SC8140

# CGU BONUS LIMITED
# FINANCIAL STATEMENTS
# 2006

# CGU Bonus Limited

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# CGU Bonus Limited

## Directors and officer

### Directors:

J Hunt
J Kitson
S C J Machell

### Officer:

Company Secretary
Aviva Company Secretarial Services Limited

### Auditors:

Ernst & Young LLP
Registered Auditor
1 More London Place
London
SE1 2AF

### Registered office:

Pitheavlis
Perth
Scotland
PH2 0NH

Registered in Scotland No SC8140

A member of the Association of British Insurers and the Financial Ombudsman Service, and regulated by the Financial Services Authority

The Company is a member of the Aviva plc group of companies ("the Group")

# CGU Bonus Limited

## Directors' report
**for the year ended 31 December 2006**

The directors present their annual report and audited financial statements for CGU Bonus Limited ("the Company") for the year ended 31 December 2006

## Principal activity

The principal activity of the Company is the transaction of general insurance business in the United Kingdom

## Business review

**Basis of preparation**

This business review is addressed to, and written for, the members of the Company with the aim of providing a fair review of the business development, performance and position at the current time, during the financial period and at the end of the financial period In providing this review, the aim is to present a view that is both balanced and comprehensive and is consistent with the size and complexity of the business

**Objectives and future developments**

High level strategies are determined by Aviva plc and these are shown in their financial statements The Company has commenced transfer of its general insurance business for commercial and personal lines on renweal to its parent, Aviva Insurance Limited (commercial), and fellow subsidiary undertaking, Norwich Union Insurance Limited (personal)

**Financial position and performance indicators**

The directors consider that the Company's key performance indicators ("KPIs") are those that communicate the financial performance as follows

- increase/(decrease) in net written premiums
- combined operating ratio ("COR") this comprises the sum of the following ratios
  - net incurred claims to net earned premiums ratio,
  - net written commissions to net written premiums ratio, and
  - net written expenses to net written premiums ratio

A summary of the KPIs is set out below

| Measure | 2006 | 2005 |
|---|---|---|
| Decrease in net written premiums | (28%) | (11%) |
| Combined operating ratio | 71% | 91% |
| net incurred claims ratio | 31% | 58% |
| net written commissions ratio | 21% | 21% |
| net written expenses ratio | 19% | 12% |

Net written expenses exclude restructuring costs £3m (2005 £nil) and corporate costs of £nil (2005 £1m), net of reinsurance

# CGU Bonus Limited

## Directors' report (continued)

### Business review (continued)

**Financial key performance indicators**

The financial position of the Company at 31 December 2006 is shown in the balance sheet on page 17, with the trading results shown in the income statement on page 16

Profit before tax increased from £64m in 2005 to £98m in 2006 This is due to several factors as summarised by the KPIs and also detailed below

The result has been achieved against the backdrop of increasingly tough market conditions It includes a benefit from better than expected weather, together with savings on prior year claims that have arisen as a result of management action to control claims costs and improve processes and the reserving approach These benefits have allowed the Company to re invest in the business to secure future profitability

In commercial lines intense competition has led to a reduction in rates of around approximately 3% (2005 1% decrease) in commercial property but retention rates remain very strong In commercial motor there has been a reduction in rates of approximately 2% (2005 1% decrease), although the Company is seeing the first indications that the sector is hardening Retention rates have remained strong

Distribution costs have risen in 2006, with the Company's expense ratio increasing to 19% (2005 12%), as the Company has invested to secure future profitability In September, the Company announced details of a UK Cost & Efficiency review programme which will deliver cost savings and enhanced cost flexibility

Investment income is £15 million in 2006 compared to £29 million in 2005 Both realised and unrealised losses are each £7 million higher than in 2005, which reflects decreased values of fixed interest debt securities as base rates rose in the year

**Risk management**

Description of the principal risks and uncertainties facing the Company and the Company's risk management policies are set out in note 22 to the financial statements

Risk factors beyond the Company's control, that could cause actual results to differ materially from those estimated include, but are not limited to

- frequency and severity of significant natural hazards,
- UK domestic economic business conditions, and
- the impact of competition, inflation and deflation

# CGU Bonus Limited

## Directors' report (continued)

### Financial instruments

The business of the Company includes use of financial instruments Details of the Company's risk management objectives and policies and exposures to risk are set out in note 22 to the financial statements

### Dividends

An interim dividend of £50 million was paid in November 2006 (2005 £40 million) The directors do not recommend the payment of a final dividend (2005 £ nil)

### Payment policy

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

The amounts due to trade creditors at 31 December 2006 represented approximately 13 days of average daily purchases through the year (2005 8 days)

### Employees

All employees are employed by a fellow subsidiary undertaking of Aviva plc, Aviva Employment Services Limited Disclosures relating to employees may be found in the consolidated accounts of Aviva plc

### Resolutions

On 24 May 2002, the members of the Company passed resolutions to dispense with the holding of Annual General Meetings, the laying of directors' reports, financial statements and auditors' reports before the members in general meeting, and the obligation to appoint auditors annually

# CGU Bonus Limited

## Directors' report (continued)

### Directors' interests

The names of the present directors of the Company appear on page 1

M S Hodges and P J R Snowball resigned as directors of the Company on 9 May 2006 and J Kitson and S C J Machell were appointed on the same date

J Seaton was appointed as an altenate director to J Kitson on 19 June 2006 and resigned on 9 October 2006

P C Easter resigned as a director of the Company on 1 January 2007 and J Hunt was apppointed on the same date

| | At 1 January 2006 (or appointment if later) Number | At 31 December 2006 Number |
|---|---|---|
| **S C J Machell** | 13,111 | 13,272 |
| **P C Easter** | 6,628 | 7,239 |
| **J Kitson** | 2,506 | 2,506 |

### Incentive plans

Details of the directors who held office at the end of the financial year, and hold or held options to subscribe for ordinary shares of Aviva plc or hold or held awards over shares in Aviva plc, pursuant to Aviva plc's share based incentive plans, are set out below and on page 6

**(i) Share options**

| | At 1 January 2006 (or appointment if later) Number | Options granted during the year Number | Options cancelled during the year Number | At 31 December 2006 Number |
|---|---|---|---|---|
| **S C J Machell** | | | | |
| Savings related options | 4,426 | | | 4,426 |
| **P C Easter** | | | | |
| Savings related options | 4,096 | | | 4,096 |
| **J Kitson** | | | | |
| Savings related options | | | | |

(i) "Savings related options" are options granted under the Inland Revenue approved SAYE Share Option Scheme Options granted from 1999 to 2006 are normally exercisable during the six month period following either the third, fifth or seventh anniversary of the relevant savings contract

(ii) During the year no director exercised any share options and therefore no gains on such were made

# CGU Bonus Limited

## Directors' report (continued)
**for the year ended 31 December 2006**

**(ii) Share awards**

| | At 1 January 2006 (or appointment if later) Number | Awards granted during the year Number | Awards vested during the year Number | Awards lapsed during the year Number | At 31 December 2006 Number |
|---|---|---|---|---|---|
| **S C J Machell** | | | | | |
| Aviva Long Term Incentive Awards | 109,758 | | | | 109,758 |
| Aviva Annual Bonus Plan 2005 | 32,725 | | | | 32,725 |
| Aviva Deferred Bonus Plan | 68,528 | | | | 68,528 |
| **P C Easter** | | | | | |
| Aviva Long Term Incentive Awards | 170,305 | 38,048 | (44,699) | (24,176) | 139,478 |
| Aviva Annual Bonus Plan 2005 | | 32,301 | | | 32,301 |
| Aviva Deferred Bonus Plan | 126,232 | 5,712 | (43,938) | | 88,006 |
| **J Kitson** | | | | | |
| Aviva Long Term Incentive Awards | 50,058 | | | | 50,058 |
| Aviva Annual Bonus Plan 2005 | 18,800 | | | | 18,800 |
| Aviva Deferred Bonus Plan | 36,488 | | | | 36,488 |
| Aviva Executive Share Option Plans | 4,517 | | | | 4,517 |

(i) Aviva Long Term Incentive Plan, awards under the Plan are made on an annual basis in March Awards are subject to the attainment of performance conditions over a three year period

(ii) The Aviva Annual Bonus Plan 2005, was approved by shareholders in April 2005 and it replaced the Aviva Deferred Bonus Plan (the"Plan") The awards disclosed include those made in lieu of some of the cash bonus earned that are paid in the form of shares and deferred for three years The vesting of the awards on the third anniversary of their grant is not subject to performance conditions

(iii) Aviva Deferred Bonus Plan, awards disclosed include those made in lieu of some or all of the cash bonus earned and deferred under Aviva plc's Annual Bonus Plan and also the matching awards granted on a one for one basis The awards are not subject to performance conditions and vest on the third anniversary of their grant

(iv) Aviva Executive Share Option Plans, options granted on various dates from 1996 to 2004, under the Aviva Executive Share Option Scheme or predecessor schemes The exercise of options granted in 1996 is not subject to performance conditions Options granted between 1997 and 2000 were subject to the satisfaction of conditions relating to either the Company's return on capital employed ("ROCE") or its relative total shareholder return ("TSR") against a chosen comparator group In respect of options granted from 2000 the performance condition has been a mixture of both ROCE and TSR measures In all cases, performance is measured over a three year performance period and the options are normally exercisable between the third and tenth anniversary of their grant

### Directors' liabilities

Aviva plc, the ultimate parent undertaking, has granted an indemnity to the directors against liability in respect of proceedings brought by third parties, subject to the conditions set out in the Companies Act 1985 This indemnity and the provisions in the Company's Articles of Association constitute "qualifying third party indemnities" for the purposes of section 309A to 309C of the Companies Act 1985 Such qualifying third party indemnity provision remains in force as at the date of approving the directors' report

# CGU Bonus Limited

## Directors' report (continued)

### Directors' statement as to disclosure of information to auditors

The directors who were members of the Board at the time of approving the directors' report are listed on page 1 Having made enquiries of fellow directors and of the Company's auditors, each of these directors confirms that

- to the best of each director's knowledge and belief, there is no information relevant to the preparation of their report of which the Company's auditors are unaware, and
- each director has taken all the steps a director might reasonably be expected to have taken to be aware of relevant audit information and to establish that the Company's auditors are aware of that information

### Statement of directors' responsibilities

The directors are required to prepare financial statements for each accounting period that comply with the relevant provisions of the Companies Act 1985 and of the International Financial Reporting Standards ("IFRS") as adopted by the European Union, and which present fairly the financial position, financial performance and cash flows of the Company at the end of the accounting period A fair presentation of the financial statements in accordance with IFRS requires the directors to

select suitable accounting policies and verify they are applied consistently in preparing the financial statements on the going concern basis unless it is inappropriate to presume that the Company will continue in business,

present information, including accounting policies, in a manner that provides relevant, reliable, comparable and understandable information,

provide additional disclosures when compliance with the specific requirements in IFRS is insufficient to enable users to understand the impact of particular transactions, other events and conditions on the Company's financial position and financial performance, and

state that the Company has complied with IFRS, subject to any material departures disclosed and explained in the financial statements

The directors are responsible for maintaining proper accounting records which are intended to disclose with reasonable accuracy, at any time, the financial position of the Company They are also responsible for the systems of internal control maintained by the Company safeguarding the assets of the Company and for prevention and detection of fraud and other irregularities

On behalf of the Board

Director

23 MARCH 2007

# CGU Bonus Limited

## Independent auditors' report

### To the shareholders of CGU Bonus Limited

We have audited the Company's financial statements for the year ended 31 December 2006, which comprise the Accounting Policies, the Income Statement, the Balance Sheet, the Statement of Changes in Shareholder's Equity, the Cash Flow Statement, and the related notes 1 to 24 These financial statements have been prepared under the accounting policies set out therein

This report is made solely to the Company's members, as a body, in accordance with Section 235 of the Companies Act 1985 Our audit work has been undertaken so that we might state to the Company's members those matters we are required to state to them in an auditors' report and for no other purpose To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Company and the Company's members as a body, for our audit work, for this report, or for the opinions we have formed

**Respective responsibilities of directors and auditors**

The directors are responsible for preparing the financial statements in accordance with the applicable United Kingdom law and International Financial Reporting Standards (IFRS) as adopted by the European Union as 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)

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 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 audit opinion**

We conducted our audit in accordance with International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the financial statements 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

# CGU Bonus Limited

## Independent auditors' report (continued)

**To the shareholders of CGU Bonus Limited**

**Opinion**

In our opinion

- the financial statements give a true and fair view, in accordance with IFRS as adopted by the European Union, of the state of the Company's affairs as at 31 December 2006 and of its profit for the year then ended,

- 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

Ernst & Young LLP

**Ernst & Young LLP**
Registered Auditor
London

26 March 2007

# CGU Bonus Limited

## Accounting policies

CGU Bonus Limited a limited liability company incorporated and domiciled in the United Kingdom ("UK"), transacts general insurance business in the UK

The principal accounting policies adopted in the preparation of these financial statements are set out below

**(A) Basis of presentation**

The financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS) and International Accounting Standards (IAS), as endorsed by the European Union, applicable at 31 December 2006

In August 2005, the IASB issued IFRS 7, Financial Instruments Disclosures, and an amendment to IAS 1, Capital Disclosures Although their requirements are applicable for accounting periods beginning on or after 1 January 2007, the Company has decided to adopt IFRS 7 early and reflect its impact in these financial statements The amendment to IAS 1 brings the capital disclosures into line with those already required by FRS 27 and, although the Company is not adopting it early, this is not expected to result in any material additional disclosures

In August 2005, the IASB issued an amendment to IAS 39, Financial Guarantee Contracts, which requires financial guarantees issued to be recognised initially at their fair value, and subsequently measured at the higher of the expected liability (or receivable) under the guarantee and the amount initially recognised, less any cumulative amortisation This amendment affects the Company in respect of intercompany guarantees given and taken in the ordinary course of business, where guarantee fees had not necessarily reflected the fair value to each party of the issued instrument This value must now be reflected in the Company's financial statements, and will result in additional accruals (for fee income) and prepayments (for fees payable) in the balance sheet, with movements in these values credited or charged to profit in the income statement

In accordance with the standard for Phase I IFRS 4, Insurance Contracts, the Company has applied existing accounting practices for insurance, modified as appropriate to comply with the IFRS framework and applicable standards Further details are given in policy C overleaf

The financial statements are stated in British pounds, which is the Company's functional and presentation currency Unless otherwise noted, the amounts shown in these financial statements are in thousands of British pounds (£000)

**(B) Use of estimates**

The preparation of financial statements requires the Company to make estimates and assumptions that affect items reported in the balance sheet and income statement and the disclosure of contingent assets and liabilities at the date of the financial statements Although these estimates are based on management's best knowledge of current facts, circumstances and, to some extent, future events and actions, actual results ultimately may differ from those estimates, possibly significantly

## Accounting policies (continued)

**(C) Product classification**

Insurance contracts are defined as those containing significant insurance risk if, and only if, an insured event could cause an insurer to pay significant additional benefits in any scenario, excluding scenarios that lack commercial substance, at the inception of the contract Such contracts remain insurance contracts until all rights and obligations are extinguished or expire Contracts can be reclassified as insurance contracts after inception if insurance risk becomes significant Any contracts not considered to be insurance contracts under IFRS are classified as investment or service contracts

As noted in policy A above, insurance contracts in general continue to be measured and accounted for under existing accounting practices at the date of transition to IFRS Accounting for insurance contracts is determined in accordance with the Statement of Recommended Practice issued by the Association of British Insurers in December 2005 (as amended in December 2006)

**(D) Premiums earned**

Insurance premiums written reflect business incepted during the year, and exclude any sales based taxes or duties or levies Written premiums include an estimate of pipeline premiums less a provision for anticipated lapses Unearned premiums are those proportions of the premiums written in a year that relate to periods of risk after the balance sheet date Unearned premiums are computed principally on either a daily or monthly pro rata basis Premiums collected by intermediaries, but not yet received, are assessed based on estimates from underwriting or past experience, and are included in premiums written

**(E) Net investment income**

Investment income consists of interest receivable for the year, movements in amortised cost on debt securities, realised gains and losses, and unrealised gains and losses on FVPL investments (as defined in policy I) Interest income is recognised as it accrues, taking into account the effective yield on the investment

The realised gain or loss on disposal of an investment is the difference between the proceeds received, net of transaction costs, and its original cost or amortised cost as appropriate Unrealised gains and losses represent the difference between the carrying value at the year end and the carrying value at the previous year end or purchase value during the year, less the reversal of previously recognised unrealised gains and losses in respect of disposals made during the year

**(F) Insurance contract liabilities**

*Claims*

Insurance claims incurred include all losses occurring during the year, whether reported or not, loss adjustment expenses, a reduction for the value of salvage and other recoveries, and any adjustments to claims incurred in previous years

Loss adjustment expenses include internal and external costs incurred in connection with the negotiation and settlement of claims Internal costs include all direct expenses of the claims handling department and any part of the general administrative costs directly attributable to the loss adjustment function

*Outstanding claims provisions*

Insurance outstanding claims provisions are based on the estimated ultimate cost of all claims incurred but not settled at the balance sheet date, whether reported or not, together with related loss adjustment expenses Significant delays are experienced in the notification and settlement of certain types of general insurance claims, particularly in respect of liability business, including environmental and pollution exposures, the ultimate cost of which cannot be known with certainty at the balance sheet date Any estimate represents a determination within a range of possible outcomes Further details of estimation techniques are given in note 12

Outstanding claims provisions are valued net of an allowance for expected future recoveries Recoveries include non insurance assets that have been acquired by exercising rights to salvage and subrogation under the terms of insurance contracts

# CGU Bonus Limited

## Accounting policies (continued)

**(F) Insurance contract liabilities (continued)**

*Provision for unearned premiums*

The proportion of written premiums, gross of commission payable to intermediaries, attributable to subsequent periods is deferred as a provision for unearned premiums The change in this provision is taken to the income statement in order that revenue is recognised over the period of risk

*Liability adequacy*

At each reporting date, the Company reviews its unexpired risks and carries out a liability adequacy test for any overall excess of expected claims and deferred acquisition costs over unearned premiums, using the current estimates of future cash flows under its contracts, after taking account of the investment return expected to arise on assets relating to the relevant general business provisions If these estimates show that the carrying amount of its insurance liabilities (less related deferred acquisition costs) is insufficient in light of the estimated future cash flows, the Company recognises the deficiency in the income statement by setting up a provision in the balance sheet

*Other assessments and levies*

The Company is subject to various periodic insurance related assessments or guarantee fund levies Related provisions are established where there is a present obligation (legal or constructive) as a result of a past event Such amounts are not included within insurance liabilities but are included under "other liabilities" in the balance sheet

**(G) Reinsurance**

The Company cedes reinsurance in the normal course of business, with retention limits varying by line of business The cost of reinsurance is accounted for over the life of the underlying reinsured policies, using assumptions consistent with those used to account for these policies Gains or losses on buying retroactive reinsurance are recognised in the income statement immediately at the date of purchase and are not amortised

Reinsurance assets primarily include balances due from reinsurance companies for ceded insurance liabilities Amounts recoverable from reinsurance are estimated in a manner consistent with the outstanding claims provisions or settled claims associated with the reinsured policies and in accordance with the relevant reinsurance contract

If a reinsurance asset is impaired, the Company reduces the carrying amount accordingly and recognises that impairment loss in the income statement A reinsurance asset is impaired if there is objective evidence, as a result of an event that occurred after initial recognition of the reinsurance asset, that the Company may not receive all amounts due to it under the terms of the contract, and the event has a reliably measurable impact on the amounts that the Company will receive from the reinsurer

**(H) Derecognition and offset of financial assets and financial liabilities**

A financial asset (or, where applicable, a part of a financial asset or part of a group of similar financial assets) is derecognised where

(i) the rights to receive cash flows from the asset have expired,

(ii) the Company retains the right to receive cash flows from the asset, but has assumed an obligation to pay them in full without material delay to a third party under a "pass through" arrangement, or

(iii) the Company has transferred its rights to receive cash flows from the asset and either

(a) has transferred substantially all the risks and rewards of the asset, or

(b) has neither transferred nor retained substantially all the risks and rewards of the asset, but has transferred control of the asset

A financial liability is derecognised when the obligation under the liability is discharged, cancelled or expires Financial assets and liabilities are offset and the net amount reported in the balance sheet when there is a legally enforceable right to set off the recognised amounts and there is an intention to settle on a net basis, or realise the asset and settle the liability simultaneously

**(I) Financial investments**

The Company classifies its investments as financial assets at fair value through profit or loss ("FVPL") The FVPL category is used as, in most cases, the Company's strategy is to manage its financial investments on a fair value basis

The FVPL category has two sub categories those that meet the definition of "being held for trading" and those the Company chooses to designate as FVPL (referred to in this accounting policy as "other than trading") Fixed maturities, which the Company buys with the intention to resell in the near term (typically between three and six months), are classified as being held for trading All other securities in the FVPL category are classified as other than trading

Purchases and sales of investments are recognised on the trade date, which is the date that the Company commits to purchase or sell the assets, at their fair values less transaction costs Debt securities are initially recorded at their fair value, which is taken to be amortised cost, with amortisation credited or charged to the income statement Investments classified as trading and other than trading are subsequently carried at fair value Changes in the fair value of trading and other than trading investments are included in the income statement in the period in which they arise

The fair values of investments are based on quoted bid prices or amounts derived from cash flow models

**(J) Derivative financial instruments and hedging**

Derivative financial instruments include interest rate swaps that derive their value mainly from underlying interest rates All derivatives are initially recognised in the balance sheet at their fair value, which usually represents their cost They are subsequently re measured at their fair value, with the method of recognising movements in this value depending on whether they are designated as hedging instruments and, if so, the nature of the item being hedged Fair values are obtained from quoted market prices or, if these are not available, by using valuation techniques such as discounted cash flow models or option pricing models All derivatives are carried as assets when the fair values are positive and as liabilities when the fair values are negative

## Accounting policies (continued)

**(J) Derivative financial instruments and hedging (continued)**

Over the counter ("OTC") derivative contracts are individually negotiated between contracting parties and include forwards, swaps, caps and floors Derivatives are subject to various risks including market, liquidity and credit risk, similar to those related to the underlying financial instruments

The notional or contractual amounts associated with derivative financial instruments are not recorded as assets or liabilities on the balance sheet as they do not represent the potential gain or loss associated with such transactions These amounts are disclosed in note 23

*Interest rate swaps*

Interest rate swaps are contractual agreements between two parties to exchange periodic payments in the same currency, each of which is computed on a different interest rate basis, on a specified notional amount Most interest rate swaps involve the net exchange of payments calculated as the difference between the fixed and floating rate interest payments Exposure to gain or loss swap contracts will increase or decrease over their lives as a function of maturity dates, interest rates, and the timing of payments

*Derivative instruments for hedging*

No derivatives have been designated as hedging instruments

**(K) Deferred acquisition costs**

The costs directly attributable to the acquisition of new business for insurance contracts are deferred to the extent that they are expected to be recoverable out of future margins in revenues on those contracts

Where such business is reinsured, an appropriate proportion of the deferred acquisition costs is attributed to the reinsurer, and is treated as a separate liability

Deferred acquisition costs are amortised over the period in which the related revenues are earned The reinsurers' share of deferred acquisition costs is amortised in the same manner as the underlying asset

Deferred acquisition costs are reviewed by category of business at the end of each reporting period and are written off where they are no longer considered to be recoverable

**(L) Cash and cash equivalents**

Cash and cash equivalents consist of cash at banks and in hand, deposits held at call with banks, treasury bills and other short term highly liquid investments with less than 90 days' maturity from the date of acquisition For the purposes of the cash flow statement, cash and cash equivalents also include bank overdrafts, which are included within payables and other financial liabilities on the balance sheet

# CGU Bonus Limited

## Accounting policies (continued)

**(M) Contingent liabilities**

Contingent liabilities are disclosed if the future obligation is probable and the amount cannot be reasonably estimated

**(N) Income taxes**

The current tax expense is based on the taxable profits for the year, after any adjustments in respect of prior years Tax, including tax relief for losses if applicable, is allocated over profits before taxation and amounts charged or credited to reserves as appropriate

Provision is made for deferred tax liabilities, or credit taken for deferred tax assets, using the liability method, on all material temporary differences between the tax bases of assets and liabilities and their carrying amounts in the financial statements

The principal temporary differences arise from the equalisation provision The rates enacted or substantively enacted at the balance sheet date are used to determine the deferred tax

Deferred tax assets are recognised to the extent that it is probable that future taxable profit will be available against which the temporary differences can be utilised

**(O) Share capital and dividends**

*Equity instruments*

An equity instrument is a contract that evidences a residual interest in the assets of an entity after deducting all of its liabilities Accordingly, a financial instrument is treated as equity if

(i) there is no contractual obligation to deliver cash or other financial assets or to exchange financial assets or liabilities on terms that may be unfavourable, and

(ii) the instrument will not be settled by delivery of a variable number of shares or is a derivative that can be settled other than for a fixed amount of cash, shares or other financial assets

*Dividends*

Interim dividends on ordinary shares are recognised in equity in the period in which they are paid Final dividends on these shares are recognised when they have been approved by shareholders

**(P) Equalisation provision**

Equalisation provisions are established in accordance with UK company law These provisions are in addition to the provisions required to meet the anticipated ultimate cost of settlement of outstanding claims at the balance sheet date Under IFRS, the provisions are not reported in the balance sheet as no liability exists but are presented within retained earnings, net of attributable tax relief

**(Q) Financial guarantee contracts**

Financial guarantees are recognised initially at their fair value They are subsequently measured at the higher of the expected receivable or liability under the guarantee and the amount initially recognised less any accumulated amortisation

# CGU Bonus Limited

## Income statement

### For the year ended 31 December 2006

| | Note | 2006 | 2005 |
|---|---|---|---|
| | | £000 | £000 |
| **Income** | 1 | | |
| Gross written premiums | | 222,545 | 305,857 |
| Premiums ceded to reinsurers | | (8,956) | (10,966) |
| Premiums written, net of reinsurance | | 213,589 | 294,891 |
| Net change in provision for unearned premiums | | 38,339 | 22,932 |
| Net premiums earned | | 251,928 | 317,823 |
| Net investment income | | 14,806 | 29,268 |
| | | 266,734 | 347,091 |
| **Expenses** | 2 | | |
| Claims and benefits paid, net of reinsurers | | 121,624 | 131,026 |
| Change in insurance liabilities, net of reinsurance | | (44,570) | 55,409 |
| Fee and commission expense | | 78,709 | 84,973 |
| Other operating expenses | | 12,735 | 12,158 |
| | | 168,498 | 283,566 |
| **Profit before tax** | | 98,236 | 63,525 |
| Tax expense | 6 | 29,484 | 19,119 |
| **Profit for the year** | | 68,752 | 44,406 |

The Company has no recognised income and expense other than those included in the results above and therefore a statement of recognised income and expense has not been presented

The accounting policies on pages 10 to 15 and notes on pages 20 to 44 are an integral part of these financial statements

# CGU Bonus Limited

## Balance sheet

### As at 31 December 2006

| | Note | 2006 | 2005 |
|---|---|---|---|
| **Assets** | | **£000** | **£000** |
| Financial investments | 8 | 470,193 | 473,773 |
| Reinsurance | 9 | 1,578 | 792 |
| Asset for current tax | 15 | 895 | |
| Receivables and other financial assets | 10 | 91,513 | 114,578 |
| Deferred acquisition costs | 11 | 33,877 | 40,643 |
| Prepayments and accrued income | | 8,911 | 5,483 |
| Cash and cash equivalents | 21(b) | 125,248 | 173,713 |
| **Total assets** | | 732,215 | 808,982 |
| **Liabilities** | | | |
| Insurance | 12 | 400,841 | 482,965 |
| Deferred tax | 15 | 9,758 | 9,392 |
| Liability for current tax | | | 17,167 |
| Payables and other financial liabilities | 16 | 83,825 | 80,559 |
| Other liabilities | 17 | 3,495 | 3,355 |
| **Total liabilities** | | 497,919 | 593,438 |
| **Net assets** | | 234,296 | 215,544 |
| **Equity** | | | |
| Capital | | | |
| Ordinary share capital | 18 | 157,000 | 157,000 |
| Retained earnings | 19 | 77,296 | 58,544 |
| **Total equity** | | 234,296 | 215,544 |

The accounting policies on pages 10 to 15 and notes on pages 20 to 44 are an integral part of these financial statements

Approved by the Board on 23 MARCH 2007

Director

# CGU Bonus Limited

## Statement of changes in shareholder's equity

### For the year ended 31 December 2006

| | Note | Ordinary share capital | Retained earnings | Total equity |
|---|---|---|---|---|
| | | £000 | £000 | £000 |
| **Balance at 1 January 2005** | | 157,000 | 54,138 | 211,138 |
| Total recognised income and expense for the year | | | 44,406 | 44,406 |
| Dividends | 7 | | (40,000) | (40,000) |
| Total movements in the year | | | 4,406 | 4,406 |
| **Balance at 31 December 2005** | | 157,000 | 58,544 | 215,544 |
| Total recognised income and expense for the year | | | 68,752 | 68,752 |
| Dividends | 7 | | (50,000) | (50,000) |
| Total movements in the year | | | 18,752 | 18,752 |
| **Balance at 31 December 2006** | | 157,000 | 77,296 | 234,296 |

The accounting policies on pages 10 to 15 and notes on pages 20 to 44 are an integral part of these financial statements

# CGU Bonus Limited

## Cash flow statement

**For the year ended 31 December 2006**

| | Note | 2006 | 2005 |
|---|---|---|---|
| | | £000 | £000 |
| **Cash flows from operating activities** | | | |
| Net cash inflow from operating activities | 21(a) | 1,535 | 99,988 |
| *Net cash from operating activities* | | 1,535 | 99,988 |
| **Cash flows from financing activities** | | | |
| Ordinary dividends paid | 7 | (50,000) | (40,000) |
| *Net cash used in financing activities* | | (50,000) | (40,000) |
| **Net (decrease)/increase in cash and cash equivalents** | | (48,465) | 59,988 |
| Cash and cash equivalents at 1 January | | 173,713 | 113,725 |
| **Cash and cash equivalents at 31 December** | 21(b) | 125,248 | 173,713 |

The accounting policies on pages 10 to 15 and notes on pages 20 to 44 are an integral part of these financial statements

# CGU Bonus Limited
## Notes to the financial statements (continued)

### 1. Details of income

| | 2006 | 2005 |
|---|---|---|
| | £000 | £000 |
| **Premiums earned** | | |
| Gross written premiums | 222,545 | 305,857 |
| Less premiums ceded to reinsurers | (8,956) | (10,966) |
| Gross change in provision for unearned premiums | 37,951 | 22,746 |
| Reinsurers' share of change in provision for unearned premiums | 388 | 186 |
| Net change in provision for unearned premiums | 38,339 | 22,932 |
| Net premiums earned | 251,928 | 317,823 |
| Total revenue | 251,928 | 317,823 |
| **Net investment income** | | |
| Interest and similar income | | |
| From investments designated as trading and other than trading | 27,710 | 27,405 |
| Realised losses and gains | (4,092) | 3,384 |
| Unrealised losses | (7,839) | (909) |
| Movement in amortised cost on debt securities | (406) | (266) |
| (Losses)/gains on investments | (12,337) | 2,209 |
| Other investment expenses | (567) | (346) |
| Net investment income | 14,806 | 29,268 |
| **Total income** | 266,734 | 347,091 |

# CGU Bonus Limited
## Notes to the financial statements (continued)

### 2. Details of expenses

| | 2006 | 2005 |
|---|---|---|
| | £000 | £000 |
| **Claims and benefits paid, net of reinsurance** | | |
| Claims and benefits paid to policyholders | 119,624 | 133,393 |
| Add/(Less) Claims recoveries from reinsurers | 2,000 | (2,367) |
| | 121,624 | 131,026 |
| **Change in insurance liabilities, net of reinsurance** | | |
| Change in insurance liabilities | (44,172) | 55,010 |
| (Less)/Add Change in reinsurance asset for insurance | (398) | 399 |
| | (44,570) | 55,409 |
| **Fee and commission expense** | | |
| Acquisition costs | | |
| Commission expenses | 46,581 | 60,694 |
| Other acquisition costs for insurance | 25,362 | 25,999 |
| Change in deferred acquisition costs | 6,766 | (1,720) |
| | 78,709 | 84,973 |
| **Other operating expenses** | 12,735 | 12,158 |
| **Total expenses** | 168,498 | 283,566 |

### 3. Employee information

All employees are employed by a fellow Group undertaking, Aviva Employment Services Limited Disclosures relating to employees may be found in the Reports and Accounts of Aviva plc

### 4. Directors

The emoluments of the directors have been borne by the parent undertaking, Aviva Insurance Limited, in both 2005 and 2006

### 5. Auditors' remuneration

The total remuneration payable by the Company, excluding VAT, to its auditors, Ernst & Young LLP, in respect of the audit of these financial statements is shown below The Company is exempt from disclosing other fees payable, to its auditors, in respect of other work by virtue of regulation 5(2) of The Companies Regulations 2005, as it is disclosed within the consolidated Reports and Accounts of Aviva plc, the Company's ultimate controlling entity (note 24(c))

| | 2006 | 2005 |
|---|---|---|
| | £000 | £000 |
| Audit services | | |
| Statutory audit of the Company's financial statements, current year | 40 | 44 |

# CGU Bonus Limited
## Notes to the financial statements (continued)

## 6. Tax

**(a) Tax charged to the income statement**

**(i) The total tax charge comprises.**

| | 2006 | 2005 |
|---|---|---|
| | £000 | £000 |
| **Current tax** | | |
| For this year | 29,105 | 16,887 |
| Prior year adjustments | 13 | 208 |
| Total current tax | 29,118 | 17,095 |
| **Deferred tax:** | | |
| Origination and reversal of temporary differences | 366 | 2,024 |
| Total deferred tax | 366 | 2,024 |
| Total tax charged to income statement | 29,484 | 19,119 |

Unrecognised tax losses and temporary differences of previous years were used to reduce current tax expense and deferred tax expense by £nil and £nil, respectively (2005 £138 thousand and £nil, respectively)

**(ii) Deferred tax charged to the income statement represents movements on the following items**

| | 2006 | 2005 |
|---|---|---|
| | £000 | £000 |
| Insurance items | 366 | 1,302 |
| Provisions and other timing differences | | 32 |
| Pensions and other post retirement obligations | | 690 |
| Total deferred tax charged to income statement | 366 | 2,024 |

**(b) Tax reconciliation**

The tax on the Company's profit before tax differs from the theoretical amount that would arise using the tax rate in the United Kingdom as follows

| | 2006 | 2005 |
|---|---|---|
| | £000 | £000 |
| Net profit before tax | 98,236 | 63,525 |
| Tax calculated at standard UK corporation | | |
| tax rate of 30% (2005 30%) | 29,472 | 19,057 |
| Adjustment to tax charge in respect of prior years | 13 | 208 |
| Deferred tax assets not recognised | | (138) |
| Other | (1) | (8) |
| Tax charged for the period (note 6a) | 29,484 | 19,119 |

## 7. Dividends

| | 2006 | 2005 |
|---|---|---|
| | £000 | £000 |
| Ordinary dividends declared and charged to equity in the year | | |
| Interim 2005 25 48p per share paid in December 2005 | | 40,000 |
| Interim 2006 31 85p per share paid in December 2006 | 50,000 | |
| | 50,000 | 40,000 |

## 8. Financial investments

**(a) Financial investments comprised**

| | Other than trading at fair value through profit or loss | |
|---|---|---|
| | 2006 | 2005 |
| | £000 | £000 |
| Debt securities | | |
| Listed | 470,193 | 473,773 |

Of the above total, £434,570 thousand (2005 £449,396 thousand) is expected to be recovered in more than one year after the balance sheet date

**(b) The following is a summary of the cost/amortised cost, gross unrealised gains and losses and fair value of financial investments**

| 2006 | Cost/amortised cost | Unrealised gains | Unrealised losses | Fair value |
|---|---|---|---|---|
| | £000 | £000 | £000 | £000 |
| Debt securities | 475,495 | | (5,302) | 470,193 |

| 2005 | Cost/amortised cost | Unrealised gains | Unrealised losses | Fair value |
|---|---|---|---|---|
| | £000 | £000 | £000 | £000 |
| Debt securities | 470,283 | 3,490 | | 473,773 |

**(c) Stocklending**

The Company has entered into stocklending arrangements in the United Kingdom during the year in accordance with established market conventions Investments are lent to locally domiciled counterparties and governed by agreements written under English and Welsh law

The carrying amounts of financial assets received and pledged as collateral under stocklending arrangements at 31 December 2006 were £13,330 thousand (2005 £352,000 thousand)

## 9. Reinsurance

### (a) Carrying amounts

The following is a summary of the reinsurance assets and related insurance reserves as at 31 December

| | 2006 | | | 2005 | | |
|---|---|---|---|---|---|---|
| | Gross insurance provisions | Reinsurance assets | Net | Gross insurance provisions | Reinsurance assets | Net |
| | £000 | £000 | £000 | £000 | £000 | £000 |
| Outstanding claims provisions | 243,676 | 389 | 243,287 | 281,953 | 5 | 281,948 |
| Provisions for claims incurred but not reported | 50,347 | 14 | 50,333 | 56,242 | | 56,242 |
| | 294,023 | 403 | 293,620 | 338,195 | 5 | 338,190 |
| Provision for unearned premiums | 106,818 | 1,175 | 105,643 | 144,770 | 787 | 143,983 |
| **Total** | 400,841 | 1,578 | 399,263 | 482,965 | 792 | 482,173 |

Of the above total, £185 thousand (2005 £ nil) of the reinsurance assets is expected to be recovered in more than one year after the balance sheet date

### (b) Assumptions

The assumptions used for reinsurance contracts follow those used for insurance contracts, shown in note 12 (c)
Reinsurance assets are valued net of any provisions for their recoverability

### (c) Movements

(i) Reinsurance asset

| | 2006 | 2005 |
|---|---|---|
| | £000 | £000 |
| **Carrying amount at 1 January** | 5 | 404 |
| Reinsurers' share of claims losses and expenses incurred in current year | 144 | 2,365 |
| Reinsurers' share of claims losses and expenses incurred in prior years | (1,746) | (397) |
| Reinsurers' share of incurred claims losses and expenses | (1,602) | 1,968 |
| Less | | |
| Reinsurance recoveries received on claims incurred in current year | (144) | (266) |
| Reinsurance recoveries received on claims incurred in prior years | 2,144 | (2,101) |
| Reinsurance recoveries received in the year | 2,000 | (2,367) |
| Change in reinsurance asset recognised in income statement | 398 | (399) |
| **Carrying amount at 31 December** | 403 | 5 |

(ii) Reinsurers' share of the provision for unearned premiums

| | 2006 | 2005 |
|---|---|---|
| | £000 | £000 |
| **Carrying amount at 1 January** | 787 | 601 |
| Premiums ceded to reinsurers in the year | 8,956 | 10,966 |
| Less | | |
| Reinsurers' share of premiums earned during the year | (8,568) | (10,780) |
| Change in reinsurance asset recognised in income statement | 388 | 186 |
| **Carrying amount at 31 December** | 1,175 | 787 |

## 10. Receivables and other financial assets

| | 2006 | 2005 |
|---|---|---|
| | £000 | £000 |
| Amounts due from intermediaries | 90,390 | 110,935 |
| Amounts due from reinsurers | 1,123 | 3,643 |
| Total | 91,513 | 114,578 |
| Expected to be recovered in less than one year | 91,513 | 114,578 |

Concentrations of credit risk with respect to receivables are limited due to the size and spread of the Company's trading base No further credit risk provision is therefore required in excess of the normal provision for doubtful receivables

## 11. Deferred acquisition costs

**(a) The carrying amount comprised**

| | 2006 | 2005 |
|---|---|---|
| | £000 | £000 |
| Deferred acquisition costs | 33,877 | 40,643 |

**(b) The movements in deferred acquisition costs during the year were.**

| | 2006 | 2005 |
|---|---|---|
| | £000 | £000 |
| **Carrying amount at 1 January** | 40,643 | 38,923 |
| Acquisition costs written during the year | 71,943 | 86,693 |
| Amortisation | (78,709) | (84,973) |
| **Carrying amount at 31 December** | 33,877 | 40,643 |

Deferred acquisition costs are generally recoverable within one year of the balance sheet date

## 12. Insurance liabilities

**(a) Carrying amount**

Gross insurance liabilities at 31 December comprised

| | 2006 | 2005 |
|---|---|---|
| | £000 | £000 |
| Outstanding claims provisions | 243,676 | 281,953 |
| Provision for claims incurred but not reported | 50,347 | 56,242 |
| | 294,023 | 338,195 |
| Provision for unearned premiums | 106,818 | 144,770 |
| Total | 400,841 | 482,965 |

**(b) Provisions for outstanding claims**

Significant delays occur in the notification and settlement of claims and a substantial measure of experience and judgement is involved in assessing outstanding liabilities, the ultimate cost of which cannot be known with certainty at the balance sheet date The reserves are based on information currently available However, it is inherent in the nature of the business written that the ultimate liabilities may vary as a result of subsequent developments

Provisions for outstanding claims are established to cover the outstanding expected ultimate liability for losses and loss adjustment expenses ("LAE") in respect of all claims that have already occurred The provisions established cover reported claims and associated LAE, as well as claims incurred but not yet reported and associated LAE

Outstanding claims provisions are based on undiscounted estimates of future claims payments

## 12. Insurance liabilities (continued)

### (c) Assumptions

Outstanding claims provisions are estimated based on known facts at the date of estimation Case estimates are generally set by skilled claims technicians applying their experience and knowledge to the circumstances of individual claims The ultimate cost of outstanding claims is then estimated by using a range of standard actuarial claims projection techniques, such as the Chain Ladder and Bornhuetter Ferguson methods The main assumption underlying these techniques is that the Company's past claims development experience can be used to project future claims development and hence ultimate claims costs As such these methods extrapolate the development of paid and incurred losses, average costs per claim and claim numbers based on the observed development of earlier years and expected loss ratios

Historical claims development is mainly analysed by accident period, although underwriting or notification period is also used where this is considered appropriate Claims development is separately analysed by each line of business Certain lines of business are also further analysed by claims type or type of coverage

In most cases no explicit assumptions are made regarding future rates of claims inflation or loss ratios Instead, the assumptions used are those implicit in the historic claims development data on which the projections are based Additional qualitative judgement is used to assess the extent to which past trends may not apply in the future, for example, to reflect one off occurrences, changes in external or market factors such as public attitudes to claiming, economic conditions, levels of claims inflation, judicial decisions and legislation, as well as internal factors such as portfolio mix, policy conditions and loss adjustment procedures, in order to arrive at the estimated ultimate cost of claims

### (d) Movements

The following changes have occurred in the technical provisions during the year

| | 2006 £000 | 2005 £000 |
|---|---|---|
| **Carrying amount at 1 January** | 338,195 | 283,185 |
| Claims losses and expenses incurred in the current year | 145,084 | 188,594 |
| Decrease in estimated claims losses and expenses incurred in prior years | (69,632) | (191) |
| Incurred claims losses and expenses | 75,452 | 188,403 |
| Less | | |
| Payments made on claims incurred in the current year | (37,691) | (58,245) |
| Payments made on claims incurred in prior years | (81,933) | (75,148) |
| Claims payments made in the year, net of reinsurance | (119,624) | (133,393) |
| Changes in claims provisions reserve recognised in the income statement | (44,172) | 55,010 |
| **Carrying amount at 31 December** | 294,023 | 338,195 |

## 12. Insurance liabilities (continued)

**(e) Loss development tables**

The table that follows presents the development of claims payments and the estimated ultimate cost of claims for the accident years 2001 to 2006 The upper half of the table shows the cumulative amounts paid during successive years related to each accident year For example, with respect to the accident year 2001, by the end of 2006 £104,137 thousand had actually been paid in settlement of claims In addition, as reflected in the lower section of the table, the original estimated ultimate cost of claims of £105,606 thousand was re estimated to be £112,156 thousand at 31 December 2006 This increase from the original estimate would generally be a combination of a number of factors, including claims being settled for larger or smaller amounts than originally estimated The original estimates will also be increased or decreased, as more information becomes known about the individual claims and overall claim frequency and severity

In 2005, the year of adoption of IFRS, only five years were required to be disclosed This will be increased in each succeeding additional year, until ten years' information is included

The Company aims to maintain strong reserves in order to protect against adverse future claims experience and development As claims develop and the ultimate cost of claims become more certain, the absence of adverse experience will then result in a release of reserves from earlier accident years, as shown in the loss development tables below

| Accident Year | All prior years | 2001 | 2002 | 2003 | 2004 | 2005 | 2006 | Total |
|---|---|---|---|---|---|---|---|---|
| | £000 | £000 | £000 | £000 | £000 | £000 | £000 | £000 |
| **Gross cumulative claims payments** | | | | | | | | |
| At end of accident year | | (38,600) | (37,780) | (38,950) | (40,563) | (58,245) | (37,691) | |
| One year later | | (68,997) | (69,919) | (72,246) | (70,833) | (101,367) | | |
| Two years later | | (81,993) | (78,944) | (83,231) | (85,917) | | | |
| Three years later | | (94,281) | (85,069) | (94,383) | | | | |
| Four years later | | (100,081) | (92,001) | | | | | |
| Five years later | | (104,137) | | | | | | |
| **Estimate of gross ultimate claims** | | | | | | | | |
| At end of accident year | | 105,606 | 98,138 | 141,580 | 163,222 | 188,594 | 145,084 | |
| One year later | | 109,838 | 114,621 | 131,332 | 149,865 | 163,190 | | |
| Two years later | | 119,919 | 108,307 | 134,552 | 133,505 | | | |
| Three years later | | 118,038 | 110,204 | 123,910 | | | | |
| Four years later | | 117,194 | 105,332 | | | | | |
| Five years later | | 112,156 | | | | | | |
| **Estimate of ultimate claims** | | 112,156 | 105,332 | 123,910 | 133,505 | 163,190 | 145,084 | |
| **Cumulative payments** | | (104,137) | (92,001) | (94,383) | (85,917) | (101,367) | (37,691) | |
| **Outstanding claims provisions recognised in the balance sheet** | 26,342 | 8,019 | 13,331 | 29,527 | 47,588 | 61,823 | 107,393 | 294,023 |

## 12. Insurance liabilities (continued)

**(e) Loss development tables (continued)**

After the effect of reinsurance, the loss development table is

| Accident Year | All prior years | 2001 | 2002 | 2003 | 2004 | 2005 | 2006 | Total |
|---|---|---|---|---|---|---|---|---|
| | £000 | £000 | £000 | £000 | £000 | £000 | £000 | £000 |
| **Net cumulative claims payments** | | | | | | | | |
| At end of accident year | | (38,247) | (37,780) | (38,950) | (40,429) | (55,880) | (37,547) | |
| One year later | | (68,824) | (69,664) | (72,246) | (70,699) | (100,636) | | |
| Two years later | | (81,822) | (78,686) | (83,224) | (84,124) | | | |
| Three years later | | (94,111) | (84,811) | (64,205) | | | | |
| Four years later | | (100,011) | (91,570) | | | | | |
| Five years later | | (103,931) | | | | | | |
| **Estimate of net ultimate claims** | | | | | | | | |
| At end of accident year | | 105,447 | 98,137 | 141,401 | 163,088 | 188,328 | 144,940 | |
| One year later | | 109,667 | 114,365 | 131,328 | 148,072 | 162,151 | | |
| Two years later | | 119,247 | 108,048 | 134,374 | 131,711 | | | |
| Three years later | | 117,468 | 109,773 | 123,732 | | | | |
| Four years later | | 116,988 | 104,901 | | | | | |
| Five years later | | 111,949 | | | | | | |
| **Estimate of ultimate claims** | | 111,949 | 104,901 | 123,732 | 131,711 | 162,151 | 144,940 | |
| **Cumulative payments** | | (103,931) | (91,570) | (64,205) | (84,124) | (100,636) | (37,547) | |
| **Net outstanding claims provisions recognised in the balance sheet** | 26,249 | 8,018 | 13,331 | 59,527 | 47,587 | 61,515 | 107,393 | 323,620 |

The table above includes information on asbestos and enviromental pollution claims provisions The total gross and net claims provisions in respect of this business were £8,260 thousand and £7,548 thousand respectively at 31 December 2006 (2005 £9,354 thousand and £9,354 thousand respectively)

**(f) Provision for unearned premiums**

*Movements*

The following changes have occurred in the provision for unearned premiums during the year

| | 2006 | 2005 |
|---|---|---|
| | £000 | £000 |
| **Carrying amount at 1 January** | 144,770 | 167,516 |
| Premiums written during the year | 222,545 | 305,857 |
| Less | | |
| Premiums earned during the year | (260,496) | (328,603) |
| Change in year | (37,951) | (22,746) |
| **Carrying amount at 31 December** | 106,818 | 144,770 |

## 13. Effects of changes in estimates during the year

Durıng the year, gross prıor years' claıms provısıons of £69,632 thousand (£67,886 thousand net of reınsurance) (2005 £191 thousand (£206 thousand net of reınsurance)) were released to the ıncome statement The maın reason for thıs release was a reassesment of the level of provısıons for commercıal lıabılıty and property claıms

## 14. Financial guarantees and options

Wıth the approval of the Fınancıal Servıces Authorıty, Avıva Internatıonal Insurance Lımıted and each of ıts Unıted Kıngdom ınsurance undertakıngs transactıng general ınsurance busıness, of whıch the Company ıs one, have mutually guaranteed to dıscharge all lıabılıtıes attachıng to theır respectıve polıcıes The guarantee enables a company, ıf ıt ıs unable to pay polıcyholder claıms, to seek financıal support from one of the guarantors The guarantors are not oblıged to make the payment ıf they cannot do so wıthout seekıng recourse to theır long term funds where applıcable If any payments are made under the guarantee, the guarantors are entıtled to seek repayment from the company benefitıng from the guarantee The guarantee cannot be relıed upon by any other person, ıncludıng wıthout lımıtatıon the holder of any contracts of ınsurance ıssued by a party to the guarantee There ıs no maxımum amount the Company would have to pay under the guarantee but, ın the opınıon of the dırectors, the faır value of the guarantee above ıs not materıal and no materıal loss ıs expected to arıse therefrom

## 15. Tax assets and liabilities

**(a) General**

Current tax assets and liabilities recoverable or payable in more than one year are £895 thousand and £nil (2005 £nil and £16,887 thousand) respectively

**(b) Deferred taxes**

| The deferred tax liability at the period end comprises | 2006 £000 | 2005 £000 |
|---|---|---|
| Insurance items | 9,758 | 9,392 |
| Net liability at 31 December | 9,758 | 9,392 |

The movement in the net deferred tax liability was as follows

| | 2006 £000 | 2005 £000 |
|---|---|---|
| Net liability at 1 January | 9,392 | 7,368 |
| Amounts charged to profit (note 6a) | 366 | 2,024 |
| Net liability at 31 December | 9,758 | 9,392 |

The Company has unrecognised tax losses of £1,064 thousand (2005 £1,064 thousand) to carry forward indefinitely against future taxable income

## 16. Payables and other financial liabilities

| | 2006 £000 | 2005 £000 |
|---|---|---|
| Payables arising out of direct insurance | 1,428 | 2,473 |
| Payables arising out of ceded reinsurance | 1,825 | 166 |
| Other financial liabilities | 80,572 | 77,920 |
| | 83,825 | 80,559 |
| Expected to be settled within one year | 83,825 | 80,559 |

## 17. Other liabilities

| | 2006 £000 | 2005 £000 |
|---|---|---|
| Accruals | 3,495 | 3,355 |
| Expected to be settled within one year | 3,495 | 3,355 |

## 18. Ordinary share capital

Details of the Company's ordinary share capital are as follows

| | 2006 £000 | 2005 £000 |
|---|---|---|
| **Authorised** | | |
| 157,000,000 Ordinary shares of £1 each | 157,000 | 157,000 |
| **Allotted, called up and fully paid** | | |
| 157,000,000 Ordinary shares of £1 each | 157,000 | 157,000 |

## 19. Retained earnings

| | 2006 £000 | 2005 £000 |
|---|---|---|
| **Balance at 1 January** | 58,544 | 54,138 |
| Profit for the year | 68,752 | 44,406 |
| Dividends (note 7) | (50,000) | (40,000) |
| **Balance at 31 December** | 77,296 | 58,544 |

In accordance with the accounting policy P, retained earnings includes £22,769 thousand (2005 £21,916 thousand) relating to equalisation provisions, net of attributable tax relief, which are not distributable

## 20. Contingent liabilities and other risk factors

**Uncertainty over claims provisions**

Note 12 gives details of the estimation techniques used in determining the outstanding claims provisions which are designed to allow for prudence These are estimated to give a result within the normal range of outcomes To the extent that the ultimate cost falls outside this range, for example where future claims inflation differs from that expected, there is uncertainty in respect of this liability

### 21. Cash flow statement

| | 2006 £000 | 2005 £000 |
|---|---|---|
| **(a) The reconciliation of profit before tax to the net cash inflow from operating activities is** | | |
| Profit before tax | 98,236 | 63,525 |
| Adjustments for | | |
| Losses/(gains) on investments (note 1) | 12,337 | (2,209) |
| Changes in working capital | | |
| (Increase)/decrease in reinsurance assets | (786) | 213 |
| (Increase)/decrease in deferred acquisition costs | 6,766 | (1,720) |
| (Increase)/decrease in receivables and other financial assets | 23,065 | 16,087 |
| (Increase)/decrease in prepayments and accrued income | (3,428) | (170) |
| Increase/ (decrease) in insurance liabilities | (82,124) | 32,264 |
| Increase/ (decrease) in payables and other financial liabilities | (42,962) | (7,825) |
| Increase/(decrease) in other liabilities | 140 | 1,500 |
| Net (purchases) / sales of operating assets | | |
| Financial investments | (9,709) | (1,677) |
| Net cash (outflow)/inflow from operating activities | 1,535 | 99,988 |

Purchases and sales of loans and financial investments are included in operating cash flows as the purchases are funded from cash flows associated with the origination of insurance contracts, net of repayments of claims

| | 2006 £000 | 2005 £000 |
|---|---|---|
| **(b) Cash and cash equivalents in the cash flow statement at 31 December comprised** | | |
| Cash at bank and in hand | 100,658 | 92,693 |
| Cash equivalents | 24,590 | 81,020 |
| | 125,248 | 173,713 |

## Notes to the financial statements (continued)

### 22. Risk management policies

The Company has established a risk management framework with the primary objective of protecting the Company from events that hinder the sustainable achievement of the Company's performance objectives, including failing to exploit opportunities This framework is operated by a group of companies, "the NUI Group", (including the UK general insurance business carried out within Aviva Insurance Limited and Aviva International Insurance Limited), within the Aviva plc group ("the Group"), that are engaged in writing general insurance business and in various non insurance activities in the United Kingdom Risk is categorised as follows

- market
- credit
- insurance
- liquidity
- operational

The NUI Group recognises the critical importance of having efficient and effective risk management systems in place To this end, the NUI Group has an established governance framework, which has three key elements

- defined terms of reference for the legal entity Boards and the associated executive management and other committees within the NUI Group,
- a clear organisational structure with documented delegated authorities and responsibilities from the legal entity Boards to executive management committees and senior management, and
- adoption of the Group policy framework that sets out risk appetite, risk management, control and business conduct standards for the Group's worldwide operations Each policy has a member of senior management who is charged with overseeing compliance with the policy throughout the NUI Group

The NUI Group monitors risk on an ongoing basis and prepares quarterly reports identifying all material risks, along with information on likelihood, severity and mitigating actions taken or planned The NUI Group has also developed a framework, using Internal Capital Assessment ("ICA") principles, for quantifying the impact of risks on economic capital The ICA combines the results of financial and operating experience tests

#### (i) Market risk

Market risk is the risk of adverse financial impact due to changes in fair values or future cash flows of financial instruments from fluctuations in interest rates, equity prices, property prices, and foreign currency exchange rates Market risk arises due to fluctuations in both the value of liabilities and the value of investments held

The NUI Group manages market risk locally within its market risk framework, within local regulatory constraints and in line with established Group policy, including minimum principles for matching liabilities with appropriate assets

For each of the major components of market risk, described in more detail below, the NUI Group has put in place additional policies and procedures to set out how each risk should be managed and monitored, and the approach to setting an appropriate risk appetite

## 22. Risk management policies (continued)

### (ı) Market rısk (contınued)

Interest rate rısk arıses prımarıly from the Company's ınvestments and long term debt, whıch are exposed to fluctuatıons ın ınterest rates The Company maıntaıns a close matchıng of assets and technıcal lıabılıtıes, economıcally, by duratıon, usıng derıvatıve ınstruments ıf necessary, to mınımıse thıs rısk

The Company operates predomınantly the UK so there ıs no materıal exposure to foreıgn currency exchange rates

Derıvatıves are used wıthın polıcy guıdelınes agreed by the Avıva plc Board of Dırectors Derıvatıves are only used for ınvestment management or rısk hedgıng purposes

Derıvatıve transactıons are fully covered by eıther cash or correspondıng assets and lıabılıtıes Speculatıve actıvıty ıs prohıbıted, unless approval has been obtaıned from the Group Derıvatıves Commıttee and Group Fınance Dırector Over the counter derıvatıve contracts are entered ınto only wıth approved counterpartıes ın accordance wıth Group polıcıes, thereby reducıng the rısk of credıt loss The Company applıes strıct requırements to the admınıstratıon and valuatıon processes ıt uses, and has a control framework that ıs consıstent wıth market and ındustry practıce The Group Derıvatıves Commıttee monıtors thıs framework and exposure levels, and approves large or complex transactıons

# Notes to the financial statements (continued)

## 22. Risk management policies (continued)

### (ii) Credit risk

Credit risk is the risk of loss in the value of financial assets due to counterparties failing to meet all or part of their obligations

The Company's management of credit risk is carried out in accordance with the NUI Group credit risk policy The Company's management of credit risk includes setting exposure limits and monitoring exposures in accordance with ratings set by credit ratings agencies such as Standard & Poor's

Financial assets are graded according to current credit ratings issued AAA is the highest possible rating Investment grade financial assets are classified within the range of AAA to BBB ratings Financial assets which fall outside this range are classified as speculative grade Credit limits for each counterparty are set based on default probabilities that are in turn based on the rating of the counterparty concerned

The following table provides information regarding the aggregated credit risk exposure of the Company

| | Credit rating | | | | | | |
|---|---|---|---|---|---|---|---|
| 31 December 2006 | AAA | AA | A | BBB | Speculative grade | Not rated | Carrying value in the balance sheet |
| | % | % | % | % | % | % | £000 |
| Debt securities | 6% | 32% | 47% | 15% | | | 470,193 |

| | Credit rating | | | | | | |
|---|---|---|---|---|---|---|---|
| 31 December 2005 | AAA | AA | A | BBB | Speculative grade | Not rated | Carrying value in the balance sheet |
| | % | % | % | % | % | % | £000 |
| Debt securities | 92% | 5% | 2% | 1% | | | 473,773 |

The Company is not individually exposed to significant concentrations of credit risk due to the regulations limiting investments in individual assets and classes

The Company manages exposure to reinsurance counterparties in accordance with Group policy Exposure limits are set by the Group Reinsurance Security Committee and there is a range of reinsurers that have acceptable credit ratings Reinsurer exposure and the impact of any reinsurer default is monitored regularly

# CGU Bonus Limited

## Notes to the financial statements (continued)

### 22. Risk management policies (continued)

#### (ii) Credit risk (continued)

The following table provides information regarding the carrying value of financial assets that have been impaired and the ageing of financial assets that are past due but not impaired

| 31 December 2006 | Neither past due nor impaired | 0 3 months | 3 6 months | 6 months 1 year | Greater than 1 year | Carrying value of impaired financial assets | Carrying value in the balance sheet |
|---|---|---|---|---|---|---|---|
| | | Financial assets that are past due but not impaired | | | | | |
| | % | % | % | % | % | % | £000 |
| Debt securities | 100% | | | | | | 470,193 |
| Reinsurance | 100% | | | | | | 1,578 |
| Amounts due from intermediaries | 92% | 6% | 1% | 1% | | | 90,390 |
| Amounts due from reinsurers | 100% | | | | | | 1,123 |

| 31 December 2005 | Neither past due nor impaired | 0 3 months | 3 6 months | 6 months 1 year | Greater than 1 year | Carrying value of impaired financial assets | Carrying value in the balance sheet |
|---|---|---|---|---|---|---|---|
| | | Financial assets that are past due but not impaired | | | | | |
| | % | % | % | % | % | % | £000 |
| Debt securities | 100% | | | | | | 473,773 |
| Reinsurance | 100% | | | | | | 792 |
| Amounts due from intermediaries | 91% | 6% | 2% | 1% | | | 110,935 |
| Amounts due from reinsurers | 100% | | | | | | 3,643 |

At 31 December 2006, receivables are £91,513 thousand (2005 £114,578 thousand) Concentrations of credit risk with respect to receivables are limited due to the size and spread of the Company's trading base Exposure by counterparty is monitored for the NUI Group for all exposures greater than £20 million

### 22. Risk management policies (continued)

**(iii) General insurance risk**

The NUI Group considers insurance risk within its general insurance activity to be comprised of the following

- fluctuations in the timing, frequency and severity of claims and claims settlements relative to expectations,
- the assessment and pricing of risk,
- the adequacy of exposure management through the use of accumulation management techniques and reinsurance tools, and
- the adequacy of reserving

The majority of the general insurance business underwritten by the Company is of a short tail nature such as motor, household and commercial property insurances The Group's underwriting strategy and appetite is agreed by the Aviva Group Executive Committee and communicated via specific policy statements and guidelines The NUI Group also sets its own underwriting strategy, consistent with the Group version The vast majority of the Company's general insurance business is managed and priced in the same country as the domicile of the customer, predominantly in the UK

Increasingly, risk based capital models are being used to support the quantification of risk under the ICA framework The NUI Group undertakes a quarterly review of insurance risks, the output from which is a key input into the ICA and risk based capital assessments

The NUI Group has developed mechanisms that identify, quantify and manage accumulated exposures to contain them within the limits of the appetite of the NUI Group The NUI Group has pioneered various developments, such as the Norwich Union UK Digital Flood Map, to manage exposures arising from specific perils

The adequacy of the NUI Group's general insurance claims provisions is overseen by the NUI Reserving Committee Actuarial claims reserving is conducted by the NUI Group's actuaries in compliance with the Group General Insurance Reserving Policy There are periodic external reviews by consultant actuaries

Reinsurance purchases are reviewed to verify that the levels of protection being bought reflect any developments in exposure and the risk appetite of the NUI Group, including the Company The basis of these purchases is underpinned by extensive financial and capital modelling and actuarial analysis to optimise the cost and capital efficiency benefits This involves utilising externally sourced probabilistic models to verify the accumulations and loss probabilities based on the NUI Group's specific portfolios of business Where external models are not available, scenarios are developed and tested using the NUI Group's data to determine potential losses and appropriate levels of reinsurance protection The reinsurance is placed with providers who meet the Aviva Group's counterparty security requirements

# CGU Bonus Limited

## Notes to the financial statements (continued)

### 22. Risk management policies (continued)

**(iii) General insurance risk (continued)**

The NUI Group has processes in place to manage catastrophe risk The NUI Group purchases catastrophe reinsurance to protect against significant natural hazard events For a single realistic catastrophic event, the NUI Group's maximum retention is approximately £306 million, plus any losses in excess of £2,036 million

**(iv) Liquidity risk**

The Company has set its investment strategy to ensure it has sufficient liquid funds to meet its expected obligations as they fall due In extreme circumstances, the Company would approach Group for additional short term borrowing whilst the Company liquidated other assets

The following table shows the gross insurance liabilities analysed by duration

| | Total | Within 1 year | 1 5 years | 5 15 years | Over 15 years |
|---|---|---|---|---|---|
| | £000 | £000 | £000 | £000 | £000 |
| **31 December 2006** | | | | | |
| Gross insurance liabilities | 400,841 | 217,306 | 168,464 | 15,071 | |

| | Total | Within 1 year | 1 5 years | 5 15 years | Over 15 years |
|---|---|---|---|---|---|
| | £000 | £000 | £000 | £000 | £000 |
| **31 December 2005** | | | | | |
| Gross insurance liabilities | 482,965 | 237,454 | 233,372 | 12,139 | |

# CGU Bonus Limited

## Notes to the financial statements (continued)

### 22. Risk management policies (continued)

#### (v) Operational risk

Operational risk arises as a result of inadequately controlled internal processes or systems, human error, or from external events Operational risks include information technology, information security, human resources, project management, outsourcing, tax, legal, fraud and compliance risks In accordance with Group policies, business unit management has primary responsibility for the effective identification, management, monitoring and reporting of risks to the business unit executive management team and to Group The NUI Group risk management and governance function is responsible for implementing the Group risk management methodologies and frameworks to assist line management in this work They also provide support and independent challenge on the completeness, accuracy and consistency of risk assessments, and the adequacy of mitigating action plans As a result, the business unit executive management team satisfies itself that material risks are being mitigated and reported to an acceptable level

Operational risks are assessed according to the potential impact and probability of the event concerned These impact assessments are made against financial, operational and reputational criteria

#### (vi) Risk and capital management

The Group uses a number of sensitivity test based risk management tools to understand the volatility of earnings, the volatility of its capital requirements, and to manage its capital more efficiently Primarily, risk based capital models and increasingly ICA are used Sensitivities to economic and operating experience are regularly produced on all of the NUI Group's financial performance measurements to inform the NUI Group's decision making and planning processes, and as part of the framework for identifying and quantifying the risks to which the NUI Group is exposed

General insurance claims liabilities are estimated by using standard actuarial claims projection techniques These methods extrapolate the claims development for each accident year based on the observed development of earlier years In most cases, no explicit assumptions are made as projections are based on assumptions implicit in the historic claims development on which the projections are based As such, in the analysis below, the sensitivity of general insurance claims liabilities is primarily based on the financial impact of changes to the reported loss ratio

### 22. Risk management policies (continued)

**(vi) Risk and capital management (continued)**

Some results of sensitivity testing for general insurance business are set out below For each sensitivity test the impact of a change in a single factor is shown, with other assumptions left unchanged

| Sensitivity factor | Description of sensitivity factor applied |
|---|---|
| Interest rate and investment return | The impact of a change in market interest rates by +/ 1% (e g if a current interest rate is 5%, the impact of an immediate change to 4% and 6%) The test allows consistently for similar changes to investment returns and movements in the market value of fixed interest securities |
| Expenses | The impact of an increase in expenses by 10% |
| Gross loss ratios | The impact of an increase in gross loss ratios for general insurance by 5% |

The above sensitivity factors are applied using actuarial and statistical models, with the following pre tax impacts on profit and shareholder's equity at 31 December 2006

**General insurance business impact on profit before tax (£000)**

| | Interest rates +1% | Interest rates 1% | Expenses +10% | Gross loss ratios +5% |
|---|---|---|---|---|
| Gross of reinsurance | (11,900) | 11,900 | (9,144) | (3,773) |
| Net of reinsurance | (11,900) | 11,900 | (9,144) | (3,853) |

**General insurance business impact on shareholder's equity (£000)**

| | Interest rates +1% | Interest rates 1% | Expenses +10% | Gross loss ratios +5% |
|---|---|---|---|---|
| Gross of reinsurance | (11,900) | 11,900 | (9,144) | (3,773) |
| Net of reinsurance | (11,900) | 11,900 | (9,144) | (3,853) |

## Notes to the financial statements (continued)

### 22. Risk management policies (continued)

#### (vi) Risk and capital management (continued)

Due to the importance of reinsurance, the impact of sensitivities on profit and equity is shown gross and net of reinsurance For general insurance, the impact of the expense sensitivity on profit also includes the increase in ongoing administration expenses

The above tables demonstrate the effect of a change in a key assumption while other assumptions remain unchanged In reality, such an occurrence is remote, due to correlations between the assumptions and other factors It should also be noted that these sensitivities are non linear, and larger or smaller impacts should not be interpolated or extrapolated from these results

The sensitivity analyses do not take into consideration that the Company's assets and liabilities are actively managed Additionally, the financial position of the Company may vary at the time that any actual market movement occurs For example, the Company's financial risk management strategy aims to manage the exposure to market fluctuations As investment markets move past various trigger levels, management actions could include selling investments, changing investment portfolio allocation, and taking other protective action

Other limitations in the above sensitivity analyses include the use of hypothetical market movements to demonstrate potential risk that only represent the Group's view of possible near term market changes that cannot be predicted with any certainty and the assumption that all interest rates move in an identical fashion

## 23. Derivative financial instruments

**Non hedge activities**

The Company had a contract to reduce the average duration interest rate on certain fixed interest investments to an agreed tolerance

The Company's non hedge activity at 31 December 2006 was as follows

| | 2006 | | | 2005 | | |
|---|---|---|---|---|---|---|
| | Contract/ notional amount | Fair value asset | Fair value liability | Contract/ notional amount | Fair value asset | Fair value liability |
| | £000 | £000 | £000 | £000 | £000 | £000 |
| **Interest rate contracts** | | | | | | |
| OTC | | | | | | |
| Interest swaps | | | | 28,000 | | 955 |
| **Totals at 31 December** | | | | 28,000 | | 955 |

### 24. Related party transactions

**(a) The Company had the following related party transactions in 2006 and 2005.**

**(i) Services provided by related parties**

| | 2006 | | 2005 | |
|---|---|---|---|---|
| | Expense incurred in year | Payable at year end | Expense incurred in year | Payable at year end |
| | £000 | £000 | £000 | £000 |
| Parent | | 17,348 | | 33,202 |
| Fellow subsidiaries | 50,000 | 47,792 | 43,000 | 40,416 |
| | 50,000 | 65,140 | 43,000 | 73,618 |

**(ii) Key management compensation**

The directors and key management of the Company are considered to be the same as for Norwich Union Insurance Limited, a fellow Group undertaking Information on key management compensation may be found in note 30 of the Norwich Union Insurance Limited financial statements

**(b) Immediate parent undertaking**

The Company's immediate parent undertaking is Aviva Insurance Limited, registered in Scotland

**(c) Ultimate controlling entity**

The ultimate controlling entity is Aviva plc, registered in England and Wales Its consolidated Report and Accounts are available on application to the Group Company Secretary, Aviva plc, St Helen's, 1 Undershaft, London EC3P 3PQ