

**ROYAL & SUN ALLIANCE INSURANCE PLC**

**Report & Accounts**

**for the year ended 31st December 2006**

**WEDNESDAY**



A36 \*A2DONOTH\* 57  
18/04/2007  
COMPANIES HOUSE

<b>Contents</b>	<b>Page</b>
Directors	2
Directors' report	3-6
Statement of directors' responsibilities	7
Independent auditors' report	8
Accounting policies	9-14
Estimation techniques, uncertainties and contingencies	15-18
Profit and loss account	19-20
Statement of total recognised gains and losses	20
Reconciliation of movements in shareholders' funds	20
Balance Sheet	21-22
Notes to the Accounts	23-48

**Royal & Sun Alliance Insurance plc**  
**Directors**

**Directors**

R J Clayton  
D P Cockrem  
I A Craston  
M G Culmer  
M Harris  
A K Haste  
A P Latham  
S P G Lee  
B F McIntyre

**Secretary**

L Thomas

**Registered office**

St Mark's Court  
Chart Way  
Horsham  
West Sussex  
RH12 1XL

**Auditors**

PricewaterhouseCoopers LLP  
Chartered Accountants and Registered Auditors  
Southwark Towers  
32 London Bridge Street  
London  
SE1 9SY

### **Business review and principal activities**

The principal activity of the Company, its subsidiaries and overseas branches is the transaction of insurance and related financial services in the United Kingdom and overseas. The results for the Company show a profit on ordinary activities before tax of £151m (2005 £635m) for the year and gross premiums written of £3,313m (2005 £3,482m). The shareholders' funds of the Company were £4,180m as at 31 December 2006 (31 December 2005 £4,242m).

### **Future outlook**

The Company is focused on driving strong retention of business and in building momentum in its target markets in the UK and overseas to deliver profitable growth. The Company is committed to disciplined risk selection and underwriting and to the delivery of sustainable earnings.

### **Principal risks and uncertainties**

From the perspective of the Company, the principal risks and uncertainties are integrated within the principal risks of the Royal and Sun Alliance Group plc (the Group) and are not managed separately. Accordingly, the principal risks and uncertainties of the Group, which include those of the Company, are set out in the estimation techniques, uncertainties and contingencies on pages 50 to 52, and in the risk framework on pages 20 to 23 of the Annual Report & Accounts of the Group which do not form part of this report.

A discussion on the Management of Financial Risk is set out below.

### **Key performance indicators**

The directors of Royal & Sun Alliance Group manage the Group's operations on a divisional basis. For this reason the Company's directors believe that analysis using key performance indicators (KPIs) for the Company is not necessary or appropriate for an understanding of the development, performance or position of the business of the Company. Financial KPIs are detailed in the Annual Report & Accounts of the Group (which do not form part of this report) within the Group CEO review on pages 6 to 9 and the regional business reviews on pages 12 to 17. This document also includes non-financial KPIs which are detailed in the regional business reviews on pages 12 to 17, the corporate responsibility report on pages 24 to 25 and the directors' report on pages 29 to 30.

### **Dividends**

An interim dividend of £300m was declared on 18th December 2006. The directors do not recommend payment of a final ordinary dividend (2005 £Nil).

### **Directors and their interests**

The names of the current directors are listed on page 2. S P G Lee and B F McIntyre were appointed as directors on 22 March 2006 and D M Boyle resigned as a director on 22 March 2006. H M Maxwell resigned as a director on 8 January 2007 and R J Clayton was appointed as a director on the same date. I A Craston was appointed a director on 27 March 2007. The other directors whose names appear on page 2 held office throughout the year. None of the directors had any interests in the shares of the Company.

# Royal & Sun Alliance Insurance plc

## Directors' Report (continued)

for the year ended 31st December 2006

The interests in the ordinary shares of 27 5p each in Royal & Sun Alliance Insurance Group plc of M G Culmer, A K Haste and B F McIntyre, who were also directors of that company during the year are disclosed in the financial statements of that company. The interests of A P Latham in the ordinary shares of 27 5p each in Royal & Sun Alliance Insurance Group plc are disclosed in the financial statements of Royal Insurance Holdings plc. The interests in the ordinary shares of 27 5p each in Royal & Sun Alliance Insurance Group plc of D P Cockrem, M Harris, S P G Lee and H M Maxwell were as follows

	Ordinary shares held at 1st January 2006 or on appointment (Note 1)	Ordinary shares acquired during the year	Ordinary shares disposed during the year	Ordinary shares held at 31st December 2006
D P Cockrem	-	-	-	-
M Harris	-	-	-	-
S P G Lee	24,125	859	-	24,984
H M Maxwell	-	-	-	-

Note 1 Ordinary shares of 27 5p each

In addition to the interests shown above, D P Cockrem, M Harris, S P G Lee and H M Maxwell had a beneficial interest, as at 31 December 2006 in 17,751,097 (2005 19,182,272) shares of 27 5p each in Royal & Sun Alliance Group held in the Royal & Sun Alliance Group ESOP Trust and 4,938,894 (2005 4,938,894) shares of 27 5p each in Royal & Sun Alliance Group held in the Royal & Sun Alliance Group ESOP Trust No 2. All employees of the Group and certain option-holders have a beneficial interest in the shares held in these trusts with the exception of the executive directors of Royal & Sun Alliance Insurance Group plc who are excluded from the beneficiaries of the Royal & Sun Alliance ESOP Trust.

The interests in options to subscribe for ordinary shares of Royal & Sun Alliance Group of D P Cockrem, M Harris, S P G Lee and H M Maxwell were as follows

	Held at 1st January 2006 or on appointment	Options to subscribe for shares			Held at 31st December 2006
		Granted/ Vested	During the year		
			Exercised	Lapsed	
D P Cockrem	208,716				208,716
M Harris	251,466	-	-	-	251,466
S P G Lee	1,379,354	92,113	-	-	1,471,467
H M Maxwell	386,084	13,757	-	-	399,841

Long-term incentive scheme interests held during 2006 in respect of the ordinary shares of 27 5p each in Royal & Sun Alliance Insurance Group plc for M Harris, S P G Lee and H M Maxwell were as follows

### Share Matching Plan

		Share awards held at 1st January 2006 or on appointment	Share awards granted	During the year		Share awards held at 31st December 2006
				Share awards exercised/ vested	Share awards lapsed	
M Harris	Deferred share awards	25,713	-	-	-	25,713
	Matching share awards	77,139	-	-	-	77,139
S P G Lee	Deferred share awards	139,409	-	43,327	-	96,082
	Matching share awards	418,227	-	48,786	81,195	288,246
H M Maxwell	Deferred share awards	12,942	-	6,471	-	6,471
	Matching share awards	38,826	-	7,286	12,127	19,413

## Royal & Sun Alliance Insurance plc

### Directors' Report (continued)

for the year ended 31st December 2006

#### Long Term Incentive Plan

		Share awards held at 1st January 2006 or on appointment	Share awards granted during the year	Share awards held at 31st December 2006	Date by which qualifying conditions must be met
D P Cockrem	Deferred shares	-	22,538	22,538	12/06/09
	Matching shares	-	70,036	70,036	12/06/09
	Performance shares	-	39,292	39,292	12/06/09
M Harris	Deferred shares	-	40,618	40,618	12/06/09
	Matching shares	-	122,083	122,083	12/06/09
	Performance shares	-	78,585	78,585	12/06/09
S P G Lee	Deferred shares	-	114,422	114,422	12/06/09
	Matching shares	-	359,952	359,952	12/06/09
	Performance shares	-	208,471	208,471	12/06/09
H M Maxwell	Deferred shares	-	31,086	31,086	12/06/09
	Matching shares	-	97,704	97,704	12/06/09
	Performance shares	-	39,292	39,292	12/06/09

Details of the Share Matching Plan and Long-term Incentive Plan are contained in the Group Annual Report & Accounts of Royal & Sun Alliance Group

#### **Employment Policy**

The Company's employment policies reflect our belief that motivated and skilled employees are critical to our success

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

The Company is committed to preventing discrimination on the grounds of disability. This includes ensuring that all job applicants, including those with a disability, are considered solely on the basis of ability to do the job, and making reasonable adjustments to working environment, working arrangements and working conditions to support disabled employees. We are committed, wherever possible, to supporting the rehabilitation and return to work of employees who become disabled during their career with us.

The Company is committed to fostering a constructive dialogue with independent trade unions wherever they are recognised, ensuring a regular and constructive dialogue on business issues and early consultation on changes affecting the workforce. In the UK, Amicus is formally recognised through a partnership agreement which covers collective consultation and bargaining on behalf of non management employees. The Management Association (TMA) represents managerial employees under a separate consultative agreement. An annual employee survey is conducted to measure organisational effectiveness and the impact of employment policies.

Our policy is to encourage employee share ownership. Employees from our businesses are encouraged to participate in the International Sharesave Plan of the Royal & Sun Alliance Group which is an HM Revenue & Customs approved all employee sharesave scheme.

The Company actively encourages employees to become involved in supporting their local communities, both through the recognition of charitable efforts or fund raising by individual employees or teams and formal partnerships or corporate sponsorships.

#### **Financial risk**

The Company is exposed to financial risk through its financial assets, financial liabilities, reinsurance assets and insurance liabilities. In particular the key financial risk is that the proceeds from the realisation of its financial assets are not sufficient to fund the obligations arising from its insurance contracts.

## Royal & Sun Alliance Insurance plc

### Directors' Report (continued)

for the year ended 31st December 2006

The Company manages its financial assets within a framework that has been developed to seek to ensure the ability to meet its obligations under insurance contracts. A key principle behind this process is to hold assets that provide a broad match against the liabilities arising from insurance contracts.

There is a potential risk within the investment portfolio arising from an inappropriate matching of cash and fixed interest assets against liabilities by duration. However the relatively short duration of a general insurance portfolio together with the Company's strategy of broadly matching assets and liability by duration provides mitigation against these risks. The Company reviews the duration of its liabilities and asset portfolios to ensure that they remain broadly matched. Investment directives limit permissible duration ranges within the individual portfolios. These directives also include objectives for liquidity, asset sector concentration and credit quality. The Company is not party to any arrangements for which hedge accounting is used.

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

Market risk arises within the Company's equity portfolio. A committee oversees the Company's investment strategy and sets appropriate risk limits to ensure that no significant concentrations to individual companies or sectors arise.

Liquidity risk is considered to be a low risk category. Liquidity is managed such that the Company maintains a minimum level of cash or cash equivalents or highly liquid assets that can be liquidated within a maximum stated period of time. Contingency funding plans are prepared and monitored to ensure that these minimum levels are met even in stress conditions.

#### Supplier payment policy

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

The Company's outstanding indebtedness to trade creditors on 31st December 2006 amounted to £3.4m, corresponding to 3 days payment when averaged over the year.

#### Post balance sheet events

On 4 March 2007 the Royal & Sun Alliance Insurance Group plc announced the completion of the disposal of its US operation to Arrowpoint Capital Corp.

#### Auditors

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

Following an extensive review process earlier in the year by the Group, the directors will propose at the 2007 AGM that Deloitte & Touche LLP be appointed as auditors of the Company for the year ending 31 December 2007. PricewaterhouseCoopers LLP will stand down to enable Deloitte & Touche LLP to be appointed in their place.

By order of the board



L. Thomas  
Secretary  
11 April 2007

**Royal & Sun Alliance Insurance plc**  
**Statement of Directors' Responsibilities**

**Directors' responsibilities**

The directors are required by UK company law to prepare financial statements for each financial year which give a true and fair view of the state of affairs of the Company as at the end of the financial year and of the profit or loss of the Company for that period

The directors confirm that suitable accounting policies have been used and applied consistently, and reasonable and prudent judgements and estimates have been made in the preparation of the financial statements for the year ended 31st December 2006. The directors also confirm that applicable accounting standards have been followed and that the financial statements have been prepared on the going concern basis

The directors have responsibility for ensuring that the Company keeps proper accounting records. The directors have general responsibility for taking such steps as are reasonably open to them to safeguard the assets of the Company and to prevent and detect fraud and other irregularities

**INDEPENDENT AUDITORS' REPORT TO THE MEMBERS OF ROYAL & SUN ALLIANCE INSURANCE plc**

We have audited the financial statements of Royal & Sun Alliance Insurance plc for the year ended 31st December 2006 which comprise the profit and loss account, the statement of total recognised gains and losses, the movement in shareholders' funds, the balance sheet and the related notes including the accounting policies and estimation techniques, uncertainties and contingencies. These financial statements have been prepared under the accounting policies set out therein.

**RESPECTIVE RESPONSIBILITIES OF DIRECTORS AND AUDITORS**

The directors' responsibilities for preparing the financial statements in accordance with applicable law and United Kingdom Accounting Standards (United Kingdom Generally Accepted Accounting Practice) are set out in the Statement of Directors' Responsibilities.

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

We report to you our opinion as to whether the financial statements give a true and fair view and are properly prepared in accordance with the Companies Act 1985. We also report to you whether, in our opinion, the information given in the Directors' Report is consistent with the financial statements.

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

We read the directors' report and consider the implications for our report if we become aware of any apparent misstatements within it.

**BASIS OF OPINION**

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

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

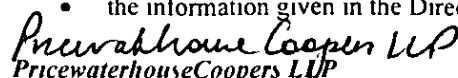
**EQUALISATION PROVISIONS**

Our evaluation of the presentation of information in the financial statements has had regard to the statutory requirement for insurance companies to maintain equalisation provisions in respect of general insurance business. The nature of equalisation provisions, the amounts set aside at 31st December 2006 and the effect of the movement in those provisions during the year on shareholders' funds, the balance on the general business technical account and the profit before tax are disclosed in note 8.

**OPINION**

In our opinion:

- the financial statements give a true and fair view, in accordance with United Kingdom Generally Accepted Accounting Practice, of the state of the Company's affairs as at 31st December 2006 and of its profit for the year then ended, and
- the financial statements have been properly prepared in accordance with the Companies Act 1985, and
- the information given in the Directors' Report is consistent with the financial statements.

  
PricewaterhouseCoopers LLP  
Chartered Accountants and Registered Auditors  
London, United Kingdom  
16 April 2007

## FINANCIAL STATEMENTS

The financial statements are prepared in accordance with applicable UK accounting standards and in compliance with s255 of and Schedule 9A to, the Companies Act 1985, and the Statement of Recommended Practice (SORP) Accounting for Insurance Business issued by the Association of British Insurers in December 2005. As noted in the investment accounting policy the true and fair override has been adopted in respect of the valuation of the Group's investment properties and no depreciation is provided. The Company has taken advantage of the exemption under s228 of CA85, to allow it not to prepare consolidated financial statements.

## CHANGES IN ACCOUNTING POLICIES

During the year the Company adopted the following financial reporting standards and has changed its accounting policies accordingly:

- The Company has adopted Financial Reporting Standard (FRS) 20 Share-based payment. There is no impact on current or prior years' profit resulting from the adoption of the standard.
- The Company has adopted Financial Reporting Standard (FRS) 26 Financial Instruments: Measurement in full in these financial statements. The adoption of this standard has given rise to the following changes in accounting policy:
  - listed investments treated as financial assets "at fair value through profit or loss" have been revalued at the bid price, having previously been valued at mid-market value
  - interest income is recognised using the effective interest rate method
- The Company has also adopted Financial Reporting Standard (FRS) 25 Financial Instruments: Disclosures and Presentation. There is no impact on current or prior years' profit resulting from the adoption of this standard, as its provisions relate to disclosure.
- The Company has adopted Financial Reporting Standard (FRS) 23 The Effects of Changes in Foreign Exchange Rates. There is no impact on current or prior years' profit resulting from the adoption of this standard.
- Financial Reporting Standard (FRS) 24 Financial Reporting in Hyperinflationary Economies is also applicable for the 2006 year end but its adoption has had no impact on the financial statements.

The Company's accounting policies have been changed to reflect the adoption of the above FRSs.

The impacts of the changes in accounting policies during the year are explained in Note 1 to the Financial Statements.

## TRANSLATION OF FOREIGN CURRENCIES

Assets and liabilities of businesses denominated in foreign currencies are translated into sterling at rates ruling at the year end and results of business denominated in foreign currencies are translated at the average rate for the period, the resulting exchange differences are taken to reserves. Transactions denominated in foreign currencies are translated at the prevailing rate at the date of the transaction and the resulting exchange differences are included within the Profit and Loss Account.

## INSURANCE CONTRACTS – PRODUCT CLASSIFICATION

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

## **GENERAL BUSINESS TECHNICAL ACCOUNT**

General business is accounted for on an annual basis. Premiums written are accounted for in the year in which the contract is entered into and include estimates where the amounts are not determined at the balance sheet date. Premiums written exclude taxes and duties levied on premiums. The commission and other acquisition costs incurred in writing the business are deferred and amortised over the period in which the related premiums are earned.

Claims paid represent all payments made during the period whether arising from events during that or earlier periods.

The balance on the General Business Technical Account is arrived at after taking account of changes in the equalisation provisions.

## **INVESTMENT RETURN**

Investment income is recognised in the Non-Technical Account. Dividends on equity investments are recognised on the date at which the investment is priced 'ex dividend'. Interest income is recognised using the effective interest rate method. Realised and unrealised gains and losses on investments are dealt with in the Non-Technical Account.

## **TAXATION**

Taxation in the Non-Technical Account is based on profits and income for the year as determined in accordance with the relevant tax legislation, together with adjustments to provisions for prior years. UK tax in respect of overseas subsidiaries and principal associated undertakings is based on dividends received.

Deferred tax is provided in full and consists of the estimated taxation or relief from taxation which is expected to arise from material timing differences using rates based on tax rates and laws that have been substantively enacted by the balance sheet date. Provision is made for taxation which might arise on the distribution of profits retained by overseas subsidiaries or associated undertakings only to the extent that dividends have been accrued as receivable. Credit is taken for relief for trading and other losses only to the extent that the directors anticipate that suitable profits will absorb such losses in future periods.

## **GOODWILL**

Goodwill, being the difference between the cost of an unincorporated business acquisition and the Company's interest in the net fair value of the identifiable assets and liabilities acquired, is initially capitalised in the balance sheet at cost and is subsequently recognised at cost less accumulated amortisation and any impairment losses. The cost of the acquisition is the amount of cash paid and the fair value of other purchase consideration given together with directly related expenses. Goodwill is regarded as having a limited useful life that does not exceed twenty years and is amortised on a straight line basis over its useful life.

Goodwill is subject to an impairment review at the end of the first full financial year following the initial recognition of the goodwill and, in other periods, if events or changes in circumstances indicate that its carrying value may not be recoverable in full. Where the review reveals that the carrying amount is more than the recoverable amount, an impairment is recognised.

## **ASSOCIATES**

Associates are entities over which the Company has significant influence but not control, generally accompanying a shareholding of between 20% and 50% of the voting rights. Investments in associates are accounted as investments in participating interests and are carried in the balance sheet at a directors' valuation (based upon the Company's share of the net current assets of the associate). Changes in the valuation of associates are recognised in the Statement of Total Recognised Gains and Losses. Dividends from associates are accounted for as income in the period in which the Company becomes entitled to receive the dividend.

## **ESTIMATION OF THE FAIR VALUE OF FINANCIAL ASSETS AND LIABILITIES OTHER THAN INVESTMENTS IN SUBSIDIARIES**

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

- For fixed maturity securities, fair values are generally based upon quoted market prices. Where market prices are not readily available, fair values are estimated using either values obtained from quoted market prices of comparable securities or estimated by discounting expected future cashflows using a current market rate applicable to the yield, credit quality and maturity of the investment.

- For equity securities fair values are based upon quoted market prices,
- If the market for a financial asset is not active, the Company establishes fair value by using valuation techniques. These include the use of recent arm's length transactions, reference to other instruments that are substantially the same, discounted cashflow analysis and option pricing models,
- For mortgage loans on real estate and collateral loans, fair values are estimated using discounted cashflow calculations based upon prevailing market rates,
- For cash, short term investments, commercial paper, other assets, liabilities and accruals carrying amounts approximate to fair value,
- For notes, bonds and loans payable, fair values are determined by reference to quoted market prices or estimated using discounted cashflow calculations based upon prevailing market rates. Loan capital is carried at amortised cost and when this is different from fair value this is shown in the relevant note. Fair value in this case is based on discounted future cashflows. For borrowings that carry a variable rate of interest (other than loan capital), carrying values approximate to fair values, and
- For derivatives, fair values are generally based upon quoted market prices

#### **INVESTMENT PROPERTY**

Investment properties are shown at market value and are valued annually by independent professionally qualified valuers at open market value. Unrealised gains and losses are recognised in the Non-Technical Account.

The Companies Act requires properties to be depreciated over their expected useful economic lives. The directors consider that depreciation of investment properties would not give a true and fair view. In accordance with Statement of Standard Accounting Practice 19 'Accounting for Investment Properties', no depreciation is provided on these properties on the basis that depreciation is already reflected in the annual valuations. The amounts attributed to this factor by the valuers cannot reasonably be separately identified or quantified.

It is the Company's practice to maintain properties occupied by the Company in a continual state of sound repair. Accordingly the directors consider that the economic lives of these properties and their residual values, based on prices prevailing at the time of acquisition or subsequent valuation, are such that any depreciation is insignificant and is thus not provided.

#### **FINANCIAL ASSETS**

A financial asset is initially recognised, on the date the Company commits to purchase the asset, at fair value plus transaction costs that are directly attributable to its acquisition. A financial asset is derecognised when the rights to receive cashflows from the investment have expired or have been transferred and the Company has also transferred substantially the risks and rewards of ownership of the asset.

Where the following conditions are satisfied, financial assets (other than derivatives and originated loans and receivables) are designated upon initial recognition as at fair value through profit or loss. The conditions are that the performance of the assets is evaluated on a total return basis (including the changes in fair values) in accordance with a documented investment strategy and information is provided internally to the Company's key management personnel on this basis.

On subsequent measurement, investments are measured at fair value with changes in fair value recognised in the Non-Technical Account. Originated loans and receivables are measured at amortised cost.

#### **INVESTMENTS IN SUBSIDIARIES**

Investments in subsidiaries are included at net asset value. Reductions in carrying value of subsidiaries below historic cost and reversals of such reductions are recognised in the Non Technical Account. Other changes in the carrying value of subsidiaries are recognised in the Statement of Total Recognised Gains and Losses, and the accumulated gains are recognised in Revaluation Reserve.

## **DERIVATIVES**

Derivatives are recognised in the Balance Sheet on a trade date basis and are carried at fair value. Derivatives are carried as assets when fair value is positive and as liabilities when fair value is negative. All gains and losses arising are taken to the Non-Technical Account.

## **TANGIBLE ASSETS AND DEPRECIATION**

Tangible assets, other than land and buildings, comprise fixtures, fittings and equipment (including computers and motor vehicles) are stated at cost and depreciated over periods not exceeding their estimated useful lives (between three and ten years) after taking into account residual value.

## **SUBORDINATED LOANS**

Subordinated loans are classified according to their contractual terms.

Subordinated loans are classified as a separate class of capital when the terms of the loan contain no obligation on the Company to deliver cash or another financial asset to another entity or to exchange financial assets or financial liabilities with another entity under conditions that are potentially unfavourable to the Company and contain no provision to settle the loan through the issue of equity instruments of the Company. Interest paid on such subordinated loans is not recognised in the profit and loss account and is deducted from the profit and loss reserve when paid.

Subordinated loans are classified as liabilities when the conditions above are not met. Interest costs on such subordinated loans are calculated using the effective interest method and are recognised in the Non-Technical Account.

## **TECHNICAL PROVISIONS**

The provision for unearned premiums represents the proportion of premiums written relating to periods of insurance subsequent to the balance sheet date, calculated principally on a daily pro rata basis.

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

Provisions for claims outstanding, and related reinsurance recoveries, are discounted where there is a particularly long period from incident to claims settlement and where there exists a suitable claims payment pattern from which to calculate the discount. In defining those claims with a long period from incident to claims settlement, those categories of claims where the average period of settlement is six years or more from the balance sheet date, has been used as a guide.

Differences between the estimated cost and subsequent settlement of claims are dealt with in the technical account for the year in which they are settled or re-estimated.

Provision is made, based on information available at the balance sheet date, for any estimated future underwriting losses relating to unexpired risks after taking into account future investment income on relevant technical provisions. The unexpired risk provision is assessed in aggregate for business classes which, in the opinion of the directors, are managed together.

Equalisation provisions are established in accordance with the requirements of legislation in certain countries and are in addition to the provisions required to meet the anticipated ultimate cost of settlement of outstanding claims at the balance sheet date.

## **OPERATING LEASES**

Payments made under operating leases are charged on a straight line basis over the term of the lease.

## **PENSION COSTS**

### **Employee Benefits**

#### **Retirement Benefits**

A defined contribution scheme is a pension scheme under which the Company pays fixed contributions into a separate entity. A defined benefit scheme is a pension scheme that defines an amount of pension benefit that an employee will receive on retirement, usually dependant on one or more factors such as age, years of service and level of salary.

Contributions to defined contribution pension schemes are charged in the period in which the employment services qualifying for the benefit are provided.

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

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

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

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

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

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

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

The expected return on scheme assets is calculated, based upon the average rate of return (including both income and changes in fair value), net of scheme expenses, expected over the remaining life of the related obligation on the actual assets held by the scheme.

Actuarial gains and losses arise from changes to actuarial assumptions when revaluing future benefits, and from actual experience in respect of scheme liabilities and investment performance of scheme assets being different from previous assumptions. Actuarial gains and losses are recognised in the Statement of Total Recognised Gains and Losses.

The value recognised in the Balance Sheet for each individual post retirement scheme, is calculated as follows:

- The present value of defined benefit obligation of the scheme at the balance sheet date,
- Minus any past service cost not yet recognised,
- Minus the fair value at the Balance Sheet date of the scheme assets out of which the obligations are to be settled directly, and
- Plus, or minus the deferred tax liability or asset respectively relating to the defined benefit asset or liability.

**PENSION COSTS (continued)**

**Termination benefits**

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

**SHARE BASED PAYMENT**

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

Vesting conditions, other than those based upon market conditions, are not taken into account when estimating the fair value of such awards but are taken into account by adjusting the number of equity instruments included in the ultimate measurement of the transaction amount. The value of the awards is recognised as an expense on a systematic basis over the period during which the employment services are provided.

## **Royal & Sun Alliance Insurance plc**

### **Estimation Techniques, Uncertainties & Contingencies**

#### **Introduction**

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

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

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

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

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

#### **Estimation techniques**

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

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

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

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

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

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

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

**Estimation Techniques, Uncertainties & Contingencies (continued)**

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

The pension assets and pension and post retirement liabilities are calculated in accordance with Financial Reporting Standard 17 (FRS17). The assets, liabilities and income statement charge, calculated in accordance with FRS17, are sensitive to the assumptions made, including inflation, interest rate, investment return and mortality. FRS17 compares, at a given date, the current market value of a pension fund's assets with its long term liabilities, which are calculated using a discount rate in line with yields on 'AA' rated bonds of suitable duration and currency. As such, the financial position of a pension fund on this basis is highly sensitive to changes in bond rates and equity markets.

**Uncertainties and contingencies**

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

- uncertainty as to whether an event has occurred which would give rise to a policyholder suffering an insured loss,
- uncertainty as to the extent of policy coverage and limits applicable,
- uncertainty as to the amount of insured loss suffered by a policyholder as a result of the event occurring, and
- uncertainty over the timing of a settlement to a policyholder for a loss suffered.

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

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

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

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

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

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

**Asbestos and environmental claims**

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

**Estimation Techniques, Uncertainties & Contingencies (continued)**

Factors contributing to this higher degree of uncertainty include

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

**Acquisitions and disposals**

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

**Contracts with third parties**

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

**Litigation, mediation and arbitration**

The Company, in common with the insurance industry in general, is subject to litigation, mediation and arbitration, and regulatory, governmental and other sectoral inquiries in the normal course of its business. In addition the Royal & Sun Alliance Group is subject to litigation in connection with its former ownership of its US operation. The directors do not believe that any current mediation, arbitration, regulatory, governmental or sectoral inquiries and pending or threatened litigation or dispute, as outlined elsewhere in this note, will have a material adverse effect on the Company's financial position, although there can be no assurance that losses resulting from any pending mediation, arbitration, regulatory, governmental or sectoral inquiries and threatened litigation or dispute will not materially affect the Company's financial position or cash flows for any period.

**Reinsurance**

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

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

**Investment risk**

The Company is exposed to credit risk on its invested assets. Credit risk includes the non performance of contractual payment obligations on invested assets and adverse changes in the credit worthiness of invested assets including exposures to issuers or counterparties for bonds, equities, deposits and derivatives. Our insurance investment portfolios are concentrated in listed securities. We use derivative financial instruments to reduce our exposure to adverse fluctuations in interest rates, foreign exchange rates and equity markets. We have strict controls over the use of derivative instruments.

**Royal & Sun Alliance Insurance plc**

**Estimation Techniques, Uncertainties & Contingencies (continued)**

**Changes in foreign exchange rates may impact our results**

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

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

**Rating agencies**

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

**Regulatory environment**

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

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

Royal & Sun Alliance Insurance plc

Profit & Loss Account

Technical Account

for the year ended 31st December 2006

	Notes	2006 £m	Restated 2005 £m
Gross premiums written	33	3,313	3,482
Outward reinsurance premiums		(536)	(726)
<b>Premiums written, net of reinsurance</b>		<b>2,777</b>	<b>2,756</b>
Change in the gross provision for unearned premiums		(62)	6
Change in the provision for unearned premiums, reinsurers' share		(76)	-
<b>Earned premiums, net of reinsurance</b>		<b>2,639</b>	<b>2,762</b>
<b>Claims paid</b>			
Gross amount		(2,452)	(2,235)
Reinsurers' share		605	564
		(1,847)	(1,671)
<b>Change in the provision for claims</b>			
Gross amount		419	(4)
Reinsurers' share		(272)	(110)
		147	(114)
<b>Claims incurred, net of reinsurance</b>		<b>(1,700)</b>	<b>(1,785)</b>
<b>Net operating expenses</b>	3	<b>(878)</b>	<b>(811)</b>
Change in the equalisation provision	8	(10)	(37)
<b>Balance on the Technical Account for General Business</b>		<b>51</b>	<b>129</b>

Current year discontinued and acquired operations do not form a material part of the figures above

The Accounting Policies on pages 9 to 14 and the notes on pages 23 to 48 form part of these financial statements

# Royal & Sun Alliance Insurance plc

## Profit & Loss Account

### Non-Technical Account

for the year ended 31st December 2006

#### Non-technical account

	Notes	2006 £m	Restated 2005 £m
<b>Balance on the General Business Technical Account</b>		<b>51</b>	<b>129</b>
Investment income	9	366	384
Realised gains on realisation of investments	9	63	60
Profit on disposal of significant shareholdings	9	-	61
		<b>429</b>	<b>505</b>
Unrealised gains on trading investments / investment property		77	80
Impairment of subsidiary undertakings	9	(184)	-
Investment expenses and charges	9	(219)	(101)
<b>Operating profit</b>		<b>154</b>	<b>613</b>
(Loss)/profit on disposal of subsidiary undertakings and branches		(3)	22
<b>Profit on ordinary activities before tax</b>		<b>151</b>	<b>635</b>
Tax charge on profit on ordinary activities	11	(66)	(207)
<b>Profit for the financial year attributable to shareholders</b>		<b>85</b>	<b>428</b>
Dividends	12	(300)	-
<b>Transfer (from)/to retained profits</b>		<b>(215)</b>	<b>428</b>

#### Statement of total recognised gains and losses

	Notes	Revaluation Reserve £m	Profit and loss account £m	2006 £m	Restated 2005 £m
Profit for the financial year		-	85	85	428
Foreign exchange gains / (losses)		-	5	5	(2)
Tax on foreign exchange gains / (losses)		-	(1)	(1)	-
Movement in valuation of participating interests		(2)	-	(2)	173
Pension fund actuarial gains / (losses)	5	-	170	170	(68)
<b>Total recognised (losses)/gains arising in the year</b>		<b>(2)</b>	<b>259</b>	<b>257</b>	<b>531</b>
Prior year adjustment	1	-	(13)	(13)	-
<b>Shareholders' recognised (losses)/gains since 31 December 2005</b>		<b>(2)</b>	<b>246</b>	<b>244</b>	

#### Movement in shareholders' funds

	Notes	Share Capital/ Premium £m	Revaluation Reserve £m	Profit and loss account £m	2006 £m	Restated 2005 £m
<b>Shareholders' funds at 1 January (as reported)</b>		<b>3,774</b>	<b>-</b>	<b>481</b>	<b>4,255</b>	<b>3,741</b>
Prior year adjustment	1	-	-	(13)	(13)	(13)
<b>Shareholders' funds at 1 January (as restated)</b>		<b>3,774</b>	<b>-</b>	<b>468</b>	<b>4,242</b>	<b>3,728</b>
Shareholders' recognised (losses)/gains		-	(2)	259	257	531
Transfer		-	2	(2)	-	-
Interest on subordinated debt net of tax	21	-	-	(19)	(19)	(17)
Dividends	12	-	-	(300)	(300)	-
<b>Shareholders' funds at 31 December</b>		<b>3,774</b>	<b>-</b>	<b>406</b>	<b>4,180</b>	<b>4,242</b>

The accounting policies on pages 9 to 14 and the notes on pages 23 to 48 form part of these financial statements

Royal & Sun Alliance Insurance plc

**Balance Sheet**  
as at 31st December 2006

ASSETS	Notes	2006 £m	Restated 2005 £m
<b>Intangible assets</b>	15	2	2
<b>Investments</b>			
Land and buildings	13	448	438
<b>Investments in Group undertakings and participating interests</b>			
Investment in subsidiary undertakings	18	6,154	6,259
Interests in associated undertakings	17	6	8
		6,160	6,267
<b>Other financial investments</b>			
Shares and other variable yield securities and units in unit trusts		1,168	1,104
Debt securities and other fixed income securities		3,103	4,248
Loans and deposits with credit institutions		579	241
	13	4,850	5,593
Deposits with ceding undertakings		-	14
<b>Total investments</b>		11,458	12,312
<b>Reinsurers' share of technical provisions</b>			
Provision for unearned premiums		135	212
Claims outstanding		1,016	1,337
		1,151	1,549
<b>Debtors</b>			
Debtors arising out of direct insurance operations	14	1,183	1,140
Debtors arising out of reinsurance operations		112	148
Amounts owed by group undertakings		2,901	2,626
Other debtors		104	97
		4,300	4,011
<b>Other assets</b>			
Tangible assets	16	36	53
Cash at bank and in hand		261	96
		297	149
<b>Prepayments and accrued income</b>			
Accrued interest and rent		51	67
Deferred acquisition costs – general		291	285
Other prepayments and accrued income		145	74
		487	426
		17,695	18,449
<b>Pension fund asset</b>	5	118	-
<b>Total assets</b>		17,813	18,449

The accounting policies on pages 9 to 14 and the notes on pages 23 to 48 form part of these financial statements

<b>LIABILITIES</b>	<b>Notes</b>	<b>2006 £m</b>	<b>Restated 2005 £m</b>
<b>Capital and reserves</b>			
Called up share capital	20	1,128	1,128
Share premium account		2,646	2,646
Profit and loss account		406	468
<b>Shareholders' funds</b>		<b>4,180</b>	<b>4,242</b>
<b>Other capital instruments</b>			
Subordinated loan note equity instrument	21	372	294
<b>Funds attributable to equity holders</b>		<b>4,552</b>	<b>4,536</b>
<b>Technical provisions</b>			
Provision for unearned premiums		1,711	1,656
Claims outstanding	22	5,606	6,192
Equalisation provision	8	338	328
		<b>7,655</b>	<b>8,176</b>
<b>Provisions for other risks and charges</b>	23	193	206
<b>Deposits received from reinsurers</b>		<b>6</b>	<b>82</b>
<b>Creditors</b>			
Creditors arising out of direct insurance operations		68	70
Creditors arising out of reinsurance operations		130	133
Amounts owed to credit institutions	24	55	93
Amounts owed to group undertakings		4,683	4,493
Other creditors including taxation and social security	25	189	224
		<b>5,125</b>	<b>5,013</b>
<b>Accruals and deferred income</b>		<b>221</b>	<b>227</b>
		<b>17,752</b>	<b>18,240</b>
<b>Pension fund liability</b>	5	<b>61</b>	<b>209</b>
<b>Total liabilities</b>		<b>17,813</b>	<b>18,449</b>

The accounting policies on pages 9 to 14 and the notes on pages 23 to 48 form part of these financial statements

The financial statements were approved by the Board on <sup>u</sup> April 2007 and were signed on its behalf by



George Culmer  
Director

# 1 IMPACT OF CHANGES ARISING FROM ACCOUNTING POLICY CHANGES

As explained in the Accounting Policies, during the year the Company made a number of changes to its accounting policies. The impact of each accounting policy change on the results for the years set out below

- The impact of changing the Company's accounting policy in respect of the recognition and measurement of financial instruments was to reduce shareholders' funds at 31 December 2005 by £13m and to reduce the profit after tax during 2005 by £2m net of tax. It is not practicable to assess the impact on the 2006 reported profit as the underlying transactions have only been measured using the revised accounting policy.

Other changes to accounting policies had no impact on the results for the year (2005 £Nil)

# 2 REORGANISATION COSTS AND OTHER ITEMS

Other items within the Technical Account include

	2006 £m	2005 £m
Reorganisation costs	23	36
Operating lease rentals – premises	59	30

Reorganisation costs comprise employee redundancy costs, vacant lease accruals and other restructuring expenses

# 3 NET OPERATING EXPENSES AND OTHER CHARGES

	2006 £m	2005 £m
Net operating expenses in the technical accounts include		
Acquisition costs	271	270
Change in deferred acquisition costs	(8)	20
Administrative expenses	250	142
Reinsurance commissions and profit participations	365	379
	878	811

# 4. EMPLOYEE INFORMATION

	2006 £m	2005 £m
Staff costs for all employees comprise		
Wages and salaries	304	308
Social security costs	32	29
Pension costs	65	(109)
	401	228

Pension costs in 2005 include a one off benefit of £180m due to the change in pension scheme design as described in note 5

	2006 Number	2005 Number
The average number of employees of the Company during the year	10,960	10,781

## 5 RETIREMENT BENEFITS

The Company operates defined contribution pension schemes and funded and unfunded defined benefit pension schemes. The assets of the funded schemes are held in separate trustee administered funds.

In April 2002, the defined benefit schemes were effectively closed to new entrants following the introduction of a new, primarily defined contribution, scheme (the 2002 scheme). However, due to a small defined benefit underpin, the 2002 Scheme is still disclosed as a defined benefit scheme.

In 2005, following discussions with the Trustees and consultation with the members, the defined benefit schemes were altered from providing benefits on a final salary basis to benefits on a revalued average salary basis with effect from 1 January 2006. Under the new benefit formula, the accrued benefits of current active members are based on salaries at the date of change and will increase in line with inflation each year (limited to 5% in any year) up to their retirement date. Benefits earned in future years will be based on salaries in that year and similarly will be revalued up to retirement. As a result of the changes, the liabilities of the schemes are reduced from the date of change. The figures shown in the tables below reflect that reduction at the balance sheet date and the one-off benefit arising from the reduction is recorded as a beneficial item in the charge to the profit before tax in 2005.

In addition to these changes, the 2002 scheme (which was the scheme to which new UK employees have been admitted since the closure of the defined benefit schemes to new members) has been closed to further accrual from 1 January 2006. It has been replaced by a Stakeholder arrangement and members of the 2002 Scheme and future new employees in the UK will accrue future benefits on a defined contribution basis under the Stakeholder Plan. In 2006 contributions of £5m (2005 £4m) were made to defined contribution schemes in the United Kingdom.

For the two main UK defined benefit schemes, the level of contributions in 2006 were 23% and 21% of pensionable salaries (2005 23% and 21%). Additional contributions totalling £86m (2005 £86m) were made to the schemes, in accordance with the plan to reduce their deficits. Expected contributions to pension and post retirement benefit plans for the year ending 31 December 2007 are approximately £175m, including a further £86m of additional contributions.

The major defined benefit schemes are subject to regular valuation using the projected unit method which provides the basis of the pension cost in the profit and loss account. Independent, qualified actuaries carry out valuations of the major defined benefit schemes for the purposes of assessing pension costs.

The components of the defined benefit pension cost that are included within profit before tax in the financial statements are as follows:

	2006 £m	2005 £m
Current service cost	49	64
Past Service cost	15	4
Curtailment gains	(4)	(181)
Total charge/(credit) to be included in Profit before tax	60	(113)
Expected return on assets	(255)	(226)
Interest cost	221	219
Total financing charge to be included in Profit before tax	(34)	(7)

The schemes are effectively closed to new entrants. The current service cost, under the projected unit method, measured as a percentage of active members' salaries, is likely to rise as the members' age profile increases.

**Royal & Sun Alliance Insurance plc**

**Notes on the Accounts (continued)**

**5 RETIREMENT BENEFITS (continued)**

Amounts recognised within the Statement of Total Recognised Gains and Losses

	2006 £m	2005 £m	2004 £m	2003 £m	2002 £m
Actual return on assets in (deficit)/excess of expected return on assets	(29)	425	138	229	(649)
Experience gains/(losses) on liabilities	67	(66)	90	(60)	115
Change in actuarial assumptions	205	(456)	(279)	(221)	81
Movement in irrecoverable surplus	-	-	-	-	-
<b>Actuarial gain/ (loss)</b>	<b>243</b>	<b>(97)</b>	<b>(51)</b>	<b>(52)</b>	<b>(453)</b>
Deferred taxation	(73)	29	15	16	136
<b>Recognised in the Statement of total recognised gains and losses</b>	<b>170</b>	<b>(68)</b>	<b>(36)</b>	<b>(36)</b>	<b>(317)</b>

	2006 %	2005 %	2004 %	2003 %	2002 %
Difference between expected and actual return as a percentage of scheme assets	(0.6)	9.5	3.6	6.5	(20.3)
Experience gains/(losses) as a percentage of scheme liabilities	1.5	(1.4)	2.1	(1.5)	3.1
Change in assumptions as a percentage of scheme liabilities	4.5	(9.5)	(6.5)	(5.5)	2.2
<b>Total actuarial gain to be recognised in Statement of Total Recognised Gains and Losses as a percentage of scheme liabilities</b>	<b>5.3</b>	<b>(2.0)</b>	<b>(1.2)</b>	<b>(1.3)</b>	<b>(12.3)</b>

Movement in deficit during the year	2006 £m	2005 £m
Deficit at 1 January	(299)	(499)
Total operating charge	(60)	113
Employer contribution	164	177
Total financing charge	34	7
Actuarial gain/(loss)	243	(97)
<b>Surplus/(deficit) at 31 December</b>	<b>82</b>	<b>(299)</b>

The value of the defined benefit liability that is included at 31 December in the financial statements is as follows

	2006 £m	2005 £m	2004 £m
Equities	2,086	2,142	1,840
Bonds	2,170	1,922	1,681
Other	417	412	302
<b>Fair value of assets held by pension schemes</b>	<b>4,673</b>	<b>4,476</b>	<b>3,823</b>
<b>Present value of pension liabilities</b>	<b>(4,591)</b>	<b>(4,775)</b>	<b>(4,322)</b>
<b>Net surplus/(deficit)</b>	<b>82</b>	<b>(299)</b>	<b>(499)</b>
Related deferred tax asset	(25)	90	150
<b>Pension fund asset</b>	<b>118</b>	<b>-</b>	<b>-</b>
<b>Pension fund liability</b>	<b>(61)</b>	<b>(209)</b>	<b>(349)</b>
<b>Net pension asset/(liability)</b>	<b>57</b>	<b>(209)</b>	<b>(349)</b>

## 5 RETIREMENT BENEFITS (continued)

Valuations as at 31 March 2006 are currently in progress. The last full valuation dates for the main schemes were 31 March 2004. The FRS 17 liabilities have been derived from the 2004 valuations adjusted for changes in financial conditions and membership changes at 31 December 2006. Valuations have been updated at 31 December 2006 by independent actuaries to take account of changes in the fair value of assets and financial assumptions.

Included in the profit and loss account reserve is a pension and post retirement reserve on a FRS 17 basis at 31 December 2006 of £(259)m (2005 £(429)m).

The main assumptions at 31 December in each year are as follows:

	2006 %	2005 %	2004 %
<b>Assumptions</b>			
Annual rate of general inflation	2.7	2.5	2.5
Annual rate of increase for pensions in payment and deferred pensions	2.7	2.5	2.5
Annual rate of increase in salaries	4.2	4.0	4.0
Interest rate used to discount liabilities	5.1	4.7	5.2
<b>Expected rate of return to be assumed for each class</b>			
Equities	7.5	7.5	7.3
Bonds	4.1	4.1	4.5
Other	6.0	5.9	6.1

The mortality assumptions are set following investigations of the main schemes' recent experience by the scheme actuaries for their funding valuations. The last such valuations were carried out in 2004 and the next ones are due in 2007. Following the last investigations, the mortality assumptions adopted used the PMA92 and PFA92 mortality tables for males and females respectively, with age ratings to reflect the schemes' recent experience compared with that expected under these tables.

Reductions in future mortality rates were allowed for using the 'medium cohort' projection and using the projected mortality rates applicable to calendar year 2012 for current pensioners and 2030 for future pensioners. The weighted average assumptions imply that a current pensioner aged 60 has an expected future lifetime of 24.7 years (males) and 26.8 years (females) and a future pensioner aged 60 has a future lifetime of 26.1 years (males) and 28.1 years (females).

## 6 SHARE BASED PAYMENT

The Royal & Sun Alliance Group (the Group) has four types of share based payment plans in which employees of the Company participate and which are settled in the form of ordinary shares: the Executive Share Option Scheme, the International Sharesave Plan, the Share Matching Plan, and the 2006 Long Term Incentive Plan.

The total employment cost recorded in the Profit and Loss Account for all plans was £9m in 2006 (2005 £6m). These costs include the costs associated with plans, which are settled in the form of ordinary shares for awards that have been granted after 7 November 2002. The value of equity settled awards granted prior to this date have been excluded in accordance with the transitional provisions contained in FRS 20 'Share-based payment'.

### Executive Share Option Scheme

The Group operates an Executive Share Option Scheme which provides options to purchase ordinary shares to officers and other key employees at prices not less than the fair value of the ordinary shares at the date of grant.

The performance conditions in respect of awards under the Executive Share Option Scheme are as follows:

- Options granted following the Group AGM in May 2003 are potentially exercisable if, at the end of the period of 3 business years starting with the business year in which the options were granted, the Group has achieved a Return on Capital (ROC) of at least 6% per annum (after inflation and excluding items of an exceptional nature which in the view of the Remuneration Committee (the Committee) do not reflect the underlying performance of the business) when averaged over the period. One retest is allowed at the end of the fourth business year, but if the performance criterion has not been met over the full 4 year period, the options lapse.

6 SHARE BASED PAYMENT (continued)

- Options granted between September 1998 and May 2003 are also subject to a performance condition that the Group must achieve a ROC of at least 6% (after inflation and excluding items of an exceptional nature which in the view of the Committee do not reflect the underlying performance of the business) when averaged over a consecutive three year period, but if the measure is not satisfied at the end of the third business year following the date of grant, the test can be repeated on an annual basis over the 10 year life of the option
- Options granted between April 1997 and September 1998 were subject to a different performance condition linked to Total Shareholder Return (TSR). For options to be eligible for exercise, the Group's TSR has to be at or above the median of companies in the FTSE 100 index over a consecutive period of 3 years, between the year of grant and the completion of the 10 year life of the option. The test is conducted twice per year, at the end of March and September, by independent external specialists. None of the terms or conditions of any of the existing options over shares of the Group was varied during the year. Full details of all directors' shareholdings and options to subscribe for shares are recorded in the Group's Register of Directors' Interests which is open to inspection in accordance with the provisions of the Companies Act 1985.

The official closing middle market price for an ordinary share in the Group at its highest during the year was 154.75p per share and at its lowest was 118.25p per share, on the last dealing day of the year it was 152.50p per share. The exercise price of all options is the fair value of the ordinary shares on the date of grant. All options expire 10 years after the date of the grant.

Additional information with respect to the plans at 31 December is as follows

	2006		2005	
	Shares	Price*	Shares	Price*
Options outstanding at 1 January	50,399,855	133.24	45,332,252	218.05
Granted	-	-	19,532,450	84.62
Exercised	(1,739,746)	105.52	-	-
Forfeited	(2,855,483)	204.02	(14,195,722)	334.44
Expired	(228,009)	342.46	(269,125)	277.04
Options outstanding at 31 December	45,576,617	128.83	50,399,855	133.24
Options exercisable at year end	12,340,155	236.33	9,528,641	345.82

\*Price refers to weighted average exercise price in sterling (pence)

The following share options under the Executive Share Option Scheme are outstanding or exercisable at 31 December

Options outstanding

Range of exercise prices	2006			2005		
	Number of shares	Weighted average remaining contractual life (years)	Weighted average exercise price*	Number of shares	Weighted average remaining contractual life (years)	Weighted average exercise price*
50.1 – 100.0	35,369,259	7.84	80.79	37,522,998	8.83	80.97
100.1 – 150.0	2,231,934	6.76	114.31	3,348,216	7.65	114.07
200.1 – 250.0	1,756,316	5.19	234.23	2,092,857	6.19	234.23
250.1 – 300.0	1,034,434	3.23	278.65	1,157,571	4.23	278.65
300.1 – 350.0	61,819	4.88	312.58	289,828	1.88	336.09
350.1 – 400.0	1,989,698	3.64	376.60	2,345,732	4.63	376.46
400.1 – 450.0	3,133,157	2.44	411.97	3,642,653	3.44	412.31
	45,576,617	7.02	128.83	50,399,855	7.91	133.24

\*Price refers to weighted average exercise price in sterling (pence)

6 SHARE BASED PAYMENT (continued)

Options exercisable

Range of exercise prices	2006		2005	
	Number of shares	Weighted average exercise price*	Number of shares	Weighted average exercise price*
50 1 – 100 0	3,052,915	58 96	-	-
100 1 – 150 0	1,930,210	114 05	-	-
200 1 – 250 0	1,756,316	234 23	2,092,857	234 23
250 1 – 300 0	1,034,434	278 65	1,157,571	278 65
300 1 – 350 0	61,819	312 58	289,828	336 09
350 1 – 400 0	1,711,251	380 31	2,345,732	376 46
400 1 – 450 0	2,793,210	410 44	3,642,653	412 31
	12,340,155	236 33	9,528,641	345 82

\*Price refers to weighted average exercise price in sterling (pence)

Under the schemes, there were no awards during 2006. The weighted average estimated fair value per option granted was 27.39p. The fair value of the share options granted under the plans during 2005 was £5m. The value of the awards is charged in the income statement over the vesting period. Fair values for the options granted under the schemes during 2005 were estimated as of the date of grant using the Black Scholes pricing model with the following weighted average assumptions: dividend yields of 5.0%, expected volatilities of 50%, risk free interest rates of 4.4%, expected terms of 5 years for Executive Share Option Scheme grants made prior to the 2003 Group AGM and 4 years for Executive Share Option Scheme grants made after the 2003 Group AGM, and the assumption that all performance criteria are expected to be met. An estimate based on past experience is made of the number of forfeitures during the vesting period due to employees leaving the Company. The actual share price for an ordinary share in the Group at 31 December 2006 was 152.50p (2005 125.75p).

International Sharesave Plan

Under the Group's International Sharesave Plan (savings related) eligible employees can receive options to purchase ordinary shares at a price equal to 80% of the fair value of the ordinary shares on the date of grant. All options vest either three or five years from the grant date and expire six months after vesting. The number of shares available for purchase from the plan by each participant is limited to the whole number of shares purchasable from the aggregate value of the individual's savings contract upon maturity. An individual's maximum monthly contribution to all current savings contracts is £250.

Additional information with respect to the International Sharesave Plan at 31 December is as follows:

	2006		2005	
	Shares	Price*	Shares	Price*
Options outstanding at 1 January	49,795,520	74 13	44,504,011	79 69
Granted	8,023,641	106.70	13,237,523	75 60
Exercised	(4,959,434)	72.04	(2,141,962)	66 38
Forfeited	(2,541,593)	76.47	(4,658,648)	73 82
Expired	(863,695)	252.91	(1,145,404)	322 77
Options outstanding at 31 December	49,454,439	76.38	49,795,520	74 13
Options exercisable at year end	883,503	197 73	1,243,705	190 51

\*Price refers to weighted average exercise price in sterling (pence)

**6. SHARE BASED PAYMENT (continued)**

The following share options under the International Sharesave Plan are outstanding or exercisable as of 31 December

**Options outstanding**

Range of Exercise Prices	2006			2005		
	Number of Shares	Weighted Average Remaining Contractual Life (Years)	Weighted Average Exercise Price *	Number of Shares	Weighted Average Remaining Contractual Life (Years)	Weighted Average Exercise Price *
50 1 — 100 0	41,062,879	2 07	67 78	48,562,501	3 03	68 23
100 1 — 150 0	7,895,195	3 73	106 71	-	-	-
150 1 — 200 0	-	-	-	-	-	-
200 1 — 250 0	34,946	0 09	250 00	34,946	1 09	250 00
250 1 — 300 0	-	-	-	499,856	-	292 00
300 1 — 350 0	461,419	-	310 00	552,793	0 88	310 76
350 1 — 400 0	-	-	-	145,424	-	354 00
	<b>49,454,439</b>	<b>2.31</b>	<b>76 38</b>	<b>49,795,520</b>	<b>2 96</b>	<b>74 13</b>

\*Price refers to weighted average exercise price in sterling (pence)

**Options exercisable**

Range of exercise prices	2006		2005	
	Number of shares	Weighted average exercise price*	Number of shares	Weighted average exercise price*
50 1 – 100 0	422,084	75 00	598,425	66 00
200 1 – 250 0	-	-	-	-
250 1 – 300 0	-	-	499,856	292 00
300 1 – 350 0	461,419	310 00	-	-
350 1 – 400 0	-	-	145,424	354 00
	<b>883,503</b>	<b>197 73</b>	<b>1,243,705</b>	<b>190 51</b>

\*Price refers to weighted average exercise price in sterling (pence)

Under the International Sharesave Plan, the weighted average estimated fair value per option granted by the Company during 2006 was 46 84p (2005 35 18p). The fair value of share options granted under the International Sharesave Plan during 2006 was £4m (2005 £5m). The value of the awards is charged in the Income Statement over the vesting period.

Fair values for the options granted under the International Sharesave Plan were estimated as of the date of grant using the Black Scholes pricing model with the following weighted average assumptions: dividend yields of 5% (2005 5 0%), expected volatilities of 35% (2005 50%), risk free interest rates of 4 8% (2005 4 2%), and expected terms equal to the vesting terms of three or five years. An estimate based on past experience is made of the number of forfeitures during the vesting period due to employees leaving the Group. The actual share price for an ordinary share in the Group at 31 December 2006 was 152 50p (2005 125 75p).

**Share Matching Plan**

The Company's Share Matching Plan for executive directors and other selected executives was adopted following approval obtained at the 2004 Group AGM. Awards were made during 2004 and 2005 and the awards granted in 2005 were the final awards under the plan.

## 6 SHARE BASED PAYMENT (continued)

The performance conditions in respect of awards under the Share Matching Plan areas follows

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

The performance condition attaching to the Matching Share awards granted in 2004 was met to the extent that 1,126 Matching Shares vested for each Deferred Share. The maximum number of Matching Shares has been adjusted accordingly. Under the plan, Deferred Share awards granted are held in trust for three years and are normally forfeited upon an employee leaving the Group. No further performance conditions apply.

Participants may also receive Matching Share awards up to a maximum of three times the number of Deferred Shares awarded. Matching Share awards are subject to the achievement of TSR targets over a single two year period, with performance measured by comparison against other UK listed companies. Matching Share awards vest with the Deferred Share awards on the third anniversary of the date of grant to the extent that the performance conditions have been met.

Additional information with respect to Deferred and Matching Share awards at 31 December is as follows:

	2006	2005
	Shares	Shares
Outstanding Deferred Share awards at 1 January	3,048,428	1,146,096
Granted	150,000	2,036,793
Exercised	(310,847)	(25,374)
Forfeited	(304,421)	(109,087)
<b>Outstanding Deferred Share awards at 31 December</b>	<b>2,583,160</b>	<b>3,048,428</b>
Potential Matching Share awards	6,198,330	9,145,284
<b>Total potential share awards outstanding at 31 December</b>	<b>8,781,490</b>	<b>12,193,712</b>

\*Price refers to weighted average exercise price in sterling (pence)

Under the Share Matching Plan, the fair values of each Deferred Share award granted by the Company during 2006 was 14.40p (2005: 71.40p) and the fair value of each potential Matching Share award was 38.10p (2005: 23.80p). The total fair value of the awards granted under the plan during 2006 was £nil (2005: £3m).

The fair value of the Deferred Share awards was calculated based upon the Group ordinary share price at grant date after deducting from it the estimated value of the dividends that will not be received during the vesting period. The fair value of the potential Matching Share awards was estimated by calculating the expected value arising from modelling the awards that would arise under different performance scenarios.

## 6 SHARE BASED PAYMENT (continued)

### Long Term Incentive Plan

The 2006 Long Term Incentive Plan for executive directors and other selected executives was adopted following approval obtained at the Group 2006 AGM. Awards were made during 2006 following shareholder approval.

The structure of the plan allows for a number of different types of awards to be made. Voluntary Deferred Shares are purchased by participants from net bonus payable (limited to a maximum value of 33% of net bonus), in addition, for senior executives, the Remuneration Committee may defer a portion of an individual's bonus (limited to 33% of that bonus) into an award over shares referred to for the purpose of the plan as Compulsory Deferred Shares. Deferred shares are held in trust for three years and compulsory deferred shares are normally forfeited on an employee leaving the Group. No further performance conditions apply. The Remuneration Committee may make a conditional award of shares on a 'matched' basis to Voluntary and Compulsory Deferred Shares ('Matching Shares').

Additionally, the Remuneration Committee may make conditional awards of Performance Shares to senior executives and conditional awards of Restricted Shares to other executives and senior managers.

Awards of Performance Share and Matching Shares related to Compulsory Deferred Shares are subject to a performance condition consisting of a combination of a return on equity target and a TSR target (with performance measured by comparison against other European insurance companies) over a single 3 year performance period. Matching Shares related to Voluntary Shares are subject only to the return on equity performance condition. Restricted Shares are not subject to performance conditions. All awards vest on the third anniversary of the date of grant to the extent that the performance conditions have been met.

	2006				
	Restricted	Voluntary Deferred	Compulsory Deferred	Performance	Total
Granted	2,355,335	585,473	1,289,563	4,214,284	8,444,655
Forfeited	(69,547)	-	-	-	(69,547)
Outstanding 31 December	2,285,788	585,473	1,289,563	4,214,284	8,375,108
Potential Matching Share awards	-	2,482,587	3,222,893	-	5,705,480
<b>Total potential awards outstanding 31 December</b>	<b>2,285,788</b>	<b>3,068,060</b>	<b>4,512,456</b>	<b>4,214,284</b>	<b>14,080,588</b>

There is no price for the Long Term Incentive Plan.

Under the 2006 Long Term Incentive Plan, the weighted average estimated fair value of each Restricted Share award granted by the Group in 2006 was 114.50p. The fair value of each Voluntary Deferred Share award was £nil and the fair value of each potential associated Matching Share was 126.00p. The fair value of each Compulsory Deferred Share award was 127.00p and the fair value of each potential associated Matching Share was 87.85p. The fair value of each Performance Share award granted was 88.83p. The total fair value of the awards granted under the plan in 2006 was £14m.

Fair values of the awards granted under the 2006 Long Term Incentive Plan scheme during 2006 are taken to be the share price on the day preceding the grant date, except for the Restricted Shares where the share price is reduced by an estimate of the value of dividends that will not be received. A dividend yield of 3.5% was assumed. Market related performance criteria were based on an arithmetic mean estimate of performance against a specified group of 13 competitors, and it is assumed that all non market related performance criteria would be met such that all awards would vest. An estimate based on past experience is made of the number of forfeitures during the vesting period due to employees leaving the Group.

## 7 DIRECTORS' EMOLUMENTS

	2006 £000	2005 £000
The aggregate emoluments of the directors, including amounts received from subsidiaries, were as follows:		
Salaries and bonuses	4,777	3,327
Allowances, benefits and other awards	561	378
	<b>5,338</b>	<b>3,705</b>

## Royal & Sun Alliance Insurance plc

### Notes on the Accounts (continued)

#### 7. DIRECTORS' EMOLUMENTS (continued)

The criteria for making bonus awards is based on targeted levels of business sector profit and specific business objectives. Details of directors' interests in Royal & Sun Alliance Insurance Group plc, including share options granted to directors under the executive and save as you earn employee share option schemes, are included in the directors' report.

	2006 £000	2005 £000
The emoluments of the highest paid director (A K Haste) were		
Salary, bonus, allowances, benefits and other awards	1,834	1,754

At 31 December 2006 the highest paid director had accrued annual pension of £6,768. This figure is based on the amount of annual pension which would be payable on his attaining normal pension age if he had left the Company's service on 31 December 2006.

Retirement benefits accrued under defined benefit schemes for A K Haste and A P Latham who served during the year. Contributions of £173,642 (2005 £61,500) were made to Group defined contribution schemes during the year in respect of the other directors.

#### 8. EQUALISATION PROVISIONS

Equalisation provisions are established in accordance with the Financial Services Authority's rules for insurers in the UK. These provisions, notwithstanding that they do not represent liabilities at the balance sheet date as they are over and above the anticipated ultimate cost of outstanding claims, are required by Schedule 9A to the Companies Act 1985 to be included within technical provisions in the balance sheet and any change in the provisions during the year is required to be shown in the General Business Technical Account.

The effect of including the provisions is as follows:

	2006 £m	2005 £m
Provisions at 1 January	328	291
Charged to the General Business Technical Account and in the profit on ordinary activities before tax	10	37
<b>Provisions at 31 December</b>	<b>338</b>	<b>328</b>

9 INVESTMENT INCOME, EXPENSES AND CHARGES

	Investment income		Net realised gains/(losses)		Net unrealised gains/(losses)		Total investment return	
	2006	Restated 2005	2006	Restated 2005	2006	Restated 2005	2006	Restated 2005
	£m	£m	£m	£m	£m	£m	£m	£m
<b>Investment income</b>								
Investment property	9	17	15	38	31	31	67	86
Equity securities	53	68	38	84	111	75	202	227
Debt securities	169	172	(2)	20	(50)	(15)	105	177
Other investments								
Loans secured by mortgages	-	-	-	-	-	-	-	-
Other loans	107	90	-	-	-	-	107	90
Other	-	1	-	-	-	-	-	1
Deposits, cash and cash equivalents	27	36	-	-	-	-	27	36
Derivatives	1	-	12	(21)	(15)	(11)	(2)	(32)
	366	384	63	121	77	80	506	585
<b>Impairment of subsidiary undertakings</b>	-	-	-	-	(184)	-	(184)	-
<b>Investment expenses and charges</b>								
Interest on bank loans and overdrafts							(2)	(3)
Interest on other loans							(56)	(85)
Investment management expenses							(7)	(13)
Impairment on loan to US subsidiary							(154)	-
							(219)	(101)
<b>Net investment return</b>							103	484

10 AUDITORS' REMUNERATION

Fees payable to PricewaterhouseCoopers LLP for the audit of the Company's annual accounts were £42,000 (2005 £40,000). The Royal & Sun Alliance Insurance Group plc accounts disclose amounts receivable by PricewaterhouseCoopers LLP and its associates for other services. Details of non-audit fees payable to PricewaterhouseCoopers LLP are disclosed in the Royal & Sun Alliance Group 2006 Report & Accounts.

## 11. TAXATION

The taxation on profit on ordinary activities charged in the profit and loss account is as follows

	Non-Technical Account	
	2006 £m	2005 £m
<b>Current tax</b>		
UK Corporation tax	50	52
Double taxation relief	(10)	(8)
Overseas taxation	10	17
Adjustments in respect of prior periods	(2)	(98)
<b>Total current tax</b>	<b>48</b>	<b>(37)</b>
<b>Deferred tax</b>		
Timing differences – origination and reversal	18	252
Movement in discount	-	(8)
<b>Total deferred tax</b>	<b>18</b>	<b>244</b>
<b>Tax charge</b>	<b>66</b>	<b>207</b>

UK corporation tax for the current year is based on a rate of 30% (2005 30%)

The current tax charge for the year is greater than (2005 less than) 30% due to the items set out in the reconciliation below

	2006 £m	Restated 2005 £m
<b>Profit on ordinary activities before tax</b>	<b>151</b>	<b>635</b>
Tax at 30%	45	191
Factors affecting charge		
Disallowed expenditure	43	4
Tax exempt income and investment gains	(12)	(18)
Fiscal adjustments	(21)	(19)
Group relief	-	17
Unrelieved foreign tax credits	-	6
Adjustment to prior year provisions	(2)	(99)
Other timing differences	(66)	(119)
Tax on items included in the Statement of Total Recognised Gains and Losses	6	-
Tax on impairment of subsidiary undertakings	55	-
<b>Current tax charge for the period</b>	<b>48</b>	<b>(37)</b>

## 12 DIVIDENDS

	2006 £m	2005 £m
Ordinary interim dividend paid in respect of current year 6 p per share (2005 Nil)	300	-

### 13. INVESTMENTS

	2006 £m	Restated 2005 £m
<b>Land and buildings</b>		
Freehold	400	392
Long leasehold	43	40
Short leasehold	5	6
<b>Total land and buildings</b>	<b>448</b>	<b>438</b>
Of which Group occupied	55	83
<b>Other financial investments</b>		
Shares and other variable yield securities and units in unit trusts	1,168	1,104
Debt securities and other fixed income securities		
British government securities	1,254	1,285
Other government securities	428	716
Corporate bonds	1,420	2,146
Preference shares	1	101
Loans and deposits with credit institutions		
Other loans	61	1
Deposits with credit institutions	518	240
<b>Total other financial investments</b>	<b>4,850</b>	<b>5,593</b>
<b>Listed investments</b>		
Included in total investments are the following		
Shares and other variable yield securities and units in unit trusts	1,103	980
Debt securities and other fixed income securities	2,629	2,996
	<b>3,732</b>	<b>3,976</b>

Included within shares and other variable yield securities and units in unit trusts above are ordinary shares in Royal & Sun Alliance Insurance Group plc, the Company's ultimate parent, held by the Royal & Sun Alliance ESOP Trust and Royal & Sun Alliance ESOP Trust No 2, which have a carrying value of £35m (2005 £30m)

The historical cost of total investments is £4,814m (2005 £5,952m)

Non-listed investments of £1,391m (2005 £1,587m) are carried at directors valuation as at 31st December 2006

The property valuations have been prepared on the basis of open market value at the balance sheet date in accordance with The Royal Institute of Chartered Surveyors' Appraisal and Valuation Manual, by external qualified valuation surveyors

At the period end the Company had pledged £635m (2005 £821m) of financial assets as collateral for liabilities or contingent liabilities and had accepted £943m (2005 £839m) that could be sold or pledged

### 14 DEBTORS

Debtors arising out of direct insurance operations are analysed as follows

	2006 £m	2005 £m
Due from policyholders	339	329
Due from intermediaries	844	811
	<b>1,183</b>	<b>1,140</b>

15 INTANGIBLE ASSETS

	2006 £m
<b>Cost</b>	
At 1 January 2006	7
Additions	-
Disposals	-
<b>At 31 December 2006</b>	<b>7</b>
<b>Depreciation</b>	
At 1 January 2006	(5)
Charge for the year	-
Disposals	-
<b>At 31 December 2006</b>	<b>(5)</b>
<b>Net book value</b>	
<b>At 31 December 2006</b>	<b>2</b>
At 31 December 2005	2

Intangible assets comprise goodwill arising on acquisitions

16. TANGIBLE ASSETS

	2006 £m
<b>Cost</b>	
At 1 January 2006	185
Additions	6
Disposals	(6)
Transfers	3
<b>At 31 December 2006</b>	<b>188</b>
<b>Depreciation</b>	
At 1 January 2006	(132)
Charge for the year	(20)
Disposals	(3)
Transfers	3
<b>At 31 December 2006</b>	<b>(152)</b>
<b>Net book value</b>	
<b>At 31 December 2006</b>	<b>36</b>
At 31 December 2005	53

Tangible assets principally comprise short leasehold improvements, fixtures, fittings and equipment

# 17. INTERESTS IN ASSOCIATED UNDERTAKINGS

The Company has a 26.0% holding of ordinary shares in Royal Sundaram Alliance Insurance Limited which operates and is incorporated in India

	2006 £m	2005 £m
Shares at cost		
At 1 January	8	8
At 31 December	8	8
Adjustment to valuation	(2)	-
Net asset value	6	8

# 18 INVESTMENT IN SUBSIDIARY UNDERTAKINGS

The Company's principal subsidiaries at 31 December 2006 are set out in note 34. The companies are principally all engaged in the transaction of insurance or related business. The countries shown are those of incorporation and principal operation. The figure for shares in subsidiaries in the balance sheet comprises

	2006 £m	2005 £m
Shares at cost		
At 1 January	7,223	7,226
Acquisitions	83	-
Disposals	(4)	(3)
At 31 December	7,302	7,223
Revaluation	(1,148)	(964)
Net asset value	6,154	6,259

# 19 CAPITAL COMMITMENTS

The estimated amount of capital commitments contracted but not provided for in these financial statements is £Nil (2005: £Nil)

# 20 SHARE CAPITAL

	2006 £m	2005 £m
Authorised		
4,750,000,000 (2005: 4,750,000,000) ordinary class A shares of 25p each	1,188	1,188
10 (2005: 10) ordinary class B shares of US\$1 each	-	-
Issued and fully paid		
4,511,091,326 (2005: 4,511,091,326) ordinary class A shares of 25p each	1,128	1,128
1 (2005: 1) ordinary class B share of US\$1	-	-

## 21 SUBORDINATED LOAN NOTES

	2006 £m	2005 £m
Subordinated loan equity instruments	372	294

On 1 December 2004, the Company obtained a subordinated loan from Royal & Sun Alliance Insurance Group plc, its ultimate Parent Company, of £294m, derived from the issue of £450m of subordinated guaranteed perpetual notes on 23 July 2004. The notes have an annual coupon of 8.50%. The claims of the ultimate Parent Company on the loan are subordinated to the same extent as the claims of the holders of the notes. The loan has no specified maturity.

On 5 June 2006, the Company obtained a subordinated loan from Royal & Sun Alliance Insurance Group plc, its ultimate Parent Company, of £78m, derived from the issue of £375m of step up perpetual guaranteed subordinated capital securities on 12 May 2006. The notes have an annual coupon of 6.701%. The claims of the ultimate Parent Company on the loan are subordinated to the same extent as the claims of the holders of the capital securities. The loan has no specified maturity.

## 22 CLAIMS PROVISIONS

Claims outstanding include claims less reinsurance recoveries on certain classes of business which have been discounted. The total value of outstanding claims provisions less related reinsurance recoveries before discounting amounted to £5,029m (2005 £5,191m).

Claims are discounted as follows:

		Discount rate		Average period to settlement in years	
		2006 %	2005 %	2006	2005
UK	Asbestos & Environmental	5.00	5.00	15	13

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

## 23. PROVISIONS FOR OTHER RISKS AND CHARGES

	Deferred Tax £m	Reorganis- ation provision £m	Other provisions £m	2006 £m	2005 £m
At 1 January 2006 (as reported)	76	10	125	211	113
Prior year restatement	(5)	-	-	(5)	(5)
At 1 January 2006 (as restated)	71	10	125	206	108
Charged/transferred to Profit and Loss Account	25	32	99	156	175
Charged/transferred to Statement of Total Recognised Gains and Losses	1	-	-	1	-
Transfer	(50)	-	-	(50)	-
Utilised	-	(16)	(104)	(120)	(79)
Release	-	-	-	-	2
At 31 December 2006	47	26	120	193	206

The reorganisation provision primarily comprises severance and property costs and is part of a programme to achieve business improvement and expense savings to be substantially achieved by year end 2006.

## 23 PROVISIONS FOR OTHER RISKS AND CHARGES (continued)

Other provisions includes provisions of £52m (2005 £54m) held relating to vacant property leases, dilapidations and refurbishments, the costs relating to which will be borne across the period over which the leases expire, which is up to 20 years. Other provisions also includes various litigation provisions of £9m (2005 £4m), the payment of which is dependent upon legal processes and Motor Insurance Bureau provision of £33m (2005 £24m).

## 24. BORROWINGS

	2006 £m	2005 £m
Amounts owed to credit institutions— unsecured	55	93

Borrowings comprise bank overdrafts which are repayable on demand

## 25 OTHER CREDITORS

Other creditors including taxation and social security includes £53m (2005 £Nil) in respect of corporation tax payable

## 26. DEFERRED TAXATION

	2006 £m	2005 £m
Unrealised investment gains	(67)	(61)
Other timing differences	20	15
	(47)	(76)

A deferred tax asset has not been recognised in respect of capital losses with an estimated tax value of £106m (2005 £162m) as it is not considered likely that suitable profits will arise to absorb these losses in the near future

## 27 OPERATING LEASES

The future aggregate minimum lease payments under non-cancellable operating leases are as follows

	Land & buildings	
	2006 £m	2005 £m
One year or less	3	1
Between two and five years	10	7
After five years	30	21
	43	29

All material leases of land and buildings are subject to rent review periods of between three and five years

## 28 MANAGEMENT OF RISK

The Royal & Sun Alliance Group employs a comprehensive risk management framework to identify, assess, manage and monitor the risks arising as a result of operating the business. The framework includes a comprehensive suite of risk policies, procedures, measurement and monitoring techniques and a series of stress tests and scenario analyses to ensure that the Group's exposures do not exceed risk appetite.

The Company is exposed to financial risk through its financial assets, financial liabilities (investment contracts and borrowings), reinsurance assets and insurance liabilities. In particular the key financial risk is that the proceeds from the realisation of its financial assets are not sufficient to fund the obligations arising from its insurance and investment contracts.

The Company manages its financial assets within a framework that has been developed to seek to ensure the ability to meet its obligations under insurance and investment contracts. A key principle behind this process is to hold assets that provide a broad match against the liabilities arising from insurance and investment contracts.

Risks arise within the investment portfolio from the inappropriate matching of cash and fixed interest assets against liabilities by duration (e.g. inflation and reinvestment risk). However, the relatively short duration of a general insurance portfolio together with the Company's strategy of broadly matching assets and liabilities by duration provides mitigation against these risks. The Company reviews the duration of its liabilities and asset portfolios to ensure that they remain broadly matched. Regional investment directives limit permissible duration ranges within the individual portfolios. These directives also include objectives for liquidity, asset sector concentration and credit quality.

Credit market and liquidity risks are addressed below.

### Credit risk

The Board Risk Committee (BRC) of the Royal & Sun Alliance Group is responsible for ensuring that the Board approved Group credit risk appetite is not exceeded.

In defining its risk appetite the Royal & Sun Alliance Group draws a distinction between credit risks incurred as a result of offsetting insurance risks or operating in the insurance market (e.g. reinsurance credit risks and insurance operations credit risks) for which risk tolerances and target profiles are identified, and credit risks incurred for the purposes of generating a return (e.g. invested assets credit risk) for which strict exposure limits are set.

The Company controls its credit exposures according to a series of Royal & Sun Alliance Group credit risk policies that reflects the individual considerations of the risk categories. These policies are supported by a series of procedures (e.g. counterparty assessment processes) and limits (e.g. investment and bank counterparty limits), which are designed to ensure that the Group's risk appetite is not exceeded.

Reinsurance counterparties are subject to a rigorous internal assessment process on an ongoing basis to ensure that their creditworthiness continues to be satisfactory. Collateral is taken to mitigate exposures where appropriate to the size or credit quality of the exposure. Invested assets credit risk is discussed in more detail below. The Company's maximum exposure to credit risk can be set out as follows:

	2006 Maximum credit risk (carrying value) £m	2005 Maximum credit risk (carrying value) £m
Cash at bank and in hand	261	96
Debt securities	3,103	4,248
Other loans and deposits with ceding undertakings	61	15
Deposits with credit institutions	518	240
Derivative assets	16	12
Insurance debtors	1,183	1,140
Reinsurance debtors	112	148
Reinsurers' share of insurance contract liabilities	1,107	1,549

28 MANAGEMENT OF RISK (continued)

The Company's investments comprise a broad range of financial investments issued principally in the UK. The mix of investments and their carrying values, which include fixed maturities and equity securities, is set out below.

Analysis of debt securities

The credit profile of the Company's fixed income portfolios reflects the Company's commitment to matching its liabilities with investment rated liquid instruments for the protection of the policyholder.

	2006		2005	
	£m	%	£m	%
<b>By country/region</b>				
UK	1,729	56	2,686	63
US	378	12	339	8
Scandinavia	50	2	35	1
International	946	30	1,188	28
<b>Total</b>	<b>3,103</b>	<b>100</b>	<b>4,248</b>	<b>100</b>
<b>By industry</b>				
Banks	670	22	1,860	44
Insurance	-	-	42	1
Manufacturing	-	-	53	1
Utilities	18	1	62	1
Retail	-	-	18	-
Government securities	1,410	45	2,016	48
Mortgage backed securities	73	2	-	-
Telecommunications	-	-	31	1
Services	-	-	3	-
Other	932	30	163	4
<b>Total</b>	<b>3,103</b>	<b>100</b>	<b>4,248</b>	<b>100</b>

Credit profile of the Company's fixed income portfolio (note 1)

	2006		2005	
	£m	%	£m	%
AAA (note 2)	1,731	56	2,119	50
AA	486	16	1,280	30
A	756	24	800	19
BBB	79	2	37	1
<BBB	51	2	12	-
<b>Total</b>	<b>3,103</b>	<b>100</b>	<b>4,248</b>	<b>100</b>

Notes

1 The ratings set out above are assigned by Standard & Poor's

2 Includes UK government guaranteed fixed income securities that are not rated

28 MANAGEMENT OF RISK (continued)

Analysis of equity securities

The Company's equity portfolio is diversified as follows across sectors

	2006		2005	
	£m	%	£m	%
<b>By country/region</b>				
UK	1,111	95	1,068	97
US	7	1	-	-
International	50	4	36	3
<b>Total</b>	<b>1,168</b>	<b>100</b>	<b>1,104</b>	<b>100</b>
<b>By industry</b>				
Banks	193	17	229	21
Pharmaceuticals	69	6	73	7
Insurance	77	7	69	6
Manufacturing	54	5	45	4
Utilities	40	3	46	4
Construction	61	5	21	2
Mining	57	5	178	16
Retail	93	8	43	4
Telecommunications	57	5	63	6
Services	12	1	121	11
Energy	146	12	-	-
Other	309	26	216	19
<b>Total</b>	<b>1,168</b>	<b>100</b>	<b>1,104</b>	<b>100</b>

Maturity periods or contractual repricing

The following table summarises the contractual repricing or maturity dates (whichever is earlier) for financial assets and financial liabilities, that are subject to fixed and variable interest rates. Equity instruments are not subject to interest rate risk.

	Less than one year	One to two years	Two to three years	Three to four years	Four to five years	Greater than five years	Total
	£m	£m	£m	£m	£m	£m	£m
<b>2006</b>							
<b>Financial assets</b>							
Cash at bank and in hand	261	-	-	-	-	-	261
Debt securities	1,053	623	499	351	97	480	3,103
Other loans and deposits with ceding undertakings	10	14	12	12	12	1	61
Deposits with credit institutions	518	-	-	-	-	-	518
Derivative assets	12	-	-	-	-	4	16
<b>Total</b>	<b>1,854</b>	<b>637</b>	<b>511</b>	<b>363</b>	<b>109</b>	<b>485</b>	<b>3,959</b>
<b>Financial liabilities</b>							
<b>Borrowings</b>							
Amounts owed to credit institutions – unsecured	55	-	-	-	-	-	55
Derivative trading liabilities	21	-	-	-	-	7	28
<b>Total</b>	<b>76</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>7</b>	<b>83</b>

# Royal & Sun Alliance Insurance plc

## Notes on the Accounts (continued)

### 28 MANAGEMENT OF RISK (continued)

	Less than one year	One to two years	Two to three years	Three to four years	Four to five years	Greater than five years	Total
	£m	£m	£m	£m	£m	£m	£m
<b>2005</b>							
<b>Financial assets</b>							
Cash at bank and in hand	96	-	-	-	-	-	96
Debt securities	1,646	932	542	455	378	295	4,248
Other loans and deposits with ceding undertakings	15	-	-	-	-	-	15
Deposits with credit institutions	240	-	-	-	-	-	240
Derivative assets	8	-	-	-	-	4	12
<b>Total</b>	<b>2,005</b>	<b>932</b>	<b>542</b>	<b>455</b>	<b>378</b>	<b>299</b>	<b>4,611</b>
<b>Financial liabilities</b>							
<b>Borrowings</b>							
Amounts owed to credit institutions—unsecured	93	-	-	-	-	-	93
Derivative trading liabilities	20	-	-	-	12	7	39
<b>Total</b>	<b>113</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>12</b>	<b>7</b>	<b>132</b>

#### Market risk

The Company is exposed to the risk of potential losses from adverse movements in market rates and prices as follows

- Interest rate risk,
- Equity price risk,
- Property price risk,
- Foreign currency exchange risk,
- Derivatives

The investment risk policy governs the Company's exposure to market risks. Exposures are controlled by the setting of investment limits in line with the Royal & Sun Alliance Group's risk appetite.

The Group Investment Committee (GIC), on behalf of the Royal & Sun Alliance Group Board, is responsible for reviewing and approving the investment strategy for the Company's investment portfolios. It provides approval for all major changes of the Company's investment strategy and, in particular, approves any substantive changes to the balance of the Company's funds between the major asset classes. Importantly the GIC also approves the terms of reference of the Royal & Sun Alliance Group's main operational investment committee, the Group Asset Management Committee (GAMC).

#### Interest rate risk

The fair value of the Company's portfolio of fixed income securities is inversely correlated to changes in the market interest rates. Thus if interest rates fall the fair value of the portfolio would tend to rise and vice versa as set out in the sensitivity analysis.

#### Equity price risk

The Company's portfolio of equity securities is subject to equity risk arising from changes in market price. Thus if the value of equities rise so will the fair value of its portfolio and vice versa as set out in the sensitivity analysis.

Appropriate risk limits are set to ensure that no significant concentrations to individual companies or sectors arise. The Company takes a long term view in selecting stocks and looks to build value over a sustained period of time rather than churning the portfolio looking for short term gains from its equity holdings.

The Company makes use of derivative products as appropriate to protect the portfolio from losses outside of risk appetite.

The Company does not have material holdings of unquoted equities.

28 MANAGEMENT OF RISK (continued)

*Property price risk*

The Company's portfolio of properties is subject to property price risk arising from changes in the market value of properties. Thus if the value of property falls so will the fair value of the portfolio as set out in the sensitivity analysis.

A number of the Group's property holdings are Group occupied. The Group's investment in investment property is invested in as part of an efficient portfolio management strategy.

*Foreign currency exchange risk*

The Company incurs exposure to foreign currency exchange risk in two ways:

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

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

Structural foreign currency exchange risk is managed at a Royal & Sun Alliance Group level. In managing structural foreign currency exchange risk net assets maintained by the Company's subsidiaries in local currencies are taken into account to satisfy local regulatory solvency and internal risk based capital assessment requirements. These assets should prove adequate to support local insurance activities irrespective of foreign currency exchange rate movements.

*Derivatives*

The Company may use derivative financial instruments for the purpose of reducing its exposure to adverse fluctuations in interest rates, foreign exchange rates and equity price risk. The Group does not use derivatives to leverage its exposure to markets and does not hold or issue financial instruments for speculative purposes. Forward contracts are used to reduce the risk of adverse currency movements on certain forecast future cash transactions.

While these derivative instruments are subject to fluctuations in value, such fluctuations are generally offset by the changes in value of the underlying exposures. Derivatives are generally held until their maturity date.

	Remaining life 2006			Notional principal amounts		Fair value	
	Less than one year £m	One to five years £m	More than five years £m	2006 £m	2005 £m	2006 £m	2005 £m
<b>Cross currency</b>							
Asset	-	-	-	-	-	-	-
Liability	-	-	-	170	30	-	1
<b>Credit</b>							
Asset	-	-	4	37	38	4	4
Liability	-	-	7	46	110	7	21
<b>Equity/index</b>							
Asset	12	-	-	see below	see below	12	8
Liability	21	-	-	see below	see below	21	17

## 28 MANAGEMENT OF RISK (continued)

At 31 December 2006 there were derivative contracts in place to protect the value of the UK equity portfolios of the Company. These provided limited protection against declines in market levels whilst also capping participation in any appreciation of the market. In total, this strategy covered an underlying equity value of approximately £800m. The impact of these derivatives as of 31 December 2006 if world equity markets decreased by 15% would be to decrease the impact of the decline by £41m (2005 £18m).

### Sensitivity analysis

Change in fair value of investments and borrowings (note 1 and note 5)

	(Decrease)/increase	
	2006	2005
	£m	£m
Interest rate markets (note 2)		
Impact on fixed interest securities of increase in interest rates of 100bps	(54)	(64)
Equity markets (note 3)		
Decrease of equity markets of 15%	(178)	(166)
Impact arising from derivatives	41	18
Property markets (note 3)		
Decrease of property markets of 15%	(67)	(66)
Currency markets (note 4)		
Decrease of major currencies versus British pound of 15%	(193)	(165)

### Notes

1 This analysis assumes that there is no correlation between equity price, interest rate, property market and foreign currency exchange rate risks. It also assumes that all other assets and liabilities remain unchanged and that no management action is taken. This analysis does not represent management's view of future market change.

2 The sensitivity of the bond assets of the Company has been modelled by reference to a reasonable approximation of the average interest rate sensitivity of the investments held within each of the portfolios.

3 The effect of movements in equity and property markets is reflected as a one time decrease of worldwide equity and property markets on 1 January 2007 and 1 January 2006 which results in a 15% decline in the value of the Company's assets in these investment categories.

4 The effect of currency movements on investments is reflected as a one time decrease in the value of major currencies against the British pound on 1 January 2007 and 1 January 2006.

5 This analysis has not considered the impact of the above market changes on the valuation of the Company's insurance liabilities.

### Liquidity risk

Liquidity risk is the risk that cash may not be available to pay obligations when due at a reasonable cost. The Company has no appetite for incurring liquidity risk and is committed to meeting all liabilities as they fall due. The investment limits ensure the Company's portfolio is kept in highly liquid marketable securities sufficient to meet its liabilities as they become due based on actuarial assessment.

The investment limits are monitored at Royal & Sun Alliance Group level.

## 29 RELATED PARTIES TRANSACTIONS

Advantage has been taken of the exemption provided in FRS8 from disclosing details of transactions with Royal & Sun Alliance Insurance Group plc and its subsidiaries and associated undertakings.

## 30 CASHFLOW

The Company is a wholly owned subsidiary of Royal & Sun Alliance Insurance Group plc and the cash flows of the Company are included in the consolidated cash flow statement of Royal & Sun Alliance Insurance Group plc. The Company has thus taken advantage of the exemption permitted by FRS1 (revised) and has elected not to prepare its own cash flow statement.

### 31 CONTINGENT LIABILITIES

Royal & Sun Alliance Insurance plc has guaranteed on behalf of Royal & Sun Alliance Insurance Group plc the following

- the issue of €500m subordinated guaranteed Euro bonds due 15 October 2019,
- the US \$73m 8.95% subordinated guaranteed bonds due 15 October 2029,
- the issue of £450m 8.50% subordinated guaranteed perpetual notes. There is an option to call the notes on 8 December 2014 and every five years thereafter,
- the issue of £375m step up perpetual guaranteed subordinated capital securities. There is an option to repay the bonds on specific dates starting 12 July 2007, and
- a £500m syndicated loan facility, of which £nil has been drawn

### 32 ULTIMATE PARENT COMPANY

The Company's ultimate parent company is Royal & Sun Alliance Insurance Group plc, incorporated in Great Britain and registered in England and Wales, which prepares consolidated accounts which include Royal & Sun Alliance Insurance plc. The Company's immediate parent company is Royal Insurance Holdings plc. Copies of the consolidated accounts of Royal & Sun Alliance Insurance Group plc can be obtained from the registered office at 9th Floor, One Plantation Place, 30 Fenchurch Street, London EC3M 3BD.

### 33. SEGMENTAL INFORMATION

	Accident & Health	Motor	Fire & Property	Marine Aviation & Transport	Third Party Assistance Liability	Other	Total
2006	£m	£m	£m	£m	£m	£m	£m
Gross premiums written	31	1,079	1,535	190	461	11	3,313
Gross premiums earned	125	954	1,558	142	452	9	3,251
Gross claims incurred	(69)	(793)	(647)	(214)	(324)	6	(2,043)
Gross operating expenses	(33)	(214)	(507)	(50)	(115)	(26)	(951)
Gross technical result	23	(53)	404	(122)	13	(11)	257
Reinsurance balance	(26)	58	(332)	147	(36)	(17)	(206)
Net technical result	(3)	5	72	25	(23)	(28)	51
2005 (restated)							
Gross premiums written	211	1,062	1,587	138	477	2	3,482
Gross premiums earned	215	993	1,670	115	484	5	3,488
Gross claims incurred	(118)	(755)	(826)	(164)	(414)	1	(2,276)
Gross operating expenses	(38)	(202)	(505)	(41)	(115)	(14)	(918)
Gross technical result	59	36	339	(90)	(45)	(8)	294
Reinsurance balance	(49)	6	(223)	118	(16)	(1)	(165)
Net technical result	10	42	116	28	(61)	(9)	129

All the gross written premiums relate to contracts written in EC Member States. Gross operating expenses for direct business include commissions of £423m (2005 £454m).

Net premiums are disclosed by origin and there is no material difference between the origin and destination of contracts. Of the total GWP of £3,313m (2005 £3,482m), £249m (2005 £267m) relates to our business in the Republic of Ireland and the remainder to our UK business.

# Royal & Sun Alliance Insurance plc

## Notes on the Accounts (continued)

### 34 PRINCIPAL SUBSIDIARY COMPANIES

		Principal activity
United Kingdom	British Aviation Insurance Company Limited (57.1%) The Globe Insurance Company Limited The Marine Insurance Company Limited* Martello Underwriting Limited Royal International Insurance Holdings Limited* Royal & Sun Alliance Reinsurance Limited* Sun Alliance and London Insurance plc* Sun Insurance Office Limited	General insurance General insurance General insurance General insurance General insurance General insurance General insurance General insurance
Argentina	Royal & Sun Alliance Seguros (Argentina) SA (note 5)	General insurance
Bahrain	Royal & Sun Alliance Insurance (Middle East) Limited E.C. (50.01%)	General insurance
Brazil	Royal & Sun Alliance Seguros (Brasil) SA	General insurance
Canada	Roins Financial Services Limited Quebec Assurance Company The Johnson Corporation Royal & Sun Alliance Insurance Company of Canada Western Assurance Company	Holding company General insurance Holding Company General insurance General insurance
Chile	Royal & Sun Alliance Seguros (Chile) SA (99.4%) (note 6)	General insurance General insurance
Colombia	Royal & Sun Alliance Seguros (Colombia) SA (86.5%)	General insurance
Denmark	Codan A/S (71.7%) (note 4) Codan Forsikring A/S (71.7%) (note 4)	Holding company General insurance
Guernsey	Insurance Corporation of Channel Islands Limited	General insurance
Isle of Man	Tower Insurance Company Limited	General insurance
Mexico	Royal & Sun Alliance Seguros (Mexico) SA de C.V.	General insurance
Netherlands Antilles	Royal & Sun Alliance Insurance (Antilles) NV (51.0%)	General insurance
Norway	Duborgh Skadeforsikring AS (71.7%) (note 4) White Label Holding AS Group (71.7%) (note 4)	Insurance brokerage Holding Company
Republic of Ireland	EGI Holdings Limited	General insurance
Singapore	Royal & Sun Alliance Insurance (Singapore) Limited	General insurance
Sweden	Trygg-Hansa Forsakrings AB, Publikt (71.7%) (note 4)	General insurance
United States of America	Royal & Sun Alliance USA, Inc. Royal Indemnity Company Royal Surplus Lines Insurance Company Security Insurance Company of Hartford (note 7)	Holding company General insurance General insurance General insurance

## Royal & Sun Alliance Insurance plc

### Notes on the Accounts (continued)

#### 34 PRINCIPAL SUBSIDIARY COMPANIES (continued)

Uruguay	Royal & Sun Alliance Seguros (Uruguay) SA	General insurance
Venezuela	Royal & Sun Alliance Seguros (Venezuela) SA (998%)	General insurance

#### Notes

- 1 UK companies are incorporated in Great Britain and are registered in England & Wales,  
\*100% direct subsidiaries of Royal & Sun Alliance Insurance plc
- 2 Except where indicated all holdings are of equity shares and represent 100% of the nominal issued capital
- 3 Some subsidiaries have been omitted from this statement to avoid providing particulars of excessive length
- 4 During the year, Codan A/S purchased DKK736m (£66m) of its own shares on the market. This increased the Company's share of the shareholders' equity of Codan A/S and its subsidiaries from 71.7% to 74.5%. The Company legally owns 71.7% of Codan A/S until the shares are cancelled at their AGM.
- 5 Merged with La Republica Compania Argentina de Seguros Generales SA
- 6 Merged with Compania de Seguros Generales Cruz del Sur SA
- 7 Merged with Guaranty National Insurance Company