

Aviva Insurance Limited

Registered in Scotland No. SC2116

Annual Report and Financial Statements 2011

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Directors and officers

Directors

C J Abrahams (appointed 21 December 2011)
D F M Côté (resigned 5 December 2011)
T W Harris (resigned 30 March 2012)
M S Hodges (resigned 2 June 2011)
T J Matthews (appointed 2 December 2011)
I M Mayer (appointed 25 February 2011)
A J Moss
P C Regan
R L Spencer

Officer – Company Secretary

K A Cooper
St Helen's
1 Undershaft
London
EC3P 3DQ

Auditor

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

Registered Office

Pitheavlis
Perth
Scotland
PH2 0NH

Company Number

Registered in Scotland no. SC2116

Other Information

Aviva Insurance Limited (the Company) is a member of the Association of British Insurers and the Financial Ombudsman Service and is authorised and regulated by the Financial Services Authority.

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

Directors' report

The directors present their annual report and financial statements for the Company for the year ended 31 December 2011.

Directors

The current directors, and those in office during the year, are as follows:

C J Abrahams (appointed 21 December 2011)
D F M Côté (resigned 5 December 2011)
T W Harris (resigned 30 March 2012)
M S Hodges (resigned 2 June 2011)
T J Matthews (appointed 2 December 2011)
I M Mayer (appointed 25 February 2011)
A J Moss
P C Regan
R L Spencer

Principal activities

The Company transacts most classes of general and health insurance business. The Company also invests in securities, properties and loans.

Business review

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 during the period and position at the current time. 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.

Financial position

The financial position of the Company at 31 December 2011 is shown in the Statement of Financial Position on page 23, with the trading results shown in the Income Statement on page 20 and the Statement of Cash Flows on page 24.

Legal entity governance is managed by the Company's board of directors.

The major class of business underwritten by the Company, excluding inwards reinsurance are personal lines (motor, home and creditor), transferred from Aviva Insurance UK Limited, health and commercial lines (property, liability, motor and other).

The result before tax decreased from a profit of £386 million in 2010 to a loss of £2,597 million in 2011. This loss was primarily due to an impairment charge in respect of AIH of £2,247 million. This impairment is due to the decline in the value of the European business and the loss on transfer of Aviva USA Corporation (AUSA).

Major events

Part VII transfer

On 17 June 2011, the Company's Board approved the transfer of the insurance business of certain Group undertakings to the Company. The transfer was effective from 14 November 2011. The assets and liabilities were transferred to the Company at carrying value by way of an insurance portfolio transfer under Part VII of the Financial Services and Markets Act 2000. The carrying value of the assets and liabilities transferred to the Company was £4,376 million, comprising a transfer from parent undertaking of £2,472 million, transfer from subsidiary undertakings of £1,921 million and transfer to subsidiary undertakings of £17 million and the relevant reinsurance elimination, which has a net impact of £Nil. Refer to note 1 in the accompanying financial statements for further details.

Directors' report continued

Major events continued

Part VII transfer continued

Under the Part VII insurance portfolio transfer, the UK general insurance businesses (including the relevant assets and liabilities) of the following companies were transferred to the Company on 14 November 2011:

- Aviva International Insurance Limited
- Aviva Insurance UK Limited
- CGU Bonus Limited
- CGU Underwriting Limited
- Hamilton Insurance Company Limited
- London and Edinburgh Insurance Company Limited
- Scottish Boiler and General Insurance Limited

Also under the Part VII transfer, the business written in the London Market prior to 2000 and wholly reinsured through reinsurance agreements with National Indemnity Company in 2000 (London Market Business) was transferred to The Ocean Marine Insurance Company Limited (the transferee) directly from the Company, and from Aviva International Insurance Limited and London and Edinburgh Insurance Company Limited via the Company.

US restructuring

On 31 December 2011, the entire shareholding in AUSA and the associated intercompany loan assets were transferred from the Company's subsidiary, Aviva International Holdings Limited (AIH), to a fellow Group company, Aviva Group Holdings Limited (AGH), via the Company at their fair value of £1,545 million. The transfer was settled via intercompany current account and assumption of an intercompany loan liability to Aviva plc. No profit or loss has been recognised by the Company on these transfers. The transfer has increased the intercompany receivable balance with AGH and the entire intercompany balance of £4,710 million at 31 December 2011 was converted into an intercompany loan.

Financial performance

Net written premiums in 2011 in total increased to £1,776 million (2010: £1,286 million), an increase of 38.1%. This increase includes the effects of the Part VII insurance portfolio transfer of £377 million and an inwards reinsurance premium of £69 million from a subsidiary company for excess of loss cover on London Market business. Excluding the impact of the Part VII transfer, year on year growth was 4.0%.

Conditions in commercial lines have been challenging. The Company has taken remedial action to exit poor performing lines as well as applying increased rates of up to 13% over the year in a hardening market. In property and liability, profitability continued to be adversely affected by rate increases that remained below claims inflation and in low single digits. The Company maintained its discipline of writing business for profit not volume in these competitive segments.

Key ratios

The net incurred claims ratio worsened to 56.6% (2010: 47.3%), mainly due to the strengthening of reserves in respect of prior years claims of £57 million (2010: £116 million release). This includes the discounted cost of £35 million for strengthening latent claims provisions in the UK on business written a significant number of years ago. It also reflects a change in the mix of business in the Company following the Part VII transfer.

The net written commission ratio improved to 29.4% (2010: 32.1%) mainly due to the benefit of lower commission ratios on business transferred into the Company as part of the Part VII transfer.

Investment performance

Net investment income increased in 2011 to £1,982 million (2010: £343 million). This increase is primarily driven by the net assets and liabilities of subsidiary undertakings transferred to the Company under the Part VII transfer on 14 November 2011, shown as dividend income of £1,921 million.

In 2011, fair value unrealised losses on investments in subsidiary companies reflected in other comprehensive income were £4,811 million (2010: £435 million gain). These unrealised losses have been recognised in the investment valuation reserve, resulting in a net surplus of £54 million (2010: £386 million surplus) after impairments of £4,479 million (2010: £Nil).

Directors' report continued

Future outlook

High level strategies are determined by the Board of Aviva plc and these are shown in the Group Report and Accounts and 2011 Preliminary Announcement. The directors consider that the Company's principal activities will continue unchanged for the foreseeable future.

For 2012, the Aviva Group general insurance businesses aim to deliver a 2012 general insurance Combined Operating Ratio (COR) of 97% or better. The Company's strategy is in line with this aim.

Principal risks and uncertainties

A description of the principal risks and uncertainties facing the Company and the Company's risk management policies are set out in note 31 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 and international economic business conditions, including where the Company's underlying subsidiaries transact business;
- The impact of competition, inflation and deflation; and
- Change in discount rates.

Key performance indicators

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

- Increase/(decrease) in net written premiums; and
- Combined operating ratio (COR) – which 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	2011	2010
Increase in net written premiums	38.1%	11.4%
Combined operating ratio	99.0%	92.0%
Net incurred claims ratio	56.6%	47.3%
Net written commissions ratio	29.4%	32.1%
Net written expenses ratio	13.0%	13.0%

The written expense ratio excludes corporate costs of £39 million (2010: £33 million), and £11 million (2010: £8 million) relating to the Company's restructuring costs.

Dividends

The directors do not recommend the payment of a dividend for the financial year ending 31 December 2011 (2010: £450 million).

Directors' report continued

Going concern

The Company's business activities, together with the factors likely to affect its future development, performance and position including the Business Review, are set out in this report. In addition, the financial statements include notes on the Company's contingent liabilities and other risk factors (note 27); its capital structure (note 30); management of its major risks including market, credit and liquidity risk (note 31); and derivative financial instruments (note 32).

The Company and its ultimate holding company Aviva plc have considerable financial resources together with a diversified business model, with a spread of businesses and geographical reach. As a consequence, the directors believe that the Company is well placed to manage its business risks successfully despite the current uncertain macro-economic outlook. After making enquiries, the directors have a reasonable expectation that the Company and its subsidiaries as a whole have adequate resources to continue in operational existence for the foreseeable future. For this reason, they continue to adopt the going concern basis in preparing the financial statements.

Events since the Statement of Financial Position date

There have been no events since the Statement of Financial Position date to report.

Overseas branches

During the year, the Company had branch offices outside the UK in Cyprus and France.

Financial instruments

The business of the Company includes the use of financial instruments. Details of the Company's risk management objectives and policies and exposures to risk relating to financial instruments are set out in note 31 to the financial statements.

Employees

All employees are employed by a subsidiary undertaking of Aviva plc, Aviva Employment Services Limited. Disclosures relating to employees may be found in the Annual Report and Financial Statements of that Company.

Disclosure of information to the Auditor

Each person who was a director of the Company on the date that this report was approved confirms that, so far as the director is aware, there is no relevant audit information, being information needed by the auditor in connection with preparing their report, of which the auditor is unaware. Each director has taken all the steps that he ought to have taken as a director in order to make himself aware of any relevant audit information and to establish that the auditor is aware of that information.

Auditor

Following a competitive tender process by the Company's ultimate parent company, Aviva plc, PricewaterhouseCoopers LLP is to be appointed auditor to the Company. Ernst & Young LLP will resign as auditors with effect from the signing of the Company's annual report and financial statements for the year ended 31 December 2011, and the directors will appoint PricewaterhouseCoopers LLP as auditor to the Company in accordance with the provisions of the Companies Act 2006.

Directors' liabilities

Aviva plc, the Company's ultimate parent, 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, which continue to apply in relation to any provision made before 1 October 2007.

These indemnities were granted in 2004 and the provisions in the Company's articles of association constitute "qualifying third party indemnities" for the purposes of sections 309A to 309C of the Companies Act 1985. These qualifying third party indemnity provisions remain in force as at the date of approving the Directors' Report by virtue of paragraph 15, Schedule 3 of The Companies Act 2006 (Commencement No. 3, Consequential Amendments, Transitional Provisions and Savings) Order 2007.

Directors' report continued

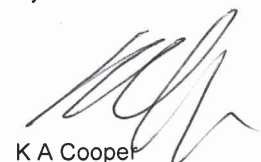
Statement of directors' responsibilities

The directors are required to prepare financial statements for each accounting period that comply with the relevant provisions of the Companies Act 2006 and 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 a 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 applicable IFRS, subject to any material departures disclosed and explained in the financial statements.

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

By order of the Board 30 March 2012



K A Cooper
Company Secretary

Independent auditor's report

To the members of Aviva Insurance Limited

We have audited the financial statements of Aviva Insurance Limited for the year ended 31 December 2011, which comprise the Accounting Policies, the Income Statement, the Statement of Comprehensive Income, the Statement of Changes in Equity, the Statement of Financial Position, the Statement of Cash Flows, and the related notes 1 to 34. The financial reporting framework that has been applied in their preparation is applicable law and International Financial Reporting Standards (IFRSs) as adopted by the European Union.

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

Respective responsibilities of directors and auditors

As explained more fully in the Directors' Responsibilities statement set out on page 8, the directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view. Our responsibility is to audit and express an opinion on the financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

Scope of the audit of the financial statements

An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of: whether the accounting policies are appropriate to the Company's circumstances and have been consistently applied and adequately disclosed; the reasonableness of significant accounting estimates made by the directors; and the overall presentation of the financial statements. In addition we read all the financial and non-financial information in the Annual Report & Financial Statements to identify material inconsistencies with the audited financial statements. If we become aware of any apparent material misstatements or inconsistencies we consider the implications for our report.

Opinion on financial statements

In our opinion, the financial statements:

- give a true and fair view of the state of the Company's affairs as at 31 December 2011 and of its loss for the year then ended;
- have been properly prepared in accordance with IFRSs as adopted by the European Union; and
- have been prepared in accordance with the requirements of the Companies Act 2006.

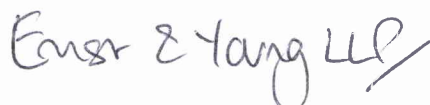
Opinion on other matter prescribed by the Companies Act 2006

In our opinion, the information given in the Directors' Report for the financial year for which the financial statements are prepared is consistent with the financial statements.

Matters on which we are required to report by exception

We have nothing to report in respect of the following matters where the Companies Act 2006 requires us to report to you if, in our opinion:

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



Michael Purrington (Senior Statutory Auditor)
For and on behalf of Ernst & Young LLP (Statutory Auditor)
London
30 March 2012

Accounting policies

The Company is a limited liability company incorporated and domiciled in the United Kingdom (UK). The principal accounting policies adopted in the preparation of these financial statements are set out below.

(A) Basis of presentation

The Company is exempt from preparing group financial statements by virtue of section 400 of the Companies Act 2006, as it is a subsidiary of an EEA parent and is included in consolidated financial statements for the Aviva Group at the same date. These financial statements therefore present information about the Company as an individual entity.

The financial statements of the Company have been prepared in accordance with International Financial Reporting Standards (IFRS) issued by the International Accounting Standards Board (IASB) and endorsed by the European Union, applicable at 31 December 2011. The date of transition to IFRS was 1 January 2004.

During 2009 and 2010, the IASB issued amendments to IFRS 1, *First time adoption of IFRS*, IAS 24, *Related Party Disclosures* and IAS 32 *Financial Instruments – Presentation*, and the results of its annual improvements project, all of which have been endorsed by the EU. These are all applicable for the first time in the current accounting period and are now reflected in the Company's financial reporting, with no material impact.

Further amendments to IFRS 1, IFRS 7, *Financial Instruments – Disclosures*, IAS 12, *Income Taxes*, and IAS 32 have been issued but have not yet been endorsed. These are applicable prospectively for accounting periods commencing on 1 July 2011 or later, and are therefore not applicable for the current accounting period. On adoption, they will not have any material impact on the Company's financial reporting.

In 2009, the IASB issued IFRS 9, *Financial Instruments – Classification and Measurement*, followed by additional requirements on accounting for financial liabilities in 2010. These are the first two parts of a replacement standard for IAS 39. They are applicable prospectively for accounting periods commencing 1 January 2015 or later, and are therefore not applicable for the current accounting period. IFRS 9 has not yet been endorsed by the EU but, on adoption, will require us to review the classification of certain financial instruments while allowing us to retain fair value measurement as we deem necessary. We have not yet completed our assessment of its impact, which is to a large extent, dependent on the finalisation of the IASB's insurance contracts accounting project.

During 2011, the IASB issued IFRS 11, *Joint Arrangements*, IFRS 12, *Disclosure of Interests in other Entities*, IFRS 13, *Fair Value Measurement*, and reissued IAS 27, *Separate Financial Statements*, and IAS 28, *Investments in Associates and Joint Ventures*. It also issued amendments to IAS 1, *Presentation of Financial Statements* and IAS 19, *Employee Benefits*. They are applicable for accounting periods commencing 1 July 2012 or later, and are therefore not applicable for the current accounting period. None of these has yet been endorsed by the EU.

In accordance with IFRS 4, *Insurance Contracts*, the Company has applied existing accounting practices for insurance and participating investment contracts, modified as appropriate to comply with the IFRS framework and applicable standards. Further details are given in policy E.

Items included in the financial statements of each of the Company's branches are measured in the currency of the primary economic environment in which that entity operates (functional currency). The Company's financial statements are stated in sterling, which is the Company's functional and presentation currency. Unless otherwise noted, the amounts shown in these financial statements are in millions of pound sterling (£m).

(B) Critical accounting policies and the use of estimates

The preparation of financial statements requires the Company to select accounting policies and make estimates and assumptions that affect items reported in the Income Statement, Statement of Financial Position, other primary statements and notes to the financial statements.

Critical accounting policies

The major areas of judgement on policy application are considered to be on product classification (set out in policy E), the classification of financial investments (set out in policy P) and insurance contract liabilities (set out in policy I).

Accounting policies continued

(B) Critical accounting policies and the use of estimates continued

Use of estimates

All estimates are based on management's knowledge of current facts and circumstances, assumptions based on that knowledge and their predictions of future events and actions. Actual results can always differ from those estimates, possibly significantly.

The table below sets out those items we consider particularly susceptible to changes in estimates and assumptions, and the relevant accounting policy.

Item	Accounting policy
Fair value of investments in subsidiaries	C
Insurance contract liabilities	I
Impairment of financial investments	P
Fair value of derivative financial instruments	Q
Deferred acquisition costs	T
Provisions and contingent liabilities	W
Deferred income taxes	X

(C) Subsidiaries

Subsidiaries are those entities (including special purpose entities) in which the Company, directly or indirectly, has power to exercise control over financial and operating policies in order to gain economic benefits.

Subsidiaries are stated at their fair values, estimated using applicable valuation models underpinned by the quoted market valuations of comparable listed entities, and with regard to the Aviva Group's market capitalisation. As a result of restructuring the ownership of intermediate holding companies within the Aviva Group in the last year, the method of estimating the fair value of subsidiaries has been re-assessed. As a result further weight has been given to information relating to the quoted market value of comparable listed entities in the valuation model. The Directors believe that the revised technique provides a more relevant estimate of the fair value of the Company's investments. The impact of the change in estimate is given in note 10(b).

Where the cumulative changes recognised in equity represent an unrealised loss, the investments are reviewed annually to test whether an impairment exists. Where there is objective evidence that such an asset is impaired, such as the financial difficulty of the entity or a significant or prolonged decline in its fair value below cost, the unrealised loss recorded in equity is reclassified and charged to the Income Statement.

(D) Foreign currency transactions

Foreign currency transactions are accounted for at the exchange rates prevailing at the date of the transactions. Gains and losses resulting from the settlement of such transactions, and from the translation of monetary assets and liabilities denominated in foreign currencies, are recognised in the Income Statement.

Translation differences on debt securities and other monetary financial assets measured at fair value and designated as held at fair value through profit and loss (FV) (see policy P) are included in foreign exchange gains and losses in the Income Statement. Translation differences on non-monetary items, such as equities which are designated as FV, are reported as part of the fair value gain or loss, whereas such differences on available for sale equities are included in the investment valuation reserve.

Accounting policies continued

(E) Product classification

Insurance contracts are defined as those containing significant insurance risk if, and only if, an insured event could cause an insurer to make significant additional payments 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 contracts.

As noted in policy A, insurance contracts in general continue to be measured and accounted for under existing accounting practices at the later of the date of transition to IFRS or the date of the acquisition of the entity, in accordance with IFRS 4. Accounting for insurance contracts is determined in accordance with the Statement of Recommended Practice issued by the Association of British Insurers, the most recent version of which was issued in December 2005, and amended in December 2006. The accounting policies or accounting estimates have been changed, as permitted by IFRS 4 and IAS 8 respectively, to remeasure designated insurance liabilities to reflect current market interest rates and changes to regulatory capital requirements. When accounting policies or accounting estimates have been changed and adjustments to the measurement basis have occurred then the financial statements of that year will have disclosed the impacts accordingly.

(F) Premiums earned

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 Statement of Financial Position date. Premiums collected by intermediaries, but not yet received, are assessed based on estimates from underwriting or past experience, and are included in premiums written.

(G) Fee and commission income

Fee and commission income consists primarily of reinsurance commissions receivable, which are deferred in the same way as acquisition costs as described in policy T. All other fee and commission income is recognised as the services are provided.

(H) Net investment income

Investment income consists of dividends, interest and rents receivable for the year, movements in amortised cost on debt securities, realised gains and losses, and unrealised gains and losses on fair value investments (as defined in policy P). Dividends on equity securities are recorded as revenue on the ex-dividend date. Interest income is recognised as it accrues, taking into account the effective yield on the investment. It includes the interest rate differential on forward foreign exchange contracts. Rental income is recognised on an accruals basis.

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, arising on investments which have not been derecognised as a result of disposal or transfer, 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.

(I) Insurance contract liabilities

Claims

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

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

Accounting policies continued

(I) Insurance contract liabilities continued

Insurance provisions

(i) Outstanding claims provisions

Insurance outstanding claims provisions are based on the estimated ultimate cost of all claims incurred but not settled at the Statement of Financial Position date, whether reported or not, together with related claims handling costs. 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 Statement of Financial Position date. Any estimate represents a determination within a range of possible outcomes. Further details of estimation techniques are given in note 22.

Provisions for latent claims are discounted, using rates based on the relevant swap curve, in the relevant currency at the reporting date, having regard to the expected settlement dates of the claims. The discount rate is set at the start of the accounting period with any change in rates between the start and end of the accounting period being reflected as a change in insurance liabilities. The range of discount rates used is described in note 22.

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.

(ii) 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.

(iii) 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 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 Statement of Financial Position.

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 Statement of Financial Position.

(J) Reinsurance

The Company assumes and cedes reinsurance in the normal course of business, with retention limits varying by line of business. Premiums on reinsurance assumed are recognised as revenue in the same manner as they would be if the reinsurance were considered direct business, taking into account the product classification of the reinsured business. The cost of reinsurance related to long-duration contracts is accounted for over the life of the underlying reinsured policies, using assumptions consistent with those used to account for these policies.

Where general insurance liabilities are discounted, any corresponding reinsurance assets are also discounted using consistent assumptions.

Gains or losses on buying retroactive reinsurance are recognised in the Income Statement immediately at the date of purchase and are not amortised. Premiums ceded and claims reimbursed are presented on a gross basis in the Income Statement and Statement of Financial Position as appropriate.

Accounting policies continued

(J) Reinsurance continued

Reinsurance assets primarily include balances due from reinsurance companies for ceded insurance liabilities. Amounts recoverable from reinsurers 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.

Reinsurance contracts that principally transfer financial risk are accounted for directly through the Statement of Financial Position and are not included in reinsurance assets or liabilities. A deposit asset or liability is recognised, based on the consideration paid or received less any explicitly identified premiums or fees to be retained by the reinsured.

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 an impact that can be reliably measured on the amounts that the Company will receive from the reinsurer.

(K) Intangible assets

Intangible assets consist primarily of contractual relationships such as access to distribution networks and customer lists. These intangibles are amortised over their useful lives, which range from four to six years.

(L) Property and equipment

Owner-occupied properties are carried at their revalued amounts, which are supported by market evidence, and movements are taken to a separate reserve within equity. When such properties are sold, the accumulated revaluation surpluses are transferred from this reserve to retained earnings. These properties are depreciated down to their estimated residual values over their useful lives. All other items classed as property and equipment within the Statement of Financial Position are carried at historical cost less accumulated depreciation.

Depreciation is calculated on the straight-line method to write-down the cost of other assets to their residual values over their estimated useful lives of three to five years. The assets' residual values, useful lives and method of depreciation are reviewed regularly and at least at each financial year end, and adjusted if appropriate.

Where the carrying amount of an asset is greater than its estimated recoverable amount, it is written down immediately to its recoverable amount. Gains and losses on disposal of property and equipment are determined by reference to their carrying amount.

Borrowing costs directly attributable to the acquisition and construction of property and equipment are capitalised. All repairs and maintenance costs are charged to the Income Statement during the financial period in which they are incurred. The cost of major renovations is included in the carrying amount of the asset when it is probable that future economic benefits in excess of the most recently assessed standard of performance of existing asset will flow to the Company and the renovation replaces an identifiable part of the asset. Major renovations are depreciated over the remaining useful life of the related asset.

(M) Investment property

Investment property is held for long-term rental yields and is not occupied by the Company. Completed investment property is stated at its fair value, which is supported by market evidence, as assessed by qualified external valuers. Changes in fair values are recorded in the Income Statement within net investment income.

(N) Impairment of non-financial assets

Property and equipment and other non-financial assets are reviewed for impairment losses whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. An impairment loss is recognised for the amount by which the carrying amount of the asset exceeds its recoverable amount, which is the higher of an asset's net selling price and value in use. For the purposes of assessing impairment, assets are grouped at the lowest level for which there are separately identifiable cash flows.

Accounting policies continued

(O) 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:

- The rights to receive cash flows from the asset have expired;
- 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
- The Company has transferred its rights to receive cash flows from the asset and either transferred substantially all the risks and rewards of the asset, or 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 or cancelled or expires.

Financial assets and liabilities are offset and the net amount reported in the Statement of Financial Position 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.

(P) Financial investments

The Company classifies its investments as either financial assets at fair value through profit or loss (FV) or financial assets available for sale (AFS). The classification depends on the purpose for which the investments were acquired, and is determined by management at initial recognition. The FV category has two sub-categories – those that meet the definition as being held for trading and those the Company chooses to designate as FV (referred to in this accounting policy as "other than trading").

With the exception of investments in subsidiaries, the FV category is used as the Company's investment or risk management strategy is to manage its financial investments on a fair value basis. All securities in the FV 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. 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 other than trading are subsequently carried at fair value. Changes in the fair value of other than trading investments are included in the Income Statement in the period in which they arise.

Investments carried at fair value are measured using a fair value hierarchy, described in note 14, with values based on quoted bid prices or amounts derived from cash flow models. Fair values for unlisted equity securities are estimated using applicable price/earnings or price/cash flow ratios refined to reflect the specific circumstances of the issuer.

Equity securities, for which fair values cannot be measured reliably, are recognised at cost less impairment.

Financial guarantees are recognised initially at their fair value and are subsequently amortised over the duration of the contract. A liability is recognised for amounts payable under the guarantee if it is more likely than not that the guarantee will be called upon.

Impairment

The Company reviews the carrying value of its investments on a regular basis. If the carrying value of an investment is greater than the recoverable amount, the carrying value is reduced through a charge to the Income Statement in the period of impairment.

Accounting policies continued

(Q) Derivative financial instruments and hedging

Derivative financial instruments include foreign exchange contracts, currency and equity options and interest rate and currency swaps that derive their value mainly from underlying foreign exchange rates interest rates, equity instruments or indices. All derivatives are initially recognised in the Statement of Financial Position 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. Premiums paid for derivatives are recorded as an asset on the Statement of Financial Position at the date of purchase, representing their fair value at that date.

Derivative contracts may be traded on an exchange or over-the-counter (OTC). Exchange-traded derivatives are standardised and include certain futures and option contracts and foreign exchange contracts. 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. Many OTC transactions are contracted and documented under ISDA (International Swaps and Derivatives Association) master agreements or their equivalents, which are designed to provide legally enforceable set-off in the event of default, reducing the Company's exposure to credit risk.

The notional or contractual amounts associated with derivative financial instruments are not recorded as assets or liabilities on the Statement of Financial Position as they do not represent the fair value of these transactions. These amounts are disclosed in note 32. The Company has collateral agreements in place between the Company and relevant counterparties. Accounting policy S covers collateral, both received and pledged, in respect of these derivatives.

Interest rate and currency swaps

Interest rate swaps are contractual agreements between two parties to exchange periodic payments in 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. Currency swaps, in their simplest form, are contractual agreements that involve the exchange of both periodic and final amounts in two different currencies. Exposure to gain or loss on both types of swap contracts will increase or decrease over their respective lives as a function of maturity dates, interest and foreign exchange rates, and the timing of payments.

Foreign exchange contracts

Foreign exchange contracts, which include spot, forward and futures contracts, represent agreements to exchange the currency of one country for the currency of another country at an agreed price and settlement date. Foreign exchange option contracts are similar to interest rate option contracts, except that they are based on currencies, rather than interest rates. Exposure to gain or loss on these contracts will increase or decrease over their respective lives as currency exchange and interest rates fluctuate.

For a variety of reasons, the above derivative transactions, while providing effective economic hedges under the Company's risk management positions, do not qualify for hedge accounting under the specific IFRS rules and are therefore treated as derivatives held for trading. Their fair value gains and losses are recognised immediately in other trading income.

(R) Loans

Loans with fixed maturities, including mortgage loans on investment property and collateral loans, are recognised when cash is advanced to borrowers. The majority of these loans are carried at their unpaid principal balances and adjusted for amortisation of premium or discount, non-refundable loan fees and related direct costs. These amounts are deferred and amortised over the life of the loan as an adjustment to loan yield using the effective interest rate method.

At each reporting date, we review loans carried at amortised cost for objective evidence that they are impaired and uncollectable, either at the level of an individual security or collectively within a group of loans with similar credit risk characteristics. To the extent that a loan is uncollectable, it is written down as impaired to its recoverable amount, measured as the present value of expected future cash flows discounted at the original effective interest rate of the loan, including any collateral receivable. Subsequent recoveries in excess of the loan's written-down carrying value are credited to the income statement.

Accounting policies continued

(S) Collateral

The Company receives and pledges collateral in the form of cash or non-cash assets in respect of stock lending transactions, certain derivative contracts and loans, in order to reduce the credit risk of these transactions. The amount and type of collateral required depends on an assessment of the credit risk of the counterparty.

Collateral received in the form of cash, which is not legally segregated from the Company, is recognised as an asset in the statement of financial position with a corresponding liability for the repayment in financial liabilities. Non-cash collateral received is not recognised in the Statement of Financial Position unless the Company either (a) sells or repledges these assets in the absence of default, at which point the obligation to return this collateral is recognised as a liability; or (b) the counterparty to the arrangement defaults, at which point the collateral is seized and recognised as an asset.

Collateral pledged in the form of cash, which is legally segregated from the Company, is derecognised from the Statement of Financial Position with a corresponding receivable recognised for its return. Non-cash collateral pledged is not derecognised from the Statement of Financial Position unless the Company defaults on its obligations under the relevant agreement, and therefore continues to be recognised in the Statement of Financial Position within the appropriate asset classification.

(T) 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.

(U) Statement of cash flows

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 that are readily convertible to known amounts of cash and which are subject to an insignificant risk of change in value. Such investments are those with less than three months' maturity from the date of acquisition, or which are redeemable on demand with only an insignificant change in their fair values.

For the purposes of the Statement of Cash Flows, cash and cash equivalents also include bank overdrafts, which are included in payables and other financial liabilities on the Statement of Financial Position.

Operating cash flows

Purchases and sales of loans and financial investments, and related investment income, are included within operating cash flows as the purchases are funded from cash flows associated with the origination of insurance contracts, net of payments of related claims.

(V) Leases

Leases, where a significant portion of the risks and rewards of ownership is retained by the lessor, are classified as operating leases. Payments made as lessee under operating leases (net of any incentives received from the lessor) are charged to the Income Statement on a straight-line basis over the period of the relevant leases.

Accounting policies continued

(W) Provisions and contingent liabilities

Provisions are recognised when the Company has a present legal or constructive obligation as a result of past events, it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation, and a reliable estimate of the amount of the obligation can be made. Where the Company expects a provision to be reimbursed, for example under an insurance contract, the reimbursement is recognised as a separate asset but only when the reimbursement is virtually certain.

The Company recognises a provision for onerous contracts when the expected benefits to be derived from a contract are less than the unavoidable costs of meeting the obligations under the contract.

Contingent liabilities are disclosed if there is a possible future obligation as a result of a past event, or if there is a present obligation as a result of a past event but either a payment is not probable or the amount cannot be reliably estimated.

(X) Income taxes

The current tax credit or 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 rates enacted or substantively enacted at the balance sheet date are used to determine the deferred tax.

Current and deferred tax relating to items recognised in other comprehensive income and directly in equity are recognised in other comprehensive income and directly in equity respectively. Deferred tax related to fair value re-measurement of available for sale investments, owner-occupied properties and other amounts charged or credited directly to other comprehensive income is recognised in the statement of financial position as a deferred tax asset or liability.

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.

Deferred tax is provided on temporary differences arising from investments in subsidiaries, associates and joint ventures, except where the timing of the reversal of the temporary difference can be controlled and it is probable that the difference will not reverse in the foreseeable future.

Deferred tax is not provided on revaluations of investments in subsidiaries as under current tax legislation no tax is expected to arise on their disposal.

(Y) 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.

(Z) 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 Statement of Financial Position date. Under IFRS, the provisions are not reported in the Statement of Financial Position as no liability exists but are included in the non-distributable element of retained earnings, net of attributable tax relief.

Accounting policies continued

(AA) Insurance portfolio transfer

Recognition of business transferred

An insurance portfolio transfer under Part VII of the Financial Services and Markets Act 2000 is considered to be a business combination between entities under common control. There is no guidance in IFRS 3 or IFRS 4 on accounting for business combinations between entities under common control. In the absence of specific guidance the assets and liabilities transferred have been recorded at predecessor carrying value which is a basis consistent with previous accounting for such transactions under UK GAAP and also consistent with pooling accounting which is widely used for common control business transactions.

Transfers from parent

The receipt of assets and liabilities from the Company's parent undertaking has been accounted for as a capital contribution, reflected as a movement in the Statement of Changes in Equity, and taken to a separate reserve (capital contribution reserve) at an amount equal to the net assets (or liabilities) recorded.

Transfers from subsidiaries

The receipt of assets and liabilities from its subsidiary undertakings has been recorded as dividend income, reflected as a credit in the Company's Income Statement. To the extent the fair value of these subsidiaries has fallen as a consequence of the transfers, the Company has recognised an impairment charge in its Income Statement.

Transfers to subsidiaries

The transfer of assets and liabilities from the Company to its subsidiary undertaking has been accounted for as a capital contribution, reflected as an increase in its investment by the carrying value of those assets and liabilities at the date of transfer.

Income statement

For the year ended 31 December 2011

	Note	2011 £m	2010 £m
Income	2		
Gross written premiums		1,892	1,452
Premiums ceded to reinsurers		(116)	(166)
Premiums written net of reinsurance		1,776	1,286
Net change in provision for unearned premiums		43	(12)
Net earned premiums	F & J	1,819	1,274
Fee and commission (expense) / income	G	(12)	16
Net investment income	H	1,982	343
		3,789	1,633
Expenses	3		
Claims paid, net of recoveries from reinsurers	I	(1,026)	(667)
Change in insurance liabilities, net of reinsurance	I	(40)	63
Fee and commission expense		(685)	(542)
Other expenses		(4,630)	(97)
Finance costs		(5)	(4)
		(6,386)	(1,247)
(Loss) / profit before tax		(2,597)	386
Tax (charge) / credit	X & 7	(84)	33
(Loss) / profit for the year		(2,681)	419

The accounting policies (identified alphabetically) on pages 10 to 19 and notes (identified numerically) on pages 25 to 80 are an integral part of these financial statements.

Statement of comprehensive income

For the year ended 31 December 2011

	Note	2011 £m	2010 £m
(Loss) / profit for the year		(2,681)	419
Other comprehensive income			
Subsidiaries			
Fair value (losses) / gains on investments in subsidiaries	C, 10 & 20	(4,811)	435
Impairment losses on investments previously revalued through other comprehensive income, now taken to income statement	C, 3 & 20	4,479	-
Other comprehensive income, net of tax		(332)	435
Total comprehensive income for the year		(3,013)	854

The accounting policies (identified alphabetically) on pages 10 to 19 and notes (identified numerically) on pages 25 to 80 are an integral part of these financial statements.

Statement of changes in equity

For the year ended 31 December 2011

	Ordinary share capital £m	Share premium £m	Owner- occupied properties reserve £m	Investment valuation reserve £m	Special reserve £m	Capital contribution reserve £m	Retained earnings £m	Total equity £m
Balance at 1 January 2010	7,584	3,049	3	(49)	111	-	3,976	14,674
Profit for the year	-	-	-	-	-	-	419	419
Other comprehensive income	-	-	-	435	-	-	-	435
Total comprehensive income for the year	-	-	-	435	-	-	419	854
Shares issued (note 19)	54	-	-	-	-	-	-	54
Reduction in share capital (note 19)	-	(3,049)	-	-	-	-	3,049	-
Dividends (note 8)	-	-	-	-	-	-	(450)	(450)
Balance at 31 December 2010	7,638	-	3	386	111	-	6,994	15,132
Loss for the year	-	-	-	-	-	-	(2,681)	(2,681)
Other comprehensive income	-	-	-	(332)	-	-	-	(332)
Total comprehensive income for the year	-	-	-	(332)	-	-	(2,681)	(3,013)
Shares issued (note 19)	28	-	-	-	-	-	-	28
Transfer from parent undertaking (note 1)	-	-	-	-	-	2,472	-	2,472
Balance at 31 December 2011	7,666	-	3	54	111	2,472	4,313	14,619

The accounting policies (identified alphabetically) on pages 10 to 19 and notes (identified numerically) on pages 25 to 80 are an integral part of these financial statements.

Statement of financial position

As at 31 December 2011

	Note	2011 £m	2010 £m
Assets			
Intangible assets	K & 9	8	-
Investments in subsidiaries	C & 10	8,685	11,913
Property and equipment	L & 11	6	3
Investment property	M & 12	7	-
Loans	R & 13	524	-
Financial investments	P & 15	2,653	411
Reinsurance assets	J & 23	491	181
Receivables	16	9,011	4,861
Deferred acquisition costs, prepayments and accrued income	T & 17	650	333
Current tax asset	X & 18	-	21
Group relief asset	18	104	45
Cash and cash equivalents	U & 29	1,394	196
Total assets		23,533	17,964
Equity			
Capital			
Ordinary share capital	19	7,666	7,638
Other reserves	20	2,640	500
Retained earnings	21	4,313	6,994
Total equity		14,619	15,132
Liabilities			
Gross insurance liabilities	I & 22	6,829	2,360
Provisions	W & 24	22	5
Current tax liabilities	X & 18	36	-
Payables and other financial liabilities	O & 25	1,434	315
Other liabilities	26	593	152
Total liabilities		8,914	2,832
Total equity and liabilities		23,533	17,964

Approved by the Board on 30 March 2012


P C Regan
Director

The accounting policies (identified alphabetically) on pages 10 to 19 and notes (identified numerically) on pages 25 to 80 are an integral part of these financial statements.

Statement of cash flows

For the year ended 31 December 2011

	Note	2011 £m	2010 £m
Cash flows from operating activities			
Cash (used in) / generated from operations	29(a)	(44)	117
Net cash (used in) / generated from operating activities		(44)	117
Cash flows from investing activities			
Disposals of subsidiaries net of cash transferred		-	(1)
Cash and cash equivalents transferred from parent undertaking	1	414	-
Cash and cash equivalents transferred from subsidiary undertakings	1	443	-
Cash and cash equivalents transferred to subsidiary undertaking	1	(24)	-
Net cash generated from / (used in) investing activities		833	(1)
Net increase in cash and cash equivalents		789	116
Cash and cash equivalents at 1 January		183	67
Cash and cash equivalents at 31 December	29(b)	972	183

The accounting policies (identified alphabetically) on pages 10 to 19 and notes (identified numerically) on pages 25 to 80 are an integral part of these financial statements.

Notes to the financial statements

1. Insurance portfolio transfer

On 14 November 2011, the general insurance business and relevant assets and liabilities of a number of fellow Group undertakings, were transferred to the Company at carrying value by way of an insurance portfolio transfer under Part VII of the Financial Services and Markets Act 2000. Subsequent to the initial transfers, various assets and liabilities were transferred from the Company to its direct subsidiary, The Ocean Marine Insurance Company Limited (Ocean Marine).

Net assets and liabilities of the following companies were transferred:

	Transfer from Parent undertaking £m	Transfer from subsidiary undertakings £m	Transfer to subsidiary undertakings £m	Total £m
Aviva International Insurance Limited	2,472	-	-	2,472
Aviva Insurance UK Limited	-	1,282	-	1,282
CGU Bonus Limited	-	221	-	221
CGU Underwriting Limited	-	201	-	201
Hamilton Insurance Company Limited	-	41	-	41
London and Edinburgh Insurance Company Limited	-	169	-	169
Scottish Boiler and General Insurance Company Limited	-	7	-	7
The Ocean Marine Insurance Company Limited	-	-	(17)	(17)
Total	2,472	1,921	(17)	4,376

Notes to the financial statements continued

1. Insurance portfolio transfer continued

The assets and liabilities transferred were as follows:

	Note	Transfer from Parent undertaking £m	Transfer from subsidiary undertakings £m	Transfer to subsidiary undertakings £m	Reinsurance elimination £m	Total £m
Assets						
Intangible assets	9	-	3	-	-	3
Investments in subsidiaries	10	222	1,246	-	-	1,468
Property and equipment	11	3	-	-	-	3
Investment property	12	-	7	-	-	7
Loans	13(b)	138	383	-	-	521
Financial investments		803	1,479	-	-	2,282
Reinsurance assets	23	401	1,856	(311)	(1,622)	324
Receivables		6,853	1,465	(831)	(43)	7,444
Deferred acquisition costs, prepayments and accrued income		190	364	-	(135)	419
Current tax asset		18	-	-	-	18
Deferred tax asset	18(c)	30	13	-	-	43
Cash and cash equivalents		414	443	(24)	-	833
Total assets		9,072	7,259	(1,166)	(1,800)	13,365
Liabilities						
Gross insurance liabilities	22	2,608	3,804	(311)	(1,622)	4,479
Provisions	24	8	14	-	-	22
Current tax liabilities		-	31	-	-	31
Payables and other financial liabilities		3,913	1,017	(837)	(43)	4,050
Other liabilities		71	472	(1)	(135)	407
Total liabilities		6,600	5,338	(1,149)	(1,800)	8,989
Total net assets transferred on 14 November 2011		2,472	1,921	(17)	-	4,376

All assets and liabilities were transferred at carrying value for no consideration.

The transfer from parent undertaking of £2,472 million is shown as a capital contribution in the Statement of Changes in Equity on page 22.

The transfer from subsidiary undertakings of £1,921 million is shown as dividend income in the income note (note 2) on page 27.

The transfer to subsidiary undertakings of £17 million was reflected as a capital contribution and is shown as an addition to the investment in subsidiary note (note 10) on page 32.

The reinsurance elimination represents the offset of reinsurance assets and liabilities transferred from subsidiary undertakings with the assets and liabilities transferred from the parent undertaking in respect of quota share reinsurance agreements.

Notes to the financial statements continued

2. Details of income

	Note	2011 £m	2010 £m
Gross written premiums			
Less: premiums ceded to reinsurers	22(d)	1,892	1,452
Gross change in provision for unearned premiums	23(c)(ii)	(116)	(166)
Reinsurers' share of change in provision for unearned premiums	22(d)	80	31
Net change in provision for unearned premiums	23(c)(ii)	(37)	(43)
Net earned premiums		43	(12)
Reinsurance commissions (payable) / receivable		1,819	1,274
Other fee income		(17)	16
Fee and commission (expense) / income		5	-
Total revenue		(12)	16
		1,807	1,290
Net investment income			
Interest and similar income			
From AFS investments and financial instruments at amortised cost		4	-
From investments designated as trading and other than trading		26	22
		30	22
Income from subsidiaries			
Dividend income		1,921	452
Interest income		34	-
		1,955	452
Other income / (expense) from investments designated as trading			
Realised losses		(28)	(174)
Unrealised gains	15(b)	29	43
		1	(131)
Other (expense) / income from investments designated as other than trading			
Realised losses		(48)	(4)
Unrealised gains	15(b)	47	14
		(1)	10
Foreign exchange gains and losses on investments other than trading		-	1
Change of economic assumptions on assets and liabilities other than claims reserves		1	(7)
Other investment expenses		(4)	(4)
Net investment income		1,982	343
Total income		3,789	1,633

Notes to the financial statements continued

3. Details of expenses

	Note	2011 £m	2010 £m
Claims and benefits paid, net of recoveries from reinsurers			
Claims and benefits paid	22(b)(iv)	1,051	716
Less: Claim recoveries from reinsurers	23(c)(i)	(25)	(49)
		1,026	667
Change in insurance liabilities, net of reinsurance			
Change in insurance liabilities	22(b)(iv)	61	(81)
Change in reinsurance asset for insurance provisions	23(c)(i)	(21)	18
		40	(63)
Fee and commission expense, net of reinsurance			
Acquisition costs			
Commission expenses		505	429
Change in deferred acquisition costs		42	2
Other acquisition costs		138	111
		685	542
Other operating expenses			
Impairment of investments in subsidiaries	20	4,479	-
Amortisation of intangible assets	9	3	-
Net foreign exchange losses		4	1
Corporate costs		39	33
Restructuring costs		11	8
Other expenses		94	55
		4,630	97
Finance costs			
Unwind of discount on claims provisions, net of reinsurance	22(b)(iv) & 23(c)(i)	5	4
		5	4
Total expenses		6,386	1,247

4. Employees

The Company has no employees. Aviva Employment Services Limited, a fellow Group company, is the employing company for staff of the Aviva plc group in the UK. Disclosures relating to employees may be found in the Annual Report and Accounts of Aviva Employment Services Limited.

Notes to the financial statements continued

5. Directors

Messrs Hodges, Matthews, Mayer, Moss and Regan were all directors of Aviva plc during the year and their emoluments are disclosed in that company's report and accounts. They were remunerated by Aviva Employment Services Limited, a fellow subsidiary of Aviva plc for their services to the Aviva Group as a whole. Their emoluments have been recharged, as part of a head office management charge, to all operating divisions of the Aviva Group and it is not practical to calculate the exact charge for the emoluments borne by the Company.

Ms Cote and Messrs Harris and Spencer were all senior executives of Aviva plc during the year and were remunerated by Aviva Employment Services Limited for their services to the Aviva Group as a whole. Their emoluments have also been recharged, as part of a head office management charge, to all operating divisions of the Aviva Group and it is not practical to calculate the exact charge for the emoluments borne by the Company.

Total emoluments receivable by directors and chargeable to the Company were £21,000, including £2,000 of employer contributions, in respect of one director who is accruing retirement benefits under a money purchase scheme.

6. Auditor's remuneration

The total remuneration payable by the Company, excluding VAT, to its principal auditor, Ernst & Young LLP, in respect of the audit of these financial statements is shown below.

	2011 £'000	2010 £'000
<i>Audit Services:</i>		
Statutory audit of the Company's financial statements	81	71

Fees payable to the Company's auditor, Ernst & Young LLP, and its associates for services other than the statutory audit of the Company are not disclosed in the Company's financial statements since the consolidated financial statements of the ultimate parent, Aviva plc, disclose non-audit fees on a consolidated basis.

Notes to the financial statements continued

7. Tax

(a) Tax (charged) / credited to the income statement

(i) The total tax (charge) / credit comprises:

	2011 £m	2010 £m
Current tax:		
For the year	15	21
Adjustment in respect of prior years	(56)	12
Total current tax	(41)	33
Deferred tax:		
Origination and reversal of temporary differences	(43)	-
Total deferred tax	(43)	-
Total tax (charged) / credited to income statement	(84)	33

(ii) There were no unrecognised tax losses and temporary differences of previous years used to reduce current tax expense and deferred tax expense in either 2011 or 2010.

(iii) Deferred tax (charged) / credited to the Income Statement represents movements on the following items:

	2011 £m	2010 £m
Insurance items	2	-
Unused losses and tax credits	(43)	(1)
Provisions and other temporary differences	(1)	3
Pensions and other post retirement obligations	(1)	(2)
Total deferred tax charged to income statement	(43)	-

(b) Tax credited / (charged) to other comprehensive income

There was no tax credited or charged to other comprehensive income in either 2011 or 2010.

(c) Tax reconciliation

The tax on the Company's (loss) / profit before tax differs from the theoretical amount that would arise using the tax rate of the United Kingdom as follows:

	2011 £m	2010 £m
(Loss) / profit before tax	(2,597)	386
Tax calculated at standard UK corporation tax rate of 26.5% (2010: 28%)	688	(108)
Adjustment to tax (charge) / credit in respect of prior years	(56)	12
Non-assessable dividends	509	127
Non-taxable loss on sale of subsidiaries	(2)	-
Disallowable expenses	(7)	-
Movement in deferred tax	(29)	2
Impairment of investments in subsidiaries	(1,187)	-
Tax (charged) / credited for the period (note 7(a))	(84)	33

Notes to the financial statements continued

7. Tax continued

A reduction in the UK corporation tax rate from 28% to 26% was substantively enacted in March 2011 and is effective from 1 April 2011. A further reduction from 26% to 25% was substantively enacted in July 2011 and will be effective from 1 April 2012. Accordingly, these rates have been applied in the measurement of the Company's deferred tax assets and liabilities as at 31 December 2011.

In addition, a further 1% reduction in the UK corporation tax rate to 24%, effective from 1 April 2012, was announced in the 2012 Budget on 21st March 2012. On the same day it was announced that the UK corporation tax rate would reduce to 23% from 1 April 2013 and to 22% from 1 April 2014. There is no impact to the Company's net assets from the reduction in the rate as the Company has no net deferred tax asset or liability.

8. Dividends

	2011 £m	2010 £m
Ordinary dividends declared and charged to equity in the year:		
Interim dividend - paid on 25 November 2010	-	450
Total dividends for the year	-	450

9. Intangible assets

	2011 £m	2010 £m
Gross amount		
At 1 January	-	-
Additions	8	-
Transfer from subsidiary undertakings (note 1)	3	-
At 31 December	11	-
Accumulated amortisation		
At 1 January	-	-
Amortisation for the year	(3)	-
At 31 December	(3)	-
Carrying value at 31 December	8	-

Intangible assets consist primarily of contractual relationships such as access to distribution networks and customer lists.

Notes to the financial statements continued

10. Investment in subsidiaries

(a) Movements in the Company's investments in its subsidiaries are as follows:

	2011 £m	2010 £m
Fair value at 1 January	11,913	11,424
Transfer from parent undertaking (see (b)(i) below)	250	54
Transfer from subsidiary undertakings (see (b)(ii) below)	2,791	-
Transfer to subsidiary undertakings	(38)	(54)
Transfer to fellow group company (see (b)(iii) below)	(1,545)	-
Additions (see (b)(iv) below)	125	54
Movement in fair value (note 20)	(4,811)	435
Fair value at 31 December	8,685	11,913

All investments in subsidiaries are recorded as Level 3 investments in the fair value hierarchy (see note 14(b)).

(b) Material movements

(i) Transfer from parent undertaking

The transfer from parent undertaking of £250 million comprises Part VII transfer of £222 million and Asia restructuring of £28 million.

Part VII transfer

On 14 November 2011, under the Part VII transfer, the Company's immediate parent company, Aviva International Insurance Limited (AIIL), transferred its entire shareholding in subsidiaries listed below with a carrying value of £222 million for £Nil consideration. The subsidiaries transferred at the date were:

- Aviva Consumer UK Products Limited
- Bluecycle.com Ltd
- Commercial Union Corporate Member Ltd
- Gresham Insurance Company Ltd
- Solus Automotive Ltd

Asia restructuring

On 1 January 2011, Aviva Asia Pte Limited (AAPL) was transferred at its fair value of £28 million from AIIL, to the Company. On the same day, it was then transferred to Aviva International Holdings Limited, the Company's direct subsidiary. The consideration for the transfers was the issue of 2,840 ordinary shares of £10,000 each by the Company and Aviva International Holdings Limited (AIH) respectively. No profit or loss has been recognised by the Company for the transfers.

Notes to the financial statements continued

10. Investment in subsidiaries continued

(b) Material movements continued

(ii) Transfer from subsidiary undertakings

The transfer from subsidiary undertakings of £2,791 million comprises Part VII transfer of £1,246 million and US restructuring of £1,545 million.

Part VII transfer

As part of the Part VII transfer (note 1) the entire shareholding in the subsidiaries listed below were transferred to the Company from its subsidiary undertakings at their fair value of £1,246 million.

- Aviva Risk Management Solutions UK Limited
- Aviva UKGI Investments Limited
- CGU Bonus Limited
- CGU Underwriting Limited
- Hamilton Insurance Company Limited
- London and Edinburgh Insurance Company Limited
- Scottish Boiler and General Insurance Company Limited
- The Ocean Marine Insurance Company Limited
- The World Auxiliary Insurance Corporation Limited.

US restructuring

On 31 December 2011, the entire shareholding in Aviva USA Corporation (AUSA) together with the associated intercompany loan assets was transferred from AIH to a fellow Group Company, Aviva Group Holdings Limited, via the Company at its fair value of £1,545 million. No profit or loss has been recognised by the Company for the transfers.

(iii) Transfer to fellow group company

The transfer to a fellow group company of £1,545 million reflects the US restructuring (above).

(iv) Additions

Additions of £125 million relate to the Part VII transfer of £97 million and the Asia restructuring of £28 million (described above).

Part VII transfer

Subsequent to the initial transfers, certain assets and liabilities were transferred from the Company to The Ocean Marine Insurance Company Limited (Ocean Marine), its direct subsidiary at carrying value. This transfer was reflected as a capital contribution and has resulted in a £17 million net increase in the Company's investment in Ocean Marine. In addition, Ocean Marine has issued new share capital of £69 million to the Company in return for settlement of an intercompany balance.

(v) Movement in fair value

The negative fair value movement is primarily due to a decline in the financial market inputs to our valuation model relative to the prior year end, reflecting global market trends over the year and resulting in a lower estimate of the fair value of the Company's investments in subsidiaries.

The effect of the change in the method of estimating the fair value of subsidiaries in the current period was to increase investments in subsidiaries at 31 December 2011 by £697 million, and to increase the investment valuation reserve at 31 December 2011 by £697 million. The impact on future reporting periods depends on future market movements and therefore cannot be estimated.

Notes to the financial statements continued

10. Investment in subsidiaries continued

(c) Principal subsidiaries

The principal subsidiary at 31 December 2011 is Aviva International Holdings Limited, an intermediate parent undertaking which holds the Company's overseas subsidiaries, is domiciled in the United Kingdom and is directly wholly-owned.

The Company has taken advantage of section 410 of the Companies Act 2006 which permits it to disclose information only in respect of those undertakings whose results, or financial position, in the opinion of the directors, principally affected the figures shown on the Company's annual accounts. Full information (both that which is disclosed in the annual accounts and that which is not) will be annexed to the Company's next Annual Return delivered to the registrar of companies.

11. Property and equipment

	2011 £m	2010 £m
Owner-occupied properties		
<i>Cost or Valuation</i>		
At 1 January	3	3
Additions	-	1
Fair value losses	-	(1)
Transfer from parent undertaking (note 1)	3	-
At 31 December	6	3

Owner-occupied properties are stated at their revalued amounts, as assessed by qualified external valuers. These values are assessed in accordance with the relevant parts of the current RICS Appraisal and Valuation Standards in the UK, and with current local valuation practices in other countries. This assessment, on the basis of Existing Use Value and in accordance with UK Practice Statement 1.3, is the estimated amount for which a property should exchange on the date of valuation between a willing buyer and a willing seller in an arm's-length transaction, after proper marketing wherein the parties had acted knowledgeably, prudently and without compulsion, assuming that the buyer is granted vacant possession of all parts of the property required by the business and disregarding potential alternative uses. The valuation assessment adopts market-based evidence and is in line with guidance from the International Valuation Standards Committee and the requirements of IAS 16, *Property, Plant and Equipment*.

If owner-occupied properties were stated on a historical cost basis, the carrying amount would be £4 million (2010: £1 million).

Notes to the financial statements continued

12. Investment property

	2011 £m	2010 £m
Fair value at 1 January	-	-
Transfer from subsidiary undertakings (note 1)	7	-
Fair value at 31 December	<u>7</u>	<u>-</u>

All investment properties are freehold. Investment properties are stated at their market values as assessed by qualified external valuers. Values are calculated using a discounted cash flow approach and are based on current rental income plus anticipated uplifts at the next rent review, assuming no growth in rental income thereafter. This uplift and the discount rate are derived from rates implied by recent market transactions on similar properties. All investment properties are leased to third parties under operating leases. Future contractual aggregate minimum lease rentals receivable under the non-cancellable portion of these leases are given in note 28.

13. Loans

(a) Carrying amounts of loans

The carrying amounts of loans at amortised cost, at 31 December are as follows:

	2011 £m	2010 £m
Mortgage loans	354	-
Unsecured loans to brokers	12	-
Other loans	158	-
As at 31 December	<u>524</u>	<u>-</u>

The fair value of the loans is estimated to be £512 million (2010: £Nil). No further impairment to amortised cost is considered necessary as at 31 December 2011.

(b) Movement

The movement during the year comprises:

	2011 £m	2010 £m
Carrying amount at 1 January	-	-
Advanced during the year	7	-
Settled during the year	(4)	-
Transfer from parent undertaking (note 1)	138	-
Transfer from subsidiary undertakings (note 1)	383	-
Carrying value at 31 December	<u>524</u>	<u>-</u>

Notes to the financial statements continued

13. Loans continued

(c) Collateral

The Company holds collateral in respect of mortgage loans, where it is considered appropriate, in order to reduce the risk of non-recovery. This collateral generally takes the form of charges over properties for the majority of the mortgage loan balances above. In all other situations, the collateral must be in a readily realisable form, such as listed securities, and is held in segregated accounts. Transfer of title for the collateral received always occurs in such cases, although no market risk or benefit is taken. In the event of a default, the Company is able to sell or repledge the collateral.

14. Fair value methodology

(a) Basis for determining fair value hierarchy of financial instruments

For financial assets and liabilities carried at fair value, the Company has categorised the measurement basis into a 'fair value hierarchy' as follows:

Quoted market prices in active markets (Level 1)

Inputs to Level 1 fair values are quoted prices (unadjusted) in active markets for identical assets and liabilities. An active market is one in which transactions for the asset or liability occurs with sufficient frequency and volume to provide pricing information on an ongoing basis. Examples are listed equities in active markets, listed debt securities in active markets and quoted unit trusts in active markets.

Modelled with significant observable market inputs (Level 2)

Inputs to Level 2 fair values are inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly. If the asset or liability has a specified (contractual) term, a Level 2 input must be observable for substantially the full term of the instrument. Level 2 inputs include the following:

- quoted prices for similar (i.e. not identical) assets and liabilities in active markets;
- quoted prices for identical or similar assets and liabilities in markets that are not active, the prices are not current, or price quotations vary substantially either over time or among market makers, or in which little information is released publicly;
- inputs other than quoted prices that are observable for the asset or liability (for example, interest rates and yield curves observable at commonly quoted intervals, volatilities, prepayment speeds, loss severities, credit risks, and default rates); and
- inputs that are derived principally from, or corroborated by, observable market data by correlation or other means (market-corroborated inputs).

Examples of these are securities measured using discounted cash flow models based on market observable swap yields, listed debt or equity securities in a market that is inactive, and investments in subsidiaries valued using applicable models underpinned by Aviva plc's market capitalisation. Valuations, whether sourced from internal models or third parties, incorporate credit risk by adjusting the spread above the yield curve for government treasury securities for the appropriate amount of credit risk for each issuer, based on observed market transactions. To the extent observed market spreads are either not used in valuing a security, or do not fully reflect liquidity risk, our valuation methodology, whether sourced from internal models or third parties, reflects a liquidity premium.

Where we use broker quotes and no information as to the observability of inputs is provided by the broker, we generally validate the price quoted by the broker by using internal models with observable inputs. When the price obtained from the broker and internal model are similar, we look to the inputs used in our internal model to understand the observability of the inputs used by the broker. In circumstances where internal models are not used to validate broker prices, and the observability of inputs used by brokers is unavailable, the investment is classified as Level 3. Broker quotes are usually non-binding.

Notes to the financial statements continued

14. Fair value methodology continued

Modelled with significant unobservable market inputs (Level 3)

Inputs to Level 3 fair values are unobservable inputs for the asset or liability. Unobservable inputs may have been used to measure fair value to the extent that observable inputs are not available, thereby allowing for situations in which there is little, if any, market activity for the asset or liability at the measurement date (or market information for the inputs to any valuation models). As such, unobservable inputs reflect the assumptions the Company considers that market participants would use in pricing the asset. Examples are certain private equity investments and private placements, and investments in subsidiaries valued at net asset value.

The Company's investments, excluding investments in subsidiaries, are valued based on quoted market information or observable market data. Third party valuations using significant unobservable inputs validated against Level 2 internally modelled valuations are classified as Level 3, where there is a significant difference between the third party price and the internally modelled value. Where the difference is insignificant, the instrument would be classified as Level 2. Investments in subsidiaries recorded at fair value, are based on estimates and recorded as Level 3 investments. Where estimates are used, these are based on a combination of independent third party evidence and internally developed models, calibrated to market observable data where possible.

(b) Fair value hierarchy

An analysis of financial assets and liabilities according to fair value hierarchy is given below:

	Fair value hierarchy					2011
	Level 1 £m	Level 2 £m	Level 3 £m	Sub Total £m	Amortised cost £m	Statement of financial position £m
Financial investments and loans						
Loans (note 13)	-	-	-	-	524	524
Debt securities (note 15)	2,330	22	-	2,352	-	2,352
Equity securities (note 15)	-	-	3	3	-	3
Other investments (including derivatives) (note 15)	217	69	12	298	-	298
Total	2,547	91	15	2,653	524	3,177
Investments in subsidiaries						
Investments in subsidiaries (note 10)	-	-	8,685	8,685	-	8,685
Total	-	-	8,685	8,685	-	8,685
Financial liabilities						
Derivative liabilities (note 32)	(102)	(79)	(32)	(213)	-	(213)
Total	(102)	(79)	(32)	(213)	-	(213)

Notes to the financial statements continued

14. Fair value methodology continued

(b) Fair value hierarchy continued

	Fair value hierarchy			Sub	Amortised	2010 Statement of financial position
	Level 1	Level 2	Level 3	Total	cost	
	£m	£m	£m	£m	£m	£m
<i>Financial investments and loans</i>						
Debt securities (note 15)	389	-	-	389	-	389
Equity securities (note 15)	3	-	-	3	-	3
Other investments (including derivatives) (note 15)	19	-	-	19	-	19
Total	411	-	-	411	-	411
<i>Investments in subsidiaries</i>						
Investments in subsidiaries (note 10)	-	-	11,913	11,913	-	11,913
Total	-	-	11,913	11,913	-	11,913

(c) Further information on Level 3 financial instruments

The tables below shows movements in the assets measured at fair value based on valuation techniques for which any significant input is not based on observable market data (Level 3 only).

	Investment in subsidiaries (note 10)	Equity securities	Other investments	Derivative liabilities
	£m	£m	£m	£m
Balance at 1 January 2010	11,424	-	-	-
Transfer from parent undertaking	54	-	-	-
Transfer to subsidiary undertaking	(54)	-	-	-
Additions	54	-	-	-
Movement in fair value (note 20)	435	-	-	-
Balance at 31 December 2010	11,913	-	-	-
Transfer from parent undertaking	250	-	12	-
Transfer from subsidiary undertakings	2,791	3	-	-
Transfer to subsidiary undertakings	(38)	-	-	-
Transfer to fellow group company	(1,545)	-	-	-
Additions	125	-	-	(32)
Movement in fair value (note 20)	(4,811)	-	-	-
Balance at 31 December 2011	8,685	3	12	(32)

The unobservable inputs to the fair value relate to assumptions made to individual subsidiary and joint ventures net assets or embedded values, all of which are underpinned by quoted market valuations of comparable listed entities.

Notes to the financial statements continued

15. Financial investments

(a) Carrying amount

Financial investments comprise:

			2011
At fair value through profit and loss	Trading	Other than Trading	Total
	£m	£m	£m
(i) Fixed maturity securities			
Debt securities			
UK Government	-	252	252
Non-UK Government	-	413	413
Corporate - UK	-	179	179
Corporate - Non UK	-	63	63
Other corporate	-	1,445	1,445
	-	2,352	2,352
(ii) Equity securities			
Ordinary shares			
Industrial miscellaneous and all other	-	3	3
	-	3	3
(iii) Other investments			
Derivative financial instruments (note 32)	287	-	287
Unit trusts and specialised investment vehicles	-	11	11
	287	11	298
Total financial investments	287	2,366	2,653

Notes to the financial statements continued

15. Financial investments continued

(a) Carrying amount continued

			2010
At fair value through profit and loss	Trading	Other than Trading	Total
	£m	£m	£m
(i) Fixed maturity securities			
Debt securities			
UK Government	-	59	59
Non-UK Government	-	69	69
Other corporate	-	261	261
	-	389	389
(ii) Equity securities			
Ordinary shares			
Corporate - Non-UK	-	3	3
	-	3	3
(iii) Other investments			
Derivative financial instruments (note 32)	19	-	19
Total financial investments	19	392	411

Of the above total, £2,067 million (2010: £356 million) is expected to be recovered more than one year after the Statement of Financial Position date.

Notes to the financial statements continued

15. Financial investments continued

(b) Cost, unrealised gains and losses, and fair value

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

	2011			
	Cost/ Amortised Cost £m	Unrealised gains £m	Unrealised losses and impairments £m	Fair Value £m
Debt Securities	2,286	92	(26)	2,352
Equity securities	2	1	-	3
Other investments				
Derivative financial instruments	314	29	(56)	287
Unit trusts and specialised investment vehicles	11	-	-	11
	2,613	122	(82)	2,653
	2010			
	Cost/ Amortised Cost £m	Unrealised gains £m	Unrealised losses and impairments £m	Fair Value £m
Debt Securities	376	13	-	389
Equity securities	5	-	(2)	3
Other investments				
Derivative financial instruments	40	-	(21)	19
Unit trusts and specialised investment vehicles	1	-	(1)	-
Other	5	-	(5)	-
	427	13	(29)	411

All unrealised gains and losses and impairments on financial investments classified as fair value through profit or loss have been recognised in the Income Statement.

Unrealised gains and losses on financial investments classified as at fair value through profit or loss recognised in the Income Statement in the year were a net gain of £76 million (2010: £57 million).

The movement in the unrealised gain/loss position reported in the Statement of Financial Position during the year, shown in the table above, includes transfers due to the realisation of gains and losses on disposal and the recognition of impairment losses.

(c) Stock lending

The Company has entered into stock lending arrangements during the year in accordance with established market conventions. The majority of the Company's stock lending transactions occurs in the UK, where investments are lent to EEA-regulated, locally-domiciled counterparties and governed by agreements written under English law.

The Company receives collateral in order to reduce the credit risk of these arrangements. Collateral must be in a readily realisable form such as listed securities and is held in segregated accounts. Transfer of title always occurs for the collateral received, although no market risk or economic benefit is taken. The level of collateral held is monitored regularly, with further collateral obtained where this is considered necessary to manage the Company's risk exposure. In certain markets, the Company's appointed stock lending managers obtain legal ownership of the collateral received and can re-pledge it as collateral elsewhere or sell outright in the absence of default. The carrying amounts of financial assets received in this manner at 31 December 2011 are £469 million (2010: £156 million). No collateral was actually sold or re-pledged in the absence of default in either 2011 or 2010.

Notes to the financial statements continued

16. Receivables

	2011 £m	2010 £m
Amounts due from contract holders	506	-
Amounts due from intermediaries	577	398
Amounts due from reinsurers	67	24
Amounts due from immediate parent company (note 34(a)(vi))	-	223
Amounts due from subsidiaries (note 34(a)(vi))	1,439	2,866
Amounts due from other Aviva Group companies (note 34(a)(vi))	39	7
Loan due from other Aviva Group companies (note 34(a)(v))	4,939	-
Loans due from subsidiaries (note 34(a)(v))	1,300	1,300
Collateral repayment obligation	49	-
Other receivables	95	43
Total at 31 December	9,011	4,861
Expected to be recovered in less than one year	2,772	3,561
Expected to be recovered in greater than one year	6,239	1,300
	9,011	4,861

Concentrations of external 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.

17. Deferred acquisition costs, prepayments and accrued income

(a) The carrying amount comprises:

	2011 £m	2010 £m
Deferred acquisition costs in respect of insurance contracts	547	310
Prepayments and accrued income	103	23
Total at 31 December	650	333

(b) The movements in deferred acquisition costs during the year are:

	2011 £m	2010 £m
Carrying amount at 1 January	310	351
Acquisition costs deferred during the year	700	535
Amortisation	(802)	(576)
Transfer from parent undertaking	172	-
Transfer from subsidiary undertakings	302	-
Reinsurance elimination	(135)	-
Carrying amount at 31 December	547	310

Deferred acquisition costs are generally recoverable within one year of the Statement of Financial Position date.

(c) Prepayments and accrued income

Prepayments and accrued income are expected to be recovered within one year of the Statement of Financial Position date.

Notes to the financial statements continued

18. Tax assets and liabilities

(a) Current tax

	2011 £m	2010 £m
<i>(i) Tax asset</i>		
Expected to be recoverable in more than one year	-	21
Tax asset recognised in statement of financial position	-	21
<i>(ii) Tax liability</i>		
Expected to be payable in more than one year	(36)	-
Tax liability recognised in statement of financial position	(36)	-

(b) Group relief

Assets for the prior year tax settled by Group relief of £104 million (2010: £45 million) are included within the related party transactions (note 34) and are recoverable in less than one year.

(c) Deferred tax

(i) The balance at the year end comprises

	2011 £m	2010 £m
Temporary differences arising on insurance items	(34)	(37)
Unused losses and tax credits	17	32
Accelerated capital allowances	6	3
Pension and other post retirement obligations	(3)	(2)
Provisions and other temporary differences	14	4
Net deferred tax asset at 31 December	-	-

(ii) The movement in the net deferred tax (liability) / asset was as follows

	2011 £m	2010 £m
Net asset at 1 January	-	-
Transferred with insurance business	43	-
Amounts charged to profit (note 7)	(43)	-
Net deferred tax asset at 31 December	-	-

The Company has unrecognised temporary differences of £738 million (2010: £290 million comprising unrecognised temporary differences of £39 million and £251 million of capital losses) to carry forward indefinitely against future taxable income. The £738 million comprises £462 million trading losses, £252 million capital losses and £24 million general provisions. The increase in the year mainly relates to transfers into the Company on 14 November 2011 of £116 million as part of the insurance portfolio transfer, consisting of £25 million in general provisions, £90 million in trading losses and £1 million capital losses.

Notes to the financial statements continued

19. Ordinary share capital

(a) Details of the Company's ordinary share capital are as follows:

	2011 £m	2010 £m
Allotted, called up and fully paid 766,605 (2010: 763,765) ordinary shares of £10,000 each	7,666	7,638

Ordinary shares in issue in the Company rank pari passu. All the ordinary shares in issue carry the same right to receive all dividends and other distributions declared, made or paid by the Company.

(b) Movements in the year comprise:

	Number of shares	Share capital £m	Share premium £m
At 1 January 2010	758,345	7,584	3,049
Shares issued	5,420	54	-
Reduction in share capital (note 21)	-	-	(3,049)
At 31 December 2010	763,765	7,638	-
Shares issued (note 10)	2,840	28	-
At 31 December 2011	766,605	7,666	-

20. Other reserves

	Owner- occupied properties reserve (see accounting policy L) £m	Investment valuation reserve (see accounting policy P) £m	Special reserve £m	Capital contribution reserve £m	Total other reserves £m
Balance at 1 January 2010	3	(49)	111	-	65
<i>Arising in the year:</i>					
Fair value gains on investments in subsidiaries (note 10)	-	435	-	-	435
Balance at 31 December 2010	3	386	111	-	500
<i>Arising in the year:</i>					
Fair value losses on investments in subsidiaries (note 10)	-	(4,811)	-	-	(4,811)
Impairment losses on investments previously revalued through other comprehensive income, now taken to income statement (note 3)	-	4,479	-	-	4,479
Transfer from parent undertaking (note 1)	-	-	-	2,472	2,472
Balance at 31 December 2011	3	54	111	2,472	2,640

Notes to the financial statements continued

20. Other reserves continued

Impairments

Impairment charges in the year recognised in the Income Statement amount to £4,479 million relate to the Company's investments in the following subsidiaries:

- Aviva Insurance UK Ltd
- Aviva International Holdings Limited
- CGU Bonus Limited
- CGU Underwriting Limited
- Hamilton Insurance Company Limited
- London and Edinburgh Insurance Company Limited
- Scottish Boiler and General Insurance Company Limited
- The Ocean Marine Insurance Company Limited.

The investments in the subsidiaries, which transferred assets and liabilities to the Company under the Part VII transfer, have either been fully impaired or written down to their net asset value at year end. This gave rise to an impairment charge of £2,107 million.

The Company's principal subsidiary, Aviva International Holdings Limited was written down by £2,247 million. This impairment is driven by the revision to the fair value estimation methodology, which now takes into account local economic and market conditions in Europe and the US, reducing the fair value estimate for these entities. It is not anticipated that these conditions will significantly improve in the foreseeable future and therefore the reduction in value is not considered to be temporary.

Special reserve

As part of the ongoing Aviva Group restructuring, the Company's parent, Aviva International Insurance Limited (All) transferred its entire shareholding in Aviva Insurance UK Limited at its fair value of £1,348 million to the Company on 31 December 2007. The consideration was satisfied by the issue of new shares in the Company with the nominal value of £1,237 million to All, and the establishment of a special reserve of £111 million under the group reconstruction relief provisions of section 132 of the Companies Act 1985.

Capital contribution reserve

As described in note 1, on 14 November 2011, the Company received the assets and liabilities from its parent undertaking, Aviva International Insurance Limited, at carrying value by way of an insurance portfolio transfer under Part VII of the Financial Services and Markets Act 2000. A capital contribution reserve of £2,472 million has been established at an amount equal to the net assets and liabilities received. This represents surplus net assets gifted from Aviva International Insurance Limited to the Company, of which £1,150 million is freely distributable for dividend purposes with no constraints. The remaining £1,322 million will become distributable as and when certain criteria are met.

21. Retained earnings

	2011 £m	2010 £m
At 1 January	6,994	3,976
(Loss) / profit for the year	(2,681)	419
Dividends (note 8)	-	(450)
Transfer from share premium (note 19)	-	3,049
At 31 December	4,313	6,994
Distributable	2,756	3,066
Non distributable	1,557	3,928
At 31 December	4,313	6,994

Notes to the financial statements continued

22. Insurance liabilities

(a) Carrying amount

Insurance liabilities at 31 December comprise:

	2011	2010
	£m	£m
Outstanding claims provisions	3,512	1,303
Provision for claims incurred but not reported	1,079	297
	4,591	1,600
Provision for unearned premiums	2,238	760
Total at 31 December	6,829	2,360

(b) General insurance liabilities

(i) 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 Statement of Financial Position date. The reserves for general insurance 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.

The uncertainties involved in estimating loss reserves are allowed for in the reserving process and by the estimation of explicit reserve uncertainty distributions. The reserve estimation basis for non-life claims requires booked claims provisions to be calculated as the best estimate of the cost of future claim payments, plus an explicit allowance for risk and uncertainty.

Notes to the financial statements continued

22. Insurance liabilities continued

(b) General insurance liabilities continued

(ii) Discounting

Outstanding claims provisions are based on undiscounted estimates of future claim payments, except for the following classes of business for which discounted provisions are held:

Class	Discounting Rate		Mean term of liabilities	
	2011	2010	2011	2010
Latent claims	0.75% to 3.25%	0.88% to 4.17%	16 years	15 years
Reinsured London Market business	2.20%	3.30%	13 years	12 years
Structured settlements	2.70%	3.20%	31 years	35 years

The gross outstanding claims provision before discounting was £5,135 million (2010: £1,687 million). The period of time which will elapse before the liabilities are settled has been estimated by modelling the settlement patterns of the underlying claims.

The discount rate that has been applied to latent claims reserve is based on the relevant swap curve having regard to the expected settlement dates of the claims. The range of discount rates used depends on the duration of the claims and is given in the section above. The duration of the claims span over 35 years, with the average duration estimated to be 16 years.

During 2011, the UK General Insurance group (UKGI), have continued to experience a steady increase in the number of bodily injury claims settled by periodic payment orders (PPOs) or structured settlements, which are reserved for on a discounted basis.

Lump sum payments in settlement of bodily injury claims decided by the UK courts are calculated in accordance with the Ogden Tables. The Ogden Tables contain a discount rate that is set by the Lord Chancellor and that is applied when calculating the present value of loss of earnings for claims settlement purposes. The Ogden discount rate is currently under review by the Lord Chancellor. The timing of the conclusion of this review is unclear and it is still uncertain whether or by how much the rate will change, however an allowance has been included in provisions for a reduction in the Ogden discount rates. A reduction in the Ogden discount rates will increase lump sum payments to UK bodily injury claimants.

(iii) Assumptions

Outstanding claims provisions are estimated based on known facts at the date of estimation. Case estimates are set by skilled claims technicians and established case setting procedures. Claim technicians apply their experience and knowledge to the circumstances of individual claims. They take into account all available information and correspondence regarding the circumstances of the claim, such as medical reports, investigations and inspections. Claims technicians set case estimates according to documented claims department policies and specialise in setting estimates for certain lines of business or types of claim. Claims above certain limits are referred to senior claims handlers for authorisation.

No adjustments are made to the claims technicians' case estimates included in booked claim provisions, except for rare occasions when the estimated ultimate cost of individual large or unusual claims may be adjusted, subject to internal reserve committee approval, to allow for uncertainty regarding, for example, the outcome of a court case. 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 a 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 for each line of business. Certain lines of business are also further analysed by claim type or type of coverage. In addition, large claims are usually separately assessed, either by being reserved at the face value of loss adjuster estimates, or separately projected in order to reflect their future development.

Notes to the financial statements continued

22. Insurance liabilities continued

(b) General insurance liabilities continued

(iii) Assumptions continued

The assumptions used in most non-life actuarial projection techniques, including future rates of claims inflation or loss ratio assumptions, are implicit in the historical 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 claims handling procedures in order to arrive at the estimated ultimate cost of claims that represents the most likely outcome, from the range of possible outcomes, taking account of all the uncertainties involved. The range of possible outcomes does not, however, result in the quantification of a reserve range.

Another area of judgement is the impact of a European Court of Justice ruling in March 2011 on gender equality for the pricing of insurance products. At 31 December 2011, the impact of the ruling on existing general business provisions was not considered to be material (2010: not applicable).

(iv) Movements

The following changes have occurred in the claims provisions during the year:

	2011 £m	2010 £m
Carrying amount at 1 January	1,600	1,677
Impact of changes in assumptions	37	6
Claims losses and expenses incurred in the current year	979	711
Increase / (decrease) in estimated claim losses and expenses incurred in prior years	96	(83)
Incurred claims losses and expenses	1,112	634
Less:		
Payments made on claims incurred in the current year	(417)	(254)
Payments made on claims incurred in prior years	(634)	(461)
Claims payments made in the year	(1,051)	(715)
Unwinding of discount	7	4
Changes in claims reserve recognised as an expense	68	(77)
Foreign exchange rate movements	2	-
Transfer from parent undertaking (note 1)	1,805	-
Transfer from subsidiary undertakings (note 1)	2,380	-
Transfer to subsidiary undertakings (note 1)	(311)	-
Reinsurance elimination (note 1)	(953)	-
Carrying amount at 31 December	4,591	1,600

Notes to the financial statements continued

22. Insurance liabilities continued

(b) General insurance liabilities continued

(iv) *Movements continued*

The discount rate that has been applied to latent claims reserves and periodic payment orders is based on the relevant swap rate, in the relevant currency, having regard to the expected settlement dates of the claims. The range of discount rates used depends on the duration of the claims and is given in the table in section (b) above. The duration of the latent claims spans 35 years, with the average duration 16 years, and for periodic payment orders, the average duration is 31 years. Any change in discount rates between the start and the end of the accounting period is reflected as an economic assumption change. The increase in interest rates in 2011 has resulted in a decrease in the net discounted provision of £37 million (2010: £6 million).

(v) *Effect of changes in estimates during the year*

During the year, gross prior years' claims provisions of £96 million (£57 million, net of reinsurance) (2010: £83 million gross release, £104 million net of reinsurance) were charged to the Income Statement.

The main reason for this is the reassessment of the level of provision for commercial motor claims and the discounted cost of £45 million (£35 million net of reinsurance) for strengthening latent claims provisions in the UK on business written a significant number of years ago.

(c) Loss development tables

(i) *Description of tables*

The tables that follow present the development of claims payments and the estimated ultimate cost of claims for the accident years 2002 to 2011. The upper half of the tables shows the cumulative amounts paid during successive years related to each accident year. For example, with respect to the accident year 2002, by the end of 2011 £517 million 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 £561 million was re-estimated to be £520 million at 31 December 2011. The original estimates increase or decrease, as more information becomes known about the individual claims and overall claim frequency and severity.

The Company aims to maintain strong reserves in respect of its general insurance business 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 claims experience will then result in a release of reserves from earlier accident years, as shown in the loss development tables below. However, in order to maintain overall reserve adequacy the Company establishes strong reserves in respect of the current accident year (2011), where the development of claims is less mature and there is much greater uncertainty attaching to the ultimate cost of claims.

The loss development tables in respect of the insurance liabilities of the Company, both before and after the Part VII transfer are shown below.

Notes to the financial statements continued

22. Insurance liabilities continued

(c) Loss development tables continued

(ii) Gross figures

Before the effect of reinsurance, the loss development table, excluding the development prior to 14 November 2011 on business transferred as part of the Part VII transfer, is:

Accident year	All prior years	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	Total
Gross cumulative claim payments												
At end of accident year		(175)	(148)	(158)	(176)	(199)	(328)	(299)	(302)	(254)	(417)	
One year later		(314)	(329)	(302)	(384)	(448)	(640)	(568)	(532)	(526)		
Two years later		(385)	(383)	(344)	(465)	(512)	(761)	(652)	(619)			
Three years later		(418)	(428)	(379)	(520)	(569)	(821)	(746)				
Four years later		(450)	(473)	(401)	(547)	(607)	(896)					
Five years later		(478)	(514)	(408)	(553)	(645)						
Six years later		(497)	(526)	(414)	(570)							
Seven years later		(501)	(535)	(419)								
Eight years later		(507)	(541)									
Nine years later		(517)										
Estimate of gross ultimate claims												
At end of accident year		561	608	622	704	755	1,006	925	865	711	979	
One year later		592	588	498	653	756	1,000	941	811	770		
Two years later		574	585	495	664	738	991	920	808			
Three years later		570	579	464	622	712	997	923				
Four years later		551	554	432	602	697	989					
Five years later		543	542	419	576	704						
Six years later		529	541	416	581							
Seven years later		526	537	419								
Eight years later		527	549									
Nine years later		520										
Estimate of gross ultimate claims		520	549	419	581	704	989	923	808	770	979	
Cumulative payments		(517)	(541)	(419)	(570)	(645)	(896)	(746)	(619)	(526)	(417)	
Gross outstanding claims provisions	388	3	8	-	11	59	93	177	189	244	562	1,734
Effect of discounting	(66)	-	(4)	-	-	(1)	(6)	(3)	-	-	-	(80)
Present value	322	3	4	-	11	58	87	174	189	244	562	1,654
Acquired reserves	-	4	4	4	4	-	-	-	-	-	-	16
Gross discounted reserves excluding Part VII transfer	322	7	8	4	15	58	87	174	189	244	562	1,670
Gross undiscounted reserves transferred	1,185	55	66	29	104	156	162	275	240	339	774	3,385
Gross discount on reserves transferred	(380)	(2)	(20)	(1)	(34)	(23)	-	(4)	-	-	-	(464)
Gross discounted reserves transferred	805	53	46	28	70	133	162	271	240	339	774	2,921
Total gross undiscounted reserves	1,573	62	78	33	119	215	255	452	429	583	1,336	5,135
Total gross discount	(446)	(2)	(24)	(1)	(34)	(24)	(6)	(7)	-	-	-	(544)
Present value in the statement of financial position	1,127	60	54	32	85	191	249	445	429	583	1,336	4,591

Notes to the financial statements continued

22. Insurance liabilities continued

(c) Loss development tables continued

(ii) Gross figures continued

Before the effect of reinsurance, the total loss development table includes the development of both existing business of the Company and the business transferred as part of the Part VII transfer is:

Accident year	All prior years	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	Total
Gross cumulative claim payments												
At end of accident year		(1,559)	(1,470)	(1,493)	(1,727)	(1,881)	(2,301)	(1,995)	(1,752)	(1,488)	(1,487)	
One year later		(2,418)	(2,231)	(2,355)	(2,675)	(2,907)	(3,555)	(2,898)	(2,494)	(2,282)		
Two years later		(2,707)	(2,477)	(2,634)	(2,957)	(3,194)	(3,872)	(3,127)	(2,695)			
Three years later		(2,879)	(2,730)	(2,825)	(3,180)	(3,379)	(4,049)	(3,307)				
Four years later		(3,019)	(2,931)	(2,935)	(3,306)	(3,538)	(4,192)					
Five years later		(3,106)	(3,017)	(3,027)	(3,372)	(3,621)						
Six years later		(3,150)	(3,074)	(3,080)	(3,413)							
Seven years later		(3,163)	(3,101)	(3,092)								
Eight years later		(3,177)	(3,109)									
Nine years later		(3,202)										
Estimate of gross ultimate claims												
At end of accident year		3,424	3,523	3,620	3,738	3,883	4,308	3,753	3,208	2,810	2,823	
One year later		3,452	3,374	3,497	3,666	3,862	4,417	3,727	3,133	2,865		
Two years later		3,406	3,370	3,388	3,625	3,859	4,418	3,737	3,124			
Three years later		3,396	3,297	3,235	3,544	3,795	4,448	3,759				
Four years later		3,367	3,215	3,118	3,508	3,814	4,447					
Five years later		3,305	3,155	3,117	3,507	3,832						
Six years later		3,275	3,176	3,121	3,526							
Seven years later		3,274	3,174	3,120								
Eight years later		3,267	3,182									
Nine years later		3,260										
Estimate of gross ultimate claims		3,260	3,182	3,120	3,526	3,832	4,447	3,759	3,124	2,865	2,823	
Cumulative payments		(3,202)	(3,109)	(3,092)	(3,413)	(3,621)	(4,192)	(3,307)	(2,695)	(2,282)	(1,487)	
Gross outstanding claims provisions	1,573	58	73	28	113	211	255	452	429	583	1,336	5,111
Effect of discounting	(446)	(2)	(24)	(1)	(34)	(24)	(6)	(7)	-	-	-	(544)
Present value	1,127	56	49	27	79	187	249	445	429	583	1,336	4,567
Acquired reserves	-	4	5	5	6	4	-	-	-	-	-	24
Present value in the statement of financial position	1,127	60	54	32	85	191	249	445	429	583	1,336	4,591

Notes to the financial statements continued

22. Insurance liabilities continued

(iii) Net of reinsurance

After the effect of reinsurance, the loss development table, excluding the development prior to 14 November 2011 on business transferred as part of the Part VII transfer, is:

Accident year	All prior years	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	Total
Net cumulative claim payments												
At end of accident year		(153)	(137)	(145)	(171)	(199)	(320)	(294)	(296)	(250)	(416)	
One year later		(280)	(300)	(276)	(357)	(428)	(611)	(556)	(511)	(516)		
Two years later		(348)	(349)	(316)	(423)	(486)	(716)	(636)	(596)			
Three years later		(392)	(390)	(328)	(479)	(541)	(768)	(728)				
Four years later		(420)	(434)	(348)	(514)	(577)	(842)					
Five years later		(447)	(473)	(351)	(520)	(612)						
Six years later		(462)	(485)	(355)	(534)							
Seven years later		(462)	(493)	(358)								
Eight years later		(467)	(499)									
Nine years later		(476)										
Estimate of net ultimate claims												
At end of accident year		521	567	569	673	716	963	904	848	702	972	
One year later		487	555	444	606	700	948	922	789	752		
Two years later		535	548	437	614	686	935	896	778			
Three years later		532	539	403	571	668	937	897				
Four years later		512	514	371	568	650	923					
Five years later		506	501	359	542	659						
Six years later		493	496	356	543							
Seven years later		487	494	358								
Eight years later		487	500									
Nine years later		478										
Estimate of net ultimate claims		478	500	358	543	659	923	897	778	752	972	
Cumulative payments		(476)	(499)	(358)	(534)	(612)	(842)	(728)	(596)	(516)	(416)	
Net outstanding claims provisions	312	2	1	-	9	47	81	169	182	236	556	1,595
Effect of discounting	(48)	-	(3)	-	(2)	(2)	4	1	-	-	-	(50)
Present value	264	2	(2)	-	7	45	85	170	182	236	556	1,545
Acquired reserves	-	4	4	4	4	-	-	-	-	-	-	16
Net discounted reserves excluding Part VII transfer	264	6	2	4	11	45	85	170	182	236	556	1,561
Net undiscounted reserves transferred	852	41	24	20	31	107	148	258	245	344	775	2,845
Net discount on reserves transferred	(255)	-	-	-	13	4	-	1	-	-	-	(237)
Net discounted reserves transferred	597	41	24	20	44	111	148	259	245	344	775	2,608
Total net undiscounted reserves	1,164	47	29	24	44	154	229	427	427	580	1,331	4,456
Total net discount	(303)	-	(3)	-	11	2	4	2	-	-	-	(287)
Present value in the statement of financial position	861	47	26	24	55	156	233	429	427	580	1,331	4,169

Notes to the financial statements continued

22. Insurance liabilities continued

(iii) Net of reinsurance continued

After the effect of reinsurance, the total loss development table includes the development of both existing business of the Company and the business transferred as part of the Part transfer is:

Accident year	All prior years	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	Total
Net cumulative claim payments												
At end of accident year		(1,493)	(1,428)	(1,444)	(1,723)	(1,851)	(2,240)	(1,938)	(1,701)	(1,449)	(1,482)	
One year later		(2,293)	(2,169)	(2,284)	(2,640)	(2,864)	(3,431)	(2,812)	(2,417)	(2,217)		
Two years later		(2,543)	(2,410)	(2,486)	(2,906)	(3,150)	(3,722)	(3,034)	(2,613)			
Three years later		(2,713)	(2,663)	(2,667)	(3,131)	(3,332)	(3,884)	(3,211)				
Four years later		(2,850)	(2,833)	(2,774)	(3,259)	(3,489)	(4,023)					
Five years later		(2,915)	(2,918)	(2,864)	(3,326)	(3,569)						
Six years later		(2,957)	(2,967)	(2,916)	(3,368)							
Seven years later		(2,962)	(2,993)	(2,926)								
Eight years later		(2,975)	(3,002)									
Nine years later		(2,980)										
Estimate of net ultimate claims												
At end of accident year		3,269	3,360	3,471	3,693	3,794	4,142	3,653	3,128	2,754	2,813	
One year later		3,187	3,263	3,333	3,603	3,788	4,241	3,627	3,055	2,797		
Two years later		3,178	3,258	3,226	3,559	3,788	4,235	3,628	3,040			
Three years later		3,169	3,185	3,070	3,480	3,725	4,261	3,638				
Four years later		3,137	3,107	2,954	3,452	3,712	4,252					
Five years later		3,085	3,048	2,951	3,424	3,723						
Six years later		3,054	3,025	2,948	3,408							
Seven years later		3,035	3,026	2,946								
Eight years later		3,031	3,027									
Nine years later		3,023										
Estimate of net ultimate claims		3,023	3,027	2,946	3,408	3,723	4,252	3,638	3,040	2,797	2,813	
Cumulative payments		(2,980)	(3,002)	(2,926)	(3,368)	(3,569)	(4,023)	(3,211)	(2,613)	(2,217)	(1,482)	
Net outstanding claims provisions	1,164	43	25	20	40	154	229	427	427	580	1,331	4,440
Effect of discounting	(303)	-	(3)	-	11	2	4	2	-	-	-	(287)
Present value	861	43	22	20	51	156	233	429	427	580	1,331	4,153
Acquired reserves	-	4	4	4	4	-	-	-	-	-	-	16
Present value in the statement of financial position	861	47	26	24	55	156	233	429	427	580	1,331	4,169

Notes to the financial statements continued

22. Insurance liabilities continued

(c) Loss development tables continued

In the loss development tables shown, the cumulative claim payments and estimates of cumulative claims for each accident year are translated into sterling at the exchange rates that applied at the end of that accident year. Disposals are dealt with by treating all outstanding and IBNR claims of the disposed entity as "paid" at the date of disposal.

The loss development tables include information on asbestos and environmental pollution claim provisions from business written before 2002. The undiscounted claim provisions, net of reinsurance, in respect of this business were £857 million at 31 December 2011 (2010: £150 million).

(d) Provision for unearned premiums

The following changes have occurred in the provision for unearned premiums (UPR) during the year:

	2011 £m	2010 £m
Carrying amount at 1 January	760	791
Premiums written during the year	1,892	1,452
Less: Premiums earned during the year	(1,972)	(1,483)
Changes in UPR recognised as income	(80)	(31)
Transfer from parent undertaking (note 1)	803	-
Transfer from subsidiary undertakings (note 1)	1,424	-
Reinsurance elimination (note 1)	(669)	-
Carrying amount at 31 December	2,238	760

23. Reinsurance assets

(a) Carrying amounts

The following is a summary of the related reinsurance assets as at 31 December:

	2011 £m	2010 £m
Outstanding claims provisions	336	72
Provision for claims incurred but not reported	86	14
	422	86
Provisions for unearned premiums	69	95
Total at 31 December	491	181

Of the above reinsurance assets, £397 million (2010: £98 million) is expected to be recovered more than one year after the Statement of Financial Position date.

The reinsurers' share of outstanding claims provisions and provisions for claims incurred but not reported is reduced by £257 million (2010: £135 million) as a result of the discounting of latent claims and structured settlements.

Notes to the financial statements continued

23. Reinsurance continued

(b) Assumptions

The assumptions, including discount rates, used for reinsurance contracts follow those used for insurance contracts, shown in notes 22(b) and 22(c). Reinsurance assets are valued net of an allowance for their recoverability.

(c) Movements

The following movements have occurred in the reinsurance asset during the year:

(i) Reinsurer's share of outstanding claims provisions and IBNR

	2011 £m	2010 £m
Carrying amount at 1 January	86	104
Impact of changes in assumptions	-	1
Reinsurers' share of claim losses and expenses incurred in current year	7	9
Reinsurers' share of claim losses and expenses incurred in prior years	39	21
Reinsurers' share of incurred claim losses and expenses	46	30
Less:		
Reinsurance recoveries received on claims incurred in current year	(1)	(4)
Reinsurance recoveries received on claims incurred in prior years	(24)	(45)
Reinsurance recoveries received in the year	(25)	(49)
Unwind of discount	2	-
Change in reinsurance asset recognised as expense	23	(18)
Reinsurer's share of outstanding claims provisions and IBNR transferred from parent undertaking (note 1)	401	-
Reinsurer's share of outstanding claims provisions and IBNR transferred from subsidiary undertakings (note 1)	1,176	-
Reinsurer's share of outstanding claims provisions and IBNR transferred to subsidiary undertaking (note 1)	(311)	-
Reinsurer's share of outstanding claims provisions and IBNR reinsurance elimination (note 1)	(953)	-
Carrying amount at 31 December	422	86

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

	2011 £m	2010 £m
Carrying amount as at 1 January	95	138
Premiums ceded to reinsurers in the year	116	166
Less:		
Reinsurers' share of premiums earned during the year	(153)	(209)
Changes in reinsurance asset recognised as expense	(37)	(43)
Reinsurer's share of provision for unearned premiums transferred from subsidiary undertakings (note 1)	680	-
Reinsurer's share of provision for unearned premiums reinsurance elimination (note 1)	(669)	-
Carrying amount at 31 December	69	95

Notes to the financial statements continued

24. Provisions

(a) Carrying amount

	2011 £m	2010 £m
Restructuring provision	-	2
Other provisions	22	3
Total at 31 December	22	5

Of the above total, £8 million (2010: £3 million) is expected to be settled more than one year after the Statement of Financial Position date.

(b) Movements during the year

	Restructuring provision £m	Other provisions £m	Total provisions £m
At 1 January 2010	3	14	17
Additional provisions	-	1	1
Utilised during the year	(1)	(12)	(13)
At 31 December 2010	2	3	5
Additional provisions	10	-	10
Utilised during the year	(12)	(3)	(15)
Transfer from parent undertaking (note 1)	-	8	8
Transfer from subsidiary undertakings (note 1)	-	14	14
At 31 December 2011	-	22	22

Other provisions comprise many small provisions for obligations such as costs of compensation, litigation and reorganisation.

25. Payables and other financial liabilities

	2011 £m	2010 £m
Payables arising out of direct insurance and assumed reinsurance	177	126
Amounts due to holding companies (Note 34(a)(vi))	109	-
Amounts due to subsidiaries (Note 34(a)(vi))	167	19
Amounts due to other Aviva Group companies (Note 34(a)(vi))	211	157
Loans due to subsidiaries (Note 34(a)(v))	131	-
Derivative liabilities (Note 32)	213	-
Bank overdrafts (Note 29(b))	422	13
Other payables	4	-
Total at 31 December	1,434	315
Expected to be recovered in less than one year	1,332	315
Expected to be recovered in greater than one year	102	-
	1,434	315

All payables and other financial liabilities are carried at cost, which approximates to fair value, except for derivative liabilities, which are carried at their fair values.

Notes to the financial statements continued

26. Other liabilities

	2011 £m	2010 £m
Reinsurers' share of deferred acquisition costs	7	67
Accruals	329	55
Other liabilities	257	30
Total at 31 December	593	152
Expected to be settled in less than one year	577	152
Expected to be settled in greater than one year	16	-
	593	152

27. Contingent liabilities and other risk factors

(a) Uncertainty over claims provisions

Note 22 gives details of the estimation techniques used in determining the general business 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 experience is worse than that assumed, or future general business claims inflation differs from that expected, there is uncertainty in respect of this liability.

(b) Asbestos, pollution and social environmental hazards

In the course of conducting insurance business, the Company receives general insurance liability claims, and becomes involved in actual or threatened litigation arising there from, including claims in respect of pollution and other environmental hazards. Amongst these are claims in respect of asbestos production and handling in the United Kingdom. Given the significant delays that are experienced in the notification of these claims, the potential number of incidents which they cover and the uncertainties associated with establishing liability and the availability of reinsurance, the ultimate cost cannot be determined with certainty.

(c) Regulatory

The Financial Services Authority (FSA) regulates the Company's UK business and in addition monitors the financial resources and organisation of the Company as a whole. The FSA has broad powers including the authority to grant, vary the terms of, or cancel a regulated firm's authorisation, to investigate marketing and sales practices and to require the maintenance of adequate financial resources. The Company's regulators outside the UK typically have similar powers but in some cases they operate a system of "prior product approval" and hence place less emphasis than the FSA on regulating sales and marketing practices.

The directors believe that the Company dedicates appropriate resources to its compliance programme, endeavours to respond to regulatory enquiries in a constructive way, and takes corrective action when warranted. However, all regulated financial services companies face the risk that the regulator could find that they have failed to comply with applicable regulations or have not undertaken corrective action as required.

The impact of any such finding could have a negative impact on the Company's reported results or on its relations with current or potential customers. Regulatory action against the Company could result in adverse publicity for, or negative perceptions regarding, the Company, or could have a material adverse effect on the business of the Company, its results of operations and/or financial condition and divert management's attention from the day-to-day management of the business.

Notes to the financial statements continued

27. Contingent liabilities and other risk factors continued

(c) Regulatory continued

With the approval of the Financial Services Authority, the Company and certain of its United Kingdom insurance subsidiaries transacting general insurance business have mutually guaranteed to discharge all liabilities attaching to their respective insurance policies. The guarantee enables a participating company, if it is unable to pay policyholder claims, to seek financial support from one of the guarantors. The guarantors are not obliged to make the payment if they cannot do so without seeking recourse to their funds where applicable. If any payments are made under the guarantee, the guarantors are entitled to seek repayment from the company benefiting from the guarantee. The guarantee cannot be relied upon by any other person, including without limitation the holder of any contracts of insurance issued by a party to the guarantee. There is no maximum amount the Company would have to pay under the guarantee but, in the opinion of the directors, the fair value of the guarantee above is not material and no material loss is expected to arise there from.

(d) Other

The Company has guaranteed the overdrafts, borrowings and obligations under acquisition and disposal agreements of certain other Group companies. The maximum exposure of the Company is £914 million (2010: £43 million). In the opinion of the directors, no material loss will arise in respect of these guarantees and indemnities.

28. Commitments

Operating lease commitments

(i) Future contractual aggregate minimum lease rentals receivable under non-cancellable operating leases are as follows:

	2011 £m	2010 £m
Within one year	4	9
Later than one year and not later than five years	9	29
Later than five years	2	11
Total at 31 December	15	49

(ii) Future contractual aggregate minimum lease payments under non-cancellable operating leases are as follows:

	2011 £m	2010 £m
Within one year	22	-
Later than one year and not later than five years	78	-
Later than five years	128	-
Total at 31 December	228	-
The total of future minimum sublease payments expected to be received under non-cancellable subleases	32	-

The Company has no capital commitments which have not been recognised in the financial statements.

Notes to the financial statements continued

29. Statement of cash flows

(a) The reconciliation of (loss) / profit before tax to the net cash inflow from operating activities is:

	Note	2011 £m	2010 £m
(Loss) / profit before tax		(2,597)	386
Adjustments for:			
Loss on sale of investments	2	76	178
Loss on sale of investment property		-	2
Amortisation of premium or discount on debt securities		7	-
Amortisation of intangibles	9	3	-
Impairment of investments in subsidiaries	20	4,479	-
Fair value gains on investments	2	(76)	(57)
Foreign exchange losses	3	4	-
Unwind of discount	3	5	4
Dividend income	2	(1,921)	-
		2,577	127
Changes in working capital:			
Decrease in reinsurance assets		14	61
Decrease in deferred acquisition costs		102	2
Decrease in insurance liabilities		(2)	(108)
Increase in other assets and liabilities		(157)	(373)
		(43)	(418)
Net sales of operating assets			
Financial investments		22	22
Loans		(3)	-
		19	22
Cash (used in) / generated from operations		(44)	117

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 payments of related claims.

The changes in working capital have been adjusted to reflect the impact of the Part VII transfer (see note 1).

(b) Cash and cash equivalents in the cash flow statement at 31 December comprise:

	2011 £m	2010 £m
Cash at bank and in hand	346	6
Cash equivalents	1,048	190
	1,394	196
Bank overdrafts (note 25)	(422)	(13)
Total at 31 December	972	183

Notes to the financial statements continued

30. Capital structure

The Company maintains an efficient capital structure from equity shareholders' funds, consistent with the Company's overall risk profile and the regulatory and market requirements of the business. This note describes the way the Company manages capital and shows how this is structured.

(a) General

IFRS underpins the Company's capital structure and accordingly, the capital structure is analysed on this basis. The Company also uses an individual capital assessment (ICA) measure to assess its own internal economic capital requirements.

(b) Capital management

In managing its capital, the Company seeks to:

- (i) match the profile of its assets and liabilities, taking account of the risks inherent in the business;
- (ii) maintain financial strength to support new business growth and satisfy the requirements of its policyholders and regulators;
- (iii) retain financial flexibility by maintaining strong liquidity; and
- (iv) allocate capital efficiently to support growth and repatriate excess capital where appropriate.

The Company considers not only traditional sources of capital funding but alternative sources of capital including reinsurance, as appropriate, when assessing its deployment and usage of capital.

(c) Different measures of capital

The Company measures its capital on a number of different bases. These include measures which comply with the regulatory regime within which the Company operates and those which the directors consider appropriate for the management of the business. The measures which the Company uses are:

(i) Accounting basis

The Company is required to report its results on an IFRS basis.

(ii) Regulatory basis

Relevant capital and solvency regulations are used to measure and report the Company's financial strength. These measures are based on the FSA's regulatory requirements under Solvency I and the ICA regime. The regulatory capital tests verify that the Company retains an excess of solvency capital above the required minimum level calculated using a series of prudent assumptions about the type of business that is underwritten.

The Company fully complied with these regulatory requirements during the year.

(iii) Economic basis

The Company also measures its capital using a risk based capital model to assess economic capital requirements and to aid in risk and capital management. This model is used to support reporting under the ICA regime. The risk management note (note 31), gives further details.

(d) Company capital structure

	2011 £m	2010 £m
Total capital employed	14,619	15,132
Financed by:		
Equity shareholder's funds	14,619	15,132

Notes to the financial statements continued

31. Risk management

The ultimate parent company, Aviva plc, and its subsidiaries, joint ventures and associates (collectively known as "the Aviva Group"), operate a risk management framework that forms an integral part of the management and Board processes and decision making framework across the Group, including the Company. The key elements of our risk management framework comprise risk appetite, risk modelling, roles and responsibilities, risk policies and procedures and risk governance and oversight. The primary objectives of risk management in the Aviva Group are to:

- Embed rigorous risk management throughout the business, based on setting clear risk appetites and staying within these;
- Allocate capital where it will make the highest returns on a risk-adjusted basis; and
- Meet the expectations of our customers, investors and regulators that we will maintain sufficient capital surpluses to meet our liabilities even if a number of extreme risks materialise.

In 2011, in support of these objectives, the Aviva Group continued its work to enhance the risk management framework across the Aviva Group, including the Company, and promote a strong risk management culture supported by a robust governance structure.

The Aviva Group's approach to risk management ensures that significant existing or emerging risks are actively identified, measured, monitored and reported on a continuous basis. For the purposes of risk identification and measurement, risks are usually grouped by risk type: credit, market, liquidity, general insurance, life insurance and operational risk. Risks falling within these types may affect a number of key metrics including those relating to balance sheet strength, liquidity and profit. They may also affect the performance of the products that we deliver to our customers and the service to our customers and distributors, which can be categorised as risks to our brand and reputation.

Roles and responsibilities for risk management in the Aviva Group, including the Company, is based around the 'three lines of defence' model where ownership for risk is taken at all levels of the Group. Line management in the business is accountable for risk taking, implementing the risk management framework and embedding a risk culture (1st line of defence). The risk function is accountable for quantitative and qualitative oversight and challenge of the identification, measurement, management, monitoring and reporting of key risks and for developing the risk management framework (2nd line of defence). Internal audit provides an independent assessment of the risk framework and internal control processes (3rd line of defence).

To promote a consistent and rigorous approach to risk management across all our businesses and locations in which we operate, we have a set of formal risk policies and business standards. These risk policies and business standards set out our appetite for different, granular risk types and provide risk management and control requirements for the Aviva Group's worldwide operations.

A regular top-down key risk identification and assessment process is carried out in the risk function at the Aviva Group level based on group and regional chief risk officer and functional risk director input. This includes the consideration of emerging risks and is supported by deeper thematic reviews and is replicated at regional and business unit level. The risk assessment processes are used to generate risk reports which are shared with the relevant risk committees.

Risk models are an important tool in our measurement of risk and are used to support the monitoring and reporting of the risk profile and in the consideration of the risk management actions available. We carry out a range of stress (where one risk factor, such as equity returns, is assumed to vary) and scenario (where combinations of risk factors are assumed to vary) tests to evaluate their impact on the business and the management actions available to respond to the conditions envisaged. The Board has overall responsibility for determining risk appetite, which is an expression of the risk it is willing to take. The Company's position against risk appetite is monitored and reported to the Board on a regular basis. Regular monitoring of the Company's risk appetite in relation to general insurance business is carried out by the UKGI management team.

The risk governance framework allocates responsibility for the oversight of risk management to a number of committees at the Aviva Group centre, with the Asset Liability Committee (ALCO) providing a key focus on business and financial risks and the Operational Risk Committee (ORC) providing a key focus on operational risks.

Notes to the financial statements continued

31. Risk management continued

(a) Credit risk

Credit risk is the risk of financial loss as a result of the default or failure of third parties to meet their payment obligations to the Company, or variations in market values as a result of changes in expectations related to these risks. Credit risk arises as a consequence of asset investments made to achieve the returns required to satisfy policyholder liabilities and to provide enhanced long-term risk-adjusted returns to shareholders. The Company is exposed to third party credit quality changes through a range of other activities including reinsurance.

The Company's approach to managing credit risk recognises that there is a risk of adverse financial impact resulting from fluctuations in credit quality of third parties including default, rating transition and credit spread movements. Credit risk categories include spread risk, default risk and rating migration risk:

- Spread risk arises from changes in level or volatility of third party credit spreads over risk-free interest rates, that can be caused by credit concerns (improving or worsening) on the issuer, or from market factors, such as risk appetite and liquidity within the market;
- Default risk is the risk that a counterparty is unable or unwilling to meet its financial obligations when they fall due, and includes delays in repayments, restructuring of repayments/interest schedule and bankruptcy; and
- Rating migration risk is the risk that a change in external credit rating of a counterparty adversely impacts the Company;

Our credit risks arise through exposures to debt security investments, structured asset investments, derivative counterparties, mortgage lending and reinsurance counterparties.

The Company's businesses are required to implement local credit risk management processes (including limits frameworks), operate specific risk management committees, and ensure detailed reporting and monitoring of their exposures against pre-established risk criteria. At the Aviva Group level, we manage and monitor all exposures across our businesses on a consolidated basis, and operate a group limit framework that must be adhered to by all.

Management of credit risk is effected through five core elements:

- The setting up of an overall credit risk appetite by the Aviva Group Board Risk Committee, which controls the total credit risk to which the Aviva Group is exposed.
- The maintenance of and adherence to an effective governance structure. This includes clear guidance, scope and frameworks for all aspects of the risk function to ensure accountability and clarity including clear delegations of authority and a groupwide credit risk policy and associated business standards.
- The accurate and timely reporting of detailed exposure information, and their aggregation by counterparty, exposure types, sectors, geography and ratings.
- The implementation of a sophisticated capital charge-based credit limit framework that considers and quantifies the key specific attributes of each exposure (e.g. seniority, maturity, etc) and provides a counterparty level aggregation methodology covering all exposures to a counterparty. This is then managed against centrally set limits. Gross exposure limits are also set to ensure that any unexpected jump to default risks are kept within appetite. Additional limit and controls are applied for structured assets and reinsurance counterparty exposures.
- Additional committee and risk function oversight is provided on all credit risk related matters. This includes regular consideration and review of our key counterparties, systemic factors such as sector and geographic concentrations, monitoring and addressing key credit themes and news that emerge in the markets. The Aviva Group Credit Approvals Committee provides a forum to ensure that all key recommendations are considered, and decisions implemented throughout the group.

Risk mitigation techniques are used where and when deemed appropriate. These are utilised where possible to remove residual unwanted risks, as well as to bring or keep exposure limits within appetite, and include methods such as collateralisation.

The Company has significant financial exposure to amounts due from fellow Aviva Group companies. The credit risk arising from Aviva Group counterparties failing to meet all or part of their obligations is considered remote. Due to the nature of the intra-group loans, and the fact that these loans are settled, and not traded, the Company is not exposed to the risk of changes to the market value caused by changing perceptions of the credit worthiness of such counterparties.

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 sub-investment grade.

Notes to the financial statements continued

31. Risk management continued

(a) Credit risk continued

The following table provides information regarding the aggregated credit risk exposure of the Company. "Non-rated" assets capture assets not rated by external ratings agencies.

	Credit rating						2011
	AAA	AA	A	BBB	Speculative grade	Non-rated	Carrying value in the financial statements
	%	%	%	%	%	%	£m
Debt securities	28.7%	14.1%	33.5%	23.2%	0.5%	-	2,352
Reinsurance assets	-	68.0%	11.6%	-	-	20.4%	491
Loans	0.6%	4.0%	2.7%	9.4%	71.9%	11.4%	524
Other Investments	-	-	-	-	-	100.0%	298

	Credit rating						2010
	AAA	AA	A	BBB	Speculative grade	Non-rated	Carrying value in the financial statements
	%	%	%	%	%	%	£m
Debt securities	53.5%	11.6%	23.3%	11.6%	-	-	389
Reinsurance assets	-	49.2%	5.0%	-	1.1%	44.7%	181
Loans	-	-	-	-	-	-	-
Other Investments	-	-	-	-	-	100.0%	19

The carrying amount of assets included in the statement of financial position represents the maximum credit exposure. The impact of collateral held on the net credit exposure is shown below.

	Carrying value in the financial statements	Collateral held	Net credit exposure
	£m	£m	£m
Debt securities	2,352	(469)	1,883
Other investments	298	(49)	249

	Carrying value in the financial statements	Collateral held	Net credit exposure
	£m	£m	£m
Debt securities	389	(156)	233
Other investments	19	-	19

Notes to the financial statements continued

31. Risk management continued

(a) Credit risk continued

The Company is not generally exposed to significant concentrations of credit risk due to compliance with the FSA's regulations limiting investments in individual assets and classes.

The Company manages exposure to reinsurance counterparties in accordance with the Aviva Group policy. Exposure limits are set by the Aviva Group Credit Approvals Committee which maintains a list of reinsurers that have acceptable credit standing. Reinsurer exposure and the impact of any reinsurer default are monitored regularly.

The Company's largest reinsurance counterparty is Berkshire Hathaway Incorporated. At 31 December 2011, the reinsurance asset recoverable from Berkshire Hathaway Incorporated was £83 million (2010: £71 million). This exposure is monitored on a regular basis.

The Company's maximum exposure to credit risk is equal to the carrying value of assets in the Statement of Financial Position plus financial guarantees given to other group companies, outlined in note 27(d).

The credit quality of receivables and other financial assets is monitored by the Company, and provisions for impairment are made for irrecoverable amounts. 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:

							2011
Financial assets that are past due but not impaired							
	Neither past due nor impaired £m	0 – 3 months £m	3 – 6 months £m	6 months – 1 year £m	Greater than 1 year £m	Financial assets that have been impaired £m	Carrying value in the financial statements £m
Debt securities	2,352	-	-	-	-	-	2,352
Reinsurance assets	491	-	-	-	-	-	491
Loans	273	-	-	-	-	251	524
Receivables and other financial assets	9,011	-	-	-	-	-	9,011

							2010
Financial assets that are past due but not impaired							
	Neither past due nor impaired £m	0 – 3 months £m	3 – 6 months £m	6 months – 1 year £m	Greater than 1 year £m	Financial assets that have been impaired £m	Carrying value in the financial statements £m
Debt securities	389	-	-	-	-	-	389
Reinsurance assets	181	-	-	-	-	-	181
Loans	-	-	-	-	-	-	-
Receivables and other financial assets	4,861	-	-	-	-	-	4,861

Receivables and other financial assets include loans and amounts due from other group companies of £7,717 million (2010: £4,396 million).

There were no material financial assets that would have been past due or impaired had the terms not been renegotiated.

The management of credit risk is overseen by the Aviva Group's Asset and Liability Committee (ALCO) and the risks relating to the UKGI business is also overseen by the UKGI ALCO.

Notes to the financial statements continued

31. Risk management continued

(b) 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 Aviva Group has established a policy on market risk which sets out the principles that businesses are expected to adopt in respect of management of the key market risks to which the Aviva Group, including the Company, is exposed. The Aviva Group monitors adherence to this market risk policy and regularly reviews how business units are managing these risks locally, through the Aviva Group Assets Committee and ultimately the Aviva Group Asset Liability Committee (ALCO). For each of the major components of market risk, described in more detail below, the Aviva Group has put in place additional processes and procedures, described in internal business standards, to set out how each risk should be managed and monitored, and the approach to setting an appropriate risk appetite.

The management of market risk is undertaken in businesses and at the Aviva Group level. Businesses manage market risks locally using the group market risk framework and within local regulatory constraints. The Aviva Group ALM function and the Capital team within UKGI are responsible for managing market risk at the Aviva Group and Company level.

The Aviva Group market risk policy sets out the minimum principles and framework for matching liabilities with appropriate assets, the approaches to be taken when liabilities cannot be matched and the monitoring processes that are required. The Aviva Group has criteria for matching assets and liabilities for all classes of business to minimise the impact of mismatches between the value of assets and the liabilities due to market movements. The local regulatory environment for each business will also set the conditions under which assets and liabilities are to be matched.

The Aviva Group's insurance operations are subject to numerous local regulatory requirements that prescribe the type, quality, and concentration of investments, and the level of assets to be maintained in local currency in order to meet local insurance liabilities. These requirements help to maintain market risk at an acceptable level in each of the jurisdictions in which the Aviva Group operates.

For each of the major components of market risk, described in more detail below, additional policies and business standards are in place to set out how each risk should be managed and monitored, and the approach to setting an appropriate risk appetite.

Equity price risk	<p>The Company is subject to equity price risk due to daily changes in the market values of its equity securities portfolio. Equity price risk is actively managed in order to mitigate potential unfavourable market movements and includes using a variety of derivative instruments, including futures and options.</p> <p>Sensitivity to changes in equity prices is given in section (g) below.</p>
Interest rate risk	<p>Interest rate risk arises primarily from the Company's investments, fixed income securities and other liabilities, which are exposed to fluctuations in interest rates. The Company maintains a close matching of assets and liabilities by duration, using derivative instruments if necessary, to minimise this risk.</p> <p>Sensitivity to changes in interest rates is given in section (g) below.</p>
Currency risk	<p>The Company has minimal exposure to currency risk, other than through the fair value of overseas subsidiaries.</p>
Derivatives risk	<p>Derivatives are used within policy guidelines agreed by the Group Asset and Liability Committee. Derivatives are only used for efficient investment management, asset and liability management or risk hedging purposes.</p>

The fair values of investments in subsidiaries are estimated using applicable valuation models, underpinned by the quoted market valuations of comparable listed entities.

Notes to the financial statements continued

31. Risk management continued

(c) Property price risk

The Aviva Group, including the Company, is subject to property price risk due to holdings of investment properties in a variety of locations worldwide and through investments in mortgages and mortgage-backed securities. Investment in property is managed at regional and business level, and will be subject to local regulations on asset admissibility, liquidity requirements and the expectations of policyholders as well as overall risk appetite. The Aviva Group Assets Committee also monitors the Aviva Group's property exposure, relative to risk appetite. As at 31 December 2011, no material derivative contracts had been entered into to mitigate the effects of changes in property prices.

(d) Liquidity risk

Liquidity risk is the risk of the Company not being able to make payments as they become due because there are insufficient assets in cash form.

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 the Aviva Group for additional short-term borrowing whilst the Company liquidated other assets. The Aviva Group maintains significant committed borrowing facilities from a range of highly-rated banks to mitigate this risk further.

The following table provides an analysis, by maturity date of the principal, of the carrying value of financial assets and reinsurers' share of the unearned premium provisions, which are available to fund the repayment of liabilities as they crystallise:

					2011
	On demand or within 1 year £m	1-5 years £m	Over 5 years £m	No fixed term £m	Total £m
Debt securities	323	1,528	467	34	2,352
Equity securities	3	-	-	-	3
Other investments	249	36	2	11	298
Loans	120	393	11	-	524
Reinsurance assets	94	111	286	-	491
Receivables and other financial assets	2,772	6,239	-	-	9,011
Cash and cash equivalents	1,394	-	-	-	1,394
	4,955	8,307	766	45	14,073

					2010
	On demand or within 1 year £m	1-5 years £m	Over 5 years £m	No fixed term £m	Total £m
Debt securities	33	215	141	-	389
Equity securities	3	-	-	-	3
Other investments	19	-	-	-	19
Loans	-	-	-	-	-
Reinsurance assets	83	62	36	-	181
Receivables and other financial assets	3,561	1,300	-	-	4,861
Cash and cash equivalents	196	-	-	-	196
	3,895	1,577	177	-	5,649

Notes to the financial statements continued

31. Risk management continued

(d) Liquidity risk continued

The assets above are analysed in accordance with the earliest possible redemption date of the instrument at the initiation of the Company. Where an instrument is puttable back to the issuer on demand, such as a unit trust or similar type of investment vehicle, it is included in the "On demand or within 1 year" column. The Company's equity securities represent a strategic investment and, therefore, cannot be readily sold.

For insurance contracts, the analysis of liabilities below is based on the estimated timing of future cash flows. The following table shows the Company's financial liabilities and general insurance liabilities analysed by duration:

					2011
	Within 1 year	1-5 years	5-15 years	Over 15 years	Total
	£m	£m	£m	£m	£m
General insurance liabilities	3,085	2,370	917	457	6,829
Payables and other financial liabilities	1,332	70	32	-	1,434
	4,417	2,440	949	457	8,263
					2010
	Within 1 year	1-5 years	5-15 years	Over 15 years	Total
	£m	£m	£m	£m	£m
General insurance liabilities	1,229	910	127	94	2,360
Payables and other financial liabilities	315	-	-	-	315
	1,544	910	127	94	2,675

(e) Management of general insurance risk and reinsurance strategy

The Company's insurance business is managed within a group of companies, UKGI, undertaking insurance business and other non-insurance business in the UK. The Company considers insurance risk within its general insurance activity to comprise the following:

- Fluctuations in the timing, frequency and severity of claims and claim settlements relative to expectations;
- Unexpected claims arising from a single source;
- Inaccurate pricing of risks or inappropriate underwriting of risks when underwritten;
- Inadequate reinsurance protection or other risk transfer techniques; and
- Inadequate reserves.

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 Aviva Group's underwriting strategy and appetite is agreed and communicated via specific policy statements and guidelines. Aviva Group general insurance risk is monitored through the Aviva Group Insurance Committee which is part of the Aviva Group's risk management framework.

Significant insurance risks will be reported through the risk management framework. Additionally, the economic capital model is used to assess the risk that each general insurance business unit, and the Aviva Group as a whole, is exposed to, quantifying their impact and calculating appropriate capital requirements. All general insurance business units undertake a quarterly review of their insurance risks, the output from which is a key input into the economic capital assessments.

The Aviva Group Insurance Committee monitors and develops the management of insurance risk in the general insurance business units, and assesses the aggregate risk exposure. It is responsible for the development and review of the Aviva Group policies and business standards for underwriting, claims, reinsurance and reserving that form part of the risk management framework.

Notes to the financial statements continued

31. Risk management continued

(e) Management of general insurance risk and reinsurance strategy continued

Actuarial claims reserving is conducted by local actuaries in the various general insurance business units according to the general insurance reserving policy/ business standard. The Aviva Group Insurance Committee monitors and maintains the general insurance reserving policy/ business standard, and conducts quarterly reviews of the Aviva Group's general insurance claims provisions, and their adequacy. The reviews include peer reviews of the business unit's own conclusions as well as independent analysis to confirm the reasonableness of the local reviews. The adequacy of the Aviva Group's general insurance claims provisions is ultimately overseen by the Aviva Group Insurance Committee. A number of business units also have periodic external reviews by local consultants' actuaries (often as part of the local regulatory requirement).

The purchase of reinsurance is governed by the reinsurance standards for general insurance recently introduced by the Aviva Group. The standards set out the Aviva Group's minimum requirements required to achieve a consistent approach to the assessment, management, retention and placement of reinsurance across the Aviva Group. Significant reinsurance purchases are reviewed annually at both business unit and Aviva Group level, to verify the levels of protection being bought reflect any developments in exposure and the risk appetite of the Aviva Group. Reinsurance purchases must be in line with the objectives set out in the Aviva Group reinsurance business standards.

The Company also sets its own underwriting strategy, consistent with the Aviva Group version. Underwriting strategy is communicated to underwriters, with underwriting licences granted to individual underwriters according to competence and experience. 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.

Detailed actuarial analysis is used to calculate the Aviva Group and the Company's extreme risk profile and then design cost and capital efficient reinsurance programmes to mitigate these risks to within agreed appetites. For businesses writing general insurance we will analyse the natural catastrophe exposure using external probabilistic catastrophe models widely used by the rest of the (re)insurance industry. The catastrophe accumulations and loss probabilities based on the group's specific portfolios of business are reviewed internally to ensure the losses from individual territories, or from our peak exposure zone Northern Europe, are within acceptable limits.

(f) Operational risk

Operational risk is the risk of loss, arising from inadequate or failed internal processes, or from people and systems, or from external events. Operational risks include business protection, information technology, people, legal and regulatory compliance risks.

We process a large number of complex transactions across numerous and diverse products, and are highly dependent on the proper functioning of information technology and communications systems. We are partially reliant on the operational processing performance of our outsourced partners including certain servicing and IT functions. Significant resources are devoted to maintaining efficient and effective operations within our framework of corporate responsibility, policies, business standards and business ethics code.

Our businesses are primarily responsible for identifying and managing operational risks in line with minimum standards of control set out in our policies and business standards. Each operational risk is assessed by considering the potential impact and the probability of the event occurring.

Business management teams must be satisfied that all material risks falling outside our risk tolerances are being mitigated, monitored and reported to an appropriate level. Any risks with a high potential impact level are monitored centrally on a regular basis. Businesses use key indicator data to help monitor the status of the risk and control environment. They also identify and capture loss events; taking appropriate action to address actual control breakdowns and promote internal learning from these occurrences.

The Operational Risk Committee (ORC) oversees the Aviva Group's and the Company's aggregate operational risk exposure on behalf of the Aviva Group Executive Committee. It makes recommendations on the risk appetite that the group can work within for operational risk, assesses and monitors overall operational risk exposures, identifying any concentrations of operational risk across the group, and in particular verifies that mitigating action plans are implemented.

Notes to the financial statements continued

31. Risk management continued

(g) Risk and capital management

The Aviva Group uses a number of 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 scenario tests are used. Sensitivities to economic and operating experience are regularly produced on financial performance measurements to inform the Aviva Group's decision making and planning processes and quantifying the risks to which the Aviva 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 are primarily based on the financial impact of changes to the reported loss ratio.

Some results of sensitivity testing for the Company's 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 $\pm 1\%$ (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.
Equity / property market values	The impact of a change in equity/property market values by $\pm 10\%$.
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 business by 5%.

The above sensitivity factors are applied using actuarial and statistical models. The impacts are shown in the tables below.

Pre-tax impacts on profit and shareholder's equity:

(i) Impact on profit before tax (£m)

	Interest rates 1%	Interest rates -1%	Equity/ Property 10%	Equity/ Property -10%	Expenses 10%	2011 Gross loss ratios 5%
Gross of reinsurance	10	(25)	-	-	(35)	(55)
Net of reinsurance	(30)	25	-	-	(35)	(55)

The sensitivities in the above table are based on balances included in the 2011 Income Statement and Statement of Financial Position as at 31 December 2011.

	Interest rates 1%	Interest rates -1%	Equity/ Property 10%	Equity/ Property -10%	Expenses 10%	2010 Gross loss ratios 5%
Gross of reinsurance	(5)	-	-	-	(25)	(30)
Net of reinsurance	(5)	5	-	-	(25)	(30)

Notes to the financial statements continued

31. Risk management continued

(ii) Impact before tax on shareholder's equity (£m)

	Interest rates 1%	Interest rates -1%	Equity/ Property 10%	Equity/ Property -10%	Expenses 10%	2011 Gross loss ratios 5%
Gross of reinsurance	10	(25)	-	-	(5)	(55)
Net of reinsurance	(30)	25	-	-	(5)	(55)

The sensitivities in the above table are based on balances included in the 2011 Income Statement and Statement of Financial Position as at 31 December 2011.

	Interest rates 1%	Interest rates -1%	Equity/ Property 10%	Equity/ Property -10%	Expenses 10%	2010 Gross loss ratios 5%
Gross of reinsurance	(5)	-	-	-	(5)	(30)
Net of reinsurance	(5)	5	-	-	(5)	(30)

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, in addition to the increase in the claims handling expense provision.

The above tables demonstrate the effect of a change in a key assumption while other assumptions remain unchanged. In reality, there is a correlation 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 Aviva Group's view of possible near-term market changes that cannot be predicted with any certainty, and the assumption that all interest rates, equity prices and property values move in an identical fashion.

Assets are held at fair value in accordance with the relevant accounting policy. The majority of such assets are valued based on quoted market information or observable market data. A small percentage of total assets recorded at fair value are based on estimates. Where estimates are used, these are based on a combination of independent third party evidence and internally developed models, calibrated to market observable data where possible. Whilst such valuations are sensitive to estimates, it is believed that changing one or more of the assumptions to reasonably possible alternative assumptions would not significantly change the fair value.

Notes to the financial statements continued

32. Derivative financial instruments

The Company uses a variety of derivative financial instruments, including both exchange traded and over-the-counter instruments, in line with our overall risk management strategy. The objectives include managing exposure to price, foreign currency and/or interest rate risk on existing assets or liabilities, as well as planned or anticipated investment purchases.

In the table below, figures are given for both the notional amounts and fair values of these instruments. The notional amounts reflect the aggregate of individual derivative positions on a gross basis and so give an indication of the overall scale of the derivative transaction. They do not reflect current market values of the open positions. The fair values represent the gross carrying values at the year-end for each class of derivative contract held (or issued) by the Company.

The fair values do not provide an indication of credit risk, as many over-the-counter transactions are contracted and documented under ISDA (International Swaps and Derivatives Association Inc) master agreements or their equivalent. Such agreements are designed to provide a legally enforceable set-off in the event of default, which reduces credit exposure. In addition, the Company has in place collateral agreements between the Company and relevant counterparties.

The Company's non-hedge derivative activity at 31 December 2011 was as follows:

			2011
	Contract/ notional amount £m	Fair value asset £m	Fair value liability £m
Equity/Index contracts			
ETC			
Options	1,380	207	(101)
	<u>1,380</u>	<u>207</u>	<u>(101)</u>
Foreign exchange contracts			
OTC			
Forwards	595	9	(1)
Options	4,600	33	(9)
	<u>5,195</u>	<u>42</u>	<u>(10)</u>
Interest rate contracts			
OTC			
Swaps	787	36	(70)
	<u>787</u>	<u>36</u>	<u>(70)</u>
Other	<u>1,064</u>	<u>2</u>	<u>(32)</u>
Total at 31 December	<u>8,426</u>	<u>287</u>	<u>(213)</u>

Notes to the financial statements continued

32. Derivative financial instruments continued

	Contract/ notional amount £m	Fair value asset £m	2010 Fair value liability £m
Equity/Index contracts			
ETC			
Options	1,783	19	-
Total at 31 December	1,783	19	-

Fair value assets are recognised as 'Derivative financial instruments' in note 15. Fair value liabilities are recognised as 'Other financial liabilities' in note 25.

The contractual undiscounted cash flows in relation to non-hedge derivative liabilities have the following maturities:

	2011 £m	2010 £m
Within one year	20	-
Between one and two years	20	-
Between two and three years	20	-
Between three and four years	20	-
Between four and five years	261	-
Total at 31 December	341	-

33. Pension obligations

(a) Introduction

In the United Kingdom, the Aviva Group operates two main pension schemes, the Aviva Staff Pension Scheme ("ASPS") and the smaller RAC (2003) Pension Scheme. Staff whose costs are recharged to the Company are members of the ASPS and receive benefits on either a defined benefit or a defined contribution basis. New entrants join the defined contribution section of the ASPS, as the defined benefit section is now closed. This scheme is operated by a trustee company with trustee directors, comprising representatives of the employers, staff, pensioners and an independent trustee (referred to below as the trustees).

(i) Defined benefit section of the ASPS

On 20 October 2010, following formal consultation, the Group confirmed its decision to close the final salary sections of both UK schemes with effect from 1 April 2011, with entry into the defined contribution sections being offered to the staff members affected. The consequential reduction in the liabilities of the ASPS, arising from projecting forward using estimates of inflation rather than salary inflation, together with additional contributions to affected members' defined contribution accounts and implementation costs, resulted in an overall gain on closure of £268 million, which was accounted for in 2010. Closure of the schemes has removed the volatility associated with adding future accrual for active members, and has also led to lower service costs and their cash funding since April 2011.

Notes to the financial statements continued

33. Pension obligations continued

(i) Defined benefit section of the ASPS continued

At 31 March 2009, the date of the last actuarial valuation, this section of the scheme had an excess of obligations over available assets, on a funding basis, which uses more prudent assumptions than are required for reporting under IAS 19, of £3.0 billion. As a result of that valuation, the Company and the trustees have agreed a long-term funding plan where contributions, together with anticipated growth in scheme investments, are expected to eliminate the funding deficit over time. Under this agreement, deficit funding payments of £378 million were made in 2010, and £178 million in 2011. Further funding payments of £150 million are expected in 2012. The funding payments, the reduction in scheme liabilities arising from the scheme closures described above and the benefits arising from interest rate and inflation hedging activity have been partially offset by the impact of adverse market condition, in particular significant falls in real gilt yields. At 31 December 2011, the funding deficit is estimated to have fallen to £2.3 billion.

As the employing company for most of the Group staff in the UK, the pension costs are initially borne by Aviva Employment Services Limited ("AES") and are then recharged to the operating divisions of the Group as part of an overall charge for payroll-related items. In this manner, the Company is charged on behalf of the UK General Insurance businesses. The level of recharges for pension and other costs to each business is reviewed annually. AES's contributions to the defined benefit section of the ASPS for the first three months of 2011 were 48% of employees' pensionable salaries, together with the cost of redundancies during the year and the additional deficit funding described above, together totalling £239 million. Active members of this section of the ASPS contributed between 5% and 7.5% of their pensionable salaries during the same period in 2011.

In the absence of any contractual arrangements to allocate the net defined benefit cost for the ASPS, measured in accordance with IAS 19, to individual businesses, it is the Group's policy to allocate this cost fully to AES. As required by paragraph 34B of IAS 19, disclosures for the ASPS are provided in the following pages.

(ii) Defined contribution (money purchase) section of the ASPS

Members of this section contribute at least 2% of their pensionable salaries and, depending on the percentage chosen, the Company contributes up to a maximum 14%, together with the cost of the death-in-service benefits. These contribution rates are unchanged for 2012.

All the pension costs are initially borne by AES, with the employer contributions relating to the DC section members being recharged to the relevant UK businesses.

(b) Charges to the income statement

Prior to the Part VII transfer on the 14 November 2011 the pension costs were held within Aviva Insurance UK Limited (AIUK) and were recharged to all UKGI operating businesses. Post the Part VII transfer these costs are held within the Company and are recharged to operating businesses.

The total pension credit/(costs) of the UK pension schemes borne by, and the amounts credited in, the Company and AIUK were:

	AIUK 2011 £m	AI 2011 £m	Total 2011 £m	AIUK 2010 £m
Defined benefit section	115	11	126	156
Defined contribution section	21	2	23	9
Total pension costs	136	13	149	165
Less: amounts recharged to operating businesses	(48)	(2)	(50)	(65)
Charge retained in the Company	88	11	99	100

The credit for the defined benefit sections in 2010 arose from the £268 million gain on the closure of the ASPS to future accrual, described in section (a)(i) above. There were no significant contributions outstanding or prepaid as at either 31 December 2010 or 2011.

Notes to the financial statements continued

33. Pension obligations continued

(c) IAS 19 disclosures

The details for the defined benefit section of the ASPS are given below. Although this scheme provides both defined benefit and defined contribution pensions, the assets and liabilities shown exclude those relating to defined contribution pensions.

(i) Assumptions on scheme liabilities

The valuation used for accounting under IAS 19 has been based on the most recent full actuarial valuation, updated to take account of that standard's requirements in order to assess the liabilities of the ASPS at 31 December 2011. Scheme assets are stated at their fair values at 31 December 2011.

The main actuarial assumptions used to calculate scheme liabilities under IAS 19 are:

	2011	2010
Inflation rate	3.10%	3.50%
General salary increases	4.90%	5.30%
Pension increases	3.10%	3.50%
Deferred pension increases	3.10%	3.50%
Discount rate	4.90%	5.50%

The discount rate and pension increase rate are the two assumptions that have the largest impact on the value of the liabilities, with the difference between them being known as the net discount rate. The discount rate is based on current average yields of high quality debt instruments (AA-rated corporate bonds), taking account of the maturities of the defined benefit obligations. A 1% increase in this rate (and therefore the net discount rate) would reduce the liabilities by £1.4 billion and the service cost for the year by £4 million. It would also increase the interest cost on those liabilities by £1 million.

Mortality assumptions

Mortality assumptions are significant in measuring the Company's obligations under the defined benefit section, particularly given the maturity of these obligations in this scheme. The mortality table, average life expectancy and pension duration used at 31 December 2011 for scheme members are as follows:

	Life expectancy / (pension duration) at NRA of a male			Life expectancy / (pension duration) at NRA of a female	
	Normal retirement age (NRA)	Currently aged NRA	20 years younger than NRA	Currently aged NRA	20 years younger than NRA
Club Vita pooled experience, including allowances for future improvements	60	89.9 (29.9)	93.2 (33.2)	89.9 (29.9)	92.1 (32.1)

The assumptions above are based on commonly-used mortality tables and are those used by the scheme's trustees in the most recent full actuarial valuation. The tables make allowance for observed variations in such factors as age, gender, pension amount, salary and postcode-based lifestyle group, and have been adjusted to reflect recent research into mortality experience. However, the extent of future improvements in longevity is subject to considerable uncertainty and judgement is required in setting this assumption. These assumptions include an allowance for future mortality improvement, based on the actuarial profession's long cohort projection tables and incorporating underpins to the rate of future improvement equal to 1.5% p.a. for males and 1.0% p.a. for females. The effect of assuming all members were one year younger would increase the scheme's liabilities by £214 million and the service cost for the year by £0.3 million.

The discounted scheme liabilities have an average duration of 20 years.

Notes to the financial statements continued

33. Pension obligations continued

(ii) Assumptions on scheme assets

The expected rates of return on the schemes' assets are:

	2012	2011
Equities	5.8%	7.2%
Bonds	3.4%	4.4%
Property	4.3%	5.7%
Cash	0.7%	0.6%

The overall rates of return are based on the expected returns within each asset category and on current asset allocations.

(iii) Recognition in the statement of financial position

The assets and liabilities of the ASPS, attributable to defined benefit members, at 31 December 2011 were:

	2011 £m	2010 £m
Equities	583	2,117
Bonds	8,029	5,103
Property	578	483
Other	894	739
Total fair value of assets	10,084	8,442
Present value of scheme liabilities	(8,414)	(7,918)
Net surplus in the schemes	1,670	524

Notes to the financial statements continued

33. Pension obligations continued

(iv) Movements in the scheme's surplus

Movements in the pension scheme's surplus comprise:

	Scheme assets £m	Scheme liabilities £m	2011 Pension surplus £m
Surplus in the scheme at 1 January	8,442	(7,918)	524
Employer contributions	239	-	239
Benefits paid	(257)	257	-
Current and past service cost	-	(29)	(29)
Credit/(charge) to finance costs	384	(429)	(45)
Actuarial gains/(losses)	1,276	(295)	981
Surplus in the scheme at 31 December	10,084	(8,414)	1,670

	Scheme assets £m	Scheme liabilities £m	2010 Pension surplus £m
Surplus in the scheme at 1 January	7,312	(8,371)	(1,059)
Employer contributions	501	-	501
Employee contributions	1	(1)	-
Benefits paid	(256)	256	-
Current and past service cost	-	(105)	(105)
Gains on curtailments and settlement	-	318	318
Credit/(charge) to finance costs	382	(469)	(87)
Actuarial gains/(losses)	502	454	956
Surplus in the scheme at 31 December	8,442	(7,918)	524

Notes to the financial statements continued

34. Related party transactions

(a) The Company had the following related party transactions

The Company receives dividend and interest income from, and pays dividends and interest to parent companies, subsidiaries and fellow subsidiaries in the normal course of business. These activities are reflected in the tables below.

(i) Insurance business transfer

On 14 November 2011, assets and liabilities of the Company's parent, Aviva International Insurance Limited and several of the Company's subsidiaries were transferred to the Company at carrying value by way of an insurance portfolio transfer under Part VII of the Financial Services and Markets Act 2000. Subsequent to the initial transfers, various assets and liabilities were transferred from the Company to one of its direct subsidiaries. See note 1 for further details.

(ii) Quota share arrangement

The Company has entered into a quota share reinsurance arrangement with its subsidiary undertaking, Gresham Insurance Company (GIC), with effect from 14 November 2011 as a result of the insurance portfolio transfer detailed above.

The key terms of the agreement are:

- a 100% cession rate premiums, claims and expense costs is applied in respect of that underwriting year; and
- a requirement for the Company to retain a percentage in relation to the Financial Services Compensation Scheme levy.

The premiums, claims and expenses which have been reinsured into the Company after 14 November, under the arrangement are:

	2011 £m	2010 £m
Quota Share		
Premiums earned	45	-
Claims incurred	(19)	-
Fee and commission expenses and operating expenses	(15)	-
	<u>11</u>	<u>-</u>

The material balances in the Statement of Financial Position relating to this arrangement are:

	2011 £m	2010 £m
Gross insurance liabilities	(185)	-
Payable arising out of reinsurance accepted	(8)	-
Receivables arising out of reinsurance accepted	35	-

(iii) Adverse Reserve Deterioration agreement

On completion of the insurance portfolio transfer on 14 November 2011, the Company completed an Adverse Reserve Deterioration (ARD) agreement with its subsidiary company, The Ocean Marine Insurance Company Limited (Ocean). This agreement provides an extra £1 billion of reinsurance cover to protect against circumstances in which a reinsurance arrangement with National Indemnity Company is exhausted or otherwise fails to satisfy claims. In consideration of the Company entering into the ARD agreement, Ocean paid a one-off premium of £69 million, which was settled by intercompany account.

On 14 November 2011, Ocean settled the intercompany account with the Company with funds raised from the issuance of 2,760,000 ordinary shares of £25 each to the Company.

Notes to the financial statements continued

34. Related party transactions continued

(a) The Company had the following related party transactions continued

(iv) Structured settlements arrangement

In 2011, as part of the insurance business transfer, the Company entered into an arrangement with Aviva Annuity UK Limited, a fellow Group company, for the reinsurance of its obligations in respect of structured settlements. Consistent with the previous arrangement, the consideration paid was in the form of investments assigned to Aviva Annuity UK Limited by Aviva UKGI Investments Limited and, as a consequence, a corresponding intercompany liability between the Company and Aviva UKGI Investments Limited has been established.

The premiums and claims which have been reinsured to Aviva Annuity UK Limited under the arrangement are:

	2011	2010
	£m	£m
Reinsurance premiums ceded to reinsurers	9	-
Net earned premiums	8	-
Reinsurance claims incurred	(8)	-
Net result ceded	-	-

At 31 December 2011, the material balances in the Statement of Financial Position relating to this arrangement are:

	2011	2010
	£m	£m
Reinsurance asset	142	-
Amounts owed to Aviva UKGI Investments Limited	(48)	-

(v) Loans

Loans due from other Aviva Group companies

In 2011, as part of the US restructuring, the Company provided an unsecured loan to Aviva Group Holdings Limited, a fellow Group company. This loan accrues interest at 150 base points above 12 month LIBOR, with settlement to be received in cash at maturity in December 2016. As at the Statement of Financial Position date, the loan balance outstanding was £4,710 million.

In 2011, as part of the insurance portfolio transfer, the Company provided the following loans:

- an unsecured loan to Aviva Overseas Holdings Limited, a fellow Group company. This loan accrues interest at 100 base points above 12 month LIBOR, with settlement to be received in cash at maturity in July 2016. As at the Statement of Financial Position date, the loan balance outstanding was £182 million.
- an unsecured loan to Aviva Group Holdings Limited, a fellow Group company. This loan accrues interest at 40 base points above 3 month LIBOR, with settlement to be received in cash at maturity in October 2012. As at the Statement of Financial Position date, the loan balance outstanding was £47 million.

Loans due from subsidiaries

In 2010, the Company provided an unsecured loan to Aviva International Holdings Limited (AIH), a subsidiary company. Under the terms of the loan agreement, a maximum amount of £2 billion may be drawn by AIH. This loan accrues interest at 100 base points above 12 month LIBOR, with settlement to be received in cash at maturity in December 2013. As at the Statement of Financial Position date, the loan balance outstanding was £1.3 billion (2010: £1.3 billion).

Notes to the financial statements continued

34. Related party transactions continued

(a) The Company had the following related party transactions continued

(v) Loans continued

The maturity analysis of the related party loans is as follows:

	2011	2010
Receivables	£m	£m
Within 1 year	47	-
1-2 years	1,300	-
4-5 years	4,892	-
	6,239	-
Effective interest rate	3.23%	

Loans due to subsidiaries

In 2011, as part of the insurance portfolio transfer, the Company entered into the following agreements:

- an unsecured facility agreement with Aviva UKGI Investments Limited, a subsidiary company. This facility accrues interest at 100 base points above 12 month LIBOR and is repayable in December 2012. As at the Statement of Financial Position date, the net amount drawn down under this facility was £80 million.
- an unsecured facility agreement with Solus (London) Limited, a subsidiary company. This facility accrues interest at a fixed rate of 5% and is repayable in June 2012. As at the Statement of Financial Position date, the net amount drawn down under this facility was £36 million.
- an unsecured facility agreement with Bluecycle.com Limited, a subsidiary company. This facility accrues interest at a fixed rate of 5% and is repayable in June 2012. As at the Statement of Financial Position date, the net amount drawn down under this facility was £15 million.

All loans are payable within one year after the Statement of Financial Position date.

(vi) Other transactions

Services provided to related parties

	Income earned in the year	2011 Receivable at year end	Income earned in the year	2010 Receivable at year end
	£m	£m	£m	£m
Immediate parent	-	-	-	223
Subsidiaries	1,956	39	450	2,866
Other Aviva Group companies	-	1,439	-	7
	1,956	1,478	450	3,096

The related parties' receivables are not secured and no guarantees were received in respect thereof. The receivables will be settled in accordance with normal credit terms.

Income earned of £1,956 million (2010: £450 million) relates to dividends received under the Part VII transfer of £1,921 million (2010: £450 million) and interest received on loans of £35 million (2010: £Nil).

Transactions with Group companies for settlement of corporation tax assets and liabilities by group relief are described in note 18.

Notes to the financial statements continued

34. Related party transactions continued

(a) The Company had the following related party transactions continued

(vi) Other transactions continued

Services provided and expenses recharged by related parties

	2011		2010	
	Services provided/ expenses recharged	Payable at year end	Services provided/ expenses recharged	Payable at year end
	£m	£m	£m	£m
Immediate parent	-	109	-	-
Subsidiaries	197	167	211	19
Other Aviva Group companies	142	211	1	157
	339	487	212	176

Services provided include £5 million (2010: £1 million) investment management fees payable to fellow subsidiaries of the Aviva Group.

Expenses incurred include £59 million relating to staff and pension costs from Aviva Employment Services Limited, £58 million relating to facilities' charges from Aviva Central Services UK Limited, £11 million relating to claims costs from Solus (London) Limited and £20 million relating to a recharge from Aviva Health UK Limited for operating costs relating to healthcare insurance business. The Company has recharged expenses of £3 million to parent companies, subsidiaries and other Group companies, leaving net expenses incurred in the year of £141 million.

Expenses recharged up to 14 November represent £189 million management charges payable to Aviva Insurance UK limited, a subsidiary of the Company.

The related parties' payables are not secured and no guarantees were received in respect thereof. The payables will be settled in accordance with normal credit terms.

(b) Key management compensation

The total compensation to those employees classified as key management, being those having authority and responsibility for planning, directing and controlling the activities of the Company, including the directors, is as follows:

	2011	2010
	£m	£m
Salary and other short-term benefits	5	-
Post employment benefits	1	-
Equity compensation plans	1	-
	7	-

(c) Parent entity

The immediate parent undertaking is Aviva International Insurance Limited, registered in the UK.

(d) Ultimate controlling entity

The ultimate controlling entity is Aviva plc. Its Group Financial Statements are available on application to the Group Company Secretary, Aviva plc, St Helen's, 1 Undershaft, London EC3P 3DQ, and on the Aviva Plc website at www.aviva.com.