–	–	–	–	–
Total	**1,016,500**	**50,698**	**5,830**	**3,191**	**1,105**	**4,930**	**950,746**
Liabilities							
Insurance contract provisions	32,353	17,893	4,397	2,774	1,151	6,138	–
Investment contracts	918,291	–	–	–	–	–	918,291
Liabilities relating to policyholders' funds held by the group	41,107	–	–	–	–	–	41,107
Other liabilities	46,705	23,876	7,205	6,223	3,436	5,965	–
Total	**1,038,456**	**41,769**	**11,602**	**8,997**	**4,587**	**12,103**	**959,398**
Difference in expected cash flows	**(21,956)**	**8,929**	**(5,772)**	**(5,806)**	**(3,462)**	**(7,173)**	**(8,652)**

** Amounts included under unit linked funds are deemed to have a maturity up to one year as they are repayable or transferable on demand.*

31 December 2008

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 years £000	Unit linked* £000
Assets							
Equity securities at fair value through income	–	–	–	–	–	–	–
Collective investment schemes	588,744	5,482	–	–	–	–	583,262
Debt securities at fair value through income	613	613	–	–	–	–	–
Reinsurers' share of insurance contract provisions	24,678	7,070	3,944	1,489	609	11,566	–
Insurance and other receivables	8,876	8,876	–	–	–	–	–
Accrued income and prepayments	1,119	1,119	–	–	–	–	–
Cash and cash equivalents	21,769	8,557	–	–	–	–	13,212
Total	**645,799**	**31,717**	**3,944**	**1,489**	**609**	**11,566**	**596,474**
Liabilities							
Insurance contract provisions	27,938	7,131	4,730	1,777	715	13,585	–
Investment contracts	596,474	–	–	–	–	–	596,474
Other liabilities	49,082	27,704	6,880	6,184	3,649	4,665	–
Total	**673,494**	**34,835**	**11,610**	**7,961**	**4,364**	**18,250**	**596,474**
Difference in expected cash flows	**(27,695)**	**(3,118)**	**(7,666)**	**(6,472)**	**(3,755)**	**(6,684)**	**–**

** Amounts included under unit linked funds are deemed to have a maturity up to one year as they are repayable or transferable on demand.*

Foreign exchange exposure

The Swedish Business underwrites insurance contracts in Norway and its exposures to foreign exchange risk arises primarily with respect to the Norwegian Krone. The business reinsures 90 per cent of the risk and has some assets denominated in the same currencies as the foreign insurance liabilities, which should eliminate most of the foreign currency exchange rate risk on these operations.

The following table sets out the foreign exchange exposure of the financial assets and financial liabilities of the Swedish Business: the information as at 31 December 2008 relates to the pre-acquisition period and is provided for illustrative purposes.

	31 December		31 December	
	2009 NOK 000	2008 NOK 000	2009 EUR 000	2008 EUR 000
Foreign assets and liabilities				
Assets:				
Reinsurers' share of insurance contract provisions	85,543	76,952	–	–
Deferred acquisition costs	327	209	–	–
Equity securities at fair value through income	–	–	–	–
Debt securities at fair value through income	–	–	–	–
Insurance and other receivables	(402)	2,030	–	–
Loans and other receivables	–	–	7,609	–
Cash and cash equivalents	12,135	12,263	16	119
Total	**97,603**	**91,454**	**7,625**	**119**
Liabilities				
Insurance contract provisions	(102,262)	(90,997)	–	–
Other liabilities	(762)	(4,740)	–	–
Total	**(103,024)**	**(95,737)**	**–**	**–**
Foreign exchange mismatch	**(5,421)**	**(4,283)**	**7,625**	**119**

Credit risk exposure

The Swedish Business 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 business is exposed to credit risk are:

- Reinsurers' share of insurance liabilities;
- Amounts due from reinsurers in respect of claims already paid;
- Counterparty risk with respect to corporate bond, deposits and debt securities; and
- Amounts paid to independent financial advisers representing advances of commission not yet earned by them.

Amounts due from policyholders are insignificant and claims against policyholders carry a limited credit risk as non-payment leads to cancellation of the insurance policy. Unit-linked assets are only acquired upon receipt of the premium from the policyholder.

The business 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 business is in relation to its reinsurance assets.

The business retains some residual risks on assets which support shareholders' equity. The business'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 monthly.

The exposure to credit risk of the Swedish Business in relation to its debt securities, receivables and cash balances is summarised below: the information as at 31 December 2008 relates to the pre-acquisition period and is provided for illustrative purposes.

	Credit rating – debt securities				
As at 31 December 2009	AAA £000	AA £000	A £000	Unrated £000	Total £000
Debt securities at fair value through income	1,908	–	–	–	1,908
Insurance and other receivables	–	–	–	10,108	10,108
Cash balances	–	–	–	14,776	14,776
Total debt, receivables and cash balances	**1,908**	**–**	**–**	**24,884**	**26,792**

6 Management of financial risk (continued)

As at 31 December 2008	Credit rating – debt securities				
	AAA £000	AA £000	A £000	Unrated £000	Total £000
Debt securities at fair value through income	613	–	–	–	613
Insurance and other receivables	–	3,155	–	5,721	8,876
Cash balances	–	20,607	1,076	86	21,769
Total debt, receivables and cash balances	**613**	**23,762**	**1,076**	**5,807**	**31,258**

Reinsurance credit risk

Reinsurance is used to manage insurance risk in the Swedish Business. This does not however discharge the business's liability as primary insurer. If a reinsurer fails to pay a claim for any reason, the business remains liable for the payment to the policyholder. The creditworthiness of major reinsurers is considered on an annual basis by reviewing their financial strength. The current rules state that re-insurance should only be made using reinsurance companies with a credit rating from Standard & Poor's of A or higher (except for the reinsurer which is an associate of the Group).

The business has entered into reinsurance arrangements with four reinsurers. With the main reinsurer, there is an associated financial reinsurance agreement in place whereby the amount due to the reinsurer is more than the reinsurer's share of the claims.

In relation to the other significant reinsurer (which is an associate of the Group), there is a credit risk exposure which is managed by the Group being represented on the Board of the reinsurer. The Group is therefore closely involved and can influence its strategy.

Reinsurance Credit Risk Exposure

	Credit rating – reinsurers				
	AAA £000	AA £000	A £000	Unrated £000	Total £000
As at 31 December 2009	–	16,483	38	10,741	27,262
As at 31 December 2008*	–	9,917	3	17,913	27,833

* This information relates to the pre-acquisition period and is provided for illustrative purposes.

Financial assets that are past due or impaired

There are no financial assets that are impaired, would otherwise be past due or impaired whose terms have been renegotiated or past due but not impaired.

Sensitivity analysis

Certain of the information below relates to the pre acquisition period and is provided for illustrative purposes.

Sensitivity analysis – interest rate risk

The sensitivity analysis for interest rate risk within the Swedish Business 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 minimise the impact of a change in values due to a parallel movement in all yield curves.

The interest rate risk for the fixed interest debt securities of the Swedish Business is deemed to be low as these assets are mainly short term (less than a year). 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 2009 or shareholder equity as at that date.

Sensitivity analysis – equity risk

The direct and indirect investment in equities of the Swedish Business and the management fees on the unit linked assets (which are based on the asset value of the unit-linked assets) are impacted by movement in the equities market.

A decrease of 10 per cent in equities markets would result in a £0.1m decrease in profit for the year ended 31 December 2009 and to shareholder equity as at 31 December 2009, (year ended 31 December 2008 and as at 31 December 2008 £0.1m).

An increase of 10 per cent in equities markets would result in a £0.1m increase in profit for the year ended 31 December 2009 and to shareholder equity as at 31 December 2009 (year ended 31 December 2008 and as at 31 December 2008: £0.1m).

Sensitivity analysis – foreign exchange risks

An increase or decrease of 10% in exchange rates in relation to the Swedish Business has no material effect on profit and shareholder equity either for the year ended 31 December 2009 or for the year ended 31 December 2008 or as at those dates.

Corporate

The financial risks in relation to Other Group Activities relate to the risks associated with Chesnara plc company assets and liabilities. These comprise:

(i) Cash and cash equivalents

The related risks are included in the analysis of credit risk management set out above.

(ii) Borrowings

Borrowings issued at variable rates of interest expose the Group to cash flow interest risk. Information on borrowings is set out in Note 36. A 1% increase in interest rates would result in a decrease of less than £0.1m in profit after tax attributable to shareholders for the year ended 31 December 2009 (year ended 31 December 2008: £0.1m decrease) and in shareholder equity as at 31 December 2009 (31 December 2008: £0.1m decrease)

(iii) Foreign exchange rate risk

The Group has exposure to foreign exchange risk in relation to movements between the Swedish Krona and Sterling as a result of its ownership of the Swedish Business.

An increase of 10% in the 31 December 2009 SEK to £ rate from SEK 11.5305 to £1 to SEK 12.6836 to £1 would result in a reduction in shareholder equity of £4.3m as at 31 December 2009.

An increase of 10% in the average SEK to £ rate from SEK 11.5594 to £1 to SEK 12.7153 to £1 for the year ended 31 December 2009 would result in an increase in the profit after tax attributable to shareholders of £0.2m for the year ended 31 December 2009.

7 Acquisition of subsidiaries

Acquisition of Moderna Försäkringar Liv AB

On 23 July 2009, Chesnara plc acquired the entire issued share capital (100%) of Moderna Försäkringar Liv AB (‘Moderna’) from Moderna Finance AB for a total consideration of SEK 250m (£19,956,000), paid in cash.

Moderna is a Stockholm-based insurance and investment company which specialises in corporate and personal pension arrangements and life assurance policies. Primarily it aggregates client funds into a range of investment providers and provides policy wrappers. It sells principally through the independent financial adviser channel and has, approximately, a 5.7% per cent market share of the Swedish unit-linked pension market. It was established in 2000, with its unit-linked business being launched in 2002. The business was acquired from Moderna Finance AB which is owned by Glitnir Bank in Iceland.

7 Acquisition of subsidiaries (continued)

The acquisition of this shareholding has given rise to a profit on acquisition of £25,056,000 calculated as follows:

The estimated book and fair values of the assets and liabilities at the date of acquisition were:	**Book value £000**	**Fair value and accounting policy adjustments £000**	**Fair value £000**
Assets			
Intangible assets			
Value of in-force insurance contracts	–	779	779
Value of in-force investment contracts	–	59,746	59,746
Value of customer relationships	–	2,352	2,352
Deferred acquisition costs	41,831	(41,831)	–
Internally-developed software	3,313	–	3,313
Property and equipment	369	–	369
Investment in associates	781	–	781
Reinsurers' share of insurance contract provisions	25,713	–	25,713
Financial assets	749,279	–	749,279
Cash and cash equivalents	14,012	–	14,012
Total assets	**835,298**	**21,046**	**856,344**
Liabilities			
Insurance contract provisions	30,642	–	30,642
Investment contracts	737,858	–	737,858
Borrowings	23,451	1,279	24,730
Provisions	265	–	265
Deferred tax liabilities	172	826	998
Reinsurance payables	9,324	–	9,324
Payables related to direct insurance and investment contracts	2,732	–	2,732
Income taxes	2,193	–	2,193
Other payables	2,590	–	2,590
Total liabilities	**809,227**	**2,105**	**811,332**
Net assets	**26,071**	**18,941**	**45,012**
Net assets acquired (100%)			**45,012**
Total consideration			**(19,956)**
Profit arising on acquisition of subsidiary			**25,056**

The assets and liabilities as at the acquisition date in the table above are stated at their provisional fair values and may be amended for 12 months after the date of acquisition in accordance with paragraph 62 of IFRS 3 Business Combinations.

The results of Moderna have been included in the consolidated financial statements of the Group with effect from 23 July 2009, and have contributed revenue of £103.3 million over this period, whilst contributing £2.8 million loss to the overall consolidated profit before tax.

Had Moderna been consolidated from 1 January 2009 the consolidated statement of comprehensive income would have included revenue of £209.7 million, and have contributed £0.3 million loss to the overall consolidated profit before tax.

Acquisition of AkademikerRådgivning i Sverige AB

On 23 November 2009, Moderna acquired 41% of the share capital in the associated company AkademikerRådgivning i Sverige AB ('AkademikerRådgivning') from Akademikertjänst I.A.S for a total consideration of SEK 3,550,000 (£311,321), payable in cash, resulting in 90% total ownership.

AkademikerRådgivning is an independent financial adviser of insurance and savings products. The target customers are the members of one of the six Unions of Academics that are also shareholders in the company. AkademikerRådgivning was established in 2006, but started its operations in 2007 and is based in Stockholm.

The estimated book and fair values of the assets and liabilities at the date of acquisition were:	Book value 100% £000	Book value 41% £000	Fair value and accounting policy adjustments £000	Fair value £000
Assets				
Intangible assets				
Other intangibles	–	–	348	348
Internally-developed software	82	33	–	33
Property and equipment	55	23	–	23
Financial assets	21	9	–	9
Deferred tax asset	190	78	–	78
Cash and cash equivalents	42	17	–	17
Total assets	**390**	**160**	**348**	**508**
Liabilities				
Borrowings	228	93	–	93
Deferred tax liabilities	–	–	92	92
Other payables	30	12	–	12
Total liabilities	**258**	**105**	**92**	**197**
Net assets	**132**	**55**	**256**	**311**
Net assets acquired (41%)				**311**
Total consideration				**(311)**
Profit arising on acquisition of this holding				–

The assets and liabilities as at the acquisition date in the table above are stated at their provisional fair values and may be amended for 12 months after the date of acquisition in accordance with paragraph 62 of IFRS 3 Business Combinations.

The results of AkadermikerRådgivning have been included in the consolidated financial statements of the Group with effect from 23 November 2009, and have contributed a £66,031 loss to the overall consolidated profit before tax. Had AkadermikerRådgivning been consolidated from 1 January 2009, the consolidated statement of comprehensive income would have included revenue of £217,127 and a loss of £585,597

On 31 December 2009 Moderna acquired an additional 1% of the share capital of AkademikerRådgivning for a consideration of SEK 87,000 (£7,545), resulting in a total ownership of 91%. The consideration paid represents the additional net assets acquired and no goodwill was recognized.

8 Operating segments

The Group considers that it has no product or distribution-based business segments. It reports segmental information on the same basis as reported internally to the Chief Operating Decision Maker, which is the Board of Directors of Chesnara plc.

There were no changes to the basis of segmentation or the measurement basis for segment profit during the year ended 31 December 2009.

UK Business

This segment comprises the UK insurance and investment operation, Countrywide Assured Life Holdings Limited ('CAHL'), which holds the Group's UK insurance and investment assets and liabilities, and is responsible for managing both unit-linked and non-linked business.

8 Operating segments (continued)

Swedish Business

This segment comprises the Swedish insurance and investment operation, Moderna Försäkringar Liv AB ('Moderna'), which holds the Group's Swedish insurance and investment assets and liabilities, and is responsible for managing both unit-linked and non-linked business.

Other Group Activities

The functions performed by the holding company, Chesnara plc, are defined under the operating segment analysis as Other Group Activities. Also included therein are consolidation and elimination adjustments.

Measurement basis

The accounting policies of the segments are the same as those for the Group as a whole. Any transactions between the business segments are on normal commercial terms and market conditions. The Group evaluates performance of operating segments on the basis of the profit before tax attributable to shareholders and the total assets and liabilities of the reporting segments and the Group.

(i) Segmental income statement for the year ended 31 December 2009

	UK Business £000	Swedish Business £000	Other Group Activities £000	Total £000
Insurance premium revenue	88,469	11,636	–	100,105
Insurance premium ceded to reinsurers	(15,831)	(9,166)	–	(24,997)
Net insurance premium revenue	**72,638**	**2,470**	**–**	**75,108**
Fee and commission income				
Insurance contracts	34,285	1,579	–	35,864
Investment contracts	8,258	6,998	–	15,256
Net investment return	233,926	92,239	515	326,680
Total revenue (net of reinsurance payable)	**349,107**	**103,286**	**515**	**452,908**
Other operating income	4,689	–	–	4,689
Segmental income	**353,796**	**103,286**	**515**	**457,597**
Insurance contract claims and benefits incurred				
Claims and benefits paid to insurance contract holders	(126,737)	(2,820)	–	(129,557)
Net (increase)/decrease in insurance contract provisions	(128,064)	224	–	(127,840)
Reinsurers' share of claims and benefits	45,630	2,267	–	47,897
Net insurance contract claims and benefits incurred	(209,171)	(329)	–	(209,500)
Change in investment contract liabilities	(107,524)	(92,224)	–	(199,748)
Reinsurers' share of investment contract liabilities	4,710	–	–	4,710
Net change in investment contract liabilities	(102,814)	(92,224)	–	(195,038)
Fees, commission and other acquisition costs	(1,116)	(4,051)	–	(5,167)
Administrative expenses	(9,806)	(5,276)	(3,163)	(18,245)
Other operating expenses				
Charge for amortisation of acquired value of in-force business	(3,688)	(3,265)	–	(6,953)
Charge for amortisation of customer relationships	–	(188)	–	(188)
Other	(2,417)	(110)	332	(2,195)
Segmental expenses	**(329,012)**	**(105,443)**	**(2,831)**	**(437,286)**
Segmental income less expenses	**24,784**	**(2,157)**	**(2,316)**	**20,311**
Share of profit from associates	–	39	–	39
Profit recognised on acquisition of subsidiary	–	–	25,056	25,056
Segmental operating profit/(loss)	**24,784**	**(2,118)**	**22,740**	**45,406**
Financing costs	–	(508)	(157)	(665)
Profit/(loss) before tax	**24,784**	**(2,626)**	**22,583**	**44,741**
Income tax credit/(expense)	948	(148)	392	1,192
Non-controlling interest	–	7	–	7
Profit/(loss) after tax attributable to shareholders	**25,732**	**(2,767)**	**22,975**	**45,940**

(ii) Segmental income statement for the year ended 31 December 2008

	UK Business £000	Swedish Business £000	Other Group Activities £000	Total £000
Insurance premium revenue	94,274	–	–	94,274
Insurance premium ceded to reinsurers	(17,193)	–	–	(17,193)
Net insurance premium revenue	**77,081**	**–**	**–**	**77,081**
Fee and commission income				
Insurance contracts	35,289	–	–	35,289
Investment contracts	9,305	–	–	9,305
Net investment return	(225,080)	–	2,338	(222,742)
Total revenue (net of reinsurance payable)	**(103,405)**	**–**	2,338	**(101,067)**
Other operating income	1,224	–	90	1,314
Segmental income	**(102,181)**	**–**	**2,428**	**(99,753)**
Insurance contract claims and benefits incurred				
Claims and benefits paid to insurance contract holders	(131,829)	–	–	(131,829)
Net decrease in insurance contract provisions	180,265	–	–	180,265
Reinsurers' share of claims and benefits	(8,736)	–	–	(8,736)
Net insurance contract claims and benefits incurred	39,700	–	–	39,700
Change in investment contract liabilities	108,516	–	–	108,516
Reinsurers' share of investment contract liabilities	(4,743)	–	–	(4,743)
Net change in investment contract liabilities	103,773	–	–	103,773
Fees, commission and other acquisition costs	(1,377)	–	–	(1,377)
Administrative expenses	(12,161)	–	(1,472)	(13,633)
Other operating expenses				
Charge for amortisation of acquired value of in-force business	(3,578)	–	–	(3,578)
Other	(562)	–	(1,091)	(1,653)
Segmental expenses	**125,795**	**–**	**(2,563)**	**123,232**
Segmental operating profit/(loss)	**23,614**	**–**	**(135)**	**23,479**
Financing costs	–	–	(752)	(752)
Profit/(loss) before tax	**23,614**	**–**	**(887)**	**22,727**
Income tax (expense)/credit	(2,856)	–	146	(2,710)
Profit/(loss) after tax attributable to shareholders	**20,758**	**–**	**(741)**	**20,017**

8 Operating segments (continued)

(iii) Segmental balance sheet as at 31 December 2009

	UK Business £000	Swedish Business £000	Other Group Activities £000	Total £000
Intangible assets	32,471	70,061	–	102,532
Property and equipment	–	491	–	491
Investment in associates	–	1,051	–	1,051
Reinsurers' share of insurance contract provisions	209,604	27,262	–	236,866
Amounts deposited with reinsurers	27,056	–	–	27,056
Investment properties	3,355	–	–	3,355
Financial assets	1,413,798	974,475	71	2,388,344
Reinsurers' share of accrued policyholder claims	4,728	–	–	4,728
Income tax	–	–	395	395
Cash and cash equivalents	120,830	14,776	19,635	155,241
Total assets	**1,811,842**	**1,088,116**	**20,101**	**2,920,059**
Bank overdrafts	2,312	–	–	2,312
Insurance contract provisions	1,044,680	32,353	–	1,077,033
Investment contracts at fair value through income	610,930	918,291	–	1,529,221
Liabilities relating to policyholders' funds held by the Group	–	41,107	–	41,107
Borrowings	–	24,799	4,197	28,996
Derivative financial instruments	54	–	–	54
Provisions	1,452	–	–	1,452
Deferred tax liabilities	9,613	751	2	10,366
Reinsurance payables	2,064	12,975	–	15,039
Payables related to direct insurance and investment contracts	24,751	5,682	–	30,433
Deferred income	13,132	–	–	13,132
Income taxes	854	459	–	1,313
Other payables	3,825	3,990	2,018	9,833
Total liabilities	**1,713,667**	**1,040,407**	**6,217**	**2,760,291**
Net assets	**98,175**	**47,709**	**13,884**	**159,768**
Non-controlling interest	–	(13)	–	(13)
Net assets attributable to shareholders	**98,175**	**47,696**	**13,884**	**159,755**

(iv) Segmental balance sheet as at 31 December 2008

	UK Business £000	Swedish Business £000	Other Group Activities £000	Total £000
Intangible assets	37,066	–	–	37,066
Reinsurers' share of insurance contract provisions	182,693	–	–	182,693
Amounts deposited with reinsurers	22,181	–	–	22,181
Investment properties	3,432	–	–	3,432
Financial assets	1,236,534	–	1,177	1,237,711
Reinsurers' share of accrued policyholder claims	4,100	–	–	4,100
Cash and cash equivalents	155,009	–	37,372	192,381
Total assets	**1,641,015**	**–**	**38,549**	**1,679,564**
Bank overdrafts	1,086	–	8	1,094
Insurance contract provisions	923,506	–	–	923,506
Investment contracts at fair value through income	558,542	–	–	558,542
Borrowings	–	–	8,358	8,358
Derivative financial instruments	70	–	–	70
Provisions	3,397	–	–	3,397
Deferred tax liabilities	10,798	–	–	10,798
Reinsurance payables	1,397	–	–	1,397
Payables related to direct insurance and investment contracts	23,891	–	–	23,891
Deferred income	14,575	–	–	14,575
Income taxes	1,213	–	(139)	1,074
Other payables	4,207	–	2,287	6,494
Total liabilities	**1,542,682**	**–**	**10,514**	**1,553,196**
Net assets	**98,333**	**–**	**28,035**	**126,368**

9 Net insurance premium revenue

	Year ended 31 December 2009				Year ended 31 December 2008			
	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
UK business								
Insurance premium revenue	66,740	18,936	2,793	88,469	71,636	19,705	2,933	94,274
Insurance premium ceded to reinsurers	(9,821)	(3,448)	(2,562)	(15,831)	(10,366)	(4,114)	(2,713)	(17,193)
	56,919	15,488	231	72,638	61,270	15,591	220	77,081
Swedish business								
Insurance premium revenue	–	11,636	–	11,636	–	–	–	–
Insurance premium ceded to reinsurers	–	(9,166)	–	(9,166)	–	–	–	–
	–	2,470	–	2,470	–	–	–	–
Net insurance premium revenue	**56,919**	**17,958**	**231**	**75,108**	**61,270**	**15,591**	**220**	**77,081**

10 Fees and commission income

	Year ended 31 December 2009		Year ended 31 December 2008	
Fee income	Insurance contracts £000	Investment contracts £000	Insurance contracts £000	Investment contracts £000
Policy-based fees	5,405	5,805	6,350	4,427
Fund management-based fees	2,619	7,720	2,572	2,839
Benefit-based fees	25,838	315	25,916	310
Change in deferred income – gross	–	1,443	–	1,787
Change in deferred income – reinsurer's share	–	(57)	–	(66)
Total fee income	33,862	15,226	34,838	9,297
Commission income	2,002	9	451	8
Other income	–	21	–	–
Total fee and commission income	**35,864**	**15,256**	**35,289**	**9,305**

11 Net investment return

	Year ended 31 December	
	2009 £000	2008 £000
Dividend income	23,914	35,781
Interest income	17,969	24,398
Rental income from investment properties	135	400
Net fair value gains and losses		
Equity securities designated as at fair value through income on initial recognition	277,843	(251,174)
Debt securities designated as at fair value through income on initial recognition	3,281	(6,669)
Derivative financial instruments	3,615	(25,154)
Investment properties	(77)	(324)
Net investment return	**326,680**	**(222,742)**

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 (2008: £nil).

12 Other operating income

	Year ended 31 December	
	2009 £000	2008 £000
Release of unused provisions	1,331	271
Recharge of shared property services to tenants	499	500
Administration fees charged to reinsurers	133	153
Professional indemnity insurance recoveries	135	209
Investment management fee rebate	2,181	–
HMRC interest on tax refund	235	–
Other	175	181
Total other operating income	**4,689**	**1,314**

13 Insurance contract claims and benefits

	Year ended 31 December 2009				Year ended 31 December 2008			
	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 insurance contract holders	103,578	19,957	6,022	129,557	106,779	19,795	5,255	131,829
Net increase/(decrease) in insurance contract provisions	114,360	3,519	9,961	127,840	(184,991)	13,085	(8,359)	(180,265)
Total insurance contract claims and benefits	217,938	23,476	15,983	257,397	(78,212)	32,880	(3,104)	(48,436)
Recoveries from reinsurers	(29,036)	(3,766)	(15,095)	(47,897)	9,986	(3,990)	2,740	8,736
Net insurance contract claims and benefits incurred	**188,902**	**19,710**	**888**	**209,500**	**(68,226)**	**28,890**	**(364)**	**(39,700)**

14 Change in investment contract liabilities

	Year ended 31 December	
	2009 £000	2008 £000
Net changes in the fair value of investment contracts designated on initial recognition as fair value through income	199,748	(108,516)
Reinsurer's share	(4,710)	4,743
Net change in investment contract liabilities	**195,038**	**(103,773)**

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

15 Fees, commission and other acquisition costs

	Year ended 31 December	
	2009 £000	**2008 £000**
Directly expensed costs		
Insurance contracts		
Commission	1,201	171
New business and renewal costs	485	144
Investment contracts		
Commission	3,240	87
New business and renewal costs	996	61
Additions to deferred acquisition costs		
Insurance contracts	(1,202)	–
Investment contracts	(1,600)	–
Amortisation of deferred acquisition costs		
Insurance contracts	1,239	–
Investment contracts-gross	841	952
Investment contracts-reinsurance	(33)	(38)
Total	**5,167**	**1,377**

16 Administrative expenses

	Year ended 31 December	
	2009 £000	**2008 £000**
Personnel-related costs	5,443	2,298
Investment management fees	3,128	2,546
Amortisation charge on internally developed software	414	–
Depreciation charge on property and equipment	73	–
Costs paid to third-party administrators	4,120	3,430
Other goods and services	5,067	5,359
Total	**18,245**	**13,633**

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	
	2009 £000	**2008 £000**
Fees payable to the Company's Auditor for the audit of the company's annual accounts	62	55
Fees payable to the Company's Auditor and its associates for other services:		
The audit of the Company's subsidiaries pursuant to legislation	189	195
Other services pursuant to legislation	70	102
Tax services	53	58
Services related to corporate finance transactions	20	95
All other services	3	1
	397	506

17 Other operating expenses

Charge for amortisation of acquired value of in-force business	Year ended 31 December	
	2009 £000	2008 £000
Insurance contracts	2,765	2,561
Investment contracts	4,188	1,017
Total	**6,953**	**3,578**

Charge for amortisation of acquired value of customer relationships	2009 £000	2008 £000
Insurance contracts	100	–
Investment contracts	88	–
Total	**188**	**–**
Other		
Increase in provisions	1,509	185
Direct operating expenses of investment properties		
Revenue-generating properties	68	141
Non revenue-generating properties	–	–
Contributions to associate companies immediately expensed	97	–
(Recovery)/writedown of cash deposit	(326)	1,091
Other	847	236
Total	**2,195**	**1,653**

The writedown of cash deposit represents the writedown of the full amount of a cash deposit with Kaupthing Singer and Friedlander who entered administration in 2008 and the recovery of cash deposit represents an interim distribution received from the administrators during 2009.

18 Financing costs

	Year ended 31 December	
	2009 £000	2008 £000
Interest expense on bank borrowings	157	752
Interest expense on financial reinsurance	453	–
Interest expense on reinsurance deposit	51	–
Other interest	4	–
Total financing costs	**665**	**752**

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.

19 Income tax expense

Total income tax (credit)/expenses comprises:	Year ended 31 December	
	2009 £000	2008 £000
UK Business and Other Group Activities	(1,340)	2,710
Swedish Business	148	–
Total	**(1,192)**	**2,710**

UK Business and Other Group Activities	Year ended 31 December	
	2009 £000	2008 £000
Current tax expense		
Current year	3,548	3,037
Overseas tax	976	730
Adjustment to prior years	(4,681)	(8)
Net (credit)/expense	(157)	3,759
Deferred tax credit		
Origination and reversal of temporary differences	(1,183)	(1,049)
Total income tax (credit)/expense	**(1,340)**	**2,710**

Reconciliation of effective tax rate on profit before tax	Year ended 31 December	
	2009 £000	2008 £000
Profit before tax	**47,367**	**22,727**
Income tax using the domestic corporation tax rate of 28% (2008: 28.5%)	13,263	6,477
Non-taxable profit on acquisition of subsidiary	(7,016)	–
Impact of small companies rate for subsidiaries		–
Permanent differences	304	116
Effect of UK taxing bases on insurance profits		
Offset of franked investment income	(3,859)	(3,885)
Variation in rate of tax on amortisation of acquired in-force value	73	90
Other	576	(80)
Overprovided in prior years	(4,681)	(8)
Total income tax (credit)/expense	**(1,340)**	**2,710**

The amount overprovided in prior years relates principally to the writeback of a provision for current tax in Countrywide Assured plc in respect of 2007. This provision had been established because of uncertainty surrounding the interpretation of UK tax legislation relating to that year. In the event, the submission to HMRC of the tax computation for that year has resolved the uncertainty and the provision has, accordingly, been released.

The Income tax credit relates to the UK Business and Other Group Activities operating segments together.

19 Income tax expense (continued)

Swedish Business	Year ended 31 December	
	2009 £000	2008 £000
Current tax expense		
Current year	12	–
Overseas tax	–	–
Adjustment to prior years	–	–
	12	
Deferred tax expense		
Origination and reversal of temporary differences	136	–
Total income tax expense	**148**	**–**

Reconciliation of effective tax rate on profit before tax	Year ended 31 December	
	2009 £000	2008 £000
Loss before tax	**(2,626)**	**–**
Income tax using the domestic corporation tax rate of 26.3%	(691)	–
Non-taxable income in relation to unit-linked business	349	
Policyholder tax	13	–
Non-taxable fair value adjustment on acquisition	440	–
Impact of different rate for subsidiaries	5	–
Permanent differences	(13)	–
Unrecognised tax recoverable	47	
Non-deductible expenses	8	–
Overprovided in prior years	(10)	–
Total income tax expense	**148**	**–**

20 Deferred acquisition costs

UK Business	Investment contracts	
	2009 £000	2008 £000
Balance at 1 January	**8,590**	**9,542**
Amortisation charged to income	(908)	(952)
Impairment losses	–	–
Balance at 31 December	**7,682**	**8,590**
Current	805	1,423
Non-current	6,877	7,167
Total	**7,682**	**8,590**

Swedish Business	Insurance and Investment contracts	
	2009 £000	2008 £000
Balance at 1 January	**–**	**–**
Additions – new business	2,802	–
Amortisation charged to income	(1,172)	–
Impairment losses	–	–
Foreign exchange translation difference	15	–
Balance at 31 December	**1,645**	**–**
Current	91	–
Non-current	1,554	–
Total	**1,645**	**–**
Total at 1 January	**8,590**	**9,542**
Total at 31 December	**9,327**	**8,590**

The amortisation charged to income is recognised in Fees, Commission and Other Acquisition Costs (see Note 15).

21 Acquired value of in-force business (AVIF)

	AVIF on insurance contracts £000	AVIF on investment contracts £000	Total £000
Cost			
Balance at 1 January 2008	**33,278**	**15,254**	**48,532**
Additions	–	–	–
Balance at 31 December 2008	**33,278**	**15,254**	**48,532**
Additions – acquisition of subsidiary	779	59,747	60,526
Foreign exchange translation difference	57	4,365	4,422
Balance at 31 December 2009	**34,114**	**79,366**	**113,480**
Amortisation and impairment losses			
Balance at 1 January 2008	**13,851**	**2,627**	**16,478**
Amortisation for the year	2,561	1,017	3,578
Impairment charge	–	–	–
Balance at 31 December 2008	**16,412**	**3,644**	**20,056**
Amortisation for the year	2,765	4,188	6,953
Impairment charge	–	–	–
Foreign exchange translation difference	–	8	8
Balance at 31 December 2009	**19,177**	**7,840**	**27,017**
Carrying amounts			
At 1 January 2008	**19,427**	**12,627**	**32,054**
At 31 December 2008	**16,866**	**11,610**	**28,476**
At 31 December 2009	**14,937**	**71,526**	**86,463**
31 December 2008			
Current	2,671	1,017	3,688
Non-current	14,195	10,593	24,788
Total	**16,866**	**11,610**	**28,476**
31 December 2009			
Current	2,859	7,722	10,581
Non-current	12,078	63,804	75,882
Total	**14,937**	**71,526**	**86,463**

The amortisation is charged to income and is recognised in Other Operating Expenses (see Note 17).

22 Acquired value of customer relationships (AVCR)

	AVCR on insurance contracts £000	AVCR on investment contracts £000	Total £000
Cost			
Balance at 1 January 2008	**–**	**–**	**–**
Additions	–	–	–
Balance at 31 December 2008	**–**	**–**	**–**
Additions arising on acquisition of subsidiary	784	1,565	2,349
Additions	–	350	350
Foreign exchange translation difference	57	115	172
Balance at 31 December 2009	**841**	**2,030**	**2,871**
Amortisation and impairment losses			
Balance at 1 January 2008	**–**	**–**	**–**
Amortisation for the year	–	–	–
Impairment charge	–	–	–
Balance at 31 December 2008	**–**	**–**	**–**
Amortisation for the year	100	88	188
Impairment charge	–	–	–
Foreign exchange translation difference	–	1	1
Balance at 31 December 2009	**100**	**89**	**189**
Carrying amounts			
At 1 January 2008	**–**	**–**	**–**
At 31 December 2008	**–**	**–**	**–**
At 31 December 2009	**741**	**1,941**	**2,682**
31 December 2008			
Current	–	–	–
Non-current	–	–	–
Total	**–**	**–**	**–**
31 December 2009			
Current	318	221	539
Non-current	423	1,720	2,143
Total	**741**	**1,941**	**2,682**

The amortisation period of AVCR is based on the underlying returns on the policies expected to be written as a result of the customer relationships.

The amortisation is charged to income and is recognised in Other Operating Expenses (see Note 17).

23 Internally-developed software

Cost	2009 £000	2008 £000
Balance at 1 January	**–**	**–**
Additions – acquisition of subsidiary	4,237	–
Additions	871	–
Disposals	(59)	–
Foreign exchange translation difference	301	–
Balance at 31 December	**5,350**	**–**

Amortisation and impairment losses	2009 £000	2008 £000
Balance at 1 January	**–**	**–**
Additions – acquisition of subsidiary	842	–
Amortisation charge for the year	414	–
Disposals	(26)	–
Foreign exchange translation difference	60	–
Balance at 31 December	**1,290**	**–**
Carrying amounts at 31 December	**4,060**	**–**
Current	1,010	–
Non-current	3,050	–
Total	**4,060**	**–**

24 Property and equipment

Cost	2009 £000	2008 £000
Balance at 1 January	**–**	**–**
Additions – acquisition of subsidiary	713	–
Additions	166	–
Disposals	(85)	–
Foreign exchange translation difference	46	–
Balance at 31 December	**840**	**–**

Amortisation and impairment losses	2009 £000	2008 £000
Balance at 1 January	**–**	**–**
Additions – acquisition of subsidiary	292	–
Depreciation charge for the year	73	–
Disposals	(33)	–
Foreign exchange translation difference	17	–
Balance at 31 December	**349**	**–**
Carrying amounts at 31 December	**491**	**–**
Current	162	–
Non-current	329	–
Total	**491**	**–**

25 Investment in associates

Cost	2009 £000	2008 £000
Balance at 1 January	**–**	**–**
Additions – acquisition of subsidiary	781	–
Equity contribution	334	–
Share of profit	39	–
Reclassification to subsidiary	(65)	–
Impairment of investment in associates	(96)	–
Foreign exchange translation difference	58	–
Balance at 31 December	**1,051**	**–**

Associates at 100%	Assets £000	Liabilities £000	Revenues £000	Profit/(loss) £000
AkademikerRådgivning i Sverige AB	–	–	85	(219)
Modernac S.A.	14,731	12,586	2,801	298
Total 31 December 2009	**14,731**	**12,586**	**2,886**	**79**

Associates at 49%	Equity at 100% £000	Equity at 49% £000	49% share of profit/(loss) £000
AkademikerRådgivning i Sverige AB	–	–	(107)
Modernac S.A.	2,145	1,051	146
Total 31 December 2009	**2,145**	**1,051**	**39**

As detailed in Note 7, AkademikerRådgivning i Sverige AB became a subsidiary in November 2009, having previously been an associate.

26 Investment properties

	31 December	
	2009 £000	2008 £000
Balance at 1 January	**3,432**	**4,983**
Disposals	–	(1,227)
Fair value adjustments	(77)	(324)
Balance at 31 December	**3,355**	**3,432**
Current	188	188
Non-current	3,167	3,244
Total	**3,355**	**3,432**

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 2009.

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

26 Investment properties (continued)

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

Both of these amounts are disclosed in Net Investment Return (see Note 11). Expenses incurred in the operation and maintenance of investment properties are disclosed in Other Operating Expenses (see Note 17).

During the year ended 31 December 2008 the Group completed its plan to dispose of directly held properties, in the unit-linked property funds, in favour of indirect property investments through holdings in collective investment schemes.

27 Financial assets

Group	31 December 2009 £000	31 December 2008 £000
Financial assets by measurement category		
Fair value through income		
Designated at fair-value through income on initial recognition	2,356,774	1,219,485
Derivative financial instruments	7,964	5,570
Insurance and other receivables	19,822	11,056
Prepayments	3,784	1,600
Total	**2,388,344**	**1,237,711**

Fair value is the amount for which an asset could be exchanged between willing parties in an arm's length transaction. The tables below show the determination of fair value according to a three-level valuation hierarchy. Fair values are generally determined at prices quoted in active markets (Level 1). However, where such information is not available, the Group applies valuation techniques to measure such instruments. These valuation techniques make use of market-observable data for all significant inputs where possible (Level 2), but, in some cases it may be necessary to estimate other than market-observable data within a valuation model for significant inputs (Level 3).

	Fair value measurement at 31 December 2009 using			
	Level 1 £000	Level 2 £000	Level 3 £000	Total £000
Financial assets at fair value through income				
Equities				
Listed	454,970	–	–	454,970
Debt securities – fixed rate				
Government Bonds	171,149	–	–	171,149
Listed	39,557	–	–	39,557
Debt securities – floating rate				
Listed	37,130	–	–	37,130
Total debt securities	247,836	–	–	247,836
Holdings in collective investment schemes	1,612,861	–	–	1,612,861
Policyholders' funds held by the group	41,107	–	–	41,107
Derivative financial instruments	4,420	3,544	–	7,964
Total	**2,361,194**	**3,544**	**–**	**2,364,738**
Current				292,251
Non-current				2,072,487
Total				**2,364,738**

	Fair value measurement at 31 December 2008 using			
	Level 1 £000	Level 2 £000	Level 3 £000	Total £000
Financial assets at fair value through income				
Equities				
Listed	363,879	–	–	363,879
Debt securities – fixed rate				
Government Bonds	174,617	–	–	174,617
Listed	68,161	–	–	68,161
Debt securities – floating rate				
Listed	36,326	–	–	36,326
Total debt securities	279,104	–	–	279,104
Holdings in collective investment schemes	576,502	–	–	576,502
Policyholders' funds held by the group	–	–	–	–
Derivative financial instruments	5,570	–	–	5,570
Total	**1,225,055**	**–**	**–**	**1,225,055**
Current				159,047
Non-current				1,066,008
Total				**1,225,055**

Company	31 December	
	2009 £000	2008 £000
Investments in subsidiaries		
Balance at 31 January	**52,006**	**52,006**
Acquisition of Moderna Försäkringar Liv AB	19,956	–
Equity contribution paid to Moderna Försäkringar Liv AB	2,067	–
Balance at 31 December	**74,029**	**52,006**
Current	–	–
Non-current	74,029	52,006
Total	**74,029**	**52,006**

A list of investments in subsidiaries held by the Group is disclosed in Note 54.

28 Insurance and other receivables and prepayments

Group	31 December 2009 £000	31 December 2008 £000
Insurance and other receivables		
Receivables arising from insurance contracts		
Brokers	2,856	–
Policyholders	3,415	1,847
Receivables arising from investment contracts		
Policyholders	9	14
Reinsurance receivables	328	111
Commission receivables	74	1,005
Debtor for professional indemnity insurance	2	18
Other receivables		
Loan to associated company	660	–
Accrued interest income	3,251	6,456
Related party receivables	–	78
Receivables from fund management companies	7,483	–
Recoveries relating to unit pricing redress	294	294
Other	1,450	1,233
Total	**19,822**	**11,056**
Current	19,162	11,056
Non-current	660	–
Total	**19,822**	**11,056**

Recoveries relating to unit pricing redress are explained in Note 37.

The carrying amount is a reasonable approximation of fair value.

	31 December 2009 £000	31 December 2008 £000
Prepayments	**3,784**	**1,600**
Current	2,434	400
Non-current	1,350	1,200
Total	**3,784**	**1,600**

The carrying amount is a reasonable approximation of fair value.

Company	31 December 2009 £000	31 December 2008 £000
Loans and receivables		
Amounts due from subsidiary companies	192	662
Other	7	458
Total	**199**	**1,120**
Current	199	1,120
Non-current	–	–
Total	**199**	**1,120**

The carrying amount is a reasonable approximation of fair value.

	31 December 2009 £000	31 December 2008 £000
Prepayments	**63**	**57**
Current	–	–
Non-current	63	57
Total	**63**	**57**

The carrying amount is a reasonable approximation of fair value.

29 Derivative financial instruments

The Group does not use derivatives as part of any hedging strategies to mitigate risk and does not hold derivatives outside the unit-linked funds, except for an option to repay a financial reinsurance contract early, which comprises an embedded derivative.

	31 December 2009		31 December 2008	
	Asset £000	Liability £000	Asset £000	Liability £000
Exchange-traded futures	4,420	(54)	5,570	(70)
Financial reinsurance embedded derivative	3,544	–	–	–
Total	**7,964**	**(54)**	**5,570**	**(70)**
Current	7,964	(54)	5,570	(70)
Non-current	–	–	–	–
Total	**7,964**	**(54)**	**5,570**	**(70)**

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.

29 Derivative financial instruments (continued)

All the contracts are exchange-traded futures, with their fair value being the bid price at the balance sheet date: they are, accordingly, determined at Level 1 in the three-level fair value determination hierarchy set out in Note 27.

	31 December 2009		31 December 2008	
	Asset £000	**Liability £000**	**Asset £000**	**Liability £000**
Exchange-traded futures (by geographical investment market)				
Australia	344	–	211	–
Switzerland	–	–	148	(13)
Europe	1,326	–	1,038	–
UK	987	(54)	2,009	–
Hong Kong	102	–	236	(31)
Japan	142	–	811	–
South Korea	691	–	605	–
Sweden	–	–	29	(2)
Singapore	42	–	37	(1)
USA	786	–	446	(23)
Total	**4,420**	**(54)**	**5,570**	**(70)**

Financial reinsurance embedded derivative

In respect of the Swedish Business, the Group has entered into a reinsurance contract with a third party that has a section that is deemed to transfer significant insurance risk and a section that is deemed not to transfer significant insurance risk. This assessment has been determined by management based on the contractual terms of the reinsurance agreement. The element of the contract that does not transfer significant insurance risk has two components and has been accounted for as a financial liability at amortised cost and an embedded derivative at fair value.

The embedded derivative represents an option to repay the amounts due under the contract early at a discount to the amortised cost, with its fair value being determined by reference to market interest rates at the balance sheet date. It is, accordingly, determined at Level 2 in the three-level fair value determination hierarchy set out in Note 27.

30 Income tax assets

	31 December	
	2009 £000	**2008 £000**
Income tax assets, which are all current, comprise:		
Group		
Corporation tax recoverable	**395**	**–**
Company		
Corporation tax recoverable	**395**	**139**

The carrying amount is a reasonable approximation of fair value.

31 Cash and cash equivalents

	31 December	
	2009 £000	**2008 £000**
Group		
Bank and cash balances	54,387	35,669
Call deposits due within 1 month	54,555	91,615
Call deposits due after 1 month	46,299	65,097
Total cash and cash equivalents	**155,241**	**192,381**
Bank overdrafts	(2,312)	(1,094)
Cash and cash equivalents in the statement of cash flows	**152,929**	**191,287**

The effective interest rate on short term bank deposits was 0.57% (2008: 5.09%), 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 £48,417,000 (2008: £45,046,000) held in unit-linked policyholders' funds.

	31 December	
	2009 £000	**2008 £000**
Company		
Bank and cash balances	11	–
Call deposits due within 1 month	12,611	36,372
Short term deposits due within 1 year	7,013	1,000
	19,635	37,372
Bank overdrafts	–	(8)
Total	**19,635**	**37,364**

32 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's regulated companies operate.

As at 31 December 2008 the Group operated exclusively in the UK, through its UK Business, and the Group's regulatory capital requirements were, accordingly, determined by the regulations established by the Financial Services Authority ('FSA') in the UK. The Swedish Business, which was acquired during 2009, includes a regulated entity, Moderna Försäkringar Liv AB ('Moderna'), the capital requirements of which are determined by the regulations established by Finansinspektionen, the Swedish regulator. Consolidated Group regulatory capital requirements continue to be assessed in accordance with FSA regulations. The overall capital dynamics of the Group are such that the UK Business, being substantially in run off, is a net contributor of capital, which is reflected in the medium-term by way of dividend distributions to the parent company, while, in the medium-term, the Swedish Business, as it expands, and before it achieves economies of scale, is a net consumer of capital, which is reflected by way of additional capital contributions from the parent company.

32 Capital Management (continued)

(b) Operation of the UK, Swedish and EU regulatory regimes

UK Business

The operation of FSA regulation with respect to the UK Business's regulated life assurance entity, Countrywide Assured plc ('CA plc'), 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 was 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 CA plc Board's policy in targeting regulatory capital resource cover for total regulatory capital resource requirements.

CA plc's 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.

Swedish Business

Moderna is subject to the Swedish regulatory regime and has to maintain a minimum level of regulatory capital, being the prescribed minimum solvency margin requirements.

The solvency surplus under the Swedish regulatory regime is the excess of the regulatory capital resources over the capital resource requirements which are based on the insurance business. This calculation is set out below in Section (c) Regulatory Capital Resources and Requirements together with the Moderna Board's policy in targeting regulatory capital resource cover for total regulatory capital resource requirements. The Swedish Business also includes a 49% interest in an associated company, Modernac S.A. ('Modernac'), a Luxembourg-based reinsurer, which is subject to EU regulatory solvency requirements: its scale of operations are such that its capital resource requirement is the EU regulatory minimum.

Group

In addition to the solvency requirements for the UK and Swedish Businesses, as set out above, 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.

(c) Regulatory capital resources and requirements

UK Business

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

	31 December	
	2009 £m	2008 £m
Available capital resources (CR)	43.6	43.0
Long-term insurance capital requirement (LTICR)	19.8	22.5
Resilience capital requirement (RCR)	2.3	1.8
Total capital resource requirements (CRR)	22.1	24.3
Excess of CR over CRR (solvency surplus)	21.5	18.7
Ratio of available CR to CRR	197%	177%
Target capital requirement cover	32.0	35.6
Excess of CR over target requirement	11.6	7.4

Available capital resources as at 31 December 2009 are stated after provision for a dividend of £28.5m which was approved by the CA plc Board subsequent to 31 December 2009 (as at 31 December 2008: £26.0m subsequent to 31 December 2008).

CA plc'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.

Swedish Business

The following summarises the Capital Resources and the Capital Resources Requirements of Moderna as determined for Swedish regulatory purposes and Moderna's 49% proportionate share in the Capital Resources and Capital Resources Requirements of Modernac:

	As at 31 December 2009	
	Moderna £m	Modernac £m
Available Capital Resources (CR)	24.5	2.0
Capital Resource Requirements (CRR)	(8.1)	(1.4)
Excess of CR over CRR (solvency surplus)	16.4	0.6
Ratio of available CR to CRR	302%	143%
Target capital requirement cover	12.1	n/a
Excess over target requirement	12.4	n/a

Moderna's Board, as a matter of policy, will continue to target total CR cover for total CRR at a minimum level of 150%. The regulatory capital requirements are assessed and monitored by the Moderna Board on a continuous basis and further capital is injected into the Moderna Group by the parent company as and when required.

(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:

32 Capital Management (continued)

As at 31 December 2009	UK Life business			Swedish Life and Non-life business	Group Life and Non-life insurance businesses
	Non-participating £000	Shareholder £000	Total £000	Total £000	Total £000
Shareholder funds outside long-term insurance funds	–	48,655	48,655	27,453	76,108
Shareholder funds in long-term insurance funds	2,969	–	2,969	–	2,969
Total shareholder funds	**2,969**	**48,655**	**51,624**	**27,453**	**79,077**
Adjustment onto regulatory basis					
Adjustments to assets	(572)	(7,538)	(8,110)	(3,983)	(12,093)
Other	91	–	91	990	1,081
Total available capital resources	**2,488**	**41,117**	**43,605**	**24,460**	**68,065**

	Group Life and Non-life insurance businesses	Other activities		Consolidation adjustments	Group total	Adjustment for dividend	Group total IFRS basis
	Total £000	UK Business £000	Swedish Business £000	£000	£000	£000	£000
Shareholder funds outside long-terminsurance funds	76,108	106,300	1,323	(37,399)	146,332	10,454	156,786
Shareholder funds in long-term insurance funds	2,969	–	–	–	2,969	–	2,969
Total shareholder funds	**79,077**	**106,300**	**1,323**	**(37,399)**	**149,301**	**10,454**	**159,755**
Adjustment onto regulatory basis							
Adjustments to assets	(12,093)	(52,224)	–	15,271	(49,046)		
Other	1,081	–	1,230	(2,902)	(591)		
Total available capital resources	**68,065**	**54,076**	**2,553**	**(25,030)**	**99,664**		

As at 31 December 2008	UK Life business			Swedish Life and Non-life business	Group Life and Non-life insurance businesses
	Non-participating £000	Shareholder £000	Total £000	Total £000	Total £000
Shareholder funds outside long-term insurance funds	–	49,182	49,182	–	49,182
Shareholder funds in long-term insurance funds	2,581	–	2,581	–	2,581
Total shareholder funds	**2,581**	**49,182**	**51,763**	**–**	**51,763**
Adjustment onto regulatory basis					
Adjustments to assets	(717)	(8,173)	(8,890)	–	(8,890)
Other	86	–	86	–	86
Total available capital resources	**1,950**	**41,009**	**42,959**	**–**	42,959

	Group Life and Non-life insurance businesses	Other activities		Consolidation adjustments	Group total	Adjustment for dividend	Group total IFRS basis
	Total £000	UK Business £000	Swedish Business £000	£000	£000	£000	£000
Shareholder funds outside long-term insurance funds	49,182	96,108	–	(31,703)	113,587	10,200	123,787
Shareholder funds in long-term insurance funds	2,581	–	–	–	2,581	–	2,581
Total shareholder funds	**51,763**	**96,108**	**–**	**(31,703)**	**116,168**	**10,200**	**126,368**
Adjustment onto regulatory basis							
Adjustments to assets	(8,890)	(52,163)	–	31,703	(29,350)		
Other	86	–	–	–	86		
Total available capital resources	**42,959**	**43,945**	**–**	**–**	**86,904**		

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 2009 they are stated after provision of a dividend of £10.5m and, as at 31 December 2008, after provision of a dividend of £10.2m, which were approved by the Chesnara plc Board subsequent to the respective year ends. 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 2009, 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 tables set out the principal forms of capital, which comprise (i) total available capital resources for the total UK Life Business, the total Swedish Life and Non-life Business and the total Group for regulatory purposes and (ii) total shareholder funds for the Group on the IFRS basis.

32 Capital Management (continued)

	Available Capital Resources for Regulatory Purposes			Shareholder Funds IFRS Basis
	Total UK Life Business £000	Total Swedish Life and Non-life Business £000	Total Group £000	Total Group £000
Share capital	40,000	1,127	41,501	41,501
Share premium	–	–	20,458	20,458
Treasury shares	–	–	(3,379)	(3,379)
Other equity contributions	–	33,551	–	–
Capital redemption reserve	–	–	50	50
Foreign exchange translation reserve	–	–	3,381	3,381
Surplus in long-term fund	2,488	–	–	–
Retained earnings/(accumulated deficit)	1,117	(10,218)	37,653	97,744
Total	**43,605**	**24,460**	**99,664**	**159,755**

The following tables summarise the movement in the available capital resources of the constituent funds of the life businesses, as determined under the respective regulatory regimes for the year ended 31 December 2009:

UK Business

Year ended 31 December 2009	Life business UK non-participating £000	Life business shareholder £000	Total life business £000
At beginning of period	**1,950**	**41,009**	**42,959**
Surplus arising in the year, net of the effect of the items shown above	29,034	–	29,034
Net profit arising in shareholder fund	–	112	112
Transfer from long-term business fund to shareholder fund	(28,500)	28,500	–
Proposed dividend	–	(28,500)	(28,500)
At end of period	**2,484**	**41,121**	**43,605**

There were no changes in available capital resources for the year ended 31 December 2009 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.

Swedish Business

Year ended 31 December 2009	Total £000
At beginning of period	**–**
Arising on acquisition of Swedish Business	21,363
Post-acquisition loss	(610)
Equity contributions	2,067
Change in untaxed reserves	408
Change in intangible assets: internally-developed software	(428)
Change in deferred tax	1,660
At end of period	**24,460**

There were no changes in available capital resources for the period ended 31 December 2009 due to changes in management policy, regulatory changes or external factors.

The capital position of the Swedish business is sensitive to changes in market conditions affecting the asset values and changes in the assumptions for calculating the insurance contract liabilities, as described in Note 5.

Group Capital Adequacy

The following sets out the Group's capital adequacy established in accordance with the requirements of the EU Insurance Group Directive:

	31 December	
	2009 £m	2008 £m
Total available capital resources (CR)	99.7	86.9
Capital resources requirement		
UK Business – CA plc	22.1	24.3
Swedish Business – Moderna	8.1	–
Associate – Modernac SA	1.4	–
Total (CRR)	31.6	24.3
Group solvency surplus (CR less CRR)	68.1	62.6
Group solvency ratio	316%	358%

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

There has been no material change in the Group's management of capital during the period, except that, notwithstanding that there are no formal intragroup funding arrangements in place, the parent company continues to make additional capital contributions to support the target capital requirement of Moderna as set out in subsection (c) above.

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

(e) Technical provisions net of reassurance – UK Business

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 UK principal operating subsidiary, Countrywide Assured plc, in which the whole of the UK Business now subsists. However, within this Note and the following Note 33 Insurance Contract Provisions, 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.

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

	31 December	
	2009 £000	2008 £000
Technical provisions		
Unit-linked		
Unit		
Insurance contracts	704,794	610,333
Investment contracts	560,350	480,373
Non-unit (sterling)		
Insurance contracts	16,980	20,980
Investment contracts	6,030	7,294
Non-participating		
Insurance contracts	113,654	110,249
Investment contracts	33,680	65,464
Total	**1,435,488**	**1,294,693**

32 Capital Management (continued)

(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 UK Business 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. This is a prudent assumption.

Discount rates

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

	31 December 2009		31 December 2008	
Rate of interest	CA business	CWA business	CA business	CWA business
Assurances				
Without profit: non linked business	3.40%	3.70%	3.40%	3.20%
Without profit: annual premium	3.40%	3.70%	3.40%	3.20%
Without profit: guaranteed income bonds	1.20%	–	1.60%	–
Annuities				
Without profit: deferred	3.40%	3.70%	3.40%	2.80%
Without profit: vested	4.10%	3.70%	3.80%	3.10%

The rates of interest shown above have been set after consideration of the risk of default on non-government bonds by applying the following adjustments to the earned yield:

(i) a standard risk deduction, varying by credit rating, of 0.1% for 'AAA'-rated bonds, 0.3% for 'AA'-rated bonds and 0.5% for 'A'-rated bonds, based on ratings according to Standard and Poors credit rating system. No assets are held with a credit rating less than 'A'; and

(ii) an overall maximum margin over the equivalent term government fixed interest security of 0.5%.

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 rate sensitivity of the UK Business's insurance liabilities than those of the related assets, to the extent that the UK Business 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 UK Business 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 5.

(f) Valuation of options and guarantees – UK Business

(i) Stochastically-valued options and guarantees

The UK Business has a small number of guaranteed annuity options, considered in Note 5, 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 £113,000 as at 31 December 2009 (31 December 2008: £1,247,000).

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 24% and allowing for future investment returns, including presumed future equity investment return of 4.4% 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.

Reserves for this product comprise a 'unit' reserve of the current value of the benefits held and a non-unit reserve for expenses.

The underlying fund at 31 December 2009 was £7.8m (31 December 2008: £8.3m). 837 policies invested in the fund (31 December 2008: 922), of which 102 (31 December 2008: 118) were paying premiums (for a total of approximately £35,000 per annum (31 December 2008: £41,000)).

For the valuation of contract liabilities the following are projected 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:	4.5% pa
Rate of return on cash:	0.5% pa
Discount rate:	3.5% 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 2009 was £1.8m (31 December 2008: £0.7m).

32 Capital Management (continued)

(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 5 and 6 to these financial statements.

33 Insurance contract provisions

(a) Analysis of insurance contract provisions by type

	31 December 2009			31 December 2008		
	Gross £000	Reinsurance £000	Net £000	Gross £000	Reinsurance £000	Net £000
Long-term business						
UK business						
Unit-linked without DPF	835,884	117,918	717,966	728,006	99,918	628,088
Non-linked without DPF	116,403	2,806	113,597	113,068	3,291	109,777
With DPF	92,393	88,880	3,513	82,432	79,484	2,948
	1,044,680	209,604	835,076	923,506	182,693	740,813
Swedish business						
Non-linked without DPF	32,353	27,262	5,091	–	–	–
Total insurance contract provisions	**1,077,033**	**236,866**	**840,167**	**923,506**	**182,693**	**740,813**
Current	60,172	20,972	39,200	26,988	4,081	22,907
Non-current	1,016,861	215,894	800,967	896,518	178,612	717,906
Total	**1,077,033**	**236,866**	**840,167**	**923,506**	**182,693**	**740,813**

(b) Analysis of movement in insurance contract provisions

Unit-linked without DPF

	2009			2008		
UK business	Gross £000	Reinsurance £000	Net £000	Gross £000	Reinsurance £000	Net £000
Balance at 1 January	**728,006**	**99,918**	**628,088**	**922,183**	**122,092**	**800,091**
Premiums received	66,684	8,506	58,178	71,585	9,084	62,501
Fees deducted	(21,418)	(1,350)	(20,068)	(22,498)	(1,481)	(21,017)
Reserves released in respect of benefits paid	(80,076)	(8,838)	(71,238)	(84,932)	(8,478)	(76,454)
Investment return	152,044	19,845	132,199	(152,748)	(21,219)	(131,529)
Other movements	(9,356)	(163)	(9,193)	(5,584)	(80)	(5,504)
Balance at 31 December	**835,884**	**117,918**	**717,966**	**728,006**	**99,918**	**628,088**

Non-linked without DPF

	2009			2008		
	Gross £000	Reinsurance £000	Net £000	Gross £000	Reinsurance £000	Net £000
Balance at 1 January	**113,068**	**3,291**	**109,777**	**97,874**	**2,983**	**94,891**
Premiums received	18,677	3,030	15,647	19,415	3,664	15,751
Fees deducted	(8,167)	(2,321)	(5,846)	(10,030)	(2,832)	(7,198)
Reserves released in respect of benefits paid	(5,874)	(260)	(5,614)	(6,042)	387	(6,429)
Investment return	1,397	(219)	1,616	11,146	203	10,943
Other movements	(2,698)	(715)	(1,983)	705	(1,114)	1,819
Balance at 31 December	**116,403**	**2,806**	**113,597**	**113,068**	**3,291**	**109,777**

With DPF

	2009			2008		
	Gross £000	Reinsurance £000	Net £000	Gross £000	Reinsurance £000	Net £000
Balance at 1 January	**82,432**	**79,484**	**2,948**	**90,791**	**87,278**	**3,513**
Premiums received	2,793	2,672	121	2,933	2,822	111
Fees deducted	(896)	(883)	(13)	(900)	(888)	(12)
Reserves released in respect of benefits paid	(4,881)	(4,635)	(246)	(4,155)	(4,035)	(120)
Investment return	2,978	2,276	702	587	1,129	(542)
Other movements	9,967	9,966	1	(6,824)	(6,822)	(2)
Balance at 31 December	**92,393**	**88,880**	**3,513**	**82,432**	**79,484**	**2,948**

The residual net liability of £3,513,000 as at 31 December 2009 (31 December 2008: £2,948,000) relates to unit-linked holdings within policies which have been classified as 'With DPF'.

Non-linked without DPF

	2009			2008		
Swedish business	Gross £000	Reinsurance £000	Net £000	Gross £000	Reinsurance £000	Net £000
Balance at 1 January	**–**	**–**	**–**	**–**	**–**	**–**
Additions	30,642	25,713	4,929	–	–	–
Reserves released in respect of benefits paid	(2,820)	(2,412)	(408)	–	–	–
Movement in provisions for contracts sold:						
– in current year	6,074	4,858	1,216	–	–	–
– in prior years	(6,201)	(5,116)	(1,085)	–	–	–
Other movements	4,658	4,219	439	–	–	–
Balance at 31 December	**32,353**	**27,262**	**5,091**	**–**	**–**	**–**

33 Insurance contract provisions (continued)

(c) Assumptions and sensitivities for insurance contract provisions – UK Business

The information which follows relates to the UK Business only. This follows from the characteristics of the UK Business's insurance contracts which principally relate to long-term life cover. The information relating to the Swedish Business is included in Note 5.

(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 UK Business 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 UK Business 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.

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 UK Business 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 UK Business has used the following rates of interest in discounting the projected liabilities:

Rate of interest	31 December 2009		31 December 2008	
	CA business	CWA business	CA business	CWA business
Assurances				
without profit: non linked business	3.40%	3.70%	3.40%	3.20%
without profit: annual premium	3.40%	3.70%	3.40%	3.20%
Annuities				
without profit: deferred	3.40%	3.70%	3.40%	2.80%
without profit: vested	4.10%	3.70%	3.80%	3.10%

The rates of interest shown above have been set after consideration of the risk of default on non-government bonds by applying the following adjustments to the earned yield:

(i) a standard risk deduction, varying by credit rating, of 0.1% for 'AAA'-rated bonds, 0.3% for 'AA'-rated bonds and 0.5% for 'A'-rated bonds, based on ratings according to Standard and Poors credit rating system. No assets are held with a credit rating less than 'A'; and

(ii) an overall maximum margin over the equivalent term government fixed interest security of 0.5%.

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 rate sensitivity of the UK Business's insurance liabilities than those of the related assets, to the extent that the UK Business 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 UK Business 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 UK Business.

Taxation

The UK Business 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 smaller number of in-force policies. Consequently the per policy expense reserve has increased. This increased the reserves by £0.8m as at 31 December 2009 (31 December 2008: £0.3m).

The reserve held in respect of the CWA business for guaranteed annuity rates was reduced by £0.1m, making allowance principally for the vesting of policies with the guarantee, changes in unit values and interest rates.

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

33 Insurance contract provisions (continued)

The UK Business 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 2009 £m
Investment return	+1	(1.8)
Investment return	-1	0.9
Mortality/morbidity	+10	0.8
Mortality alone	+10	1.5
Morbidity alone	+10	(0.7)
Policy maintenance expenses	+10	(1.3)

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 5 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 basis the impacts are closely balanced. A decrease in mortality rates would have the contrary effect in each business but the results would remain closely balanced.

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 £1.3m for increased mortality rates and a reduction in consolidated net of tax profits and equity by £0.7m for increased morbidity rates. The sensitivities to changes in these assumptions in the opposite direction will result in changes of similar magnitude but in the opposite direction.

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 5. The impact shown above quantifies a 10% increase in those expenses.

(iv) Provisions for redress in respect of endowment misselling complaints

The insurance liabilities include an amount of £2.9m (31 December 2008: £4.2m) in respect of potential compensation payments arising from endowment misselling complaints. 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 or 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 £0.1m. A 10% increase in assumed cost of redress to settle each complaint would increase insurance contract provisions by £0.3m.

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

(a) Analysis by contract type

	31 December 2009			31 December 2008		
	Investment contract liability £000	Amount deposited with reinsurer £000	Net £000	Investment contract liability £000	Amount deposited with reinsurer £000	Net £000
UK Business						
Unit-linked	578,523	26,192	552,331	494,148	21,733	472,415
Non-linked	9,484	–	9,484	9,275	–	9,275
Guaranteed income and guaranteed growth bonds	22,923	–	22,923	55,119	–	55,119
Other	–	864	(864)	–	448	(448)
Total	610,930	27,056	583,874	558,542	22,181	536,361
Swedish Business						
Unit-linked	918,291	–	918,291	–	–	–
Total	**1,529,221**	**27,056**	**1,502,165**	**558,542**	**22,181**	**536,361**
Current	78,093	1,335	76,758	42,583	402	42,181
Non-current	1,451,128	25,721	1,425,407	515,959	21,779	494,180
Total	**1,529,221**	**27,056**	**1,502,165**	**558,542**	**22,181**	**536,361**

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

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

UK Business Unit-linked	31 December 2009			31 December 2008		
	Investment contract liability £000	Amount deposited with einsurer £000	Net £000	Investment contract liability £000	Amount deposited with reinsurer £000	Net £000
Balance at 1 January	**494,148**	**21,733**	**472,415**	**630,843**	**27,128**	**603,715**
Deposits received	18,136	909	17,227	18,956	953	18,003
Fees deducted from account balances	(5,107)	(22)	(5,085)	(8,190)	115	(8,305)
Account balances paid on terminations in the year	(32,854)	(1,215)	(31,639)	(34,761)	(1,667)	(33,094)
Investment yield	101,943	4,786	97,157	(115,345)	(4,795)	(110,550)
Other movements	2,257	1	2,256	2,645	(1)	2,646
Balance at 31 December	**578,523**	**26,192**	**552,331**	**494,148**	**21,733**	**472,415**

UK Business Non-linked	31 December 2009			31 December 2008		
	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	**9,275**	–	**9,275**	**10,293**	**–**	**10,293**
Acquisition	–	–	–	–	–	–
Deposits received	11	–	11	13	–	13
Fees deducted	(70)	–	(70)	(117)	–	(117)
Account balances paid on terminations in the year	(535)	–	(535)	(1,454)	–	(1,454)
Investment yield	399	–	399	316	–	316
Other movements	404	–	404	224	–	224
Balance at 31 December	**9,484**	**–**	**9,484**	**9,275**	**–**	**9,275**

UK Business Guaranteed income and guaranteed growth bonds	31 December 2009			31 December 2008		
	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	**55,119**	**–**	**55,119**	**85,367**	**–**	**85,367**
Deposits received	2,107	–	2,107	3,280	–	3,280
Account balances paid on terminations in the year	(35,212)	–	(35,212)	(37,282)	–	(37,282)
Investment yield	845	–	845	2,777	–	2,777
Other movements	64	–	64	977	–	977
Balance at 31 December	**22,923**	**–**	**22,923**	**55,119**	**–**	**55,119**

Swedish Business Unit-linked	31 December 2009			31 December 2008		
	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	**–**	**–**	**–**	**–**	**–**	**–**
Arising on acquisition of Swedish Business	703,548	–	703,548	–	–	–
Deposits received	109,292	–	109,292	–	–	–
Fees deducted from account balances	(3,247)	–	(3,247)	–	–	-
Account balances paid on terminations in the year	–	–	–	–	–	–
Investment yield	86,648	–	86,648	–	–	–
Foreign exchange translation differences	(29,754)	–	(29,754)			
Other movements	51,804	–	51,804	–	–	–
Balance at 31 December	**918,291**	**–**	**918,291**	**–**	**–**	**–**

The fair values of the Groups' investment contract liabilities are determined according to a three-level valuation hierarchy which is explained in Note 27.

Unit-linked liabilities

The fair value of unit-linked liabilities is based on the aggregation of prices quoted in active markets of their associated assets. (Level 1)

Non-linked and guaranteed income and growth bond liabilities

The fair value of non-linked and guaranteed income and growth bond liabilities is valued using established actuarial techniques utilising market observable data for all significant inputs, such as investment yields. (Level 2)

35 Liabilities relating to policyholders' funds held by the Group

Swedish Business Unit-linked	31 December 2009	
	£000	£000
Balance at 1 January	**–**	**–**
Arising on acquisition of subsidiary	34,310	–
Deposits received	2,662	–
Fees deducted from account balances	(87)	–
Investment yield	6,345	–
Foreign exchange translation difference	2,517	–
Other movements	(4,640)	–
Balance at 31 December	**41,107**	**–**
Current	2,153	–
Non-current	38,954	–
Total	**41,107**	**–**

The fair values of the 'Liabilities relating to Policyholders' funds held by the Group' are determined according to a three-level valuation hierarchy, which is explained in Note 27.

The fair value of these liabilities is based on the aggregation of prices quoted in active markets of their associated assets (Level 1), as disclosed in Note 27.

36 Borrowings

Group

	31 December	
	2009 £000	2008 £000
Bank loan	4,197	8,358
Amount due in relation to financial reinsurance	24,686	–
Other	113	–
Total	**28,996**	**8,358**
Current	12,474	4,168
Non-current	16,522	4,190
Total	**28,996**	**8,358**

Company

	31 December	
	2009 £000	2008 £000
Bank loan	4,197	8,358
Total	**4,197**	**8,358**
Current	4,197	4,168
Non-current	–	4,190
Total	**4,197**	**8,358**

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 2008, being that payable within one year, is £4,168,000 and the non-current portion is £4,190,000. 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 2009 was £4,200,000 (31 December 2008: £8,400,000).

The fair value of amounts due in relation to financial reinsurance was £26,415,353 (31 December 2008: £nil)

The fair value of other borrowings is not materially different from its carrying value.

37 Provisions

	MECR £000	Other complaints redress £000	Onerous contracts £000	Unit pricing redress £000	Total £000
Balance at 1 January 2008	**102**	**57**	**422**	**2,994**	**3,575**
Provisions made during the year	13	56	116	–	185
Provisions used during the year	(48)	–	(44)	–	(92)
Provisions reversed during the year	(1)	-	(70)	(200)	(271)
Balance at 31 December 2008	**66**	**113**	**424**	**2,794**	**3,397**
Provisions made during the year	1	38	159	1,311	1,509
Provisions used during the year	–	(3)	(38)	(2,082)	(2,123)
Provisions reversed during the year	(12)	–	–	(1,319)	(1,331)
Balance at 31 December 2009	**55**	**148**	**545**	**704**	**1,452**
31 December 2008					
Current	66	113	49	2,794	3,022
Non-current	–	–	375	–	375
Total	**66**	**113**	**424**	**2,794**	**3,397**
31 December 2009					
Current	55	148	92	704	999
Non-current	–	–	453	–	453
Total	**55**	**148**	**545**	**704**	**1,452**

The reversal of provisions during the year was credited to Operating Income as disclosed in Note 12.

(a) Mortgage endowment complaints redress (MECR)

As part of the mortgage endowment complaint redress process (refer to Note 33 Insurance Contract Provisions), 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.

(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 50 Operating Leases. 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.

37 Provisions (continued)

Within the provision calculation two estimates or judgements are made:

(a) The provision model assumes that if the rent is reduced to a lower percentage of the Company contract, the percentage sublet occupancy of the properties will change accordingly. The rent reduction and occupancy rates vary from property to property, depending on location and prevailing tenancy rates within the various locations: the rents are assumed to be in a range between 50% and 80% of the contractual rental and the occupancy rates are assumed to be in a range between 25% and 80% of the current occupancy rates.

(b) Future cash flows are discounted within the provision model at 5%.

Sensitivities

	Provision at 31 December 2009 £000	Post sensitivity provision £000	Change in provision £000	Change in provision %
Discount rate – decreased by 1% to 4.0%	545	598	53	10
Sublease rent mitigation – reduction of 10%	545	559	14	3
Occupancy mitigation – reduction of 10%	545	591	46	8

(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 was 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 were established at £494,000 as at the same date and these were included in 'Insurance and other receivables' as at 31 December 2007. The net charge to the income statement for the year ended 31 December 2007 in establishing the provision and associated recoveries was, accordingly, £2,500,000.

The provision established at 31 December 2007 was estimated insofar as it was not based on specific individual calculations for each policyholder, but was 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. Subsequently, a revised estimate was established at £2,794,000 based on specific policy-by-policy data and this resulted in a release of £200,000 from the provision to income during the year ended 31 December 2008. During the year ended 31 December 2009, a further amount of £1,319,000 was released from the provision based on experience of actual redress and complaint levels. The residual provision as at 31 December 2009 continues to be subject to uncertainty until all of the associated administration procedures are completed. The Directors consider that the methodology used to establish the provision continues to be prudent.

During the year ended 31 December 2008, £200,000 was received from a third party and the balance of estimated recoveries from third parties of £294,000 is included in 'Insurance and other receivables' as at 31 December 2009 and as at 31 December 2008, as set out in Note 28.

38 Deferred tax liabilities

Total deferred tax liabilities comprise:	31 December	
	2009 £000	2008 £000
UK Business and Other Group Activities	9,615	10,798
Swedish Business	751	–
Total	**10,366**	**10,798**

UK Business and Other Group Activities

(a) Recognised deferred tax assets and liabilities

As at 31 December 2009	Assets £000	Liabilities £000	Net £000
Insurance contract provisions	–	4,596	(4,596)
Intangible assets			
Deferred acquisition costs	–	2,009	(2,009)
Acquired value of in-force business	–	6,506	(6,506)
Deferred income	3,449	–	3,449
Property and equipment	49	2	47
Total	**3,498**	**13,113**	**(9,615)**
Current	–	–	–
Non-current	3,498	13,113	(9,615)
Total	**3,498**	**13,113**	**(9,615)**

As at 31 December 2008	Assets £000	Liabilities £000	Net £000
Insurance contract provisions	–	4,987	(4,987)
Intangible assets			
Deferred acquisition costs	–	2,253	(2,253)
Acquired value of in-force business	–	7,456	(7,456)
Deferred income	3,837	–	3,837
Property and equipment	61	–	61
Total	**3,898**	**14,696**	**(10,798)**
Current	–	–	–
Non-current	3,898	14,696	(10,798)
Total	**3,898**	**14,696**	**(10,798)**

(b) Unrecognised deferred tax assets

	31 December	
	2009 £000	2008 £000
Tax losses arising in pensions business	44,323	56,022
Capital losses	14,252	17,312
Unrelieved expenses	98,312	95,499
Total	**156,887**	**168,833**

38 Deferred tax liabilities (continued)

(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.

Normally, deferred tax would be recognised in respect of the taxable element of unrealised gains or losses on equities. However, the current expectation is that the Life business will continue to be taxed on a basis equivalent to surplus less franked investment income. As any unrealised amounts have already been included in surplus the theoretical taxable temporary difference is expected to have no practical consequences for tax payable at the time the assets are disposed of. Accordingly no amount is provided.

(c) Movement in temporary differences during the year

	Year ended 31 December 2009			Year ended 31 December 2008		
	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	(4,987)	391	(4,596)	(5,476)	489	(4,987)
Intangible assets						
Deferred acquisition costs	(2,253)	244	(2,009)	(2,508)	255	(2,253)
Acquired value of in-force business	(7,456)	950	(6,506)	(8,270)	814	(7,456)
Deferred income	3,837	(388)	3,449	4,319	(482)	3,837
Property and equipment	61	(14)	47	88	(27)	61
Total	**(10,798)**	**1,183**	**(9,615)**	**(11,847)**	**1,049**	**(10,798)**

Swedish Business

(a) Recognised deferred tax assets and liabilities

As at 31 December 2009	Assets £000	Liabilities £000	Net £000
Intangible assets			
Fair value adjustments on acquisition	–	512	(512)
Other intangible assets	–	91	(91)
Corporation tax recoverable	188	–	188
Equity accounting for associates	–	76	(76)
Untaxed reserves	–	260	(260)
Property and equipment	–	–	–
Total	**188**	**939**	**(751)**
Current	188	939	(751)
Non-current	–	–	–
Total	**188**	**939**	**(751)**

(b) Unrecognised deferred tax assets

	31 December	
	2009 £000	2009 £000
Corporation tax recoverable – not recognised	2,259	196
Total	**2,259**	**196**

(c) Movement in temporary differences during the year

	Year ended 31 December 2009				
	Balance at 1 January 2009 £000	Arising on acquisition £000	Recognised through income £000	Foreign exchange translation difference £000	Balance at 31 December 2009 £000
Fair value adjustment on acquisition	–	(525)	13	–	(512)
Other intangible assets	–	(87)	2	(6)	(91)
Corporation tax recoverable	–	175	–	13	188
Equity accounting for associates	–	(30)	(43)	(3)	(76)
Untaxed reserves	–	(142)	(108)	(10)	(260)
Total	**–**	**(609)**	**(136)**	**(6)**	**(751)**

39 Reinsurance payables

	31 December	
Payable to reinsurers	2009 £000	2008 £000
Payables in respect of insurance contracts	7,365	1,288
Payables in respect of investment contracts	51	109
Reinsurance claims deposits	6,992	–
Reinsurer's share of deferred acquisition costs and claims deposits	631	–
Total	**15,039**	**1,397**
Current	8,945	1,397
Non-current	6,094	–
Total	**15,039**	**1,397**

The carrying value of payables to reinsurers is a reasonable approximation of fair value.

40 Payables related to direct insurance and investment contracts

	31 December 2009			31 December 2008		
	Gross £000	Reinsurance £000	Net £000	Gross £000	Reinsurance £000	Net £000
Accrued claims	23,075	4,728	18,347	22,068	4,100	17,968
Intermediaries' liabilities	441	–	441	–	–	–
Policyholder premium liabilities	2,639	–	2,639	1,823	–	1,823
Other	4,278	–	4,278	–	–	–
Total	**30,433**	**4,728**	**25,705**	**23,891**	**4,100**	**19,791**
Current	30,433	4,728	25,705	23,891	4,100	19,791
Non-current	–	–	–	–	–	–
Total	**30,433**	**4,728**	**25,705**	**23,891**	**4,100**	**19,791**

The carrying value of payables related to the direct insurance and investment contracts is a reasonable approximation of fair value.

41 Deferred income

	31 December	
	2009 £000	2008 £000
Balance at 1 January	**14,575**	**16,362**
Release to income	(1,443)	(1,787)
Balance at 31 December	**13,132**	**14,575**
Current	1,371	1,438
Non-current	11,761	13,137
Total	**13,132**	**14,575**

The release to income is included in Fee and Commission Income (see Note 10).

42 Income tax liabilities

	31 December	
	2009 £000	2008 £000
Group		
Income tax liabilities, which are all current, comprise:		
Corporation tax – UK Business	854	1,074
Corporation tax – Swedish Business	459	–
	1,313	**1,074**
Company		
Income tax liabilities, which are all current, comprise:		
Corporation tax	**–**	**–**

The carrying value of income tax liabilities is a reasonable approximation of fair value.

43 Other payables

	31 December	
	2009 £000	2008 £000
Group		
Accrued expenses	6,500	2,599
VAT	76	–
Employee tax	266	–
Other	2,991	3,895
Total	**9,833**	**6,494**
Current	9,833	6,494
Non-current	–	–
Total	**9,833**	**6,494**
Company		
Accrued expenses	2,098	1,638
Amounts due to Group companies	–	420
Other	113	229
Total	**2,211**	**2,287**
Current	2,211	2,287
Non-current	–	–
Total	**2,211**	**2,287**

The carrying value of other payables is a reasonable approximation of fair value.

44 Share capital

Group

	31 December 2009		31 December 2008	
	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 during the year ended 31 December 2009.

The number of shares in issue at the balance sheet date included 3,096,194 shares held in treasury (31 December 2008: 3,096,194).

Under the reverse acquisition basis of accounting referred to in Note 2, 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, 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.

44 Share capital (continued)

Company

The share capital of Chesnara plc comprises:

	31 December 2009 £	31 December 2008 £
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

The number of shares in issue at the balance sheet date included 3,096,194 shares held in treasury (31 December 2008: 3,096,194).

There have been no changes in Company share capital during the year ended 31 December 2009.

45 Treasury shares

	31 December	
	2009 £000	2008 £000
Balance at 1 January	**3,379**	**–**
Purchases during the year	–	3,379
Balance at 31 December	**3,379**	**3,379**

The Company purchased 3,096,194 of its own shares between 24 September 2008 and 20 November 2008 for a total consideration of £3,379,000.

46 Other reserves

Group

	31 December	
	2009 £000	2008 £000
Capital redemption reserve	50	50
Foreign exchange translation reserve	3,381	–
Balance at 31 December	**3,431**	**50**

Company

	31 December	
	2009 £000	**2008 £000**
Capital redemption reserve	50	50
Balance at 31 December	**50**	**50**

47 Retained earnings

Group

	31 December	
	2009 £000	**2008 £000**
Retained earnings attributable to equity holders of the parent company comprise		
Balance at 1 January	**67,738**	**63,775**
Profit for the year	45,940	20,017
Dividends		
Final approved and paid for 2007	–	(10,302)
Interim approved and paid for 2008	–	(5,752)
Final approved and paid for 2008	(10,200)	–
Interim approved and paid for 2009	(5,734)	–
Balance at 31 December	**97,744**	**67,738**

The interim dividend in respect of 2008, approved and paid in 2008, was paid at the rate of 5.50p per share. The final dividend in respect of 2008, approved and paid in 2009, was paid at the rate of 10.05p per share so that the total dividend paid to the equity shareholders of the Parent Company in respect of the year ended 31 December 2008 was made at the rate of 15.55p per share.

The interim dividend in respect of 2009, approved and paid in 2009, was paid at the rate of 5.65p per share to equity shareholders of the Parent Company registered at the close of business on 12 September 2009, the dividend record date.

A final dividend of 10.3p per share in respect of the year ended 31 December 2009 payable on 20 May 2010 to equity shareholders of the Parent Company registered at the close of business on 16 April 2010, the dividend record date, was approved by the Directors after the balance sheet date. The resulting total final dividend of £10.5m 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 2008 and 31 December 2009:

	2009 p	**2008 p**
Interim – approved and paid	5.65	5.50
Final – proposed	10.30	10.05
Total	**15.95**	**15.55**

47 Retained earnings (continued)

Company

	Year ended 31 December	
	2009 £000	2008 £000
Balance at 1 January	**57,683**	**41,500**
Profit for the year	23,806	32,237
Dividends paid		
Final approved and paid for 2007	–	(10,302)
Interim approved and paid for 2008	–	(5,752)
Final approved and paid for 2008	(10,200)	–
Interim approved and paid for 2009	(5,734)	–
Balance at 31 December	**65,555**	**57,683**

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

48 Employee benefit expense

Group

	UK Business £000	Swedish Business £000	Other Group Activities £000	Year ended 31 December 2009 £000	2008 £000
Wages and salaries	1,346	1,510	797	3,653	1,786
Social security costs	160	530	96	786	216
Pension costs-defined contribution plans	160	312	108	580	296
Total	**1,666**	**2,352**	**1,001**	**5,019**	**2,298**

Company

	Year ended 31 December	
	2009 £000	2008 £000
Wages and salaries	797	300
Social security costs	96	33
Pension costs-defined contribution plans	108	62
Total	**1,001**	**395**
Average number of employees		
Company	17	17
Subsidiaries	34	7
Total	**51**	**24**

UK-based employees

UK-based employees are employed by companies within the UK Business and Other Group Activities segment.

At the end of May 2005 the Group allowed eligible employees to enter a pension scheme known as 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 their predecessor scheme continued, provided that employee contributions also continued 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 and, otherwise, has no residual obligation or commitments in respect of any defined benefit scheme.

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.

Swedish-based employees

The Swedish Business participates in a combined defined benefit and defined contribution scheme operated by Försäkringsbranschen Pensionskassa (the 'Scheme'). The Scheme is a multi-employer scheme with participants including other Swedish insurance companies not related to the Group. The Scheme provides, for those born in 1978 or earlier, benefits to employees which are linked to their final salary and to the amount of time working for companies which are members of the Scheme. For those employees born in 1979 or later, the scheme operates on a defined contribution basis.

Assets and liabilities are held on a pooled basis and are not allocated by the Trustee to any individual company. Consequently, reliable information is not available to account for the Scheme as a defined benefit scheme and therefore, in accordance with IAS 19 Employee Benefits, the Scheme is accounted for as a defined contribution scheme.

Contributions to the Scheme are based on the funding recommendations of the independent qualified actuary: the contributions paid to the Scheme subsequent to the acquisition of the Swedish Business on 23 July 2009 totalled SEK 3,728,000 (£322,500). The rate of contribution payable to the Scheme was 24% of pensionable pay. There are no employee contributions to the Scheme.

The employers within the Scheme are responsible collectively for the funding of the Scheme as a whole and therefore in the event that other employers exit from the Scheme, remaining employers would be responsible for the ongoing funding. The collective nature of the Scheme results in all participating entities sharing the actuarial risk associated with the Scheme.

49 Earnings per share

Earnings per share are based on the following:

	Year ended 31 December	
	2009	**2008**
Profit for the year attributable to shareholders (£000)	45,940	20,017
Weighted average number of ordinary shares	101,492,591	104,021,765
Basic earnings per share	45.26p	19.24p
Diluted earnings per share	45.26p	19.24p

The weighted average number of ordinary shares in respect of the year ended 31 December 2009 is based on 104,588,785 shares in issue at the beginning and end of the period less 3,096,194 shares held in treasury at the beginning and end of the period.

The weighted average number of ordinary shares in respect of the year ended 31 December 2008 is based on 104,588,785 shares in issue at the beginning of the period and on 104,588,785 shares in issue at the end of the period less 3,096,194 own shares held in treasury as disclosed in Note 45, taking account of the timing of the purchases of own shares.

49 Earnings per share (continued)

There were no share options outstanding during the year ended 31 December 2008 or during the year ended 31 December 2009. Accordingly, there is no dilution of the average number of ordinary shares in issue in respect of these periods.

Earnings per share for the year ended 31 December 2009 includes the impact of £25,056,000 of profit recognised on the acquisition of Moderna. Excluding this item both the basic and diluted earnings per share for the year ended 31 December 2009 would have been 20.58p per share.

50 Operating leases

Leases as lessee

Non-cancellable operating lease rentals are payable as follows:

	31 December 2009			31 December 2008		
	Non-investment properties £000	Motor vehicles £000	Total £000	Non-investment properties £000	Motor vehicles £000	Total £000
Operating lease rentals						
Less than one year	1,001	–	1,001	687	31	718
Between one and two years	679	–	679	678	20	698
Between two and five years	1,975	–	1,975	1,981	1	1,982
More than five years	2,276	–	2,276	2,843	–	2,843
Expenses recognised in the year in respect of operating leases	1,109	–	1,109	685	40	725

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 7 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 £545,000 at 31 December 2009 (31 December 2008: £424,000) in respect of these leases (see Note 37).

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 2009			31 December 2008		
	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	187	405	592	–	464	464
Between one and two years	187	366	553	–	450	450
Between two and five years	559	1,043	1,602	–	1,133	1,133
More than five years	378	1,441	1,819	–	2,055	2,055
Rental income recognised in the year	135	479	614	–	447	447
Repairs and maintenance costs recognised in the year	68	205	273	–	110	110

51 Contingencies

Past sales

The Group has made provision for the estimated cost of settling complaints in respect of past sales of endowment mortgages. Although the provisions are regularly reviewed, the final outcome could be different from the provisions established as these costs cannot be calculated with certainty and are influenced by external factors beyond the control of management. In particular, uncertainty exists in relation to future regulatory actions and to the outcome of a specific case which has been referred to the Financial Ombudsman Service. The outcome of this referral may lead to a review of other similar cases and the financial effect of this cannot be assessed with any certainty until the case, which the Company continues to contest, has been concluded.

52 Capital commitments

There were no capital commitments as at 31 December 2009 or as at 31 December 2008.

53 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;

(iii) its associated companies; and

(iv) other companies over which the 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:

53 Related party transactions (continued)

	Year ended 31 December	
	2009 £000	2008 £000
Short-term employee benefits	893	684
Post-employment benefits	124	160
Long-term employment benefits	485	209
Total	**1,502**	**1,053**

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	
	2009 £000	2008 £000
Annual bonus scheme	195	152
Long-term incentive plan	1,028	1,006
Discretionary bonus	300	–
Total	**1,523**	**1,158**

These amounts have been included in Group and Company Accrued Expenses as disclosed in Note 35.

The amounts payable under the annual bonus scheme were payable within one year. At 31 December 2009, £1,028,000 of the amount payable under the long-term incentive plan was payable within one year (2008: £313,000).

(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	
	2009 £000	2008 £000
	2,154	**2,017**

During the period an equity contribution of £2,067,000 was paid to Moderna Försäkringar Liv AB, a subsidiary company.

(iii) Transactions with associates

Moderna Försäkringar Liv AB and its associates

Moderna Försäkringar Liv AB, a subsidiary company, has made shareholder contributions to its associate, Akademiker Rådgivning i Sverige AB, totalling £190,321, Reinsurance premiums have been paid to its associate Modernac S.A., totalling £3,017,458 with reinsurance recoveries received totalling £1,195,045 and reinsurance commission received totalling £301,746.

As at 31 December 2009, Moderna Försäkringar Liv AB had the following amounts outstanding:

	Amounts owed by associate £000	Amounts owed to associate £000
Modernac S.A.	**660**	**1,698**

(iv) 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	
	2009 £000	**2008 £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 15	–	227
Administration services (Included in Other Operating Income: see Note 12)	–	(55)
Property services	–	(39)
Total	**–**	**133**

Amounts outstanding in respect of the above transactions at each period end were:

	31 December	
	2009 £000	**2008 £000**
Payables (included in Other Payables: see Note 43)	–	7
Receivables (included in Other Receivables: see Note 28)	**–**	**14**

54 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.

54 Group entities (continued)

Group subsidiary companies

Name	Country of incorporation or registration	Ownership interest 31 December		Functional Currency
		2009	2008	
Countrywide Assured plc	England & Wales	100% of all share capital(1)	100% of all share capital(1)	Sterling
Countrywide Assured Life Holdings Limited	England & Wales	100% of all share capital	100% of all share capital	Sterling
Countrywide Assured Services Limited	England & Wales	100% of all share capital(1)	100% of all share capital(1)	Sterling
Countrywide Assured Trustee Company Limited	England & Wales	100% of all share capital(1)	100% of all share capital(1)	Sterling
Premium Life Assurance Holdings Limited	England & Wales	–	Dissolved 05/02/08	Sterling
Reefwise Limited	England & Wales	–	Dissolved 08/01/08	Sterling
Countrywide Assured Commission Services Limited	England & Wales	–	Dissolved 18/02/08	Sterling
The Greenways Management Company (Deepcar) Limited	England & Wales	–	Dissolved 19/02/08	Sterling
CWA Trustee Company Limited	England & Wales	100% of all share capital(2)	100% of all share capital(2)	Sterling
CWA Life Holdings plc	England & Wales	100% of all share capital	100% of all share capital	Sterling
City of Westminster Assurance Company Limited	England & Wales	–	Dissolved 29/04/08	Sterling
Moderna Försäkringar Liv AB	Sweden	100% of all share capital – acquired 23/7/09	–	Swedish Krona
Modernac S.A.	Luxembourg	49% of all share capital(3)	–	Swedish Krona
Akademiker Rådgivning i Sverige AB	Sweden	91% of all share capital(3)	–	Swedish Krona
Moderna Fonder & Analys AB	Sweden	100% of all share capital(3)	–	Swedish Krona

(1) Held indirectly through Countrywide Assured Life Holdings Limited

(2) Held indirectly through CWA Life Holdings plc

(3) Held indirectly through Moderna Försäkringar Liv AB

55 Post balance sheet event

On 19 February 2010, Chesnara plc's Swedish subsidiary, Moderna Försäkringar Liv AB ('Moderna'), entered into an agreement with the Swedish Regulatory Authority, Finansinspektionen ('FI'), to take over the operational management of Aspis Försäkrings Liv AB ('Aspis'). This means that Moderna will acquire the in force business, the personnel, expertise and systems of Aspis and will also manage, but not be responsible for, the payment of in-force claims that had occurred up to 12 November 2009. Moderna, under the terms of an asset transfer agreement entered into on 10 December 2009, acquired the right to offer renewal policies to Aspis policyholders from 12 November 2009.

The FI had recently determined to revoke the Aspis licence due to issues regarding its solvency capital which remained unresolved. By taking this opportunity Moderna removes significant uncertainty for the Aspis customers, staff and supporting intermediaries and acquires a book of protection business which represents an excellent strategic fit with its current pension and savings business. The transaction is expected to be earnings enhancing in the medium term but, given the recent timing of the transaction, we are unable to make a reliable estimate of the effect on the Group's financial results at this time. This is because the negative press coverage that Aspis received within Sweden prior to the agreement will have had a negative impact on lapse rates of policies at the date of renewal which will impact the quantification of the value of the in-force intangible assets acquired. As a result, the fair value of the net assets acquired and the goodwill arising on acquisition cannot be assessed with reliability at this time.

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 the Directors of Chesnara plc on the European Embedded Value (EEV) Basis Financial Statements

We have audited the European Embedded Value ("EEV") basis financial statements of Chesnara plc for the year ended 31 December 2009 which comprise the summarised EEV consolidated income statement, the summarised EEV consolidated balance sheet, the summarised EEV consolidated statement of changes in equity and the related notes 1 to 11. The EEV basis financial statements have been prepared using the methodology and assumptions set out on pages 165 to 171.

We have reported separately on the statutory group financial statements of Chesnara plc for the year ended 31 December 2009. The EEV basis financial statements should be read in conjunction with the financial statements prepared on an IFRS basis.

This report is made solely to the company's directors in accordance with our engagement letter and solely for the purpose of expressing an opinion on whether the EEV basis financial statements have been properly prepared in accordance with the EEV principles issued in May 2004 by the European Insurance CFO Forum and supplemented by Additional Guidance on EEV Disclosures issued by the same body in October 2005 ("the EEV principles"). Our audit work has been undertaken so that we might state to the company's directors those matters we are required to state to them in an independent auditors' report and for no other purpose. To the fullest extent permitted by law, we will 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 auditors

The directors' responsibilities for preparing the financial statements in accordance with the EEV principles are set out in the Statement of Directors' Responsibilities in respect of the EEV basis financial statements.

Our responsibility is to audit the EEV basis financial statements 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 EEV basis financial statements have been properly prepared in accordance with the EEV principles using the methodology and assumptions set out on pages 165 to 171. We also report if we have not received all the information and explanations we require for our audit.

We read the other information contained in the Annual Report as described in the contents section and consider whether it is consistent with the audited EEV basis financial statements. We consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the EEV basis financial statements. Our responsibilities do not extend to any further information outside the Annual Report.

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 EEV basis financial statements. It also includes an assessment of the significant estimates and judgements made by the directors in the preparation of the EEV basis financial statements, and of whether the accounting policies are appropriate to the group's circumstances, consistently applied and adequately disclosed.

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

Opinion

In our opinion, the EEV basis financial statements for the year ended 31 December 2009 have been properly prepared in accordance with the EEV principles using the methodology and assumptions set out on pages 165 to 171.

Deloitte LLP 30 March 2010
Chartered Accountants
Manchester, United Kingdom
M60 2AT

Supplementary Information – European Embedded Value Basis

Summarised EEV consolidated income statement

	Note	Year ended 31 December 2009 £000	Year ended 31 December 2008 £000
Operating profit of covered business	6	**19,120**	**25,521**
Other operational result		868	385
Operating profit		**19,988**	**25,906**
Variation from longer-term investment return		13,750	(16,831)
Effect of economic assumption changes		(9,730)	6,951
Profit before tax and before exceptional item		**24,008**	**16,026**
Exceptional item			
Profit on acquisition of subsidiary company		54,187	–
Profit before tax		**78,195**	**16,026**
Tax		12,070	(1,200)
Profit for the year		**90,265**	**14,826**
Attributable to:			
Shareholders		90,272	14,826
Non-controlling interest		(7)	–
		90,265	**14,826**
Earnings per share			
Based on profit for the period attributable to shareholders		88.94p	14.25p
Diluted earnings per share			
Based on profit for the period attributable to shareholders		88.94p	14.25p

The notes and information on pages 165 to 177 form part of this supplementary information.

Summarised EEV consolidated balance sheet

	Note	31 December 2009 £000	31 December 2008 £000
Assets			
Value of in force business	5,8	198,312	84,940
Deferred acquisition costs arising on unmodelled business		197	–
Acquired value of customer relationships		346	–
Internally-developed software		4,060	–
Property and equipment		491	–
Investment in associate		1,051	–
Reinsurers' share of insurance contract provisions		209,537	165,648
Amounts deposited with reinsurers		26,240	21,404
Investment properties		3,355	3,432
Deferred tax assets		1,972	–
Financial assets			
Equity securities at fair value through income		454,970	363,879
Holdings in collective investment schemes at fair value through income		1,612,861	576,502
Debt securities at fair value through income		247,836	279,104
Insurance and other receivables		19,822	11,056
Prepayments		3,784	1,600
Policyholders' funds held by the Group		41,107	–
Derivative financial instruments		7,964	5,570
Total financial assets		2,388,344	1,237,711
Reinsurers' share of accrued policy claims		4,728	4,100
Income taxes		395	–
Cash and cash equivalents		155,241	192,381
Total assets		**2,994,269**	**1,709,616**
Liabilities			
Bank overdraft		2,312	1,094
Insurance contract provisions		1,049,906	907,071
Financial liabilities			
Investment contracts at fair value through income		1,543,915	573,955
Borrowings		36,307	8,358
Derivative financial instruments		54	70
Liabilities relating to policyholders' funds held by the Group		41,107	–
Total financial liabilities		1,621,383	582,383
Provisions		1,452	3,397
Reinsurance payables		15,039	1,397
Payables related to direct insurance and investment contracts		30,433	23,891
Income taxes		1,313	1,181
Other payables		9,833	6,494
Total liabilities		**2,731,671**	**1,526,908**
Net assets		**262,598**	**182,708**
Equity			
Share capital		41,501	41,501
Share premium		20,458	20,458
Treasury shares		(3,379)	(3,379)
Foreign exchange reserve		5,539	–
Other reserves		50	50
Retained earnings		198,416	124,078
Total shareholders' equity		**262,585**	**182,708**
Non-controlling interest		13	–
Total equity	5,8	**262,598**	**182,708**

The notes and information on pages 165 to 177 form part of this supplementary information.
Approved by the Board of Directors on 30 March 2010 and signed on its behalf by:

Ken Romney **Graham Kettleborough**

Supplementary Information – European Embedded Value Basis (continued)

Summarised EEV consolidated statement of changes in equity

	Year ended 31 December	
	2009 £000	**2008 £000**
Shareholders' equity at 1 January	**182,708**	**187,315**
Purchase of treasury shares	–	(3,379)
Profit for the period attributable to shareholders	90,272	14,826
Foreign exchange reserve movement	5,539	
Dividends paid	(15,934)	(16,054)
Shareholders' equity at 31 December	**262,585**	**182,708**

The notes and information on pages 165 to 177 form part of this 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.

In order to improve understanding of the Group's financial position and performance, certain of the information presented in these financial statements is presented on a segmental basis: the business segments are the same as those described in Note 8 to the primary financial statements prepared on the IFRS basis. The Swedish Business was acquired on 23 July 2009: accordingly, the results relating thereto, as reflected in segmental analysis are for a period just in excess of five months. Prior year information in respect of the financial position as at 31 December 2008 and for the year then ended is designated as £nil in respect of the Swedish Business, while other prior year data are designated as not applicable ('n/a').

2 Covered business

The Group uses EEV methodology to value the bulk of its long-term business (the 'covered business'), which is written primarily in the UK and Sweden, as follows:

(i) for the UK Business, the covered business comprises the business's long-term business being those individual life insurance, pensions and annuity contracts falling under the definition of long-term insurance business for UK regulatory purposes. The operating expenses of the holding company, Chesnara plc, are treated as an integral part of the UK covered business.

(ii) for the Swedish Business, the covered business comprises the business's long-term pensions and savings unit-linked business. Group life and sickness business, including waiver of premium and non-linked individual life assurance policies are not included in the covered business: the result relating to this business is established in accordance with IFRS principles and is included within 'other operational result' within the consolidated summarised income statement.

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.

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

UK Business

Much of the covered business is in run-off and is, accordingly, substantially closed to new business. The UK Business does still sell a small amount of new business 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.

Swedish Business

New business, in relation to the pensions and savings covered business is taken as all business where contracts are signed and new premiums paid during the reporting period, for both new policies and premium increases on existing business, but excluding standard renewals. New business premium volumes as disclosed in the Business Review on page 17 are not consistent with this definition, as they include non-covered business. They also relate to the full 2009 calendar year, as that is deemed more appropriate for that disclosure, which is made for illustrative purposes only. New business premium volume for the period which is consistent with the analysis of profit in Note 6, being the period from 23 July 2009, the date of acquisition of the Swedish Business, to 31 December 2009, is as follows:

New business premium income relating to
pensions and savings covered business, £16.5m *

*Basis: annualised premium plus 1/10 single premium translated into sterling at the post-acquisition average rate of SEK 11.5594 = £1.

The new business contribution has been assessed as at the end of the period, using opening assumptions.

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 cash flow.

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, excluding those payments made on behalf of policyholders, being policyholder tax in the UK Business and yield tax in the Swedish Business.

Cost of capital

The cost of holding the required capital to support the covered business (see 3(b) 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

UK Business

The principal financial options and guarantees in the UK Business 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.

Swedish Business

In respect of the Swedish Business, some contracts provide policyholders with an investment guarantee, whereby a minimum rate of return is guaranteed for the first 5 years of the policy, at a rate of 3% per annum. As at 31 December 2009, the total amount guaranteed was approximately £0.6m. Thus, due to low volumes and the limited exposure, the value of the guarantee is ignored as not material to the results.

3 Methodology (continued)

Allowance for risk

Allowance for risk within the covered business is made by:

(i) setting required capital levels by reference to the assessment of capital needs made by the directors of the regulated entities within the UK and Swedish Businesses (the 'Directors');

(ii) 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

(iii) explicit allowance for the cost of financial options and guarantees and, where appropriate, for reinsurer default.

Internal Group Company

EEV Guidance requires that actual and expected profit or loss incurred by an internal group company on services provided to the covered business should be included in allowances for expenses. The covered business in the Swedish Business is partially managed by an internal group fund management company. Not all relevant future income and expenses of that company have been included in the calculation of embedded value. However, the effect is not considered to be material.

(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 respective businesses. 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 (a) for the UK Business, 150% of the long-term insurance capital requirement ('LTICR') together with 100% of the resilience capital requirement ('RCR'), as determined by the regulations of the Financial Services Authority in the UK and (b) for the Swedish Business, 150% of the regulatory solvency requirement as determined by Finansinspektionen in Sweden.

The required level of regulatory capital is provided as follows:

(i) for the UK Business, by the retained surplus within the long-term business fund and by share capital and retained earnings within the shareholder funds of the regulated entity; and

(ii) for the Swedish Business, by share capital and additional equity contributions from the parent company, net of the accumulated deficit in the regulated entity, these components together comprising shareholder's equity.

The Swedish Business is reliant, in the medium term, on further equity contributions from the parent company, Chesnara plc.

(c) Discount Rates

The discount rates are a combination of the reference rate and a risk margin. The reference 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 discount rates, the Group 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 discount rate and bond-based cash flows at a bond discount rate. In practice a short-cut method known as the 'certainty equivalent' approach has been adopted. This method assumes that all cash flows earn the reference rate of return and are discounted at the reference rate. In general, and consistent with the market's approach to valuing financial instruments for hedging purposes, the reference rate is based on swap yields. In respect of the UK Business, where, in prior years, non-linked business was substantially backed by government bonds, the yields on these assets were taken. During 2009, the investment guidelines for the relevant part of the UK Business were revised, so the use of yields on government backed bonds is no longer appropriate, resulting in the use of swap yields for all reference rates.

Within the risk margin, allowance also needs to be made for non-market risks. For some of these risks, such as mortality and expense risk, it is assumed that the shareholder can diversify away any uncertainty where the impact of variations in experience on future cash flows 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 has been added to the risk margin. The margin added reflects the assumed risks within the businesses and is 50 basis points for the UK Business and 70 basis points for the Swedish Business.

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. For the UK Business, the expenses relating to corporate governance functions eliminate any taxable investment return in shareholder funds, while investment management fees are not material. For the Swedish Business, appropriate allowance is made for the cost of tax on locked-in capital and the cost for an investor of owning an asset indirectly via an investment policy rather than by direct investment into the underlying assets.

At previous reporting dates it has been our practice, having calculated an embedded value using a market-consistent method, to undertake a process known as the calibration of the Risk Discount Rate ('RDR'), whereby we have equated the results from a traditional embedded value approach, including assumed actual investment returns and traditional cost of capital, to that derived using the market-consistent method. Accordingly, the discount rate required for the traditional embedded value, to equate the results, represents the RDR, and the difference between this derived RDR and the risk-free rate is the risk margin. Disclosures, including the analysis of profit and the sensitivities, were then presented on the traditional embedded value method. In order to streamline the process, all amounts disclosed for 2009 reporting have been presented using the market-consistent method. This does not impact the level of embedded value reported, but results in changes in the disclosed sensitivities and in the analysis of profit. Unlike previous reporting periods there is no RDR to disclose.

(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, calculated on opening assumptions.

The return from in-force business is calculated using closing assumptions and comprises:

(i) the expected return, being the unwind of the discount rates 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.

3 Methodology (continued)

(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 2009.

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 UK covered business, except for a relatively small amount of expense, which is assumed to relate to business development functions, to reflect effort expended within the holding company relating to 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.

In addition, the demographic assumptions used at December 2009 are considered to be best estimate and, consequently, no further adjustments are required. In respect of the UK Business, 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.

(f) Pension Schemes

In the Swedish Business, where the Group participates in a combined defined benefit and defined contribution scheme, future contributions to the scheme are reflected in the value of in-force business.

4 Assumptions

(a) Investment Returns

Investment returns are assumed to be equal to the reference rate, as covered in note 3(c) above. For linked business, the aggregate return has been determined by the reference rate less an appropriate allowance for tax.

	UK Business 31 December		Swedish Business 31 December	
	2009	**2008**	**2009**	**2008**
Investment Return	3.8%	3.6%	3.74%*	n/a
Inflation				
RPI	2.9%	1.5%	2.0%	n/a

*A full swap curve is used: the rate quoted is for a term of ten years and is presented as an indicative rate.

(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.

For the UK Business, 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.

For the Swedish business, these have been determined by reference to:

(i) an expense analysis in which all expenses were allocated to covered and uncovered business, with expenses for the covered business being allocated to acquisition and maintenance activities; and

(ii) expense drivers, being, in relation to acquisition costs, the number of policies sold during the period and, in relation to maintenance expenses, the average number of policies in force during the period.

The expense assumptions for the UK Business also include the expected future holding company expenses which will be recharged to the worldwide covered business.

No allowance has been made for future productivity improvements in the expense assumptions.

(e) Discount Rate

The reference rate is set by reference to mid swap rates available in the market at the end of the reporting period.

An explicit constant margin is added to the reference 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, which is 50 basis points for the UK Business and 70 basis points for the Swedish Business, gives due recognition to the fact that:

(a) For the UK Business:

  (i) the covered business is substantially closed to new business;

  (ii) there is no significant exposure in the with profit 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.

(b) For the Swedish Business:

  (i) the covered business remains open;

  (ii) the in-force business is relatively small;

  (iii) reinsurance is used to significantly reduce insurance risks; and

  (iv) a number of the risks provide diversification benefits within the Chesnara Group, in relation to reinsurance counterparties, market exposures and policyholder populations.

The sensitivity of the value of in-force business to the discount rate being greater for the Swedish Business than for the UK Business, the relative margins provided by these adjustments is more material (more than twice) for the Swedish Business than for the UK Business, to reflect these different risks.

4 Assumptions (continued)

	UK Business 31 December		Swedish Business 31 December	
	2009	2008	2009	2008
Reference rate	3.8%	3.6%	3.74%*	n/a
Non-diversifiable risk	0.5%	0.5%	0.7%	n/a
Discount rate	4.3%	4.1%	4.44%*	n/a

*A full swap curve is used: the rate quoted is for a term of ten years and is presented as an indicative rate.

5 Analysis of shareholders' equity

31 December 2009	UK Business £000	Swedish Business £000	Other Group Activities £000	Total £000
Regulated entities				
Capital required	32,042	12,123	–	44,165
Free surplus	40,253	12,337	–	52,590
Shareholders' net worth of regulated entities	**72,295**	**24,460**	**–**	**96,755**
Adjustments to shareholder net worth				
Deferred acquisition costs	–	(44,721)	–	(44,721)
Financial reinsurance liability	–	(5,313)	–	(5,313)
Other asset / liability adjustments	–	4,299	–	4,299
Adjusted shareholder net worth	**72,295**	**(21,275)**	**–**	**51,020**
In-force value of covered business	85,559	112,753	–	198,312
Embedded value of regulated entities	**157,854**	**91,478**	**–**	**249,332**
Less: amount financed by borrowings	(4,197)	–	–	(4,197)
Embedded value of regulated entities attributable to shareholders	**153,657**	**91,478**	**–**	**245,135**
Net equity of other Group companies	–	(1,048)	18,498	17,450
Total shareholders' equity	**153,657**	**90,430**	**18,498**	**262,585**

31 December 2008	UK Business £000	Swedish Business £000	Other Group Activities £000	Total £000
Regulated entities				
Capital required	35,615	–	–	35,615
Free surplus	33,774	–	–	33,774
Shareholders net worth of regulated entities	**69,389**	**–**	**–**	**69,389**
In-force value of covered business	84,940	–	–	84,940
Embedded value of regulated entities	**154,329**	**–**	**–**	**154,329**
Less: amount financed by borrowings	(8,358)	–	–	(8,358)
Embedded value of regulated entities attributable to shareholders	**145,971**	**–**	**–**	**145,971**
Net equity of other Group companies	–	–	36,737	36,737
Total shareholders' equity	**145,971**	**–**	**36,737**	**182,708**

The movement in the in-force value of covered business comprises:

Year ended 31 December 2009	UK Business £000	Swedish Business £000	Total £000
Value at beginning of period	**84,940**	**–**	**84,940**
Amount arising on acquisition	–	95,953	95,953
Amount credited/ charged to operating profit	619	16,800	17,419
Value at end of period	**85,559**	**112,753**	**198,312**

Year ended 31 December 2008	UK Business £000	Swedish Business £000	Total £000
Value at beginning of period	**94,007**	**–**	**94,007**
Amount charged to operating profit	(9,067)	–	(9,067)
Value at end of period	**84,940**	**–**	**84,940**

UK Business

(i) 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 UK regulated entity 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 2008 and a further £4.2m was repaid on 2 June 2009, leaving principal outstanding at that date of £4.2m.

(ii) The embedded value of regulated entities comprises the embedded value of the covered business only.

Swedish Business

(i) The adjusted shareholder net worth of the Swedish Business is that of the regulated entity, which includes also the net worth attributable to the non-covered business within the regulated entity.

Accordingly, for the Swedish Business, the embedded value of regulated entities comprises the embedded value of covered business and the value of the non-covered business of the regulated entity, the latter component being valued on an IFRS basis.

6 Analysis of profit

Year ended 31 December 2009	UK Business £000	Swedish Business £000	Total £000
Covered business			
New business contribution	1,482	783	2,265
Return from in-force business			
Expected return	7,357	1,682	9,039
Experience variances	4,499	2,060	6,559
Operating assumption changes	8,862	(7,405)	1,457
Return on shareholder net worth	(200)	–	(200)
Operating profit	**22,000**	**(2,880)**	**19,120**
Variation from longer-term investment return	6,206	7,544	13,750
Effect of economic assumption changes	(12,286)	2,556	(9,730)
Profit on covered business before tax	**15,920**	**7,220**	**23,140**
Tax thereon	11,893	–	11,893
Profit on covered business after tax	**27,813**	**7,220**	**35,033**
Results of non-covered business and of other group companies			
Profit before tax, and exceptional item			868
Exceptional profit arising on acquisition of Swedish Business			54,187
Tax			177
Profit after tax			**90,265**
Non-controlling interest			7
Profit for the period attributable to shareholders			**90,272**

Year ended 31 December 2008	UK Business £000	Swedish Business £000	Total £000
Covered business			
New business contribution	715	–	715
Return from in-force business			
Expected return	10,445	–	10,445
Experience variances	9,166	–	9,166
Operating assumption changes	4,590	–	4,590
Return on shareholder net worth	605	–	605
Operating profit	**25,521**	–	**25,521**
Variation from longer-term investment return	(16,831)	–	(16,831)
Effect of economic assumption changes	6,951	–	6,951
Profit on covered business before tax	**15,641**	–	**15,641**
Tax thereon	(1,376)	–	(1,376)
Profit on covered business after tax	**14,265**	–	**14,265**
Results of non-covered business and of other group companies			
Profit before tax,			385
Tax			176
Profit after tax attributable to shareholders			**14,826**

The results of the non-covered business and of other Group companies before tax and before exceptional item are presented as ‘other operating income’ in the consolidated income statement. For UK Business, the result of the covered business includes the expenses of the holding company, with an equal and opposite adjustment to the result of the non-covered business and of other Group companies.

Included within the effect of economic assumption changes in respect of the UK Business for the year ended 31 December 2009 is an amount of £5,620,000 being a reduction of pre-tax profit relating to a change in the basis of taxation of overseas dividends. This change leads to a reduction in the estimate of future deductions for taxation from policyholder linked funds and is matched by a broadly offsetting reduction in the estimate of future tax payable. This is a significant component of the tax credit of £11,893,000 in respect of tax for the UK Business for the year ended 31 December 2009 as shown above.

7 Sensitivities to alternative assumptions

The following tables show the sensitivity of the embedded value as reported at 31 December 2009, and of the new business contribution of the Swedish Business for the five months then ended, 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 of the UK Business for the year ended 31 December 2009 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 broadly insensitive to changes in experience.

	Embedded Value		New Business Contribution
	UK Business £m	Swedish Business £m	Swedish Business £m
Published value as at 31 December 2009	**153.7**	**90.4**	**0.8**
Changes in embedded value/new business contribution arising from:			
Economic sensitivities			
100 basis point increase in yield curve	(3.9)	(1.5)	(0.1)
100 basis point reduction in yield curve	2.5	1.4	0.1
10% decrease in equity and property values	(3.5)	(6.4)	(0.3)
Operating sensitivities			
10% decrease in maintenance expenses	2.1	5.4	0.3
10% decrease in lapse rates	2.5	8.4	0.5
5% decrease in mortality/morbidity rates			
Assurances	1.2	0.4	0.1
Annuities	(0.9)	n/a	n/a
Reduction in the required capital to statutory minimum	0.1	0.1	–

The published value of the new business contribution relating to the Swedish Business and the related changes due to the stated sensitivities are for a five-month post-acquisition period.

The key assumption changes represented by each of these sensitivities are as follows:

Economic sensitivities

(i) 100 basis point increase in the yield curve. The reference rate is increased by 1% The rate of future inflation has also been increased by 1% so that real yields remain constant;

(ii) 100 basis point reduction in the yield curve. The reference rate is reduced by 1% The rate of future inflation has also been reduced by 1% so that real yields remain constant; 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;

7 Sensitivities to alternative assumptions (continued)

(iii) 5% decrease in mortality/morbidity rates giving rise to, for example, a base assumption of 95% of the parameters in a selected mortality/morbidity table reducing to 90.25% 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 that defined in Note 3(b) above to the minimum requirement prescribed by 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 reference rate.

Excluding the sensitivities relating to a 100 basis point increase and reduction in the yield curve, both of which are presented, 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 shareholders' equity on the EEV basis

	Swedish Business	UK Business	Other Group Activities	Total
31 December 2009	**£000**	**£000**	**£000**	**£000**
Shareholders' equity on the IFRS basis	**47,696**	**93,561**	**18,498**	**159,755**
Adjustments				
Deferred acquisition costs				
Investment contracts	(1,447)	(7,173)	–	(8,620)
Deferred income	–	12,319	–	12,319
Adjustment to provisions on investment contracts, net of amounts deposited with reinsurers	–	(15,038)	–	(15,038)
Adjustments to provisions on insurance contracts, net of reinsurers' share	–	(238)	–	(238)
Acquired in-force value	(61,675)	(18,282)	–	(79,957)
Acquired value of customer relationships	(2,336)	–	–	(2,336)
Adjustment to borrowings	(5,073)	–	–	(5,073)
Deferred tax	512	2,949	–	3,461
Shareholder net worth	**(22,323)**	**68,098**	**18,498**	**64,273**
Value of in-force business	112,753	85,559	–	198,312
Shareholders' equity on the EEV basis	**90,430**	**153,657**	**18,498**	**262,585**
Shareholder net worth comprises:				
Shareholder net worth in regulated entities	(21,275)	72,295	–	51,020
Shareholders' net equity in other Group companies	(1,048)	–	18,498	17,450
Debt finance	–	(4,197)	–	(4,197)
Total	**(22,323)**	**68,098**	**18,498**	**64,273**

31 December 2008	Swedish Business £000	UK Business £000	Other Group Activities £000	Total £000
Shareholders' equity on the IFRS basis	**–**	**89,631**	**36,737**	**126,368**
Adjustments				
Deferred acquisition costs				
Investment contracts	–	(8,047)	–	(8,047)
Deferred income	–	13,705	–	13,705
Adjustment to provisions on investment contracts, net of amounts deposited with reinsurers	–	(15,863)	–	(15,863)
Adjustments to provisions on insurance contracts, net of reinsurers' share	–	(610)	–	(610)
Acquired in-force value	–	(21,020)	–	(21,020)
Deferred tax	–	3,235	–	3,235
Shareholder net worth	**–**	**61,031**	**36,737**	**97,768**
Value of in-force business	–	84,940	–	84,940
Shareholders' equity on the EEV basis	**–**	**145,971**	**36,737**	**182,708**
Shareholder net worth comprises:				
Shareholder net worth in regulated entities	–	69,389	–	69,389
Shareholders' net equity on other Group companies	–	–	36,737	36,737
Debt finance	–	(8,358)	–	(8,358)
Total	**–**	**61,031**	**36,737**	**97,768**

9 Exceptional item

The profit arising on acquisition of a subsidiary company is presented as an exceptional item in the consolidated income statement. It arises on the purchase, on 23 July 2009, of 100% of the issued share capital of Moderna Försäkringar Liv AB ('Moderna'), comprising the Swedish Business, and is measured as the difference between the purchase consideration of SEK 250,000,000 (£19,956,000) and the embedded value of the Moderna Group at the purchase date, being SEK 917,356,510 (£74,143,000), which was established in accordance with the methodology set out in Notes 2 to 4 of these supplementary financial statements.

10 Earnings per share

	Year ended 31 December	
	2009 p	2008 p
Basic earnings per share		
Based on profit for the period attributable to shareholders	88.94	14.25
Based on profit for the period attributable to shareholders before exceptional item	35.55	14.25
Diluted earnings per share		
Based on profit for the period attributable to shareholders	88.94	14.25
Based on profit for the period attributable to shareholders before exceptional item	35.55	14.25

11 Foreign exchange translation reserve

A foreign exchange translation reserve arises on the translation of the financial statements of the Swedish Business, the functional currency of which is the Swedish Krona, into pounds sterling, which is the presentational currency of the Group financial statements. Items in the consolidated income statement are translated at the average exchange rate of SEK11.5594 = £1 ruling in the reported period, while all items in the balance sheet are stated at the closing rates ruling at the reported balance sheet date, being SEK11.5305 = £1 at 31 December 2009. The differences arising on translation using this methodology are recognised directly in shareholders' equity within the foreign exchange translation reserve.

The reported embedded value is sensitive to movements in the SEK:£ exchange rate. Had the exchange rate as at 31 December 2009 been 10% higher at SEK12.6836 = £1, then the reported embedded value of £262.6m as at 31 December 2009 would have been reported as £254.4m.

Chesnara plc

Company No. 4947166

NOTICE OF ANNUAL GENERAL MEETING

Notice is given that the 2010 Annual General Meeting of Chesnara plc will be held at the offices of Panmure Gordon (UK) Limited, Moorgate Hall, 155 Moorgate, London EC2M 6XB on 13 May 2010 at 11 a.m. for the business set out below. Resolutions 1 to 9 will be proposed as ordinary resolutions and resolutions 10 to 13 will be proposed as special resolutions.

1 To receive and adopt the Financial Statements for the financial year ended 31 December 2009 together with the reports of the directors and auditor thereon.

2 To declare a final dividend of 10.30 pence per share for the financial year ended 31 December 2009.

3 To approve the directors' remuneration report set out in the Financial Statements for the financial year ended 31 December 2009.

4 To re-elect Ken Romney as a director who retires by rotation in accordance with the Company's Articles of Association.

5 To re-elect Frank Hughes as a director who retires by rotation in accordance with the Company's Articles of Association.

6 To appoint Deloitte LLP as auditors of the Company to hold office until the conclusion of the next general meeting of the Company at which accounts are laid before shareholders.

7 To authorise the directors to fix the auditors' remuneration.

8 That, from the date of this resolution until the earlier of 12 August 2011 and the conclusion of the Company's next annual general meeting, the Company and all companies which are its subsidiaries at any time during such period are authorised:

(a) to make donations to political parties or independent election candidates;

(b) to make donations to political organisations other than political parties; and

(c) to incur political expenditure,

up to an aggregate total amount of £100,000, with the amount authorised for each of heads (a) to (c) above being limited to the same total. Any such amounts may comprise sums paid or incurred in one or more currencies. Any sum paid or incurred in a currency other than sterling shall be converted into sterling at such rate as the board may decide is appropriate. Terms used in this resolution have, where applicable, the meanings that they have in Part 14 of the Companies Act 2006 on "Control of political donations and expenditure".

9 That the directors be generally and unconditionally authorised in accordance with section 551 of the Companies Act 2006 to exercise all the powers of the Company to allot shares in the Company to grant rights to subscribe for or to convert any security in to such shares ("Allotment Rights") but so that:

(a) the maximum amount of shares that may be allotted or made the subject of Allotment Rights under this authority are shares with an aggregate nominal value of £3,382,746, of which:

(i) one-half may be allotted or made the subject of Allotment Rights in any circumstances; and

(ii) the other half may be allotted or made the subject of Allotment Rights pursuant to any rights issue (as referred to in the Financial Services Authority's listing rules) or pursuant to any arrangements made for the placing or underwriting or other allocation of any shares or other securities included in, but not taken up under, such rights issue;

(b) this authority shall expire 15 months after the passing of this resolution or, if earlier, on the date of the Company's next Annual General Meeting;

(c) the Company may make any offer or agreement before such expiry which would or might require shares to be allotted or Allotment Rights to be granted after such expiry;

(d) all authorities vested in the directors on the date of the notice of this meeting to allot shares or to grant Allotment Rights, or to allot relevant securities (as defined in the Companies Act 1985), that remain unexercised at the commencement of this meeting are revoked.

10 That, subject to the passing of resolution 9, the directors be and they are empowered, pursuant to section 570 of the Companies Act 2006, to allot equity securities (as defined in section 560 of that Act) pursuant to the authority contained in the foregoing resolution numbered 9 as if section 561 of that Act did not apply to such allotment, provided that this power shall be limited to:

(a) the allotment of equity securities in connection with any rights issue or open offer (each as referred to in the Financial Services Authority's listing rules) or any other pre-emptive offer that is open for acceptance for a period determined by the directors to the holders of ordinary shares on the register on any fixed record date in proportion to their holdings of ordinary shares (and, if applicable, to the holders of any other class of equity security in accordance with the rights attached to such class), subject in each case to such exclusions or other arrangements as the directors may deem necessary or appropriate in relation to fractions or such securities, the use of more than one currency for making payments in respect of such offer, any such shares or other securities being represented by depositary receipts, treasury shares, any legal or practical problems in relation to any territory or the requirements of any regulatory body or any stock exchange; and

(b) the allotment of equity securities pursuant to the terms of any share scheme for employees approved by the members in general meetings of the Company; and

(c) the allotment of equity securities for cash (otherwise than as mentioned in sub-paragraphs (a) and (b) 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 15 months after the passing of this resolution or, if earlier, on the date of the Company's next Annual General Meeting save that, before the expiry of this power, the Company may make any offer or agreement which would or might require equity securities to be allotted after such expiry.

11 That the Company be and is generally and unconditionally authorised for the purposes of section 701 of the Companies Act 2006 to make one or more market purchases (as defined in section 693 of that Act) on the London Stock Exchange of ordinary shares of 5p each in the capital of the Company provided that:

(a) the maximum aggregate number of ordinary shares hereby authorised to be purchased is 10,149,259 (representing 10% of the Company's issued share capital excluding shares held in Treasury);

(b) the minimum price (exclusive of expenses) which may be paid for such ordinary shares is 5p per share;

(c) the maximum price (exclusive of expenses) which may be paid for such ordinary shares is the maximum price permitted under the Financial Services Authorities listing rules or, in the case of a tender offer (as referred to in those rules), 5% above the average of the middle market quotations for the ordinary shares derived from the the London Stock Exchange Daily Official List for the five business days before the date on which the terms of the tender offer are announced;

(d) the authority hereby conferred shall expire 15 months after the passing of this resolution or, if earlier, on the date of the Company's next Annual General Meeting; and

(e) 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.

12 That the current articles of association of the Company be amended by the insertion of a new article 125 (G) in the following terms:

"(G) Subject to the statutes, the Company shall not be required to send notices, documents or information to a member where the Company does not hold a current address (as defined in section 423(3) of the Companies Act 2006) for that member".

13 That a general meeting of the Company other than an annual general meeting may be called on not less than 14 clear days' notice.

By order of the Board

Ken Romney
Company Secretary

Registered office:

Harbour House
Portway
Preston
Lancashire
PR2 2PR

Registered in England No. 4947166

Dated 30 March 2010

Notes:

1 **Any Member who is entitled to attend and vote at this meeting is entitled to appoint another person, or two or more person in respect of different shares held by him, as his proxy to exercise all or any of his rights to attend and to speak and to vote at the meeting.**

2 A member wishing to attend and vote at the meeting in person should arrive prior to the time fixed for its commencement. A member that is a corporation can only attend and vote at the meeting in person through one or more representatives appointed in accordance with section 323 of the Companies Act 2006. Any such representative should bring to the meeting written evidence of his appointment such as a certified copy of a board resolution of, or a letter from, the corporation concerned confirming the appointment. Any member wishing to vote at the meeting without attending in person or (in the case of a corporation) through its duly appointed representative must appoint a proxy to do so. 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 PXS at 34 Beckenham Road, Beckenham, Kent BR3 4TU or by post to Business Reply Licence No RSBH-UXKS-LRBC, PXS, 34 Beckenham Road, Beckenham, Kent, BR3 4TU not less than 48 hours before the time appointed for the holding of the meeting or, in the case of an adjournment, by no later than 48 hours before the time for the holding of the adjourned meeting. Alternatively, members may submit their proxy vote electronically via www.capitashareportal.com. From there you can log in to your Capita Shareportal account or register for the Capita share portal if you have not already done so. To register, select Account Registration and enter the company name Chesnara plc. Then enter your surname, Investor code, postcode and email address. Create a password and click 'Register' to proceed. You will be able to vote immediately by selecting 'Proxy Voting' from the menu. To be a valid proxy appointment, the member's electronic message confirming the details of the appointment completed in accordance with those instructions must be transmitted so as to be received by the same time. The appointment of a proxy will not preclude a shareholder from attending and voting at the meeting.

3 CREST members who wish to appoint one or more proxies through the CREST system may do so by using the procedures described in "the CREST voting service" section of the CREST Manual. CREST personal members or other CREST sponsored members, and those CREST members who have appointed one or more voting service providers, should refer to their CREST sponsor or voting service provider(s), who will be able to take the appropriate action on their behalf. In order for a proxy appointment or a proxy instruction made using the CREST voting service to be valid, the appropriate CREST message (a "CREST proxy appointment instruction") must be properly authenticated in accordance with the specifications of CREST's operator, Euroclear UK & Ireland Limited ("Euroclear"), and must contain all the relevant information required by the CREST Manual. To be valid, the message (regardless of whether it constitutes the appointment of a proxy or is an amendment to the instruction given to a previously appointed proxy) must be transmitted so as to be received by the Company's "issuer's agent" RA10 not less than 48 hours before the time appointed for the holding of the meeting or of any adjournment of the meeting. After this time any change of instruction to a proxy appointed through the CREST system should be communicated to the appointee through other means. The time of the message's receipt will be taken to be when (as determined by the timestamp applied by the CREST Applications Host) the issuer's agent is first able to retrieve it by enquiry through the CREST system in the prescribed manner. Euroclear does not make available special procedures in the CREST system for transmitting any particular message. Normal system timings and limitations apply in relation to the input of CREST proxy appointment instructions. It is the responsibility of the CREST member concerned to take (or, if the CREST member is a CREST personal member or a CREST sponsored member or has appointed any voting service provider(s), to procure that his CREST sponsor or voting service provider(s) take(s)) such action as is necessary to ensure that a message is transmitted by means of the CREST system by any particular time. CREST members and, where applicable, their CREST sponsors or voting service providers should take into account the provisions of the CREST Manual concerning timings as well as its section on "Practical limitations of the system". In certain circumstances the Company may, in accordance with the Uncertificated Securities Regulations 2001 or the CREST Manual, treat a CREST proxy appointment instruction as invalid.

4 Copies of Directors' service contracts and letters of appointment, together with a copy of the Company's existing articles of association, marked up to show the differences as proposed in resolution 12, 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 6.00 p.m. on 11 May 2010 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 30 March 2010 (being the last business day prior to the publication of this document) the Company's issued share capital consists of 104,588,785 ordinary shares, carrying one vote each. The total voting rights in the Company as at 30 March 2010 (being the last business day prior to the publication of this document) are 101,492,591.

8 Information regarding this meeting, including information required by section 311A of the Companies Act 2006, is available at www.chesnara.co.uk. Any electronic address provided either in this notice or any related documents (including the proxy form) may not be used to communicate with the Company for any purposes other than those expressly stated.

9 In accordance with section 319A of the Companies Act 2006, any member attending the meeting has the right to ask questions. The company must cause to be answered any such question relating to the business being dealt with at the meeting but no such answer need be given if (a) to do so would interfere unduly with the preparation for the meeting or involve the disclosure of confidential information, (b) the answer has already been given on a website in the form of an answer to a question, or (c) it is undesirable in the interests of the Company or the good order of the meeting that the question be answered.

10 Under section 527 of the Companies Act 2006 members meeting the threshold requirements set out in that section have the right to require the Company 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 circumstances 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 shareholders 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, it must forward the statement of 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.

11 Members meeting the threshold requirements in sections 338 and 338A of the Companies Act 2006 have the right to require the Company (i) to give to members entitled to receive notice of the meeting notice of a resolution which may properly be moved and is intended to be moved at the meeting and/or (ii) to include in the business to be dealt with at the meeting any matter (other than a proposed resolution) which may be properly included in the business. A resolution may properly be moved or a matter may properly be included in the business unless (a) (in the case of a resolution only) it would, if passed, be ineffective (whether by reason of inconsistency with any enactment or the Company's constitution or otherwise), (b) it is defamatory of any person, or (c) it is frivolous or vexatious. Such a request may be in hard copy form or in electronic form, must identify the resolution of which notice is to be given or (as applicable) the matter to be included in the business, must be authenticated by the person or persons making it, must be received by the Company not later than 6 weeks before the meeting, and (in the case of a matter to be included in the business only) must be accompanied by a statement setting out the grounds for the request.

EXPLANATORY NOTES TO THE NOTICE OF ANNUAL GENERAL MEETING

The notes on the following pages give an explanation of the proposed resolutions:

Resolution 1:

Report and accounts

For each financial year the directors are required to present the directors' report, the audited accounts and the auditors' reports to shareholders at a general meeting.

Resolution 2:

Final dividend

The payment of the final dividend requires the approval of shareholders in general meeting. If the meeting approves resolution 2, the final dividend of 10.30 pence per share will be paid on 20 May 2010 to ordinary shareholders who are on the register of members on 16 April 2010 in respect of each ordinary share.

Resolution 3:

Approval of the directors' remuneration report

The Company is required by law to seek the approval of shareholders of its annual report on remuneration policy and practice. This does not affect the directors' entitlement to remuneration and the result of this resolution is advisory only.

The remuneration report for the year ended 31 December 2009 is set out in full on pages 43 to 49 of this document.

Your directors are satisfied that the Company's policy and practice in relation to directors' remuneration are reasonable and that they deserve shareholder support.

Resolutions 4 – 5:

Re-election of directors

Under the Company's articles of association directors are obliged to retire by rotation at annual general meetings and may not serve beyond three years without being re-elected by shareholders. The directors who now fall due for retirement and re-election, through separate resolutions numbered 4 to 5 are Ken Romney and Frank Hughes. Brief biographical details of both directors seeking re-election can be found on page 8 of this document. Following formal performance evaluation of the Board, both continue to be effective and demonstrate commitment to the role. The remaining directors therefore unanimously recommend that each of these directors be re-elected as a director of the Company.

Resolutions 6 – 7:

Appointment and remuneration of auditors

The Company is required to appoint auditors, at each general meeting before which accounts are laid, to hold office until the end of the next such meeting. Deloitte LLP have indicated that they are willing to act as the Company's auditors. You are asked to appoint them and, following normal practice, to authorise the directors to determine their remuneration. The directors recommend their appointment.

Resolution 8:

Political donations

It has always been the Company's policy that it does not make political donations. This remains the Company's policy.

Part 14 of the Companies Act 2006 imposes restrictions on companies making political donations to any political party or other political organisation or to any independent election candidate unless they have been authorised to make donations at a general meeting of the Company. Whilst the Company has no intention of making such political donations, the Act includes broad and ambiguous definitions of the terms "*political donation*" and "*political expenditure*" which may apply to some normal business activities which would not generally be considered to be political in nature.

The directors therefore consider that, as a purely precautionary measure, it would be prudent to obtain the approval of the shareholders to make donations to political parties, political organisations and independent election candidates and to incur political expenditure up to the specified limit. The directors intend to seek renewal of this approval at future annual general meetings but wish to emphasise that the proposed resolution is a precautionary measure for the above reason and that they have no intention of entering into any party political activities.

Resolution 9:

Power to allot shares

The directors are currently authorised to allot relevant securities of the Company but their authorisation ends on the date of the annual general meeting. This resolution seeks to renew the directors' authority to allot shares. This year is first time the directors are seeking such an authority under the provisions of the Companies Act 2006. Other than changes to statutory references and a minor change in terminology, the allotment authority under the new Act has the same effect as under the Companies Act 1985.

The Association of British Insurers (ABI) published guidance on 31 December 2008 to the effect that ABI Members will regard as routine a request for authorisation to allot new shares in an amount of up to one third of the existing issued share capital and additionally that they will regard as routine requests to authorise the allotment of a further one third, provided that such additional headroom shall be applied to fully pre-emptive rights issues only and the authorisation shall be valid for one year only. This authority was conferred on the directors at last year's annual general meeting and the directors recommend that the Company should have this additional headroom this year. This authority is therefore limited to the amounts set out in resolution 9, being approximately one third in each of parts (a)(i) and (a)(ii) of resolution 9 and approximately two thirds in aggregate of the total ordinary share capital in issue as at 30 March 2010 being the latest practicable date prior to the publication of this document. As at 30 March 2010, the Company held 3,096,194 treasury shares, being approximately 3.05% of the total ordinary share capital in issue (calculated exclusive of treasury shares). The renewed authority will remain in force until 15 months after the passing of the resolution or, if earlier, at the conclusion of the next annual general meeting in 2011.

The directors have no present intention of exercising this authority. The purpose of giving the directors this authority is to maintain the Company's flexibility to take advantage of any appropriate opportunities that may arise.

Resolution 10:

Disapplication of pre-emption rights

This resolution, which will be proposed as a special resolution, seeks to renew the authority conferred on the directors at last year's annual general meeting to issue equity securities of the Company for cash without first offering them to existing shareholders in proportion to their existing shareholdings. This year is the first time the directors are seeking such an authority under the provisions of the Companies Act 2006. Other than changes to statutory references, the disapplication authority under the new Act has the same effect as under the Companies Act 1985. Other than in connection with a rights or other similar issue or scrip dividend (where difficulties arise in offering shares to certain overseas shareholders and in relation to fractional entitlements) the authority contained in this resolution will be limited to an aggregate nominal value of £261,471 which represents 5% of the Company's issued ordinary share capital as at 30 March 2010 (being the latest practicable date prior to the publication of this document). The renewed authority will remain in force until the date of the annual general meeting or 15 months after the passing of the resolution, whichever is the earlier. It is a standard resolution for most UK listed companies each year.

In accordance with the Statement of Principles on disapplying pre-emption rights issued in 2006 by the Pre-Emption Group (which is supported by the Association of British Insurers, the National Association of Pension Funds Limited and the Investment Managers Association), the board confirms its intention that no more than 7.5% of the issued share capital will be issued for cash on a non pre-emptive basis during any rolling three year period. The directors have no present intention of exercising this authority.

Resolution 11

Authority to purchase own shares

This resolution, which will be proposed as a special resolution, is to renew the authority granted to the directors at last year's annual general meeting, which expires on the date of the forthcoming annual general meeting, and

to give the Company authority to buy back its own ordinary shares in the market as permitted by the Companies Act 2006. The authority limits the number of shares that could be purchased to a maximum of 10,149,259 (representing 10% of the issued ordinary share capital of the Company (excluding treasury shares) as at 30 March 2010 (being the latest practicable date prior to the publication of this document)) and sets the minimum and maximum prices. This authority will expire no later than 15 months after the date of the annual general meeting.

Your directors believe that the Company should continue to have the authority to purchase its own shares. The authority will be exercised only if the directors believe that to do so would result in an increase in earnings per share and would promote the success of the Company for the benefit of its shareholders generally. To the extent that any shares so purchased are held in treasury (see below), earnings per share will be enhanced until such time, if any, as such shares are resold or transferred out of treasury.

Any purchases of ordinary shares would be by means of market purchases through the London Stock Exchange.

The Treasury Shares Regulations, which came into force on 1 December 2003, permit the Company to purchase and hold as treasury shares, ordinary shares with an aggregate nominal value not exceeding 10% of the nominal value of the issued ordinary shares of the Company at the relevant time. Shares held in treasury in this manner can be cancelled, sold for cash or, in appropriate circumstances, used to meet obligations under employee share schemes. Any shares held in treasury would not be eligible to vote nor would any dividend be paid on any such shares. If any ordinary shares purchased pursuant to this authority are not held by the Company as treasury shares then such shares would be immediately cancelled in which event the number of ordinary shares in issue would be reduced.

The directors believe that it continues to be desirable for the Company to have this choice. Holding the repurchased shares as treasury shares gives the Company the ability to re-issue them quickly and cost effectively and provides the Company with additional flexibility in the management of its capital base. No dividends will be paid on, and no voting rights will be exercised in respect of, treasury shares. In 2009 3,096,194 shares were held in treasury and none was cancelled.

This resolution also authorises the Company to transfer any treasury shares held by it for the purposes of its employee share plans. Treasury shares transferred for these purposes will, so long as required under the guidelines of the Association of British Insurers Investment Committee, count towards the limits in those plans on the number of new shares which may be issued.

Resolution 12:

Amendment to the articles of association

This special resolution will approve the making of an amendment to the Company's current articles of association. This amendment will allow the Company to stop sending correspondence, including Financial Statements, to members where it does not hold a current address for that member.

Resolution 13:

Notice of general meetings

This special resolution is required following the implementation of the Shareholder Rights Directive (**Directive**). The regulations which implemented the Directive increase the notice period for general meetings of the Company to 21 days. The Company's articles of association permit the Company to call general meetings (other than an annual general meeting) on 14 clear days notice. In order to be able to preserve this ability, shareholders must have approved the calling of meetings on 14 days' notice. Resolution 13 seeks such approval. The approval will be effective until the Company's next annual general meeting, when it is intended that a similar resolution will be proposed. The Company will also need to meet the requirements for electronic voting under the Directive before it can call a general meeting on 14 days' notice.

The directors recommend all shareholders to vote in favour of all the resolutions, as the directors intend to do so in respect of their own shares, and consider that they are in the best interests of the Company and the shareholders as a whole.

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