

4947166

Chesnara plc

Financial Statements
for the Year Ended
31 December 2010

TUESDAY



AQNYRT16

A33

05/04/2011

27

COMPANIES HOUSE

Financial Calendar

31 March 2011	Results for the year ended 31 December 2010 announced
6 April 2011	Ex dividend date
8 April 2011	Dividend record date
14 April 2011	Published Financial Statements issued to shareholders
17 May 2011	Annual General Meeting
19 May 2011	Interim Management Statement for the quarter ending 31 March 2011
20 May 2011	Dividend payment date
August 2011	Interim results for the six months ending 30 June 2011 announced
November 2011	Interim Management Statement for the quarter ending 30 September 2011

Forward-looking statements

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

Key Contacts

Registered and Head Office	Harbour House Portway Preston Lancashire PR2 2PR Tel 01772 840000 Fax 01772 840010 www.chesnara.co.uk	
Legal Advisors	Ashurst LLP Broadwalk House 5 Appold Street London EC2A 2HA Addleshaw Goddard LLP 100 Barbirolli Square Manchester M2 3AB	
Auditor	Deloitte LLP Chartered Accountants and Statutory Auditors 2 Hardman Street Manchester M60 2AT United Kingdom	
Registrars	Capita The Registry 34 Beckenham Road Beckenham Kent BR3 4TU	
Stockbrokers	Panmure Gordon Moorgate Hall Moorgate London EC2M 6XB	Collins Stewart Europe Limited 88 Wood Street London EC2V 7QR
Bankers	National Westminster Bank plc 135 Bishopsgate London EC2M 3UR The Royal Bank of Scotland 8 th Floor, 135 Bishopsgate London EC2M 3UR	Lloyds TSB Bank plc 3 rd Floor, Black Horse House Medway Wharf Road Tonbridge Kent TN9 1QS
Public Relations Consultants	Cubitt Consulting 30 Coleman Street London EC2R 5AL	
Corporate Advisors	Hawkpoint Partners Limited 41 Lothbury London EC2R 7AE	

Contents

Chairman's Statement	7
Background, Strategy and Business Model	9
Chief Executive's Statement	15
Key Performance Indicators	16
Financial Review	20
Risk and Risk Management	29
Corporate and Social Responsibility Statement	33
Board of Directors	35
Directors' Report	36
Corporate Governance Report	38
Remuneration Report	44
Directors' Responsibility Statement in respect of the Financial Statements	51
Independent Auditor's Report to the Members of Chesnara plc	52
Consolidated Statement of Comprehensive Income	54
Consolidated Balance Sheet	55
Company Balance Sheet	56
Consolidated Statement of Cash Flows	57
Company Statement of Cash Flows	58
Consolidated Statement of Changes in Equity	59
Company Statement of Changes in Equity	60
Notes to the Consolidated Financial Statements	61
Directors' Responsibility Statement in respect of the EEV Basis Supplementary Information	152
Independent Auditor's Report to the Directors of Chesnara plc on the EEV Basis Supplementary Information	153
Supplementary Information – European Embedded Value Basis	154
Notes to the Supplementary Information	156
Notice of Annual General Meeting	169
Explanatory Notes to the Notice of Annual General Meeting	175

Note on terminology

As explained in Note 8 to the IFRS financial statements, the principal reporting segments of the Group are

- (1) Countrywide Assured Life Holdings Limited and its subsidiary companies (together 'CA'),
- (2) Save & Prosper Insurance Limited and its subsidiary company Save & Prosper Pensions Limited (together 'S&P' or 'the S&P companies', as the context requires), and
- (3) Movestic Livförsäkring AB and its subsidiary and associated companies (together 'Movestic')

In addition

- (i) The operating segments under (1) and (2) above may be referred to as the 'UK businesses' and the operating segment under (3) may be referred to as the 'Swedish business' as the context requires,
- (ii) The principal operating subsidiary company within the CA segment is Countrywide Assured plc, which is designated as 'CA plc', and
- (iii) Where it is necessary to distinguish Movestic Livförsäkring AB as a separate entity from its subsidiary and associated companies it is designated as 'Movestic Liv'

Change of name

Movestic Livförsäkring AB was formerly known as Moderna Försäkringar Liv AB. The change of name occurred in November 2010.

Chesnara plc

Financial Statements for the Year Ended 31 December 2010

Overview

(1)	Financial Highlights	Page 6
(2)	Chairman's Statement	7
(3)	Background, Strategy and Business Model	9

Financial Highlights

	Year ended 31 December	
	2010	2009
IFRS basis		
Operating profit/(loss)		
CA	25 7	24 7
S&P	0 2	-
Movestic	(2 5)	(2 1)
Other group activities	(3 8)	(2 3)
Profit arising on business combinations	15 9	25 1
	35.5	45 4
Financing costs	(1 3)	(0 7)
Profit before tax	£34 2m	£44 7m
Basic earnings per share	29 05p	45 26p
Dividend per share (including proposed dividend)	16 40p	15 95p
Shareholders' net equity	£203 3m	£159 8m
European Embedded Value basis (EEV)		
Operating profit/(loss)		
Covered business		
CA	16 0	22 0
S&P	0 2	-
Movestic	(9 8)	(2 9)
Other group activities	(6 1)	0 9
	0 3	20 0
Investment variances and economic assumption changes		
CA	7 6	(6 1)
S&P	(1 5)	-
Movestic	16 4	10 1
Profit before tax and before exceptional items	22 8	24 0
Exceptional items		
Profit arising on business combinations	41 0	54 2
Effect of modelling improvements	13 2	-
Profit before tax	77 0	78 2
Tax	(4 0)	12 1
Profit for the year	£73 0m	£90 3m
Shareholders' equity on EEV basis		
Embedded value		
CA	149 7	157 8
S&P	103 2	-
Movestic	121 1	91 5
Embedded value of covered business	374 0	249 3
Acquired embedded value financed by debt	(39 3)	(4 2)
Shareholders' equity in other Group companies	19 9	17 5
	£354 6m	£262 6m
EEV per share	308 8p	258 7p

In contrast with the IFRS basis of reporting, the EEV basis recognises the discounted value of the expected future cash flows, arising from the long-term business contracts in force at the year end, as a component of shareholder equity. Accordingly, the EEV result recognises, within profit, the movement in this component.

S&P was acquired on 20 December 2010. Accordingly, the results for S&P set out above are for an 11-day post-acquisition period.

Chairman's Statement

I am pleased to present the seventh annual financial statements of Chesnara plc ('Chesnara'). With ongoing recovery in global investment markets and the acquisition of Save & Prosper Insurance Company Limited and its subsidiary Save & Prosper Pensions Limited (together 'S&P') in December, 2010 has seen further positive developments in the current and future trading prospects and in the financial strength of the Group. With continuing economic uncertainty, it remains pleasing that our results continue to show a high degree of resilience, allowing us to maintain a reliable and progressive dividend policy and to continue our pursuit of further value-enhancing acquisitions.

Review of the Business

On 20 December 2010, Chesnara completed the acquisition of S&P, a closed UK life assurance and pensions group, which currently manages a portfolio of some 172,000 life assurance and pensions policies. It is complementary to our current UK run-off business and provides the opportunity to extract capital and operational synergies through combining it with our existing UK operations. In early 2010, we also expanded our presence in the Swedish market when we completed the acquisition of the operations and certain assets of Aspis Forsakrings Liv AB ('Aspis'), a Swedish life risk and health insurer. Furthermore, in December 2010 we completed the acquisition of the in-force claims portfolio of Aspis and, therefore, we now service all former Aspis policyholders. These acquisitions widen the scope of our activities in Sweden and underpin our ability to offer a fully-rounded proposition to the Swedish market.

S&P was acquired for £63.5m, funded by a new debt facility of £40m repayable over a 5-year term and by the issue and sale of 10,458,877 new shares and the sale of 2,897,183 shares formerly held in treasury, which together raised gross proceeds of £26.7m. We were pleased with the support of our existing investors and welcome some new shareholders to our register. The acquisition was made at a significant discount of 39% to the embedded value on the acquisition date, which gave rise to an accretion to Group embedded value of £40.7m. On the IFRS basis of reporting, we have recognised a profit of £15.5m arising on acquisition. Furthermore, the acquisition enhances our ability to generate cash surpluses, which will extend the dividend paying capacity of the Group.

During the year, global investment market influences have also had a notable impact on the Group's results, with the leading UK equity market indices, for example, posting gains of between 9% and 11%, and the leading Swedish equity market indices gains of between 21% and 23%, over the whole of 2010. While the low interest rate environment has continued to dampen returns on the Group's shareholder funds, this has been more than offset by the favourable impact of rising equity markets on the Group's embedded value. This leads to higher current and prospective deductions from, and fee income arising on, unit-linked funds under management, with the UK businesses' embedded value benefiting to the extent of £6.5m pre-tax and the Swedish business's embedded value benefiting to the extent of £19.0m pre-tax.

On the EEV basis of reporting, excluding the profit of £41.0m arising on the acquisition of S&P and Aspis and the beneficial effect of £13.2m arising from modelling improvements in Movestic, we have made pre-tax profits of £22.8m for the year ended 31 December 2010, compared with £24.0m for the year ended 31 December 2009 (excluding profit of £54.2m arising on the acquisition of Movestic). Apart from the impact of rising equity markets and the expected return from the unwind of the discount rate, the UK businesses continued to benefit from favourable persistency, mortality and morbidity experience. However, we remain cautious about the underlying persistency assumptions for the UK businesses, while the prospects for the UK economy remain uncertain and pressure on household budgets increases due to tax and likely interest rate increases. While Movestic's EEV was impacted by adverse persistency and expense experience, this was more than offset by favourable investment market effects, the unwind of the discount rate and assumed higher future levels of fee income, following successful re-negotiation of terms with fund managers. There was also a creditable contribution from new business in what proved to be a challenging market.

On the IFRS basis, we have achieved a pre-tax profit of £34.2m for the year ended 31 December 2010. Excluding £15.9m profits arising on the acquisition of S&P and Aspis, the resulting amount of £18.3m compares with a pre-tax profit of £19.6m (similarly adjusted to exclude £25.1m arising on the acquisition of Movestic) for the year ended 31 December 2009. Besides favourable investment market effects of £5.0m, the pre-tax result of the UK businesses also benefited from £3.0m favourable mortality and morbidity experience. Movestic posted a pre-tax loss of £3.7m, which compares with a 5-month post-acquisition loss of £2.6m in the previous year and which is broadly in line with expectations, albeit the result was adversely impacted by £1.3m losses arising in respect of the Swedish broking subsidiary, where it has been decided to scale down operations. Movestic is expected to incur trading losses for a further two to three years as the business continues to build scale and until profits from an increasing base of in-force investment contracts outweighs the front-end strain of writing new business.

Further analysis and comment on the IFRS and EEV results is included in the Financial Review on pages 20 to 28.

Shareholder Value and Returns to Shareholders

Total shareholder equity on the EEV basis, pre appropriation of £12.2m for the final 2010 dividend, is £354.6m (308.8p per share), compared with £262.6m (258.7p per share) as at 31 December 2009. This notable uplift

reflects principally the positive impact of acquiring the S&P business at a discount of 39% to its embedded value, together with a strong core trading result in both the UK and Swedish businesses, driven by the ongoing recovery in global investment markets. In addition, the weakening of sterling against the Swedish Krona, over the year, gave rise to a further £9.5m accretion in embedded value through the recognition of foreign exchange translation gains.

The capacity of the Group to pursue its dividend policy relies on the continuing emergence of surplus in the UK businesses and in the ability to distribute that surplus which, in turn, depends on the regulatory solvency position of the UK businesses. I am pleased to report that CA's solvency ratio, post proposed dividends, at 213% (197% as at 31 December 2009) remains in excess of the target of 150% set by CA's Board, while S&P's ratio was at a healthy 268% as at 31 December 2010.

The Group's dividend policy takes account of the competing need for funds for the development of the Swedish business which, in turn, depends on the underlying regulatory solvency ratio of Movestic. This was 188% at the end of the year (302% as at 31 December 2009) which is comfortably in excess of the target of 150% set by the Movestic Board. Movestic's solvency ratio declines as the increasing scale of its business requires a higher level of regulatory capital as the ratio approaches 150%, further planned capital contributions will be made by the Group. The combined Group post dividend solvency ratio was 200% as at 31 December 2010, compared with 316% at 31 December 2009. The fall in the ratio, which remains considerably in excess of the regulatory requirement of at least 100%, reflects the anticipated dilutive effect of the S&P acquisition.

Based on the strength of our results and of our capital solvency ratios, the Board has decided to recommend a final dividend of 10.6p per share (2009 final dividend 10.3p per share), giving rise to total dividends of 16.4p per share for 2010, which represents a 2.8% increase over total dividends of 15.95p per share for 2009. At the recent trading range of 240p and 260p per share, this represents a yield to shareholders of between 6.3% and 6.8%.

Outlook

The acquisition of S&P has strengthened the long-term position of our UK business. In addition to adding further value to shareholders through the discounted purchase we have the opportunity to, and will progress the release of further value through combining S&P with our existing UK operations. The purchase of the operations and certain assets of Aspis has accelerated the re-branding of our Swedish business. In November, the launch of the new brand – Movestic – was accompanied by a number of new, well-received product features and fund launches. We expect that the acquisition of S&P and the development of our activities in Sweden will provide positive outcomes for shareholders and our teams are well-positioned to deliver these.

We also continue to focus on the implications for our businesses of the pan-European Solvency II implementation which is now due to be effective from 1 January 2013. Currently, other than the challenges of the implementation and new operational processes, we do not foresee any major implications as regards capital requirements, although a note of caution has to be raised as the rules are, as yet, not fully finalised.

The fall-out from the credit crunch and the implications of Solvency II in 2013 continue to give rise to a flow of possible acquisition opportunities. We will continue to be selective and will only pursue opportunities which demonstrate the capability of prolonging our ability to generate a dividend stream and/or of delivering a significant value uplift for shareholders.

We wish to welcome our new colleagues in S&P to the Group and thank all our UK and Swedish employees for their continuing dedication and commitment.



Peter Mason
Chairman

30 March 2011

Background, Strategy and Business Model

Our History and Development

Chesnara was listed on the London Stock Exchange in 2004, when we acquired CA on its demerger from Countrywide plc ('Countrywide'). CA was established in 1988 as the life assurance division of Countrywide and, predominantly, sold mortgage-related life assurance products through Countrywide's financial services division. As a substantially closed life business it continues to administer its in-force portfolio which mainly comprises endowment and protection policies, this reflecting CA's history of providing mortgage-related policies to clients of an estate-agency based financial services group. In 2005 we acquired City of Westminster Assurance Company Limited ('CWA') from Irish Life and Permanent plc for a total purchase consideration of £47.8m. CWA is also substantially closed to new business. In common with the CA business, the policies comprising the CWA business include a mix of endowment, protection and pension policies. However, unlike CA, there is a relatively high proportion of pension policies and this helped to improve the overall mix of Chesnara's UK business by spreading the risk subsisting within the different policy types. On 30 June 2006, the long-term business of CWA was transferred to CA under the provisions of Part VII of the Financial Services and Markets Act 2000 (the 'Part VII Transfer'). Besides reducing the reporting and regulatory burden, financial and operational synergies resulted.

Opportunities for further similar acquisitions then became limited as valuations increased to levels which would not provide attractive returns for shareholders. This was followed by uncertainty arising from disruption to financial markets and a recessionary environment which prevented any significant acquisition activity.

However, in July 2009 we acquired an open Swedish life assurance and pensions company - then named Moderna Forsäkrings Liv AB ('Moderna') - for a cash consideration of £20m. This represented a very attractive discount to its embedded value. Moderna (now rebranded Movestic) is an open unit-linked life and pensions business based in Sweden. It started writing business in 2002 and had achieved a market share of 14% of the company-paid pensions market by 2008. This market penetration fell as issues surrounding its then ownership, by an Icelandic financial services organisation, and its proposed sale became a concern to its key distributors - Swedish Independent Financial Advisers - and their clients. Following Chesnara's purchase of Movestic, market share is recovering from somewhat reduced levels. Shortly after the acquisition, the Swedish regulator, Finansinspektionen ('FI'), approved the commencement of operation of a subsidiary company Moderna Fonder & Analys AB (now Movestic Kapitalförvaltning AB) which was established to separate out the fund selection and management activities from the life company and to develop these activities in the wider market. On acquisition, Movestic owned 49% of the share capital in two associated companies, AkademikerRådgivning i Sverige AB ('AR') and Modernac SA ('Modernac'). The former is an Independent Financial Adviser which was jointly owned by Akademikeranstalt i Sverige AB ('the Akademiks') and a strategic review led to Movestic acquiring a further 42% of the shares resulting in 91% ownership. We are currently in the process of scaling this business down due to unsatisfactory returns. Modernac is a reinsurer based in Luxembourg and was established to reinsure business resulting from a group life cover arrangement with the Akademiks which was extended for five years at the time the increased shareholding in AR was acquired.

In February 2010, Movestic acquired the in-force business, personnel, expertise and systems of Aspis Forsäkrings Liv AB ('Aspis'), a small Swedish life and health risk insurer, which complements Movestic's focus on pensions and savings contracts. The acquisitions of Movestic and Aspis add a growth element to Chesnara's proposition to shareholders. Whilst requiring additional capital in the early years, the prospect for the creation of value for shareholders in the medium to longer term is significant. On 17 December 2011 we acquired the in-force claims portfolio of Aspis which we had administered since we acquired the in-force business.

On 26 November 2010 we announced the proposed acquisition of Save & Prosper Insurance Limited and its subsidiary Save & Prosper Pensions Limited from JPMorgan Asset Management Marketing Limited for a consideration of £63.5m. The acquisition was financed through a new bank facility of £40m together with the proceeds of a placing of 10,458,877 new ordinary shares and the sale of 2,897,183 shares held in treasury, which together raised gross proceeds of £26.7m. Following the issue of a Circular on 30 November 2010 shareholders approved the acquisition at a General Meeting on 16 December 2010 with completion taking place on 20 December 2010. S&P is a UK-based provider of unit-linked, non-linked and with-profit pension and life assurance products which is closed to new business. Like CWA, the company has a high proportion of pension policies and this enhances the longevity of Chesnara's UK proposition.

An opportunity is presented by the acquisition of S&P to achieve financial and operational synergies from the merger of its life assurance and pensions books with those of Countrywide Assured. Merging them into one legal entity, by means of a transfer under Part VII of the Financial Services and Markets Act 2000 ('FSMA') also provides the opportunity for more efficient use, and potential release, of capital from the combined businesses.

In the UK CA, as at 31 December 2010, managed a portfolio of some 162,000 life assurance and pension policies and the acquisition of S&P adds a further 172,000 policies to our portfolio. CA sells a small amount of protection business to existing customers while both CA and S&P also benefit from additional inward flows on their existing life and pension contracts by way of inflation-linked increases and rebates received from the government in respect of contracted-out pension policies.

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

Chesnara Group and the UK business activities are based in Preston, Lancashire with a small office in the City of London. Movestic is based in Stockholm in Sweden and has an administration office in Norrköping in southern Sweden. Chesnara has 21 FTE employees in its corporate governance team in the UK. In Sweden, the headcount, across the two sites, is in the order of 130.

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

Acquisition Strategy

Chesnara continues to seek to participate in the consolidation of life assurance and pensions businesses in the UK and Western Europe. We primarily target acquisitions with a value of between £50m and £200m, although other opportunities are considered. All opportunities are assessed against a number of key criteria including size, risk (including actual or potential product and financial liabilities), discount to embedded value, capital requirements and the pattern and quality of predicted profit emergence. Our strategic approach, however, remains that such potential acquisitions should not detract significantly from, and should contribute to, the primary aim of delivering a steady and attractive dividend yield, although opportunities which present a significant value uplift or growth opportunity will also be evaluated.

Our Operating Models

In the UK we maintain a small professional corporate governance team who are responsible for both the regulatory and operational requirements of the listed entity – Chesnara – and those of the UK closed book subsidiaries – CA and S&P. Our team in the UK is intentionally small and focussed in the interests of keeping the overall expense base tight. It has the capability to manage the UK businesses and to assess acquisition opportunities, but it is supplemented from time to time by temporary resource if justified by operational or strategic demands.

We consider the skills, knowledge and experience of the corporate governance team to be a valuable asset and to ensure continuity we utilise incentivisation schemes which provide reward for both loyalty and company performance. Accordingly, we maintain an annual bonus scheme where half of the potential payment is guaranteed provided that the individuals remain in employment on a specified date, while the remaining half is related to company performance. The three Executive Directors also have the benefit of a longer-term incentive plan, details of which are set out in the Remuneration Report on page 44.

The operating model of our UK businesses is directed towards maintaining shareholder value by outsourcing all support activities to professional specialists. This typically embraces policy administration, systems, accounting and investment management and reduces the impact of potential fixed and semi-fixed cost issues which would otherwise occur as the income streams arising from a declining in-force portfolio diminish. By securing long-term contracts to support these activities we obtain a relatively fixed cost per policy per year, which ensures that the overall cost is more predictable and reduces broadly in line with the size of the policy portfolio. It also leads to the avoidance of the full weight of systems development costs, as these will, where possible, be shared with other users of the outsourcers' platforms. Oversight of the outsourced functions forms a significant part of the workload of the UK team. In addition they focus on management of risk, including management of financial exposures, maintaining regulatory compliance, pursuing value-enhancing initiatives on the existing business, and promoting customer retention, thereby extending the longevity of the income stream from the in-force portfolio.

In Sweden, as the book is open and in a growth phase, we retain a broader-based management and operational team. Rather than outsource core functions, we believe that it is important that the drive and team ethic of Movestic is preserved whilst they seek to re-establish market share in our target markets, whilst maximising the strategic and organisational opportunities presented by the acquisition of Aspis. We do, however, outsource the provision of IT infrastructure as this mitigates operational risk and, whilst Movestic manages the selection of appropriate investment funds, investment decisions are made solely by the fund managers. Movestic has effective compliance systems and maintains a good relationship with its regulator. It has also developed its risk and reporting systems to meet the requirements of Chesnara. As well as receiving basic salary, senior managers are incentivised through the receipt of a share of the embedded value created, the majority of which is deferred for three years to engender loyalty, whilst other staff participate in an annual flat rate reward scheme, which is linked to a number of business performance measures.

Chesnara takes its responsibilities for social and environmental issues seriously and recognises the importance of developing and maintaining high standards. We do not, however, consider that these aspects are critical to the achievement of our strategic aims or that they should form any significant element of remuneration or reward. Further details of our social and environmental issues can be found on page 33.

Protecting Shareholder Interests

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

Risk and regulation

We maintain a strong internal risk management culture and regime throughout the Group and we maintain systems and controls which satisfy regulatory requirements at all levels. Details of the processes we utilise to identify, evaluate and manage the risks within the Group can be found on page 29.

The UK and Swedish life assurance and pensions industries are both highly regulated, in terms of both the conduct of business operations and of financial reporting. We place particular emphasis on managing our regulatory compliance through a proactive and prudent approach and on maintaining a positive relationship with our principal regulators, the Financial Services Authority ('FSA') and the Finansinspektionen ('FI'). Accordingly, a significant effort is directed towards ensuring that the operations are effectively managed in terms of conduct of business regulations and of prudential solvency requirements.

Managing financial exposure

The Group pays particular attention to any area in which it has a significant financial exposure. In life and pensions portfolios these typically arise in the areas of onerous policy options and guarantees and of compensation claims for past mis-selling of products. The Group's portfolios have, historically, had very little exposure to the impact of investment market performance on options and guarantees. However, just under 30% of the policies managed by S&P business contain guarantees to policyholders and therefore the Company's exposure has increased. Furthermore, it continues to have exposure to market falls by way of policyholders' linked funds, which have expanded significantly following the purchase of S&P and from which surplus is generated. Whilst S&P adds no discernable mis-selling risk we continue to have ongoing exposure, in CA, to the mis-selling of policies sold in connection with an endowment mortgage in the UK. In this regard we are required to pay redress to a subset of endowment policyholders who may have been mis-sold their product. Such exposure to redress payments has declined as policyholders have become time-barred from making a successful complaint. The current provision for future redress costs is, based on current knowledge and expectation, believed to be adequate. However, it is not set in the expectation of any change in rules or interpretation of the existing rules by the FSA or by the Financial Ombudsman Service ('FOS') who are responsible for mediating between the company and policyholders on disputed complaints.

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

Managing the expense base

We continue to maintain strong management of our expense base. In the UK our team of 21 people manages the demands of the listed entity, Chesnara, and of CA and S&P. A significantly larger workforce is in place in Sweden. Movestic's staff complement at the end of 2010 was 130. We have made progress in our aim to reduce costs through relocating support functions to Aspis's lower cost centre in Norrköping in the south of Sweden and we continue to seek further cost-reduction measures.

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

In the UK our agreement with HCL Insurance Business Services Limited ('HCL') to outsource back office functions for the CA business with effect from 1 February 2005 continues. The agreement, which runs for 10 years from that date, provides Chesnara with a defined level of cost per policy during the term and mitigates the risks and significant cost inefficiencies that arise from a diminishing policy base.

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

The S&P business, on acquisition, already operated in line with our UK strategy of outsourcing back office and support functions. It has the benefit of a rolling contract, signed in November 2009, with one of our incumbent outsourcing partners – HCL.

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

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

Promoting customer retention

A key determinant of our future profitability and of the level and longevity of the emergence of surplus, which underpins our dividend-paying capacity, is the rate at which customers leave us. This is true for both the UK and Swedish businesses. In the UK the number of policies we manage will, of course, reduce as policies mature or as claims are made. Equally, some customers' circumstances change, in some cases as a consequence of economic conditions, and their need for, or capability to fund, the relevant policy ends. We continue to maintain a strong focus on the retention of policies where it is in the interests of customers to continue with their arrangements. To date, despite the challenging economic environment, we have yet to see any significant deterioration in retention rates although we remain prudent in our future assumptions.

With regard to Movestic while the overall number of policies in force has increased, the rate at which policyholders leave us has continued to disappoint. The exit from low-margin ITP Collectum business following a competitive tender has contributed to this, as this resulted in the transfer out of funds which we had previously procured. This, together with aggressive targeting by banks of pension funds, has led us to introduce a business retention team whose whole focus will be on identifying the drivers behind lapses, transfers and surrenders and on the implementation of retention strategies.

An important element of our customer retention strategy is the pursuit of good relative investment performance in the unit-linked funds. The CA funds are primarily managed by Schroder Investment Management Limited ('Schroders') while the CWA funds continue to be managed by Irish Life Investment Managers Limited ('ILIM'). The new S&P funds will continue to be managed by JPMorgan in order to maintain continuity for policyholders. We meet formally with fund managers on a quarterly basis to assess past performance and future strategy. The Movestic funds are managed by a carefully selected range of fund managers who have strong performance records in the relevant sector. Performance is monitored very closely and regular meetings are held with fund managers. Should underperformance continue then an alternative manager is sourced and appointed to manage the relevant assets. Where a new market niche or specific opportunity is identified new funds may also be added. Further details of fund performance are provided in the Key Performance Indicators on pages 16 to 19.

Managing regulatory requirements

We continue to monitor developments on the regulatory front and we manage these proactively. These include

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

In the UK we have not been the subject of any formal FSA review as our next Arrow assessment was not due until the first half of 2011. Originally this had been set for 2010. However, the FSA advised us in January 2011 that they would postpone this until later in the year and we believe that this is a reflection of our continued good compliance record and our close contact with them during the acquisition of S&P. We will continue to keep our FSA supervisory team informed and discuss matters with them on a regular basis. We believe our current regulatory capital resources requirement (as set out on page 25) will continue to be adequate. We will continue our strong risk management culture and processes which complement our regulatory compliance ethos.

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

In Sweden the FI have not undertaken any significant review of Movestic, although a review is planned for early April 2011. As we continue to meet their information requests and operate in line with their rules and guidance, we do not expect any major issues to arise.

Financial reporting - our primary financial statements are prepared on an IFRS basis. This helps to promote transparency of trading performance and financial position of the Group as the UK and Swedish businesses are subject to sharply contrasting business dynamics. During 2010 the International Accounting Standards Board issued an Exposure Draft on Insurance Contracts and it is expected that this will have a significant impact on financial reporting for both our UK and Swedish businesses.

We continue to employ EEV principles as the basis for providing information supplementary to the IFRS financial statements, as these principles provide a framework which is intended to improve the comparability and transparency of embedded value reporting on a pan European basis. There has been no fundamental change in our application of the principles during 2010.

Solvency II - we have continued development in both the UK and Swedish businesses to ensure compliance with the requirements of the EU Solvency II Directive by the scheduled implementation date of 1 January 2013. These requirements involve far-reaching changes, not only in terms of the conduct of the operations, by way of enhancing risk management processes, but also in terms of the calculation of the technical provisions and of the risk-based determinants of capital adequacy, and reporting of the same.

Chesnara plc

Financial Statements for the Year Ended 31 December 2010

Business Review

(1)	Chief Executive's Statement	Page 15
(2)	Key Performance Indicators	16
(3)	Financial Review	20
(4)	Risk and Risk Management	29
(5)	Corporate and Social Responsibility Statement	33

Chief Executive's Statement

Developments during 2010

The key development in 2010 was the acquisition of S&P, which we announced on 26 November 2010 and which was completed on 20 December 2010 following shareholder approval at a General Meeting on 16 December 2010. The purchase price of £63.5m, funded by a new bank facility of £40m and the proceeds of a share placing and of the sale of treasury shares, together amounting to £26.7m, represented a significant 39% discount to S&P's Embedded Value on acquisition.

Save & Prosper Insurance Limited and its subsidiary Save & Prosper Pensions Limited are UK-based providers of life assurance and pension products and the companies have been closed to new business for over 12 years. The administration of these businesses is outsourced and therefore it already operates in line with Chesnara's preferred model for its UK businesses. This acquisition builds the scale of our UK operations and offers, in addition to the value added for shareholders arising from its purchase at a significant discount to its embedded value, further potential financial synergies as we seek to merge it into our current UK operations.

In February 2010 we acquired the operational business of Aspis Forsakrings Liv AB ('Aspis'), a Swedish-based life and health risk insurer. Aspis was to have its operating licence revoked due to solvency concerns and we took the opportunity to acquire the in-force portfolio, personnel, intellectual property and systems of Aspis but not the liabilities for existing claims, although we agreed to undertake the administration of these claims on a commercial basis for the Administrator of Aspis. Aspis, which has focussed on risk and health insurance, provides an extremely good fit with the existing Movestic business which formerly focussed on pensions and savings. Movestic has utilised the attributes of Aspis to offer a full solution to corporate pension scheme customers as well as separately marketing a strong range of risk products where appropriate. Further synergies continue to be obtained through the rationalisation of the capabilities of Movestic and Aspis. The rebranding of the merged entity which was launched in November together with new product features and marketing initiatives has been very well received. Late in 2010 we announced that we had acquired the aforementioned existing claims portfolio from the Administrator and, therefore, we now service all former Aspis clients.

Businesses in both the UK and Sweden have performed well with positive investment markets assisting, in conjunction with good underlying business performance, in providing strong returns for shareholders. IFRS pre-tax profits, steady at £18.3m, compared with £19.6m last year (excluding the gains arising on business combinations in both years) and EV increasing by 35% over the year to £354.6m – a particularly pleasing outcome – provide strong testament to this.

The completion of another successful acquisition has not dulled our appetite to make further value-adding purchases and we continue to review suitable opportunities in the UK and in Western Europe. In particular we believe that the implementation of the Solvency II regime in January 2013 will give rise to further acquisition opportunities.

The availability of capital to support acquisitions has improved, as demonstrated by our ability to raise funds to support the S&P acquisition. Should further financing for an attractive opportunity be required, we would, again, consider seeking funding from shareholders via the issue of further equity following their very strong support in the recent S&P transaction – of which we remain appreciative.

We look forward to investigating acquisition opportunities as they arise as we continue to believe that we can leverage further value from our existing and newly-acquired capabilities.

Future trends and developments

In line with our continued primary aim of delivering an attractive long-term dividend yield, we remain focussed on the efficient management of our businesses. The acquisition of S&P and its significant accretion to embedded value are welcome and will add strength and longevity to our ability to generate future dividend payments particularly after the synergies which we expect to arise from merging it with our current UK business are realised. That said, support for dividends from the UK run-off businesses will still diminish over time, albeit from a higher base, as the book inevitably runs down. Therefore, we recognise that further acquisitions which have income generating capability remain necessary to provide dividend growth in the medium term.

The EU Solvency II Directive brings challenges both in terms of capital requirements and, not least, in terms of implementation. We believe we remain in relatively good shape and, at this time, we are not expecting any significant adverse capital effects to arise in any of our businesses (including S&P).

All our businesses remain exposed to macroeconomic and industry-related factors including those set out in the Risk and Risk Management section on pages 29 to 32. Provided that these areas do not adversely impact the prospects of the Group significantly, the short- to medium-term outlook is positive for the ongoing emergence of surplus and, accordingly, for dividend support.

Key Performance Indicators

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

No performance indicators are presented in respect of the S&P segment as it was under Group ownership for only 11 days of the reporting period.

Information on the pre-tax results and the regulatory solvency capital position of the Group is presented within the Financial Review on pages 20 to 28.

CA

1) Per policy expenses

A key area of focus for CA is the management of expenses incurred in servicing the in-force life and pensions policy base. In particular we seek, through outsourcing arrangements, to maximise the proportion of costs which vary with policy volume. Through the assumptions we set for reporting on an EEV basis (details of which are set out on pages 160 to 162 of these financial statements), we project anticipated policy volumes in force and anticipated expenses in managing those policies over the run-off life of the policy base. Under EEV principles these expenses include the projected stream of Chesnara holding company expenses. From these projections we derive, for each period end, a projected average expense per policy per year, which is reflected in the overall value of policies in force and, therefore, in the embedded value of the CA business. This measurement will have an expected variation through lapse of time as the policy base diminishes in relation to an expense base which does not diminish at the same rate, as not all expenses vary in line with policy volume.

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

- (i) the expected variation,
- (ii) the extent to which the in-force policy base is higher or lower than previously anticipated, and
- (iii) the extent to which projected expenses are higher or lower than previously anticipated.

	As at 31 December 2009	Expected variation	Variation due to Policy volume projection	Expenses projection	As at 31 December 2010
EEV projected expense per policy per year (£'s)	64.90	0.20	(3.69)	7.29	68.70

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

Continuing favourable policy lapse experience over the year has led to higher projected policy volumes and this has translated into a favourable impact on per policy costs as fixed costs are spread over a larger policy base. As against this, we have revised our view of forward expense levels so that, overall, we are projecting a 4% increase in expenses per policy per year.

2) Policy attrition rate

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

Number of in-force policies ('000's)	2010	2009
Beginning of year	176	192
End of year	162	176
Rate of attrition over the year	8.0%	8.3%

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

3) Unit-linked fund performance

Relative outperformance in the unit-linked funds helps promote policy retention and, when positive, increases the embedded value of the Group as future management charges received will be of a higher magnitude. The CA Life Managed Fund, which represents a significant proportion of CA policyholder funds under management, provided a return of 14.2% over the year ended 31 December 2010 (31 December 2009 22.9%), while the CWA Balanced Managed Life Fund, which represents a significant proportion of CWA policyholder funds under management, provided a return of 11.74% over the same period (31 December 2009 21.16%). These returns compare favourably with the ABI UK Life Balanced Managed benchmark return of 11.54% (31 December 2009 20.47%).

4) Mortgage endowment misselling complaints

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

	2010	2009
Number of complaints received during the year	677	1,210
% upheld of complaints assessed during the year	24%	27%
% time barred of complaints assessed during the year	54%	62%

The percentage of in-force policies which are time-barred is now 84%. Time-barred policies are those mortgage endowment policies for which a misselling complaint is potentially not admissible through the application of rules and guidance issued by the FSA and the ABI. We do not expect the percentage of time-barred cases to increase significantly in future years.

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

Movestic

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

1) Premium income

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

	Year ended 31 December	
	2010	2009
	£m	£m
New Business Premium Income*		
Pension and savings	49.1	48.5
Risk insurance	7.5	3.2
Total	56.6	51.7

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

	Year ended 31 December	
	2010	2009
	£m	£m
Total Premium Income*		
Pension and savings	244.1	253.0
Risk insurance	35.6	26.1
Total	279.7	279.1

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

Pension and savings income was slightly lower than last year whilst risk and health premiums demonstrated strong growth following the acquisition of Aspis and the launch of new product features. Total premium income was flat as the fall in pensions and saving income, due to the loss of low-margin ITP Collectum business and our virtual withdrawal from the unattractive endowment market, was offset by the increase in risk and health premiums.

2) Market share

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

Share of unit-linked pensions market by quarter

	Q4 09	Q1 10	Q2 10	Q3 10	Q4 10
Total business	5.4%	3.9%	5.1%	3.1%	5.8%
Company-paid contributions business	7.8%	12.3%	12.3%	10.1%	11.3%

Total business share ended up slightly higher than the comparative figure last year whilst in the company-paid market the improvement in Q1 was largely maintained through the year. The rebranding to Movestic in November which was accompanied by new product features and fund launches, together with a restatement of our investment fund selection credentials, has driven our share higher in the fourth quarter.

3) Policy attrition

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

	Year ended 31 December	
	2010	2009
Surrenders (Endowments)	13.4%	11.4%
Transfers (Pensions)	4.6%	3.2%
Lapses (Pensions and Endowments)	19.8%	17.9%

The above percentages are, for surrenders and transfers, based on the capital amount surrendered or transferred, divided by the amount of capital potentially transferable. For lapses, it is the annual premium of lapsed policies, divided by the total annual premium in force at the start of the year. We have continued with relatively high rates of attrition and are taking active steps to improve results in this area. The surrenders figure suffers from cessations of a particular policy type in December without which the annualised rate would have been equivalent to that of 2009. Transfers, where bank-owned life insurers have been competing aggressively began to show some improvement in the latter months after suffering higher losses in the first part of the year. Lapses increased as we were unsuccessful in the ITP Collectum tender. This business was very low margin and the effect is, therefore, limited. Excluding the ITP business, the lapse rate improves to 15.9%. Movestic continues with its policy of contacting financial advisers and their clients where a termination occurs to ensure that any underlying trends are countered.

4) Assets under management

	Year ended 31 December	
	2010	2009
Assets under management	£1,302.7m	£1,054.0m

*Denominated in SEK and translated into sterling at a constant rate of SEK10.5 = £1

The value of assets under management is a key reference point for establishing the ongoing profit-earning capacity of the business, as fees are received based on those values. Assets growth enables management to negotiate improved rebates from fund managers which drives improved profitability. Therefore it is particularly welcome that assets under management increased by £248.7m during the year ended 31 December 2010.

5) Fund performance

Relative fund performance is key to maintaining funds under management, obtaining new business and to supporting business retention.

Number of funds

	Year ended 31 December	
	2010	2009
Outperformed against relevant index	18	19
Underperformed against relevant index	12	11
No relevant index	6	2

One of Movestic's key differentiators is its approach to selecting the funds available to investors. Rather than adopt mainstream funds, which, in Sweden, are those predominantly managed by subsidiaries of banks which also have life assurance subsidiaries, they select a limited number of funds from a wide range of independent fund managers. The funds selected are, in general, actively managed funds with a value approach, but in markets which are considered efficient. The performance of all funds is closely monitored and regular contact is undertaken with managers to ensure that the underlying reason for the performance, whether positive or negative, is fully understood. Funds that do not perform favourably compared to the relevant index are wholly replaced if there are no acceptable strategies for improvement in the returns. In the second half of the year we launched a small number of 'new to the market' funds which have performed particularly well and enhanced our reputation as selectors of appropriate funds. Since then we have focussed back on the core range and are undertaking the process of replacing underperforming funds.

Financial Review

Basis of Accounting

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

The Group continues to provide financial information supplementary to the IFRS basis With effect from reporting periods commencing on 1 January 2006, the Group adopted European Embedded Value (EEV) principles as the basis for providing this supplementary information EEV methodology aims to measure the underlying embedded value of the Group's life assurance, pensions and annuity businesses and provides a framework which is intended to improve the comparability and transparency of embedded value reporting across Europe During 2011 we will consider compliance with the European Insurance CFO Forum Market Consistent Embedded Value (MCEV) Principles (copyright © Stichting CFO Forum Foundation 2008)

IFRS Result

The IFRS result for the year ended 31 December 2010 comprises

	Year ended 31 December 2010			Year ended 31 December 2009		
	Pre-tax £000	Tax £000	Post-tax £000	Pre-tax £000	Tax £000	Post-tax £000
Profit arising on business combinations						
Movestic	-	-	-	25,056	-	25,056
Aspis	376	-	376	-	-	-
S&P	15,488	-	15,488	-	-	-
CA result	25,692	(4,740)	20,952	24,784	948	25,732
S&P result	224	(63)	161	-	-	-
Movestic result	(3,730)	176	(3,554)	(2,626)	(148)	(2,774)
Other group activities	(3,882)	160	(3,722)	(2,473)	392	(2,081)
Total result	34,168	(4,467)	29,701	44,741	1,192	45,933
Non-controlling interest			118			7
Total result attributable to shareholders			29,819			45,940

The derivation of the profit arising on business combinations is set out in Note 7 to the IFRS financial statements

The CA result, which is net of an amortisation charge of £3.5m in respect of the acquired value of in-force business, continues to be dominated by the strong emergence of surplus from its life and pensions contract portfolio, which is in run-off Investment market recovery over the year led to net pre-tax gains of some £5m Favourable mortality and morbidity experience was £3m pre-tax, while the pre-tax result was also significantly enhanced by the release of £3.2m in respect of amounts previously set aside to provide for policyholder claims A thorough review determined that the business had no further liability in respect of these claims

The pre-tax loss of £3.7m attributable to Movestic is stated net of an amortisation charge of £1.2m in respect of the acquired value of in-force business and compares with a pre-tax loss of £2.6m in the five-month post-acquisition period in 2009 It is also stated net of a write down of assets of £0.5m in respect of its IFA subsidiary, Akademiker, where it has been decided to scale down the operations Taking account of these items, there is a core pre-tax trading loss of some £2.0m, which represents a slight improvement over the core pre-tax loss of £2.6m reported at the half-year position This largely reflects gradually improving confidence in investment markets Movestic, however, is expected to incur trading losses for a further two years, as it continues to build scale and until realised profits from an increasing base of in-force investment contracts outweigh the front-end strain of writing new business It also faces the challenge of competition which has led to transfers out of the business being higher than expected during the year

The S&P result is in respect of an 11-day post-acquisition period and is not considered to be significant in the context of the total Group result

The result of other group activities, which principally relates to the operations of the parent company, includes £3.2m of expenses incurred in connection with the acquisition of S&P

European Embedded Value (EEV) Result

Supplementary information prepared in accordance with EEV principles and set out in the financial statements on pages 154 to 168 is presented to provide alternative information to that presented under IFRS. EEV principles assist in identifying the value being generated by the UK and Swedish life and pensions businesses. The result determined under this method represents principally the movement in the UK and Swedish businesses' embedded value, before transfers made to the parent company and ignoring any capital movements. Through including the in-force value of insurance and investment contracts, EEV recognises the discounted profit stream expected to arise from those contracts. The principal underlying components of the EEV result are the expected return from existing business, in both the UK and Swedish businesses, being the unwind of the rate used to discount the related cash flows, and the value added by the writing of new business in the Swedish business. Adjustments are made to the result for variations in actual experience from that assumed for each component of policy cash flows arising in the period and for the impact of restating assumptions for each component of the prospective cash flows.

The movement in Group EEV may be summarised as

	Year ended 31 December			
	2010		2009	
	£000	£000	£000	£000
EEV at beginning of year		262,585		182,708
Effect of modelling improvements		13,239		-
EEV at beginning of year restated		275,824		182,708
Profit arising on acquisition of				
Movestic		-		54,187
Aspis		376		-
S&P		40,667		-
Result for the period				
UK businesses (CA and S&P)				
New business	685		1,482	
Existing business	21,618		14,438	
Tax	(4,336)		11,893	
Post-tax		*17,967		27,813
Movestic				
New business	2,057		783	
Existing business	4,492		6,437	
Non-covered business	(3,674)		1,623	
Tax	177		(161)	
Post-tax		3,052		**8,682
Other group activities net of tax		(2,295)		(417)
Movement on non-controlling interest		118		7
Foreign exchange reserve movement		9,517		5,539
Dividends paid		(16,340)		(15,934)
Share capital issued		22,588		-
Disposal of Treasury shares		3,162		-
EEV at end of year		354,636		262,585

* Comprises the results of CA and S&P, the latter being for the 11-day post-acquisition period and not considered to be significant in the context of the overall result for the UK businesses

** The Movestic result for the year ended 31 December 2009 is in respect of the 5-month post-acquisition period

EEV at end of the year is stated before recognition of the final proposed dividend of £12.2m in respect of the year ended 31 December 2010 (year ended 31 December 2009 £10.5m)

The significant foreign exchange reserve movement for the year ended 31 December 2010 arises from the impact of the 9% appreciation of the Swedish Krona against sterling over the year on the translation of the Krona-denominated Movestic embedded value

The profit of £40.7m arising on the acquisition of S&P is the excess of the embedded value of S&P at the acquisition date over the purchase consideration of £63.5m. This represents a discount of 39% to S&P's embedded value at the acquisition date

The effect of modelling improvements, as shown in the table above, which is in the nature of an exceptional profit, arises from the fact that, during 2010, Movestic introduced a new system for modelling the value of its in-force policies. This provided a capability for (i) more accurately modelling the impact on commission paid on policies becoming paid-up and for (ii) determining future fee income on a case-by-case investment mix basis, whereas previously it had been necessary to adopt high-level estimates

The dominant feature underpinning the results of both the UK and Swedish businesses over the year has been the recovery in investment markets, with leading UK equity indices posting gains of 9-11% over the year and leading Swedish equity indices 21-23%. These gains were particularly strong in the second half of the year following a dull first half. Yields on fixed interest securities and swap rates drifted down over the year, but recovered towards the end of the year, the recovery in Swedish market rates being earlier and stronger than in the UK

Within the UK businesses favourable investment market effects gave rise to pre-tax gains over the year of some £6.5m (£5.2m net of tax) arising principally from higher deductions from unit-linked funds, which have increased in value. Other significant factors underlying the UK businesses' pre-tax result of £22.3m are

- (i) unwind of the discount rate on existing business of £5.2m (£4.2m net of tax),
- (ii) a new business contribution of £0.7m (£0.6m net of tax),
- (iii) continuing favourable mortality and morbidity experience of £1.1m (£0.9m net of tax), and
- (iv) continuing favourable persistency experience of £6m (£4.8m net of tax)

In addition, the UK businesses' result was further enhanced by £3.2m (£2.6m net of tax) in respect of the release of income of certain claims liabilities, as explained within 'IFRS Result' above

Within Movestic favourable investment market effects gave rise to gains over the year of £19m (all amounts stated in respect of Movestic are pre- and post-tax, the effective rate of Swedish company tax not being significant)

This outcome was enhanced by

- (i) £6.2m unwind of the discount rate on existing business,
- (ii) a £2.1m new business contribution,
- (iii) a favourable effect of £2.2m arising from the change in investment mix within underlying investor funds, and
- (iv) a favourable effect of £6m arising from higher projected levels of fee income, following negotiation of enhanced terms from investment fund managers

On the adverse side the result was impacted by

- (i) unfavourable persistency experience of £6.5m, giving rise to an additional adverse impact of £11.3m in respect of assumed future persistency rates, and
- (ii) an expense overrun of £2m, giving rise to an additional adverse impact of £8.8m in respect of assumed future expense levels

The Movestic non-covered business, which relates principally to its Risk and Health business and to its IFA subsidiary, Akademiker, has posted a combined net loss due to

- (i) the impact of losses incurred in the IFA broking subsidiary, together with a write down of related net assets, following the decision to scale down the operation,
- (ii) a re-allocation of expenses from the covered Pensions and Savings business to the Risk and Health business, following a detailed expenses review, based on activity analysis, and
- (iii) higher reinsurance financing costs

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

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

	31 December 2010				
	CA	S&P	Movestic	Other Group Activities	Total
	£000		£000	£000	£000
Value of in-force business	79,360	41,307	144,748	-	265,415
Other net assets	70,348	22,673	(24,111)	20,311	89,221
	149,708	63,980	120,637	20,311	354,636
Represented by					
Embedded value ('EV') of regulated entities	149,708	103,267	121,069	-	374,044
Less: amount financed by borrowings	-	(39,287)	-	-	(39,287)
EV of regulated entities attributable to shareholders	149,708	63,980	121,069	-	334,757
Net equity of other Group companies	-	-	(432)	20,311	19,879
Shareholders' equity	149,708	63,980	120,637	20,311	354,636

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

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

31 December 2010					31 December 2009			
	CA	S&P	Movestic	Total	CA	S&P	Movestic	Total
Number of policies	000	000	000	000	000	000	000	000
Endowment	50	8	15	73	55	-	15	70
Protection	52	6	-	58	58	-	-	58
Annuities	5	1	-	6	5	-	-	5
Pensions	48	143	75	266	51	-	70	121
Other	7	14	-	21	7	-	-	7
Total	162	172	90	424	176	-	85	261

31 December 2010					31 December 2009			
	CA	S&P	Movestic	Total	CA	S&P	Movestic	Total
	£m	£m	£m	£m	£m	£m	£m	£m
Value of in-force								
Endowment	34.1	8.3	14.0	56.4	40.2	-	15.2	55.4
Protection	49.1	2.6	-	51.7	48.1	-	-	48.1
Annuities	0.5	1.5	-	2.0	3.9	-	-	3.9
Pensions	31.1	68.1	131.0	230.2	36.2	-	98.6	134.8
Other	1.7	0.7	-	2.4	0.7	-	-	0.7
Total at product level	116.5	81.2	145.0	342.7	129.1	-	113.8	242.9
Valuation adjustments								
Holding company expenses	(8.6)	-	-	(8.6)	(9.8)	-	-	(9.8)
Other	(23.4)	(22.0)	-	(45.4)	(26.5)	-	-	(26.5)
Cost of capital/frictional costs	(1.0)	(3.7)	(0.3)	(5.0)	(0.8)	-	(1.0)	(1.8)
Value in-force pre-tax	83.5	55.5	144.7	283.7	92.0	-	112.8	204.8
Taxation	(4.1)	(14.2)	-	(18.3)	(6.4)	-	-	(6.4)
Value in-force post-tax	79.4	41.3	144.7	265.4	85.6	-	112.8	198.4

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

'Other' valuation adjustments in CA principally comprise expenses of managing policies which are not attributed at product level. In S&P they represent the estimated cost of guarantees to with-profits policyholders.

Returns to Shareholders

The Board's primary aim is to continue to provide a reliable and progressive dividend flow to shareholders within the context of the emergence of surplus in the UK life businesses. Returns to shareholders are underpinned by the emergence of surpluses in, and transfer of surpluses from, the UK life businesses' long-term insurance funds.

to shareholder funds and by the return on shareholder net assets representing shareholder net equity. These realisations are utilised in the first instance for the repayment and servicing of the bank loan on the basis set out in Note 36 to the financial statements (on page 138). The surpluses arise from the realisation of in-force value of the UK businesses, which are in run-off. The return on shareholder net assets is determined by the Group's investment policy. Shareholder funds bear central corporate governance costs which cannot be fairly attributed to the long-term insurance funds and which arise largely in connection with Chesnara's obligations as a listed company.

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

The acquisition of S&P in December 2010, besides giving rise to an immediate accretion of £40.7m to shareholder net equity as measured on the EEV basis, following from the fact that it was acquired at a discount of 39% to its embedded value, reinforces the Group's core proposition of realising surpluses from life businesses in run-off. Besides extending the time profile over which Chesnara realises such surpluses, S&P offers diversification within the overall Group portfolios, insofar as it includes a significant tranche of with-profits policies and also affords the opportunity to realise synergies by way of transfer of its long-term business funds under the provisions of Part VII of the Financial Services and Markets Act 2000.

Between mid-November 2009 and early March 2010, the share price strengthened considerably, generally trading in a range of between 185p and 210p per share. This implied a yield, based on total 2009 proposed dividends, of between 7.6% and 8.6%, with the shares trading at a discount of between 19% and 28% to embedded value of £262.6m, as reported at 31 December 2009. The improvement followed our interim management statement issued on 19 November 2009, which set out the full extent of the accretive impact of the acquisition of Movestic, while also pointing to an improvement in the fundamentals underpinning the UK businesses.

Between early March 2010 and the end of November 2010 the share price averaged some 220p per share. During that period it generally traded within a range of 200p to 250p per share and was subject to sharp fluctuations within the range, generally reflecting wider market conditions.

Since the announcement of the acquisition of S&P on 20 December 2010 up to mid-March 2011, the share price has steadily strengthened so that it is now consistently trading within a range of 240p to 260p per share. Based on total proposed dividends for 2010 of 16.4p per share, this implies a yield of between 6.3% and 6.8%, with the shares trading at a discount of between 13% to 19% to the latest published embedded value of £354.6m at 31 December 2010.

It is also worthy of note that, during 2010, our share price performance has consistently outperformed the Life sector as a whole, as illustrated by the performance graph set out in the Remuneration Report on page 44.

Solvency and Regulatory Capital

Regulatory Capital Resources and Requirements

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

Within the UK, the regulations include minimum standards for assessing the value of liabilities, including making an appropriate allowance for default risk on corporate bonds held to match liabilities when assessing the valuation discount rates used for valuing these liabilities. Market turmoil in 2008 led to significant widening of spreads on corporate bonds above gilts, through changed assessment of default risk and liquidity issues, and therefore, with the widening spreads, this issue was of concern to the industry. CA continues to maintain a prudent approach of limiting the assumed liquidity premium for corporate bonds to a maximum of 50bps as at 31 December 2010 (31 December 2009: 50bps). For S&P, where the with-profits funds have a diverse range of assets, the assumed liquidity premium for corporate bonds is limited to 200bps. Additionally, the CA Board continues to maintain their stance that permissive changes to regulations introduced in 2006, in FSA policy statement PS06/14, that would allow a reduction in liabilities are not appropriate for CA at this time.

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

	31 December	
	2010	2009
	£m	£m
Available capital resources ('CR')	44.1	43.6
Long-term insurance capital requirement ('LTICR')	19.1	19.8
Resilience capital requirement ('RCR')	1.6	2.3
Total capital resources requirement ('CRR')	20.7	22.1
Target capital requirement cover	30.2	32.0
Ratio of available CR to CRR	213%	197%
Excess of CR over target requirement	£13.9m	£11.6m

The CA Board, as a matter of policy, continues to target CR cover for total CRR at a minimum level of 150% of the LTICR and 100% of the RCR. To the extent that the target capital requirement cover of £30.2m as at 31 December 2010 falls short of the £40m share capital component of CR, so it follows that £9.8m of the reported excess of CR over target requirement is not available for distribution to shareholders except by way of a capital reduction.

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

The following summarises the capital resources and requirements of S&P for UK regulatory purposes. The Boards of the S&P companies have availed themselves of certain of the provisions of PS06/14 which has led to a reduction in certain liabilities.

	31 December	
	2010	2009
	£m	£m
Available capital resources ('CR')	69.7	74.4
Long-term insurance capital requirement ('LTICR')	24.3	22.9
Resilience capital requirement ('RCR')	1.7	4.1
Total capital resources requirement ('CRR')	26.0	27.0
Ratio of available CR to CRR	268%	276%
Excess of CR over target requirement	£43.7m	£47.4m

The information as at 31 December 2009 relates to the pre-acquisition period and is provided for illustrative purposes. It is presented after making adjustment for dividends totalling £91m, which were paid to S&P's previous shareholder prior to the acquisition date.

The Boards of the S&P companies have not established formal targets for CR cover for total CRR. It is not intended to make dividend distributions from S&P to Chesnara prior to transfer of the long-term insurance funds of S&P to CA. This process is planned to be completed towards the end of 2011.

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

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

	31 December	
	2010	2009
	£m	£m
Available capital resources (CR) represented by		
- Share capital	1 2	1 1
- Additional equity contributions	35 2	33 6
- Accumulated deficit	(13 1)	(10 2)
	<u>23 3</u>	<u>24 5</u>
Regulatory capital resource requirement (CRR)	<u>12 4</u>	<u>8 1</u>
Target requirement	<u>18 6</u>	<u>12 1</u>
Ratio of CR to CRR	<u>188%</u>	<u>302%</u>
Excess of CR over target requirements	<u>£4 7m</u>	<u>£12 4m</u>

The Movestic Board sets a minimum target of 150% of the regulatory capital requirement. Swedish solvency regulation requires that a certain proportion of assets, to be fully admissible, is to be held in the form of cash. The operation of this requirement may, from time to time, act as the operative constraint in determining the level of additional funding requirements, thereby causing the solvency ratio to rise above what it would otherwise have been, had the form of assets matching capital resources not been a constraint. Movestic's solvency ratio declines as the increasing scale of its business requires a higher level of regulatory capital as the ratio approaches 150%, further planned capital contributions will be made by the Group.

Insurance Groups Directive

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

	31 December	
	2010	2009
	£m	£m
Available group capital resources	121 2	99 7
Group regulatory capital requirement	(60 6)	(31 6)
Excess	<u>60 6</u>	<u>68 1</u>
Cover	<u>200%</u>	<u>316%</u>

The fall in the ratio, which remains considerably in excess of the regulatory requirement of at least 100%, reflects the anticipated dilutive effect of the S&P acquisition.

Individual Capital Assessments

The FSA Prudential Sourcebooks require UK insurance companies to make their own assessment of their capital needs to a required standard (a 99.5% probability of being able to meet liabilities to policyholders after one year). In the light of scrutiny of this assessment, the FSA may impose its own additional individual capital guidance. The Individual Capital Assessment (ICA) is based on a realistic liability assessment, rather than on the statutory mathematical reserves, and involves stress testing the resultant realistic balance sheet for the impact of adverse events, including such market effects as significant falls in equity values, interest rate increases and decreases, bond defaults and further widening of bond spreads.

CA completed a further full annual assessment during 2010 as a result of which it was concluded that the effective current and medium-term capital requirement constraints on distributions to Chesnara will continue to be on the basis set out under 'Regulatory capital resources and requirements' above. This assessment is subject to quarterly high-level updates until the next full annual assessment.

S&P plans to complete a full annual ICA, based on the position as at 31 December 2010, during May 2011. It is not expected that this will lead to a requirement to hold regulatory capital higher than that set out under 'Regulatory Resources and Requirements' above.

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

International Reporting Developments

Over the year, we have continued to monitor developments in the EU Solvency II framework which will impact the UK and Swedish businesses. We have established a Steering Group to oversee our implementation of the regulations, which are due to become effective on 1 January 2013. Besides ensuring that there are robust processes for the calculation of technical reserves and solvency capital, the implementation will embrace wide-ranging changes in risk management processes on a Group-wide basis. In the meantime, we have continued internal quantitative analysis and are currently formulating a detailed implementation plan.

During 2010 the IASB issued an Exposure Draft relating to Insurance Contracts to which we responded. We will continue to monitor progress on this significant IFRS development.

In June 2008, the European Insurance CFO Forum (CFO Forum) issued the European Insurance CFO Forum Market Consistent Embedded Value (MCEV) Principles. These principles, with which we had intended to comply with effect from 2009, represent a development of the existing European Embedded Value (EEV) principles issued by the same Forum, which form the current basis of preparation of our Supplementary Information – European Embedded Value Basis as set out in Note 1 to the Supplementary Information on page 156. However, on 22 May 2009, the CFO Forum announced that the mandatory MCEV reporting date for all its member firms would be deferred until 2011, in light of developments arising from the recent financial crisis. We will consider compliance with these principles during 2011.

Capital Structure, Treasury Policy and Liquidity

The Group's UK operations are ordinarily financed through retained earnings and through the current emergence of surplus in the UK life businesses. Movestic is financed by a combination of financial reinsurance arrangements and capital contributions from Chesnara. With respect to acquisitions the Group seeks to finance these through a suitable mix of debt and equity, within the constraints imposed by the operation of regulatory rules over the level of debt finance which may be borne by Insurance Groups. The acquisition of S&P in December 2010 for £63.5m was accomplished by way of debt/equity financing broadly in a ratio of 2:1. This has introduced a modest level of gearing to the structure of Group financing.

The Board continues to have a conservative approach to the investment of shareholders' funds in the UK life businesses, which underpins our strong solvency position. For the UK businesses, where the greater part of shareholders' funds subsist, this approach targets the investment of 100% of available funds in cash and fixed interest securities. In the light of recent volatility in financial markets, particular attention is given to the mix and spread of these investments to ensure that we are not unduly exposed to particular sectors and that our counterparty limits are strictly adhered to. Cash available for more than twelve months in the UK is normally transferred to fund managers for longer-term investment.

Current economic conditions heighten the risk of corporate bond default and observations on this are made in the 'Going Concern' section below.

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

Other factors which may place a demand on capital resources in the future include the costs of unavoidable large scale systems development such as those which may be involved with changing regulatory requirements. To the extent that ongoing administration of the UK life businesses is performed within the terms of its third party outsourcing agreements, the Group is sheltered, to a degree, from these development costs as they are likely to be on a shared basis.

Cash Flows

The Group's longer-term cash flow cycle continues to be characterised by the strong inflow to shareholders' funds of transfers from the long-term insurance fund of CA, which is supported by the emergence of surplus within that fund. These flows are used (i) to repay our debt obligations as set out in Note 36 of these financial statements, (ii) to support dividend distributions to shareholders, and (iii) to support the medium-term requirements of Movestic to meet regulatory solvency capital requirements as it expands.

Going Concern

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

The information set out in 'Solvency and Regulatory Capital' above indicates a strong solvency position as at 31 December 2010 as measured at both the individual regulated life company levels in both the UK and Sweden and at the Group level. In addition, in respect of CA, a Financial Condition Report and a detailed annual Individual Capital Assessment have been prepared, as also set out above. These include assessments of the ability of the business to withstand key events, including increased rates of policy lapse, expense overruns and unfavourable investment market conditions. The assessments indicate that CA is able to withstand the impact of these adverse scenarios, including the effect of continuing significant investment market falls, while the business's outsourcing arrangements protect it from significant expense overruns. As also indicated above, the current assessment of the risk-based capital requirements of Movestic indicates a comfortable excess of capital resources over those requirements.

Notwithstanding that the Group is well capitalised, the current financial and economic environment continues to present specific threats to its short-term cash flow position and it is appropriate to assess other relevant factors. In the first instance, the Group does not rely on the renewal or extension of bank facilities to continue trading – indeed, as indicated, its normal operations are cash generative. The Group does, however, rely on cash flow from the maturity or sale of fixed interest securities which match its obligations to its Guaranteed Bond policyholders. In the current economic environment there remains a continuing higher risk of bond default, particularly in respect of financial institutions. In order to manage this risk we ensure that our bond portfolio is actively monitored and well diversified. However, this risk has continued to abate through 2010 as our underlying bond obligations to policyholders continued to mature. Other significant counterparty default risk relates to our principal reinsurer Guardian Assurance plc ('Guardian'). We monitor Guardian's financial position and are satisfied that any associated credit default risk is low.

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

Risk and Risk Management

Risk management processes

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

In both the UK and Swedish businesses we maintain processes for identifying, evaluating and managing the significant risks faced by the Group, which are regularly reviewed by the Audit and Risk Committee. Our risk processes have regard to the significance of risks, the likelihood of their occurrence and take account of existing controls and the cost of mitigating them. The processes are designed to manage rather than eliminate risk and, as such, provide reasonable, but not absolute, assurance against loss.

At the subsidiary level in the UK businesses we maintain, in accordance with the regulatory requirements of the FSA, a risk and responsibility regime. Accordingly, the identification, assessment and control of risk are firmly embedded within the organisation and the procedures for the monitoring and updating of risk are robust. As part of this we have established Risk Committees in CA plc and in the S&P companies, which comprise solely of Non-executive Directors. These committees receive quarterly updates of the key risk registers, as maintained by the senior management, for review and challenge. The committees report directly to their respective subsidiary's Board, the related reports being also reviewed by the Chesnara Audit and Risk Committee on a quarterly basis. The key risk registers have been designed to complement the production of Individual Capital Assessments, which we are required to submit to the FSA on request and maintain on an ongoing basis. We categorise all risks against the following relevant categories – insurance, market, credit, liquidity, operational and group – and identify potential exposures and the necessary capital requirements accordingly.

In the Swedish business, at the subsidiary Movestic Liv level, there is full compliance with the regulatory requirement that its Board and Managing Director have responsibility for ensuring that the management of the organisation is characterised by sound internal control, which is responsive to internal and external risks and changes in them. The Board has responsibility for ensuring that there is an internal control risk function, which is charged with (i) ensuring that there is information which provides a comprehensive and objective representation of the risks within the organisation and (ii) proposing changes in processes and documentation regarding risk management. These obligations are evidenced by regular compliance, internal audit, general risk and financial risk reports to the Movestic Liv Board. The latter is supplemented by quarterly returns to the Swedish regulator, Finansinspektionen, which set out estimated capital requirements in respect of insurance, market, credit, liquidity, currency and operational risks.

Risk management processes are enhanced by stress and scenario testing, which evaluates the impact on the Group of certain adverse events occurring separately or in combination. There is a strong correlation between these adverse events and the risks identified in 'principal risks and uncertainties' below. The outcome of this testing provides context against which the Group can assess whether any changes to its risk management processes are required.

In accordance with the need to comply with the requirements of Solvency II on an EU-wide basis, we are currently reviewing and upgrading our risk management processes, so that Group-wide they will be enhanced in a uniform and consistent manner, embracing

- articulation of risk appetite statements, following from documented strategic objectives,
- formulation and monitoring of associated risk metrics,
- risk identification and assessment,
- calculation of risk-based capital, and
- the embedding of risk management processes so that they are at the forefront of and underpin strategic and operating decisions.

These developments continue through 2011 and will be completed by the end of 2012.

Principal risks and uncertainties

Risk and uncertainties are assessed by reference to the extent to which they threaten, or potentially threaten, the ability of the Group to meet its core strategic objectives. These currently centre on the intention of the Group to maintain a reliable and progressive dividend policy.

The specific principal risks and uncertainties subsisting within the Group are determined by the fact that

- (i) the Group's core operations centre on the run-off of closed life and pensions businesses in the UK,
- (ii) notwithstanding this, the Group has a material segment, which comprises an open life and pensions business operating in a foreign jurisdiction, and

- (iii) these businesses are subject to local regulation, which significantly influences the amount of capital which they are required to retain and which may otherwise constrain the conduct of business

The following identifies the principal risks and uncertainties, together with a description of their actual or potential impact and of the way in which the Group seeks to control them. Insurance and financial risks relating to (i) insurance and investment contracts provided by the Group to policyholders and to investors and to (ii) Group-level investment activities are set out in Notes 5 and 6 to the IFRS financial statements, where the information is provided on a segmented basis. The analysis below includes a re-presentation of the more significant risks identified therein on a generic basis.

Risk	Impact	Control
Adverse mortality/morbidity/longevity experience	The Group provides benefits to policyholders in the event of death or illness and to annuitants for their lifetime. Premiums are partly fixed by reference to mortality/morbidity tables. To the extent that actual mortality or morbidity rates vary from the assumptions underlying product pricing, so more or less profit will accrue to the Group.	The group uses underwriting techniques, reinsurance programmes and limits on levels of accepted risk on individuals, in order to control the overall level of risk. The Group has also retained the right on certain contracts to vary premium rates in the light of actual experience. Notwithstanding this, the Group is exposed to the possible effects of pandemics, such as AIDS and SARS. The impact of overall mortality risk is mitigated to the extent that the Group has a portfolio of annuity contracts where the benefits cease on death.
Adverse persistency experience	Persistency risk is the risk that insurance policyholders or investors in investment contracts either discontinue paying new premiums or investing new sums, or otherwise exercise their rights to discontinue the contracts. Persistency rates significantly lower than those assumed will lead to reduced Group profitability in the medium to long term.	The Group's exposure to persistency risk is naturally limited to the extent that, in closed life and pensions books, which currently continue to comprise the larger part of the Group's business, persistency rates tend to improve over time due to policyholder/investor inertia. The Group otherwise promotes retention through (i) active review of the management of, and returns arising on, policyholder investment funds and (ii) maintaining customer retention units.
Expense overruns	For the closed UK life and pensions businesses, the Group is exposed to the impact of fixed and semi-fixed expenses, in conjunction with a diminishing policy base, on profitability. For the Swedish open life and pensions business, the Group is exposed to the impact of expense levels varying adversely from those assumed in product pricing.	For the UK businesses, the Group pursues a strategy of outsourcing functions, to the fullest extent possible, to specialist outsourced services providers. It seeks to do this on pricing terms which recognise the diminishing policy base and which, in respect of contract renewal, seeks to maintain competitive tension between service providers. For the Swedish business, periodic reviews are conducted to ensure that overall expense levels are appropriate, based on activity analysis and on medium-term projections. In addition, for both the UK and Swedish businesses, the Group maintains a strict regime of budgetary control.
Significant and prolonged equity and property market falls	A significant part of the Group's income and, therefore, overall profitability derives from fees received in respect of the	Notwithstanding that individual fund mandates may give rise to diversification of risk and that, within those funds, hedging

	management of policyholder and investor funds. Fee levels are generally related to the value of funds under management and, as the managed investment funds overall comprise a significant equity and property content, the Group is particularly exposed to the impact of significant and prolonged equity market falls.	techniques are used where appropriate, there is clearly a significant residual risk to adverse global equity market conditions. The Group has taken the explicit decision not to mitigate the residual risk, by way of hedging, because of the significant cost relative to the risk it does, however, periodically review the costs of hedging.
Adverse movements in yields on fixed interest securities	The Group maintains portfolios of fixed interest securities (i) in order to match its insurance contract liabilities, in terms of yield and cash flow characteristics, and (ii) as an integral part of the investment funds it manages on behalf of policyholders and investors. It is exposed to mismatch losses arising from a failure to match its insurance contract liabilities or from the fact that sharp and discrete fixed interest yield movements may not be associated fully and immediately with corresponding changes in actual valuation interest rates.	The Group maintains rigorous matching programmes to ensure that exposure to mismatch loss is minimised. There may be some reversal of the extent of loss through the natural effluxion of time as dated securities approach their redemption date. The Group does not seek to hedge against adverse movements in fixed interest securities, as the cost is prohibitive when compared with the residual risk. The proportion of fixed interest securities in policyholder and investor managed funds is significantly less than the proportion of equities.
Adverse sterling Swedish Krona exchange rate movements	The Swedish business, whose functional and reporting currency is the Swedish Krona, is a material part of the Group. Exposure to adverse sterling/Swedish Krona exchange rate movements arises from actual planned cash flows between the Swedish subsidiary and its UK parent company and from the impact on reported IFRS and EEV results which are expressed in sterling.	The Group actively monitors exchange rate movements and the cost of hedging the currency risk on cash flows when appropriate. The Group does not seek to hedge the risk of adverse currency movements on its reported results.
Counterparty failure	The Group carries significant inherent risk of counterparty failure in respect of, - its fixed interest security portfolio, - cash deposits, and - amounts due from reinsurers	Risk to counterparty failure is mitigated generally by the operation of guidelines which limit the level of exposure to any one counterparty and which impose limits on exposure to credit ratings. In respect of exposure to one major reinsurer, Guardian Assurance plc ('Guardian'), the Group has a floating charge over the reinsurer's related investment assets, which ranks the Group equally with Guardian's policyholders. In addition, the Group reviews the regulatory returns filed by Guardian, in order to identify issues which may arise in connection with the financial viability of Guardian.
Failure of outsourced service providers to fulfil contractual obligations	The Group's UK life and pensions businesses are heavily dependent on outsourced service providers to fulfil a significant number of their core functions. In the event of failure by either or both service providers to fulfil their contractual obligations, in whole or in part, to the requisite standards specified in	The Group specifies rigorous service level measures and management information flows under its contractual arrangements. Following from this, the Group maintains continuing and close oversight of the performance of both service providers. Under the terms of the contractual

	the contracts, the Group may suffer loss as its functions degrade	arrangements the Group may impose penalties and/ or exercise step-in rights in the event of specified adverse circumstances
Key Man dependency	The nature of the Group is such that, for both its Group-level functions and for its UK life and pensions operations, it relies on a small, professional team. There is, therefore, inevitably a concentration of experience and knowhow within particular key individuals and the Group is, accordingly, exposed to the sudden loss of the services of these individuals.	The Group promotes the sharing of knowhow and expertise to the fullest extent possible. It periodically reviews and assesses staffing levels, and, where the circumstances of the Group justify and permit, will enhance resource to ensure that knowhow and expertise is more widely embedded. To minimise the risk of knowledge loss, the Group maintains succession plans and remuneration structures which comprise a retention element. Should a skills gap appear the Group seeks to utilise external resource until such time as a permanent solution can be identified. These processes are supplemented by the maintenance of procedures to assess the competence of, and training requirements for, all key individuals.
Adverse regulatory and legal changes	The Group operates in jurisdictions which are currently subject to significant change arising from regulatory and legal requirements. These may either be of a local nature, or of a wider nature, following from EU-based regulation and law. Significant issues which have arisen and where there is currently uncertainty as to their full impact on the Group include: (i) review of the UK tax regime in respect of life assurance business, (ii) review of the tax treatment of fees rebated by investment fund managers to Movestic, (iii) the implementation of Solvency II requirements, (iv) the implications of a ruling made by the ECJ, applicable to insurance companies, in connection with gender, and (v) the impact of IFRS Insurance Accounting Phase 2 developments. The outcomes of these issues may variously impact the level of reported profitability in the Group and the capacity and capability of its life and pensions subsidiaries to distribute regulatory-determined surpluses. Further information in connection with item (iv) is provided in Note 55.	The Group controls these risks and addresses the related uncertainties by assessing potential outcomes and by taking appropriate action to minimise the impact of adverse circumstances. It monitors industry comment and takes specialist professional advice, where necessary. It is in the nature of these issues, however, particularly in those areas where specific regulatory rules and/or law have not yet been framed and implemented, that there remains significant uncertainty as to their impact on the Group's longer-term profitability and on the capacity and capability of its life and pensions subsidiaries to distribute regulatory determined surpluses.

Corporate and Social Responsibility Statement

Chesnara takes its responsibilities for social and environmental issues seriously and recognises the importance of developing and maintaining high standards. We do not, however, consider that these aspects are critical to the achievement of our strategic aims or that they should form any significant element of remuneration or reward.

Equal opportunities

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

Disabled employees

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

Health, safety and welfare at work

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

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

Social, environmental and ethical issues

Chesnara aims to be sensitive to the cultural, social and economic needs of our local community and endeavours to protect and preserve the environment where it operates. To support this we allow each of our UK employees two days release on full pay each year where they can support a local charity project of their choice.

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

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

Chesnara plc

Financial Statements for the Year Ended 31 December 2010

Corporate Governance

	Page
(1) Board of Directors	35
(2) Directors' Report	36
(3) Corporate Governance Report	38
(4) Remuneration Report	44

Board of Directors

Peter Mason was appointed as Chairman of Chesnara plc and Chairman of the Nomination Committee on 1 January 2009. He was re-appointed as a member of the Remuneration and Audit & Risk Committees with effect from 22 December 2009 and was appointed as Chairman of Movestic Livforsakning AB with effect from 23 July 2009. He was also appointed as Chairman of the Boards of the S&P companies with effect from 20 December 2010. He is currently a Non-executive Director of Homeowners Friendly Society and is the Investment Director and Actuary of Neville James Group, an investment management company. He was admitted as a Fellow of the Institute of Actuaries in 1979.

Graham Kettleborough is the Chief Executive of Chesnara plc. He joined Countrywide Assured plc in July 2000 with responsibility for marketing and business development and was appointed as Managing Director and to the Board in July 2002. He was appointed as a Non-executive Director of Movestic Livforsakning AB and as Chairman of Movestic Kapitalforvaltning AB with effect from 23 July 2009. He was also appointed as Managing Director of the S&P companies with effect from 20 December 2010. Prior to joining Countrywide Assured plc, he was Head of Servicing and a Director of the Pension Trustee Company at Scottish Provident. He has lifetime experience in the financial services industry, primarily in customer service, marketing, product and business development, gained with Scottish Provident, Prolific Life, City of Westminster Assurance and Target Life.

Ken Romney is the Finance Director of Chesnara plc. He joined Countrywide Assured plc in 1989 and became a member of the Board in 1997. He was also appointed as Finance Director of the S&P companies with effect from 20 December 2010. He has worked in the life assurance industry for the last 27 years. He was Chief Accountant at Laurentian Life (formerly Imperial Trident) up to 1987 and was Financial Controller at Sentinel Life between 1987 and 1989. He worked for Price Waterhouse in their audit division until 1983 in both the UK and South Africa. He is a Fellow of the Institute of Chartered Accountants in England and Wales.

Frank Hughes is the Business Services Director of Chesnara plc. He joined Countrywide Assured plc in November 1992 as an IT Project Manager and was appointed to the Board as IT Director in May 2002. He has 26 years' experience in the life assurance industry gained with Royal Life, Norwich Union and CMG.

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

Terry Marris is an Independent Non-executive Director of Chesnara plc and serves on the Audit & Risk Committee, the Remuneration Committee and the Nomination Committee. He was also appointed as a Non-executive Director of the S&P companies with effect from 21 January 2011. He joined Countrywide Assured Group plc in 1992 and was Managing Director of Countrywide Assured plc until July 2002. Previous roles included senior management positions at Lloyds Bank and General Accident.

Peter Wright is an Independent Non-Executive Director who was appointed to the Chesnara plc Board on 1 January 2009. At the same date he was appointed as Chairman of the Audit & Risk Committee and as a member of the Remuneration Committee. He was appointed as a member of the Nomination Committee with effect from 9 July 2009. He was also appointed as a Non-executive Director of the S&P companies with effect from 20 December 2010 and as Chairman of the Risk Committees and With-profits Committees of those companies. He retired as a Principal of Towers Perrin on 1 January 2008 and is a former Vice President of the Institute of Actuaries, having been admitted as a Fellow in 1979.

Directors' Report

Chesnara plc - Company No. 4947166

The Directors present their report and the audited consolidated accounts of Chesnara plc ('Chesnara') for the year ended 31 December 2010. The Corporate Governance Report on pages 38 to 43 forms part of the Directors' Report.

Business Review

The information which fulfils the Companies Act requirements for a Business Review can be found in the following sections:

Strategic aims and how we achieve our strategic aims	The Background, Strategy and Business Model section on pages 9 to 13
Principal risks and uncertainties	The Risk and Risk Management section on pages 29 to 32
Performance and development during the year and position at the end of the year	The Chief Executive's Statement on page 15 and the Financial Review on pages 20 to 28
Likely future developments	The Chief Executive's Statement on page 15
Financial and non-financial KPIs	The Key Performance Indicators section on pages 16 to 19
Environmental, employee and social community matters	The Corporate and Social Responsibility Statement on page 33

Results and Dividends

The Group consolidated statement of comprehensive income for the year ended 31 December 2010, prepared in accordance with International Financial Reporting Standards and set out on page 54, shows:

	2010 £000	2009 £000
Profit for the year attributable to shareholders	29,819	45,940

An interim dividend of 5.8p per ordinary share was paid by Chesnara on 12 October 2010. The Board recommends payment of a final dividend of 10.6p per ordinary share on 20 May 2011 to shareholders on the register at the close of business on 8 April 2011.

Directors

The present Directors of the Company and their biographical details are set out on page 35. All of those Directors served for the period from 1 January 2009 to 31 December 2010. There have been no changes in the Directorate between 31 December 2010 and 30 March 2011.

The Non-executive Directors who served as Chairmen and members of the Nominations and Audit & Risk Committees of the Board are set out in the Corporate Governance Report on pages 38 to 43. Information in respect of the Chairman and members of the Remuneration Committee and in respect of Directors' service contracts is included in the Remuneration Report on pages 44 to 50, which also includes details of Directors' interests in shares and share options.

Pursuant to the Articles of Association, Mike Gordon and Terry Marns will retire by rotation at the Annual General Meeting and, being eligible, offer themselves for re-election. No Director seeking re-election has a service contract with the Company of more than one year's duration. In addition, no Director had any material interest in any significant contract with the Company or with any of the subsidiary companies during the year.

The Directors benefited from qualifying third party indemnity provisions in place during the years ended 31 December 2009 and 31 December 2010 and the period to 30 March 2011.

Substantial shareholdings

The following substantial interests in the Company's ordinary share capital at 31 December 2010 have been notified to the Company:

Name of substantial shareholder	Total number of ordinary shares held	Percentage of the issued share capital as at 31 December 2010
Amerprise Financial, Inc. (Threadneedle Asset Management)	12,642,746	11.01
Henderson Global Investors Limited	6,525,771	5.68
Legal and General Group	4,130,698	3.60
Standard Life Investments Limited	3,864,029	3.36

Norges Bank

3,893,220

3 38

There has been one change to the position since 31 December 2010 and the revised holding is shown below. No other person holds a notifiable interest in the issued share capital of the Company.

Name of substantial shareholder	Total number of ordinary shares held	Percentage of the issued share capital
		as at 30 March 2011
Amerprise Financial, Inc (Threadneedle Asset Management)	12,590,725	10.96

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

Charitable donations and political contributions

Charitable donations made by Group companies during the year ended 31 December 2010 were £nil (2009: £nil). No political contributions were made during the year ended 31 December 2010 (2009: £nil).

Employees

The average number of employees during the year was 150 (2009: 51).

Creditors payment policy

It is Chesnara's policy to pay creditors in accordance with the CBI Better Practice Payment Code (available at www.payontime.co.uk) on supplier payments. The number of creditor days outstanding at 31 December 2010, based on the consolidated financial statements, was 22 for the Group (2009: 1) and for the Company 67 (2009: 3).

Going concern statement

After making appropriate enquiries, the Directors confirm that they are satisfied that the Company and the Group have adequate resources to continue in business for the foreseeable future. Accordingly, they continue to adopt the going concern basis in the preparation of the financial statements as stated in Note 2(c) to the financial statements. Detailed analysis of relevant risks and other factors is included within the Risk and Risk Management section in pages [] to [] and within the sections headed 'Going Concern', 'Capital Structure, Treasury Policy and Liquidity' and 'Cash Flows' within the Financial Review in pages [] to [] and within Notes 5 and 6 to the IFRS financial statements.

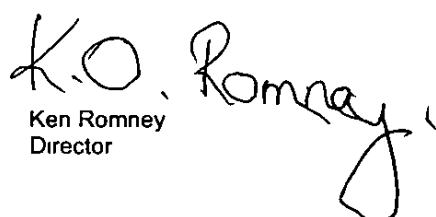
Disclosure of information to Auditor

The Directors who held office at the date of approval of this Directors' Report confirm that, so far as they are each aware, there is no relevant audit information of which the Company's Auditor is unaware, and each Director has taken all the steps that they ought to have taken as a director to make themselves aware of any relevant audit information and to establish that the Company's Auditor is aware of that information. This information is given and should be interpreted in accordance with the provisions of section 418 of the Companies Act 2006.

Auditor

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

Approved by the Board on 30 March 2011 and signed on its behalf by


Ken Romney
Director

Corporate Governance Report

The Directors are committed to achieving a high standard of corporate governance including compliance with the principles and practices of the UK corporate Governance Code (the 'Code'), as published by the Financial Reporting Council in June 2010 and as appended to the Listing Rules

The following statement, together with the Remuneration Report on pages 44 to 50, describes how the principles set out in the Code have been applied by the Company and details the Company's compliance with the Code's provisions for the year ended 31 December 2010

Compliance with the Code

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

The Board

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

Biographical details of all Directors are given on page 35. The Board, which plans to meet eight times during the year, has a schedule, which it reviews annually, of matters reserved for its consideration and approval. These matters include

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

In addition

- (i) the Directors of the Company are also Directors of Countrywide Assured plc ('CA'), one of the three UK subsidiary companies in which the UK-based life and pensions business of the Group subsists. Under FSA Prudential Regulation the Directors of CA have responsibility for maintenance and projections of solvency and for assessment of capital requirements, based on risk assessments, and for establishing the level of long-term business provisions, including the adoption of appropriate assumptions,
- (ii) five Directors of the Company, being Messrs Mason, Wright, Kettleborough, Marris and Romney, are also Directors of Save & Prosper Insurance Limited and its subsidiary company, Save & Prosper Pensions Limited (together 'S&P'), the other principal subsidiary companies in which the UK-based life and pensions business of the Group subsists. Save & Prosper Insurance Limited, and its subsidiary, were acquired by Chesnara plc on 20 December 2010 and the five directors were all appointed on that date. Under FSA Prudential Regulation the Directors of S&P have responsibility for maintenance and projections of solvency and for assessment of capital requirements, based on risk assessments, and for establishing the level of long-term business provisions, including the adoption of appropriate assumptions,
- (iii) three Directors of the Company, being Messrs Mason, Kettleborough and Gordon, are also Directors of Movestic Livförsäkring AB ('Movestic'), previously known as Moderna Försäkringar Liv AB, the principal subsidiary company in which the Swedish-based life and pensions business of the Group subsists. Under regulation by Finansinspektionen, the Directors of Movestic have responsibility for ensuring that Movestic complies with regulatory solvency requirements

The responsibilities that the Board has delegated to the respective Executive Managements of the UK and Swedish businesses include the implementation of the strategies and policies of the Group as determined by the Board, monitoring of operational and financial results against plans and budget, prioritising the allocation of capital, technical and human resources and developing and managing risk management systems

The Roles of the Chairman and Chief Executive

The division of responsibilities between the Chairman of the Board, Peter Mason, and the Chief Executive, Graham Kettleborough, is clearly defined and has been approved by the Board. The Chairman leads the Board in the determination of its strategy and in the achievement of its objectives and is responsible for organising the business of the Board, ensuring its effectiveness and setting its agenda. The Chairman has no day-to-day

involvement in the management of the Group. The Chief Executive has direct charge of the Group on a day-to-day basis and is accountable to the Board for the financial and operational performance of the Group.

Senior Independent Director

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

Directors and Directors' Independence

The Board considers that Peter Mason was independent on his appointment as Chairman on 1 January 2009. In making this determination, the Board has carefully considered the fact that he is also a Non-executive Director of Countrywide Assured plc, a position which he has held since 1 October 1990, and a Non-executive Director of Countrywide Assured Life Holdings Limited ('CALHL'), the parent company of Countrywide Assured plc, a position he has held since 18 November 1991.

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

- (i) Terry Marns had, within five years of his appointment, been an employee of a subsidiary company within the CALHL Group, which was acquired by the Company on 24 May 2004. He also held the position of Managing Director of Countrywide Assured plc, the principal operating life assurance subsidiary of CALH prior to the acquisition of CALH by the Company. He resigned these positions in July 2002, and
- (ii) Peter Wright had, within the last three years prior to his appointment, served as Head of Actuarial Function of Countrywide Assured plc and has otherwise provided actuarially-based consultancy advice, the relevant services being provided under an agreement with his employer at the time, Tillinghast Towers Perrin.

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

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

The Board is satisfied that the overall balance of the Board continues to provide significant independence of mind and judgement and further considers that, taking the Board as a whole, the Independent Directors are of sufficient calibre and number that their views carry significant weight in the Company's decision making.

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

Details of the Chairman's professional commitments are included in his biography on page 35. The Board is satisfied that these are not such as to interfere with his performance, which is based around a commitment of between fifty and sixty hours in any three-month period.

Professional Development

The Directors were advised, on their appointment, of their legal and other duties and obligations as Directors of a listed Company. This has been supplemented by the adoption and circulation to each Director of a written Code of Conduct, covering all aspects of the specific operation of Corporate Governance standards and of policies and procedures within the Group. Throughout their period in office, the Directors have, through the conduct of business at scheduled Board meetings, been continually updated on the Group's business and on the competitive and regulatory environment in which it operates. Through their membership of the CA Board all of the Directors who served during the period under review have considerable knowledge and experience of the UK-based businesses of the Chesnara plc Group. Similarly, Messrs Mason, Kettleborough and Gordon, through their membership of the Movestic Board, have considerable knowledge and experience of the Swedish-based business of the Group.

Information

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

As stated above, the Company's Directors are also variously members of the Boards of CA, S&P and Movestic. These Boards hold scheduled quarterly meetings, which are serviced by detailed regular reports and information, which cover all of the key areas relevant to the direction and operation of that subsidiary including

For CA and S&P

- Earnings report,
- Report from the Actuanal Function Holders and With-profits Actuary,
- Compliance report,
- Investment report, and
- Outsourcing reports

CA monitors risk management procedures, including the identification, measurement and control of risk through the offices of a Risk Management Committee. This committee is accountable to and reports to its Board on a quarterly basis. In addition, annual reports are produced which cover an assessment of the capital requirements of the life assurance subsidiary, its financial condition and a review of its internal financial and business controls. Following the acquisition by the Group of S&P on 20 December 2010, similar processes regarding risk management are being introduced into S&P.

For Movestic

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

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

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

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

Performance Evaluation

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

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

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

Company Secretary

The Company Secretary is responsible for advising the Board, through the Chairman, on all governance matters. For the period under review, Ken Romney held the position of Company Secretary until 21 October 2010 when Mary Fishwick was appointed to that role. The Directors have access to the advice and services of the Company Secretary.

Board Committees

The Board has established the committees set out below to assist in the execution of its duties. Each of these committees operates according to written terms of reference and the Chairman of each committee reports to the Board. The constitution and terms of reference of each committee are reviewed annually to ensure that the

committees are operating effectively and that any changes considered necessary are recommended to the Board for approval. During the year the terms of reference of all the committees were reviewed and changes made, where required, to reflect updated guidance on corporate governance. In addition, the Audit Committee was re-designated as the Audit & Risk Committee to ensure that additional focus was placed on risk management at the parent company level and specific responsibilities were included in the terms of reference to that end. The terms of reference of each committee are available on the Company's website at www.chesnara.co.uk or, upon request, from the Company Secretary.

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

	Scheduled Board	Nomination Committee	Remuneration Committee	Audit & Risk Committee
Peter Mason - Non-executive Chairman	8 (8)	2 (2)	2 (2)	5 (5)
Terry Marrs - Non-executive Director	8 (8)	2 (2)	2 (2)	5 (5)
Mike Gordon - Non-executive Director	7 (8)	2 (2)	2 (2)	4 (5)
Peter Wright - Non-executive Director (from 1 January 2009)	8 (8)	2 (2)	2 (2)	5 (5)
Graham Kettleborough - Executive Director	8 (8)	n/a	n/a	n/a
Ken Romney - Executive Director	8 (8)	n/a	n/a	n/a
Frank Hughes - Executive Director	8 (8)	n/a	n/a	n/a

The figures in brackets indicate the maximum number of meetings in the period during which the individual was a Board or Committee member. The information above relates to the period from 1 February 2010 to 31 January 2011.

Nomination Committee

During the whole of the period under review, the Nomination Committee comprised Peter Mason who also served as Chairman of the Committee, Terry Marrs, Mike Gordon and Peter Wright.

The Committee considers the mix of skills and experience that the Board requires and seeks the appointment of Directors to ensure that the Board is effective in discharging its responsibilities.

During the period, the Committee met twice and considered the continuing mix of skills and experience of the Directors.

Remuneration Committee

Full details of the composition and work of the Remuneration Committee are provided in the Remuneration Report on pages 44 to 50.

Audit & Risk Committee

During the period under review, the Audit & Risk Committee comprised Peter Wright (Chairman), Mike Gordon and Terry Marrs, as independent Non-executive Directors and Peter Mason. The Board considered updated corporate governance requirements with regard to the creation of a separate Risk Committee at Group level but decided that such a structure was inappropriate for the Group. Instead, the Audit Committee's responsibilities were extended to include an increased focus on risk and risk management and the Committee was renamed the Audit and Risk Committee. On invitation, the Chief Executive, the Finance Director, the Head of Internal Audit and the external Auditor attend meetings to assist the Committee in the fulfilment of its duties. The Committee met five times during the period under review.

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

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

- reviewing the Group's draft Financial Statements prior to Board approval and reviewing the external Auditor detailed reports thereon, in respect of the half year ended 30 June 2010 and the year ended 31 December 2010,
- reviewing the appropriateness of the Group's accounting policies,

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

Auditor Independence and Objectivity

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

Audit-related services

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

Tax advice

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

General advice

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

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

Details of the fees paid to the external Auditor, and its associates, for both audit and non-audit services during the year are provided in Note 15 to the financial statements.

Relations with Shareholders

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

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

Regular meetings are also held with industry analysts and commentators so that they are better informed in formulating opinions and making judgements on the Group's performance. Private investors are encouraged to attend the Annual General Meeting ('AGM') at which the opportunity is provided to ask questions on each proposed resolution. The Chairmen of the Board Committees will be available to answer such questions as appropriate. Details of the resolutions to be proposed at the AGM on 17 May 2011 can be found in the notice of the meeting on pages 169 to 184.

Internal Control

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

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

In accordance with the regulatory requirements of the FSA, CA has established and maintained a risk and responsibility regime. This ensures that the identification, assessment and control of risk are firmly embedded within the organisation and that there are procedures for monitoring and update of the same. The CA Risk Management function reviews and reports quarterly on this regime to the CA Board. This process is supplemented by the establishment and maintenance of key risk registers for both CA and for the Company, which ensure that, against various appropriate classes of risk, there is identification, assessment and control of the significant risks subsisting within these organisations. The maintenance of the key risk registers is the responsibility of executive management, who respectively report on them quarterly to the CA Risk Committee and to each Chesnara Audit & Risk Committee meeting. Following the acquisition by Chesnara plc of S&P on 20 December 2010, similar processes are being introduced into S&P.

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

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

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

As stated above, all of the Chesnara Directors are also members of the CA Board and the Company thereby has effective oversight of the maintenance and effectiveness of controls subsisting within CA. As to S&P, five of the Chesnara directors are also members of the S&P Boards, providing oversight as for CA. Regarding Movestic, such oversight is exercised by way of the membership of three of the Company's Directors of the Movestic Board, together with quarterly reporting by Movestic to the Chesnara Audit & Risk Committee.

In addition, the Chesnara Board confirms that it has undertaken a formal annual review of the effectiveness of the system of internal control for the year ended 31 December 2010 and that it has taken account of material developments between that date and the date of approval of the Annual Financial Statements. The Board confirms that these reviews took account of reports by the internal audit functions on the operation of controls, internal financial controls, management assurance on the maintenance of controls and reports from the external Auditor on matters identified in the course of statutory audit work.

The Board also confirms the continuing appropriateness of the maintenance of a Group Internal Audit Function, which reports to the Chairman of the Audit & Risk Committee.

Going Concern

The Directors' Statement on Going Concern is included in the Directors' Report on page 27.

Remuneration Report

The Remuneration Committee

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

During the period under review the Committee comprised of the Non-executive Directors Mike Gordon (who also acted as Chairman), Peter Wright, Terry Marns and Peter Mason, who is Chairman of the Group. The Company Secretary, Mary Fishwick, acts as Secretary to the Committee, and provides advice on legal and regulatory issues relating to remuneration policy. At the request of the Committee, Graham Kettleborough, the Chief Executive, also attends and makes recommendations to the Committee regarding changes to the remuneration packages of individual Directors (excluding himself) or to policy generally. Such recommendations are discussed by the Committee and adopted or amended as it sees fit. No Director is present at any part of the Committee meeting at which his own remuneration or contractual terms are being discussed. The membership and terms of reference of the Committee are reviewed annually and the terms of reference are available on the Company's website at www.chesnara.co.uk or, upon request, from the Company Secretary. Details of the number of meetings held and the attendance can be found in the Corporate Governance Report on page 38.

Remuneration Policy

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

The Committee also receives updates on pay and employment conditions applying to other Group employees; these are taken into consideration when setting Executive Directors' remuneration, consistent with the Group's general aim of seeking to reward all employees fairly according to the nature of their role, their performance and market forces, as demonstrated by the Company's intended offering under the Sharesave Plan (see further below).

The Company has in place the Annual Bonus Scheme and the Current Long-Term Incentive Plan, which are designed to incentivise and retain the Executive Directors. These bonus schemes, which are cash-based, reward the achievement of corporate targets set for the year and are therefore aligned with the delivery of value to shareholders. Neither the benefits under the Annual Bonus Scheme nor those under the Current Long-Term Incentive Plan are pensionable. The Committee may award other discretionary bonuses to the Executive Directors where it considers extraordinary value has been created or significant achievement has occurred.

In addition, the Company has established frameworks for approved and unapproved discretionary Share Option Plans and a Sharesave Plan, none of which has been utilised to date. However, the Company intends to make an offering under the Sharesave Plan to all UK employees of the Group in the near future and, although not strictly necessary, it seeks to re-confirm shareholders' approval of the Sharesave Plan and a resolution will be tabled at the Annual General Meeting (please see Resolution 10 on page 170).

Remuneration Policy Change for 2011

The Company notes the significant debate that has taken place regarding Executive Remuneration since the last report and has noted, in particular, the publication of the FSA's Remuneration Code (published in December 2010) and the revised Corporate Governance Code. Whilst the guidance and rules contained within these publications do not currently apply to the Group, the Committee has decided that it is appropriate to review remuneration packages and their structure whilst also noting commentary from corporate governance agencies and shareholders. As a result a number of changes are proposed for 2011 and these are outlined below.

The restructure of remuneration packages includes the following measures:

- i) removal of guaranteed bonuses from the Annual Bonus Scheme and long-term incentive arrangements,
 - these bonuses were initially put in place due to the nature of the Company in that it was, and still is, predominantly a run-off business and a salary-related retention measure was thought to be appropriate. However, the Committee has recognised the sentiment regarding this style of reward which is, effectively, deferred salary and has therefore removed the guaranteed bonuses.
- ii) increase in basic salary to compensate for the above,
 - in recognition of the guaranteed bonuses being removed, as outlined above, basic salaries have been increased to compensate for what were, in effect, deferred salary awards. As a consequence of these former bonuses being added to basic salary the Committee has decided that no further increase to annual salary will be awarded at the 2010 year end.
- iii) resetting of non-salary benefits,

- as a consequence of the above, bonus award percentages, pension contribution rates and life cover levels have been revised in order to equate these back to pre-increase salaries therefore, in absolute terms, these will remain at the pre-salary adjustment levels
- iv) resetting of basic salary/bonus relationship,
 - also as a consequence of ii) above the salary/on target bonus relationship has moved from 46% salary/54% bonus to 73% salary/27% bonus. The Committee believes this delivers a better balance between the two elements of Executive reward for a company of this nature
- v) differentiation of targets for short- and long-term bonus awards,
 - In the past the targets for both short-term and long-term bonuses have been based (wholly or predominantly) on annual IFRS pre-tax profits. In 2010, the long-term bonus awards made to Executive Directors (under the Current Long-Term Incentive Plan) were, to different degrees, subject to targets based on the Embedded Value accretion within Movestic. However, it is now proposed that long-term incentive arrangements will be, for all Executive Directors, based on the Embedded Value performance of the Group against targets set by the Committee
- vi) proposed New Long-Term Incentive Plan based on Embedded Value,
 - awards made under the proposed New Long-Term Incentive Plan will reflect Embedded Value performance over the performance year. The vesting of awards will then be deferred for a further three years and will be subject to share price and dividend performance to align Executive Directors' interests more fully with those of shareholders. The New Long-Term Incentive Plan will be a cash-based scheme. Therefore, for a performance year, a target will be set by the Committee for Group Embedded Value at the year-end. Performance will then be measured against that and an outcome based on a percentage of basic salary will be determined. This amount will then be converted to 'notional shares' at the closing price on the last day of the performance year. At the end of the three year deferral period the 'notional shares' will be valued, together with dividends paid and interest thereon, and this value will be paid to Executive Directors. It should be noted that Executive Directors will not have any rights to acquire actual shares in the Company under the New Long-Term Incentive Plan. The new arrangements maintain the alignment of Executive Directors' interests with those of shareholders
- vii) introduction of a formal cap on annual bonus amount,
 - a cap of 100% of annual basic salary will apply to the total annual rewards made under the short- and long-term bonus schemes (unless the Committee considers that exceptional circumstances exist). If necessary awards will be pro-rated to effect the cap
- viii) removal of the issue of transaction-related bonuses,
 - the measures above will allow increases in profit or value to be reflected through the revised schemes and therefore the Committee would not expect to award any further transaction-related bonuses (as were awarded in 2009 and 2010) once the new structure is in place

The Committee has, as can be seen above, made significant changes to the structure of reward and believes that the overall level of reward – which, importantly, in an on target year is no different to that currently received – is right for the type and nature of the Group. A Resolution will be tabled at the Annual General Meeting seeking approval for the introduction of the New Long-Term Incentive Plan and the Committee unanimously recommend this to shareholders. The resolution is numbered 9 and can be found on page 169. The Committee's intention is that the New Long-Term Incentive Plan will replace the current Long-Term Incentive Plan.

Bonus Schemes

Annual Bonus Scheme

The 2010 Annual Bonus Scheme was designed to incentivise the Executive Directors. The scheme consisted of two elements and the overall maximum award was 50% of basic salary.

The first element was a retention measure and this became payable on completion of service to the end of the year. This was designed to reflect the specific nature of the business which, prior to the acquisition of Movestic, was predominantly, and following the acquisition of Save & Prosper remains, a run-off proposition which requires particular skill sets and does, inherently, offer limited career opportunities.

The second element is based on Group performance and was designed to ensure that Executive Directors' awards were closely aligned to shareholders' interests on this element of the scheme. It was, therefore, based upon the level of achievement of budgeted IFRS pre-tax profit. For the period under review the exceptional profit arising from the acquisition of S&P was excluded from the calculation of the Annual Bonus. For future periods the budget for IFRS pre-tax profit will include the budgeted result of S&P.

These arrangements can be summarised as follows:

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

The table below sets out the details of the awards made to the Executive Directors under the scheme in 2010

Annual Bonus Scheme – awards made in respect of year ended 31 December 2010

Graham Kettleborough	£88,970
Ken Romney	£60,592
Frank Hughes	£54,534

Annual Bonus Scheme for 2011

For 2011 the Annual Bonus Scheme has been amended in that

- (i) the guaranteed element has been removed,
- (ii) the performance range will be nil at 75% of target increasing on a straight-line basis to 15.79% of basic salary at 100% of target and then increasing on a straight-line basis above target, and
- (iii) the annual bonus, together with any award made under the New Long-Term Incentive Plan is capped at 100% of basic salary

Current Long-Term Incentive Plan

The Current Long-Term Incentive Plan was originally designed as a long-term cash based incentive for Executive Directors. As the business was a run-off proposition prior to its acquisition of Moderna (now Movestic), the Remuneration Committee believed that a cash-based plan would be the most appropriate form of reward. Following the acquisition of S&P, a further UK run-off company, the Committee remain of the opinion that a cash-based scheme is the most appropriate form of reward. The 2010 scheme consisted of two elements and there was no overall maximum award.

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

The second element was, historically, also based solely on Group IFRS pre-tax profit performance and was designed to ensure that Executive Directors' awards were closely aligned to shareholders' interests on this element of the scheme. In 2010 the scheme was amended to cater for the acquisition of Movestic and the Executive Directors forewent a proportion of IFRS-related profit and were rewarded on the growth of Embedded Value (excluding the impact of any capital contributions from the Group) within the newly-acquired subsidiary. For the period under review the exceptional profit arising from the acquisition of S&P in the IFRS result was excluded from the calculation of awards made under the Current Long-Term Incentive Plan.

This scheme was brought in line with the Annual Bonus Scheme in 2010 in that the guaranteed and IFRS-related awards were made on an annual basis rather than a rolling half-year basis. Payment of these awards is deferred for three years. However, following the announcement of a significant rise in the rate of individual income tax for earnings above £150,000 per year from 6 April 2010 in the Pre-Budget Report of 9 December 2009, the Committee agreed to advance payment of the deferred bonuses relating to 2007, 2008 and 2009 to the Executive Directors. Payment was subject to an agreement that should an Executive Director voluntarily leave, or be dismissed from the service of the Group for performance reasons, then any bonus that would not have been due at the relevant date will be repayable net of any tax and National Insurance deductions. The agreement therefore maintained the retention element of the Current Long-Term Incentive Plan.

The arrangements for 2010 can be summarised as follows:

Element	Award
Retention	33.33% of basic salary on completion of service to year-end
Group performance IFRS pre-tax profit	
- at or less than 75% of budget in the year	Nil
- at 100% of budget in the year	And then increasing pro rata to 33.33% of basic salary

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

	<u>Graham Kettleborough</u>	<u>Ken Romney</u>	<u>Frank Hughes</u>
Percentage of Group IFRS pre-tax profit award foregone	50%	25%	10%
Percentage of Movestic EV increase awarded	0.65%	0.235%	0.0825%

The Movestic EV increase will be measured in Swedish Krona and be converted to Pounds Sterling at the rate applying at the close of business on 31 December 2010. The awards have been set at a level which reflects the Directors' responsibilities and involvement with Movestic. Outcomes resulting from this element of reward are split, with 40% paid at the end of 2010 and 60% being deferred for three years.

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

Current Long-Term Incentive Plan – awards made in 2009 and 2010

	Amount awarded in respect of the year ended 31 December 2010	Amount awarded in respect of the half-year ended 31 December 2009	Amount awarded in respect of the half-year ended 30 June 2009
Graham Kettleborough	£233,015	£69,430	£71,201
Ken Romney	£139,726	£47,285	£54,770
Frank Hughes	£112,441	£42,556	£49,293

The split between the Group- and Movestic-generated awards in 2010 was as follows:

	Graham Kettleborough	Ken Romney	Frank Hughes
Group IFRS pre-tax profit related reward	£114,660	£96,936	£97,419
Movestic EV increase related award	£118,355	£42,790	£15,022

Movestic

A scheme based on the increase in Movestic's EV (excluding any capital contributions from the Group) was implemented for a limited number of senior managers within Movestic. The total pool was 1.75% of the increase and, if other managers are added, the total pool will not exceed 2.5% of the increase in Embedded Value. Forty per cent of the award is paid at the end of the year in which it is earned with the remaining 60% being deferred for three years.

Awards to Movestic's senior managers were as follows:

	Paid SEK	Deferred SEK	Total SEK
Mikael Claesson	769,588	1,154,382	1,923,970
Michael Gunnarsson	384,794	577,191	961,985
Lars-Ola Hahlin	192,397	288,596	480,993

Mikael Claesson resigned with effect from 15 March 2011 and, therefore, his deferred bonus is no longer payable.

New Long-Term Incentive Plan

The New Long-Term Incentive Plan for Executive Directors which is being recommended by the Committee has been designed to align Executive Director reward with shareholder value and dividend experience. It will

- be based on achievement of Group Embedded Value target,
- be wholly deferred for three years from the end of the performance year,
- award a notional cash bonus amount, which at on target rate will be equivalent to 21.05% of basic annual salary, which will be converted to 'notional' shares,
- be revalued after three years to reflect share price performance and dividend payment in respect of the 'notional shares' over the three years,
- together with the annual bonus, be normally capped, on award, at 100% of salary with reward pro-rated if the total outcome exceeds that amount.

Further details of the proposed New Long-term Incentive Plan are set out in the Notice of Annual General meeting on pages 169 to 171. A Resolution will be tabled at the Annual General Meeting seeking approval for the introduction of the New Long Term Incentive Plan. The resolution is numbered 9 and can be found on page 169.

Discretionary Bonus

The exceptional profit arising from the purchase of S&P was excluded from the calculation of outcomes awarded in both the Annual Bonus Scheme and the Long-term Incentive Plan. However, the Committee decided that

extraordinary value had been created as a result of the transaction and awarded non-pensionable discretionary bonuses to the Executive Directors as shown below

	Bonus payable 31 December 2010	Bonus payable 31 December 2013
Graham Kettleborough	£40,000	£40,000
Ken Romney	£32,500	£32,500
Frank Hughes	£15,000	£15,000

The Committee notes that such awards are unlikely to be required should further transactions of the nature of the acquisition of Movestic or S&P be forthcoming as the proposed new arrangements will cater for such value-adding acquisitions

Share Options

The Board has established frameworks for a Sharesave Plan and approved and unapproved discretionary Share Option Plans which may, at the discretion of the Committee, be utilised for granting options to Executive Directors and other employees. During 2010 no such options were granted. As mentioned earlier, the Group intends to make an offering under the Sharesave Plan to all UK employees of the Group in the near future and, although not strictly necessary, it seeks to re-confirm shareholders' approval of the Sharesave Plan and a resolution will be tabled at the Annual General Meeting (please see Resolution 10 on page 170)

Service Contracts

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

Pension Policy

The Executive Directors are members of the Chesnara plc Stakeholder Scheme to which employer contributions are made at rates agreed by the Remuneration Committee. Employer contributions to the respective schemes are detailed on page 50.

Other Benefits

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

Non-executive Directors

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

	<u>Date of expiry of term of appointment</u>
Peter Mason	31 October 2011
Mike Gordon	30 April 2011
Terry Marris	1 March 2013
Peter Wright	1 January 2012

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

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

Directorate

The Directors who served during the period were

Chairman

Peter Mason

Non-executive Directors

Terry Marris

Mike Gordon

Peter Wright

Executive Directors

Graham Kettleborough

Ken Romney

Frank Hughes

Performance Graph



The above graph shows a comparison of the Company's total shareholder return ('TSR') performance against the FTSE Life Insurance sector index. The Company considers this to be the most appropriate index, given that its activities are centred on life insurance. The graph has been prepared in accordance with section 421(2) of the Companies Act 2006.

Directors' Interests in Shares

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

	31 December 2010		31 December 2009	
	Beneficial	Non-beneficial	Beneficial	Non-beneficial
Peter Mason	19,768	—	17,500	—
Terry Marns	57,708	—	52,708	—
Mike Gordon	—	—	—	—
Peter Wright	70,000	—	20,000	—
Graham Kettleborough	58,100	—	42,600	—
Ken Romney	70,476	—	15,476	—
Frank Hughes	5,832	—	5,163	—

There were no changes in the Directors' shareholdings in Chesnara plc between 31 December 2010 and 30 March 2011.

Directors' Remuneration

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

Total Directors' remuneration for the year ended 31 December 2010 is shown below with comparative figures for the year ended 31 December 2009.

	Year ended 31 December	
	2010	2009
	£000	£000
Aggregate emoluments		
Fees to Non-executive Directors	183	171
Emoluments to Executive Directors	1,256	1,207
Company contributions to pension schemes	132	124
Total	1,571	1,502

The following table, which has been prepared in accordance with regulatory requirements, sets out the constituents of Directors' emoluments for the year ended 31 December 2010

	Salaries and fees £000	Bonuses £000	Deferred bonuses £000	Benefits £000	Total 2010 £000	Total 2009 £000
Executive Directors						
Graham Kettleborough	160	176	226	15	577	536
Ken Romney	114	110	155	10	389	385
Frank Hughes	82	76	121	11	290	286
	<u>356</u>	<u>362</u>	<u>502</u>	<u>36</u>	<u>1,256</u>	<u>1,207</u>
Non-executive Directors						
Peter Mason	75	-	-	-	75	68
Terry Marris	30	-	-	-	30	30
Mike Gordon	45	-	-	-	45	40
Peter Wright	33	-	-	-	33	33
	<u>183</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>183</u>	<u>171</u>
Total	539	362	502	36	1,439	1,378

The following table sets out each Executive Director's pension benefits for the years ended 31 December 2010 and 31 December 2009

	Company contributions to money purchase scheme	
	2010	2009
	£000	£000
Graham Kettleborough	47	41
Ken Romney	41	40
Frank Hughes	44	43
	<u>132</u>	<u>124</u>

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

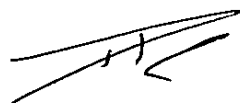
The pension arrangements for the Executive Directors are set out on page X.

No pension contributions were made by companies within the Chesnara plc Group from 1 January 2009 to 31 December 2010 in respect of any of the Non-executive Directors.

Directors' Share Options

No options were granted in respect of any Chesnara plc Share Option Scheme between 1 January 2010 and 30 March 2011, nor were there any options outstanding as at 31 December 2009, 31 December 2010 or 30 March 2011.

Approved by the Board of Directors on 30 March 2011 and signed on its behalf by



Peter Mason



Graham Kettleborough

Directors' Responsibility Statement in respect of the Financial Statements.

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

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

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

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

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

Responsibility statement

We confirm that to the best of our knowledge

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

By order of the Board



Chairman
Peter Mason
30 March 2011



Chief Executive Officer
Graham Kettleborough
30 March 2011

Independent Auditor's Report to the Members of Chesnara plc

We have audited the financial statements of Chesnara plc for the year ended 31 December 2010 which comprise the Consolidated Statement of Comprehensive Income, the Consolidated and Company Balance Sheets, the Consolidated and Company Statements of Cash Flows, the Consolidated and Company Statements of Changes in Equity and the related Notes 1 to 55. The financial reporting framework that has been applied in their preparation is applicable law and International Financial Reporting Standards (IFRSs) as adopted by the European Union and as regards the parent company financial statements, as applied in accordance with the provisions of the Companies Act 2006.

This report is made solely to the company's members, as a body, in accordance with Chapter 3 of Part 16 of the Companies Act 2006. Our audit work has been undertaken so that we might state to the company's members those matters we are required to state to them in an 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 auditor

As explained more fully in the Directors' Responsibilities Statement, the directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view. Our responsibility is to audit 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 group's and the parent company's circumstances and have been consistently applied and adequately disclosed, the reasonableness of significant accounting estimates made by the directors, and the overall presentation of the financial statements. In addition, we read all the financial and non-financial information in the annual report 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 group's and of the parent company's affairs as at 31 December 2010 and of the group's profit for the year then ended,
- the group financial statements have been properly prepared in accordance with IFRSs as adopted by the European Union,
- the parent company financial statements have been properly prepared in accordance with IFRSs as adopted by the European Union and as applied in accordance with the provisions of the Companies Act 2006, and
- the financial statements have been prepared in accordance with the requirements of the Companies Act 2006 and, as regards the group financial statements, Article 4 of the IAS Regulation.

Opinion on other matters prescribed by the Companies Act 2006

In our opinion

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

Matters on which we are required to report by exception

We have nothing to report in respect of the following

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

- adequate accounting records have not been kept by the parent company, or returns adequate for our audit have not been received from branches not visited by us, or

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

Under the Listing Rules we are required to review

- the directors' statement, contained within the Directors' Report, in relation to going concern,
- the part of the Corporate Governance Statement relating to the company's compliance with the nine provisions of the June 2008 Combined Code specified for our review, and
- certain elements of the report to shareholders by the Board on directors' remuneration



David Heaton (Senior Statutory Auditor)
for and on behalf of Deloitte LLP
Chartered Accountants and Statutory Auditor
Manchester
United Kingdom

30 March 2011

Consolidated Statement of Comprehensive Income for the year ended 31 December 2010

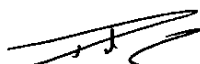
	Note	Year ended 31 December	
		2010 £000	2009 £000
Insurance premium revenue		114,950	100,105
Insurance premium ceded to reinsurers		(35,695)	(24,997)
Net insurance premium revenue		79,255	75,108
Fee and commission income	9	63,410	51,120
Net investment return	10	303,850	326,680
Total revenue (net of reinsurance payable)		446,515	452,908
Other operating income	11	9,216	4,689
Total income		455,731	457,597
Insurance contract claims and benefits incurred			
Claims and benefits paid to insurance contract holders	12	(139,424)	(129,557)
Net increase in insurance contract provisions	12	(106,618)	(127,840)
Reinsurers' share of claims and benefits	12	45,635	47,897
Net insurance contract claims and benefits		(200,407)	(209,500)
Change in investment contract liabilities	13	(180,021)	(199,748)
Reinsurers' share of investment contract liabilities	13	3,904	4,710
Net change in investment contract liabilities		(176,117)	(195,038)
Fees, commission and other acquisition costs	14	(14,688)	(5,167)
Administrative expenses	15	(29,375)	(18,245)
Other operating expenses	16	(16,157)	(9,336)
Total expenses		(436,744)	(437,286)
Total income less expenses		18,987	20,311
Share of profit from associates	24	597	39
Profit recognised on business combinations	7	15,864	25,056
Operating profit		35,448	45,406
Financing costs	17	(1,280)	(665)
Profit before income taxes		34,168	44,741
Income tax (expense)/credit	18	(4,467)	1,192
Profit for the year		29,701	45,933
Attributable to			
Shareholders	8	29,819	45,940
Non-controlling interest		(118)	(7)
		29,701	45,933
Foreign exchange translation differences arising on the revaluation of foreign operations		4,285	3,381
Total comprehensive income for the year		33,986	49,314
Attributable to			
Shareholders		34,104	49,321
Non-controlling interest		(118)	(7)
		33,986	49,314
Basic earnings per share (based on profit for the year attributable to shareholders)	49	29 05p	45 26p
Diluted earnings per share (based on profit for the year attributable to shareholders)	49	29 05p	45 26p

The notes and information on pages 61 to 151 form part of these financial statements

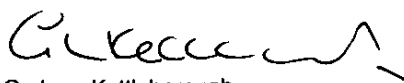
Consolidated Balance Sheet at 31 December 2010

	Note	31 December	
		2010 £000	2009 £000
Assets			
Intangible assets			
Deferred acquisition costs	19	14,659	9,327
Acquired value of in-force business	20	93,046	86,463
Acquired value of customer relationships	21	3,032	2,682
Software assets	22	6,829	4,060
Property and equipment	23	671	491
Investment in associates	24	1,783	1,051
Investment properties	25	120,820	3,355
Reinsurers' share of insurance contract provisions	33	280,743	236,866
Amounts deposited with reinsurers	34	30,264	27,056
Financial assets			
Equity securities at fair value through income	26	492,321	454,970
Holdings in collective investment schemes at fair value through income	26	3,177,265	1,612,861
Debt securities at fair value through income	26	319,516	247,836
Policyholders' funds held by the Group	26	52,337	41,107
Insurance and other receivables	26/27	33,225	19,822
Prepayments	26/27	3,908	3,784
Derivative financial instruments	26/28	9,707	7,964
Total financial assets		4,088,279	2,388,344
Reinsurers' share of accrued policyholder claims	40	3,678	4,728
Income taxes	29	5,486	395
Cash and cash equivalents	30	194,134	155,241
Assets held for sale	31	380	-
Total assets		4,843,804	2,920,059
Liabilities			
Liabilities held for sale	31	380	-
Bank overdrafts	30	2,154	2,312
Insurance contract provisions	33	2,404,079	1,077,033
Unallocated divisible surplus	33	83	-
Financial liabilities			
Investment contracts at fair value through income	34	2,002,712	1,529,221
Liabilities relating to policyholders' funds held by the Group	35	52,337	41,107
Borrowings	36	62,694	28,996
Derivative financial instruments	28	137	54
Total financial liabilities		2,117,880	1,599,378
Provisions	37	1,822	1,452
Deferred tax liabilities	38	20,526	10,366
Reinsurance payables	39	22,310	15,039
Payables related to direct insurance and investment contracts	40	35,808	30,433
Deferred income	41	11,647	13,132
Income taxes	42	6,923	1,313
Other payables	43	16,923	9,833
Total liabilities		4,640,535	2,760,291
Net assets	8	203,269	159,768
Shareholders' equity			
Share capital	44	42,024	41,501
Share premium	44	42,523	20,458
Treasury shares	45	(217)	(3,379)
Other reserves	46	7,716	3,431
Retained earnings	47	111,223	97,744
Total shareholders' equity		203,269	159,755
Non-controlling interest		-	13
Total equity		203,269	159,768

The notes and information on pages 61 to 151 form part of these financial statements
 Approved by the Board of Directors on 30 March 2011 and signed on its behalf by



Peter Mason



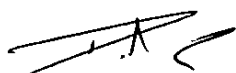
Graham Kettleborough

Company Balance Sheet at 31 December 2010

	Note	31 December	
		2010 £000	2009 £000
Assets			
Non-current assets			
Financial assets			
Investment in subsidiaries	26	141,434	74,029
Current assets			
Receivables and prepayments	27	243	262
Income taxes	29	543	395
Cash and cash equivalents	31	21,198	19,635
Total current assets		21,984	20,292
Total assets		163,418	94,321
Current liabilities			
Borrowings	36	3,807	4,197
Other payables	43	2,002	2,211
Total current liabilities		5,809	6,408
Non-current liabilities			
Borrowings	36	35,480	-
Total liabilities		41,289	6,408
Net assets		122,129	87,913
Shareholders' equity			
Share capital	44	5,752	5,229
Share premium	44	42,523	20,458
Treasury shares	45	(217)	(3,379)
Other reserves	46	50	50
Retained earnings	47	74,021	65,555
Total shareholders' equity		122,129	87,913

The notes and information on pages 61 to 151 form part of these financial statements

Approved by the Board of Directors on 30 March 2011 and signed on its behalf by



Peter Mason



Graham Kettleborough

Consolidated Statement of Cash Flows for the year ended 31 December 2010

	Year ended 31 December	
	2010	2009
	£000	£000
Profit for the year	29,819	45,940
Adjustments for		
Depreciation of tangible fixed assets	294	65
Amortisation of deferred acquisition costs	5,737	2,080
Amortisation of acquired value of in-force business	8,148	6,953
Amortisation of acquired value of customer relationships	1,182	188
Amortisation of internally-developed software	1,176	414
Tax expense/(recovery)	4,467	(1,192)
Interest receivable	(16,913)	(17,959)
Dividends receivable	(31,090)	(24,048)
Interest expense	1,280	665
Change in fair value of investment properties	(113)	77
Fair value gains on financial assets	(252,456)	(284,739)
Loss on sale of property and equipment	2	21
Profit arising on business combinations	(15,864)	(25,056)
Share of profit of associate net of impairment	(597)	122
Interest received	16,370	20,893
Dividends received	30,792	23,304
Increase in intangible assets related to insurance and investment contracts	(10,343)	(3,157)
Changes in operating assets and liabilities		
Increase in financial assets	(78,785)	(58,028)
Increase in reinsurers share of insurance contract provisions	(31,471)	(27,211)
Increase in amounts deposited with reinsurers	(3,208)	(4,875)
Decrease/(increase) in insurance and other receivables	1,305	(4,671)
Decrease/(increase) in prepayments	80	(1,293)
Increase in assets held for sale	(380)	-
Increase in liabilities held for sale	380	-
Increase in insurance contract provisions	121,382	120,648
Increase in investment contract liabilities	270,801	219,609
Increase/(decrease) in provisions	370	(2,229)
Increase in reinsurance payables	5,677	3,629
(Decrease)/increase in payables related to direct insurance and investment contracts	(6,050)	3,604
Decrease in other payables	(422)	(970)
Cash utilised by operations	51,570	(7,216)
Income tax paid	(4,537)	(2,371)
Net cash generated from/(utilised by) operating activities	47,033	(9,587)
Cash flows from investing activities		
Business combinations net of cash acquired	(46,483)	(5,944)
Investment in associates	(38)	(334)
Development of software	(2,541)	(918)
Purchases of property and equipment	(296)	(180)
Net cash utilised by investing activities	(49,358)	(7,376)
Cash flows from financing activities		
Proceeds from the issue of share capital, net of expenses	22,588	-
Sale of treasury shares	3,162	-
Proceeds from borrowings	40,000	-
Repayment of borrowings	(7,236)	(5,759)
Dividends paid	(16,340)	(15,934)
Interest paid	(2,365)	(821)
Net cash generated from/(utilised by) financing activities	39,809	(22,514)
Net increase/(decrease) in cash and cash equivalents	37,484	(39,477)
Cash and cash equivalents at beginning of the year	152,929	191,287
Effect of exchange rate changes on cash and cash equivalents	1,567	1,119
Cash and cash equivalents at end of the year	191,980	152,929

The notes and information on pages 61 to 151 form part of these financial statements

Company Statement of Cash Flows for the year ended 31 December 2010

	Year ended 31 December	
	2010	2009
	£000	£000
Profit for the year	24,806	23,806
Adjustments for		
Tax recovery	(150)	(392)
Interest expense	70	154
Dividends received from subsidiary company	(28,500)	(25,890)
Changes in operating assets and liabilities		
Decrease in loans and receivables	15	921
Decrease/(increase) in prepayments	4	(6)
Decrease in other payables	(238)	(52)
Tax received	-	133
Cash utilised by operations	(3,993)	(1,326)
Cash flows from investing activities		
Acquisition of subsidiary company	(63,524)	(19,956)
Capital contributions paid to subsidiary	(3,881)	(2,067)
Dividends received from subsidiary company	28,500	25,890
Net cash (utilised by)/generated from investing activities	(38,905)	3,867
Cash flows from financing activities		
Net proceeds from the issue of share capital	23,588	-
Repayment of borrowings	(4,200)	(4,200)
Proceeds from borrowings	40,000	-
Dividends paid	(16,340)	(15,934)
Interest paid	(749)	(136)
Sale of treasury shares	3,162	-
Net cash generated from/(utilised by) financing activities	44,461	(20,270)
Net increase/(decrease) in cash and cash equivalents	1,563	(17,729)
Cash and cash equivalents at beginning of the year	19,635	37,364
Cash and cash equivalents at end of the year	21,198	19,635

The notes and information on pages 61 to 151 form part of these financial statements

Consolidated Statement of Changes in Equity for the year ended 31 December 2010

Year ended 31 December 2010

	Share capital £000	Share premium £000	Other reserves £000	Treasury shares £000	Retained earnings £000	Total £000
Equity shareholders' funds at 1 January 2010	41,501	20,458	3,431	(3,379)	97,744	159,755
Profit for the period representing total recognised income and expenses	-	-	-	-	29,819	29,819
Dividends paid	-	-	-	-	(16,340)	(16,340)
Issue of new shares	523	22,065	-	-	-	22,588
Sale of treasury shares	-	-	-	3,162	-	3,162
Foreign exchange translation reserve	-	-	4,285	-	-	4,285
Equity shareholders' funds at 31 December 2010	42,024	42,523	7,716	(217)	111,223	203,269

Year ended 31 December 2009

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

The notes and information on pages 61 to 151 form part of these financial statements

Company Statement of Changes in Equity for the year ended 31 December 2010

Year ended 31 December 2010

	Share capital £000	Share premium £000	Other reserves £000	Treasury shares £000	Retained earnings £000	Total £000
Equity shareholders' funds at 1 January 2010	5,229	20,458	50	(3,379)	65,555	87,913
Profit for the year representing total recognised income and expenses	-	-	-	-	24,806	24,806
Dividends paid	-	-	-	-	(16,340)	(16,340)
Issue of new shares	523	22,065	-	-	-	22,588
Sale of treasury shares	-	-	-	3,162	-	3,162
Equity shareholders' funds at 31 December 2010	5,752	42,523	50	(217)	74,021	122,129

Year ended 31 December 2009

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

The notes and information on pages 61 to 151 form part of these financial statements

Notes to the Consolidated Financial Statements

1 General information

Chesnara plc (Registered Number 4947166) (the Company) is a limited liability company incorporated and domiciled in England and Wales and has primary listings on the London Stock Exchange. The address of the registered office is Harbour House, Portway, Preston, PR2 2PR, UK.

The Company and its subsidiaries, together forming the Group, comprise UK and Swedish life and pensions businesses.

The UK businesses, which comprise the CA and S&P segments described in Note 8 and the activities of which are performed entirely in the UK, underwrite life risks such as those associated with death, disability and health and provide a portfolio of investment contracts for the savings and retirement needs of customers through asset management. They are substantially closed to new business, such that new insurance contracts are only issued to existing customers, dependent on their changing needs. New investment contracts relate to the sale of Guaranteed Growth and Guaranteed Income Bonds by CA.

The Swedish business, which comprises the Movestic segment, described in Note 8, and the activities of which are performed predominantly in Sweden, underwrites life, accident and health risks and provides a portfolio of investment contracts. It is open to new business, securing distribution of its products principally through independent financial advisers, one of which is a subsidiary company, which services a specialist sector of the market.

These financial statements are presented in pounds sterling, which is the functional currency of the Parent Company. Foreign operations are included in accordance with the policies set out in Note 2. The financial statements were authorised for issue by the Directors on 30 March 2011.

2 Significant accounting policies

In the information which follows distinction is made, where necessary, in respect of the applicability of certain policies, or as to their clarification:

- (i) as between the UK businesses and the Swedish business, which comprises the Movestic segment, and
- (ii) as between the CA and S&P segments of the UK businesses.

(a) Statement of compliance

The consolidated financial statements have been prepared in accordance with International Financial Reporting Standards (IFRSs) as adopted by the European Union (Adopted IFRSs). Both the Parent Company financial statements and the Group financial statements have been prepared and approved by the Directors in accordance with Adopted IFRSs.

The Group has applied, for the first time, Improvements to IFRSs 2009, and those elements of Improvements to IFRSs 2010 effective for accounting periods beginning on or after January 1 2010. Their application has not led to any changes in Group accounting policies.

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

- IFRS9 Financial Instruments
- IAS24 (revised) Related Party Disclosures

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

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

(b) Basis of consolidation

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

Non-controlling interests in the net assets of consolidated subsidiaries are identified separately from the Group's equity therein. Non-controlling interests consist of the amount of those interests at the date of the original business combination and the non-controlling interest's share of changes in equity since the date of the combination.

Profit or loss and each component of other comprehensive income are attributed to the Company and to the non-controlling interests. Total comprehensive income is attributed to the Company shareholders and to the non-controlling interests even if this results in the non-controlling interests having a deficit balance.

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

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

(c) Basis of preparation

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

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

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

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

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

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

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

(d) Business combinations

The Group uses the purchase method of accounting to account for the acquisition of subsidiaries. The cost of an acquisition is measured as the fair value of the assets given, equity instruments issued and liabilities incurred or assumed at the date of exchange. Expenses directly attributable to the acquisition are expensed as incurred. The acquiree's identifiable assets, liabilities, and contingent liabilities, which meet the conditions for recognition under IFRS 3, are measured initially at their fair values at the acquisition date. Gains arising on a bargain purchase, where the net fair value of the identifiable assets, liabilities and contingent liabilities of the acquiree exceeds the cost of acquisition, is recognised in profit or loss at the acquisition date.

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

(e) Investments in associates

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

The results and assets and liabilities of associates are incorporated in these financial statements using the equity method of accounting. Investments in associates are carried in the balance sheet at cost as adjusted by post-acquisition changes in the Group's share of the net assets of the associate, less any impairment in the value of individual investments.

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

(f) Foreign currencies

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

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

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

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

(g) Product classification

The Group's products are classified at inception as either insurance or investment contracts for accounting purposes. Insurance contracts are contracts which transfer significant insurance risk and remain as insurance contracts until all rights and obligations are extinguished or expire. They may also transfer financial risk. Investment contracts are contracts which carry financial risk, with no significant insurance risk. Where contracts contain both insurance and investment components and the investment components can be measured reliably, the contracts are unbundled and the components are separately accounted for as insurance contracts and investment contracts respectively.

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

With-profits contracts, which subsist only within the UK businesses, all contain a discretionary participation feature ("DPF") which entitles the holder to receive, as a supplement to guaranteed benefits, additional benefits or bonuses, which may be a significant portion of the total contractual benefits.

In respect of S&P the amount and timing of such contractual benefits are at the discretion of the Group and are contractually based on realised and/or unrealised investment returns on a specified pool of assets held by the Group. The terms and conditions of these contracts, together with UK regulations, set out the bases for the determination of the amounts on which the additional discretionary benefits are based and within which the Group may exercise its discretion as to the quantum and timing of their payment to contract holders.

In respect of CA all such contracts are wholly reinsured with Guardian Assurance plc ('Guardian'), a subsidiary of Aegon NV, and the amount or timing of the additional payments are contractually at the discretion of the reinsurer and are contractually based on:

- (i) the performance of a specified pool of contracts or a specified type of contract,
- (ii) realised and/or unrealised investment returns on a specified pool of assets held by the reinsurer, or
- (iii) the profit or loss of the reinsurer.

All contracts with discretionary participation features are classified as insurance contracts.

(h) Insurance contracts

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

UK Businesses

(i) Premiums

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

(ii) Claims and benefits

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

(iii) Acquisition costs

Acquisition costs comprise all direct and indirect costs arising from the conclusion of insurance contracts. They are initial fees amortised at a rate based on the pattern of anticipated margins in respect of the related policies. An explicit deferred acquisition cost asset is established in the balance sheet to the extent that acquisition costs exceed initial fees deducted. At 31 December each year, such costs that are deferred to future years are reviewed to ensure they do not exceed available future margins.

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

(iv) Measurement of insurance contract provisions

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

Insurance contract provisions are determined following an annual actuarial investigation of the long-term funds and are calculated initially on a statutory solvency basis in order to comply with the reporting requirements of the Prudential Sourcebook for Insurers. This valuation is then adjusted to remove certain contingency and other reserves. In accordance with this, the provisions are calculated on the basis of current information, using the specific valuation methods set out below.

Unit-linked provisions are measured by reference to the value of the underlying net asset value of the Group's unitised investment funds, determined on a bid value basis, at the balance sheet date. Deferred tax on unrealised capital gains on the underlying investments in the unitised funds is also reflected in the measurement of unit-linked provisions and is not discounted.

For immediate annuities in payment the provision is calculated as the discounted value of the expected future annuity payments under the policies, allowing for mortality, including projected improvements in future mortality, interest rates and expenses. For certain temporary annuities in payment no allowance for mortality has been made.

In respect of S&P, for those classes of non-linked business with a discretionary participation feature, a gross premium method has been used to value the liability, whereby expected income and costs have been projected, allowing for mortality, interest rates and expenses.

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

In respect of CA for those classes of non-linked and unit-linked business where policyholders participate in profits the liability is wholly reassured to Guardian. The liability is calculated on a net premium basis, but is then increased to the realistic liability as a result of the liability adequacy test.

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

Insurance contract provisions can never be definitive as to their timing or the amount of claims and are therefore subject to subsequent reassessment on a regular basis.

Swedish Business – Life

(i) Premiums

Premiums are accounted for when received, and exclude any taxes or duties based on premiums. Outward reinsurance premiums are accounted for when due.

(ii) Claims and benefits

Claims are accounted for in the accounting period in which they are due or notified. Reinsurance recoveries are accounted for in the same period as the related claim.

(iii) Acquisition costs

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

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

(iv) Measurement of insurance contract provisions

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

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

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

Swedish Business – Non-life

(i) Premiums

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

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

(ii) Acquisition costs

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

(iii) Claims

Claims incurred

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

Outstanding claims provisions

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

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

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

(i) Investment contracts

(i) Amounts collected

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

(ii) Amounts deposited with reinsurers

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

(iii) Benefits

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

(iv) Acquisition costs

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

(v) Liabilities

All investment contract liabilities are designated on initial recognition as held at fair value through income. The Group has designated investment contract liabilities at fair value through income as this more closely reflects the basis on which the businesses are managed.

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

In respect of the UK businesses guaranteed income and guaranteed growth bond liabilities and other investment contract liabilities are managed together with related investment assets on a fair value basis as part of the documented risk management strategy.

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

(j) Unallocated divisible surplus

The unallocated divisible surplus represents the excess of policyholder assets over policyholder liabilities in respect of the S&P with-profits funds. As permitted under IFRS 4, the Group has opted to continue to record an unallocated surplus of such with-profits funds wholly as a liability. The annual excess or shortfall of income over expenditure of the with-profits funds, after declaration and attribution of the cost of bonuses to policyholders is transferred to or from the unallocated divisible surplus each year through a charge or credit to the income statement. The balance retained in the unallocated divisible surplus represents cumulative income arising on the with-profits business that has not been allocated to policyholders or shareholders. The balance of the unallocated divisible surplus is determined after full provision for deferred tax on unrealised appreciation on investments. In the event of the estimated liability attributable to policyholders exceeding available funds, the balance is transferred to shareholder funds.

(k) Reinsurance

The Group cedes reinsurance in the normal course of business for the purpose of avoiding the retention of undue concentration of risk on any one life, policyholder or loss event (for example multiple losses under a Group Life contract). Assets, liabilities and income and expense arising from ceded reinsurance contracts are presented separately from the related assets, liabilities, income and expenses from the related insurance contracts because the reinsurance arrangements do not relieve the Group from its direct obligations to its policyholders.

Only rights under contracts that give rise to a significant transfer of insurance risk are accounted for as reinsurance assets, which comprise amounts due from insurance companies for paid and unpaid losses and ceded life policy benefits. Rights under contracts that do not transfer significant insurance risk are accounted for as financial instruments and are presented as amounts deposited with reinsurers.

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

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

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

(l) Fee and commission income

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

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

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

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

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

(m) Investment income

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

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

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

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

(n) Expenses

(i) Operating lease payments

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

(ii) Financing costs

Financing costs comprise interest payable on borrowings and on reinsurance claims deposits included within reinsurance payables, calculated using the effective interest rate method.

(o) Income taxes

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

(i) Current tax

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

(ii) Deferred tax

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

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

(iii) Policyholders' fund yield tax

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

(p) Acquired value of in-force business

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

The difference between the fair value of insurance contracts and the liability measured in accordance with the Group's accounting policies for the contracts is recorded as acquired present value of in-force business. Present value of in-force business is carried gross of tax and is amortised against income on a time profile which, it is intended, will broadly match the profile of the underlying emergence of surplus as anticipated at the time of acquisition. The present value of in-force insurance contracts is tested for recoverability/impairment as part of the liability adequacy test.

The present value of in-force investment contracts is stated at cost less accumulated amortisation and impairment losses. The initial cost is deemed to be the fair value of the contractual customer relationships acquired. The acquired present value of the in-force investment contracts is carried gross of tax and is amortised against income on a time profile which, it is intended, will broadly match the profile of the underlying emergence of profit from the contracts. The recoverable amount is estimated at each balance sheet date. If the recoverable amount is less than the carrying amount, an impairment loss is recognised in the income statement and the carrying amount is reduced to its recoverable amount.

(q) Acquired value of customer relationships

The acquired value of customer relationships arising from business combinations is measured at fair value at the time of acquisition. This comprises the discounted cash flows relating to new insurance and investment contracts which are expected to arise from existing customer relationships. These are carried gross of tax, are amortised in accordance with the expected emergence of profit from the new contracts and are tested periodically for recoverability.

(r) Software assets

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

- (i) an asset is created that can be identified,
- (ii) it is probable that the asset created will generate future economic benefits, and
- (iii) the development costs of the asset can be measured reliably.

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

(s) Property and equipment

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

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

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

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

(t) Investment property

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

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

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

(u) Financial assets

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

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

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

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

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

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

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

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

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

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

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

(v) Derivative financial instruments

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

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

The fair value of forward exchange contracts is their quoted market price at the balance sheet date, being the present value of the quoted forward price.

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

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

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

Policyholders' funds held by the Group

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

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

Liabilities relating to policyholders' funds held by the Group

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

(x) Cash and cash equivalents

Cash and cash equivalents include cash in hand, deposits held at call with banks and other short-term highly liquid investments. Highly liquid is defined as having a short maturity of three months or less at their acquisition.

(y) Assets held for sale and liabilities held for sale

Assets and liabilities are classified as held for sale if their carrying amount is to be recovered principally through a sale transaction that is highly likely to complete within one year from the date of classification, rather than through continuing use. Such assets are measured at the lower of carrying amount and fair value and are classified separately from other assets in the balance sheet. Assets and liabilities are not netted. In the period where a non-current asset or disposal group is recognised for the first time, the balance sheet for the comparative prior period is not restated.

(z) Impairment

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

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

(aa) Provisions

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

(bb) Borrowings

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

(cc) Employee benefits

(i) Pension obligations

UK Businesses

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

Swedish Business

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

(ii) Bonus plans

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

(dd) Share capital and shares held in treasury

(i) Share capital

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

(ii) Shares held in treasury

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

(ee) Dividends

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

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

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

3 Accounting estimates and judgements

The Group makes estimates and assumptions that affect the reported amounts of assets and liabilities and also makes critical accounting judgements in applying the Group's accounting policies. Such estimates and judgements are continually evaluated and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable. The more critical areas, where accounting estimates and judgements are made, are set out below. Each item identifies the business segments, as described in Note 8, to which it is relevant.

(a) Classification of long-term contracts (CA, S&P and Movestic)

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

(b) Acquired value of in-force business (CA, S&P and Movestic)

The Group applies accounting estimates and judgements in determining the fair value, amortisation and recoverability of acquired in-force business relating to insurance and investment contracts. In the initial determination of the acquired value of in-force business, the Group uses actuarial models to determine the expected net cash flows (on a discounted basis) of the policies acquired. The key assumptions applied in the models are driven by the expected behaviour of policyholders on termination rates, expenses of management and age of individual contract holders as well as global estimates of investment growth, based on recent experience at the date of acquisition. The assumptions applied within the models are considered against historical experience of each of the relevant factors. No amendments are made for any changes that may arise as a result of changes in operational procedures or customer interaction as a result of ownership by Chesnara.

The acquired value of in-force business has been amortised on a basis that reflects the expected profit stream arising from the business acquired at the date of acquisition. Acquired value of in-force business is tested for recoverability by reference to expected future income and expense levels.

During the year ended 31 December 2010 the amortisation profile of the acquired value of in-force business associated with the acquisition of Movestic, as referred to in Note 7(III), was refined to better reflect the matching of the consumption of this asset with the expected emergence of profit. The impact of this refinement is to reduce the amortisation charge in the Group financial statements by £2.7m during the year ended 31 December 2010.

As at 31 December 2010, the carrying value of acquired in-force business, net of amortisation, was £21.1m in respect of CA (as at 31 December 2009 £24.8m), £9.1m in respect of S&P (as at 31 December 2009 £nil) and £62.9m in respect of Movestic (as at 31 December 2009 £61.7m)

(c) Deferred acquisition costs and deferred income - investment contracts (CA and Movestic)

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

As at 31 December 2010, the carrying values of deferred acquisition costs, net of amortisation, and of deferred income, in respect of CA, were £6.7m and £11.6m respectively (as at 31 December 2009 £7.7m and £13.1m respectively). An increase in the estimate of the lifetime of the investment management service contract by one year in respect of deferred acquisition costs would have increased profit before tax for the year ended 31 December 2010 by £0.1m and shareholders' equity as at 31 December 2010 by £0.1m and an increase of one year in the length of the amortisation period in respect of deferred income would have reduced profit before tax for the year ended 31 December 2010 by £0.1m and shareholders' equity as at 31 December 2010 by £0.1m.

As at 31 December 2010, the carrying values of deferred acquisition costs, net of amortisation, in respect of Movestic, was £7.9m (as at 31 December 2009 £1.6m). An increase in the length of the amortisation period by one year would have increased profit before tax for the year ended 31 December 2010 by £2.4m and shareholders' equity as at 31 December 2010 by £2.4m.

(d) Fair value of financial assets and unit-linked investments (CA, S&P and Movestic)

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

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

(e) Estimates of future benefits payments arising from long-term insurance contracts (CA and S&P)

The Group makes estimates of the expected number of deaths for each of the years that it is exposed to risk. These estimates are based on either standard mortality tables or reinsurers' rate tables as appropriate, adjusted to reflect the Group's own experience. For contracts without fixed terms the Group has assumed that it will be able to increase charges to policyholders in future years, in line with emerging mortality experience. The Group has offered guaranteed annuity options within certain contracts. Estimates have been made of the number of contract holders who will exercise these options, in order to measure their value. Changes in investment conditions could result in significantly more contract holders exercising their options than the Group has assumed in determining the liabilities arising from these contracts.

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

The assumptions used to establish insurance contract liabilities and appropriate sensitivities relating to variations in critical assumptions are disclosed in Note 33.

(f) Liability for future redress in respect of mortgage endowment mis-selling complaints (CA and S&P)

Included within insurance contract liabilities is a liability in respect of amounts anticipated to be payable as redress for upheld mortgage endowment mis-selling complaints. In establishing this liability the Group makes estimates about the number of future upheld complaints (taking into account the number of complaints received, the number of complaints time-barred and the number of complaints which are admitted) and about the average cost of redress per upheld complaint. These estimates are determined, taking into account historical experience and investment return projections. Variations in these estimates could result in higher or

lower than expected numbers of upheld complaints and higher or lower than expected amounts of redress per upheld complaint. The impact of variations in these assumptions is disclosed in Note 33 to these financial statements.

As at 31 December 2010, the liability for future redress in respect of mortgage endowment mis-selling complaints was £2.4m (as at 31 December 2009 £2.9m) for CA and as at 31 December 2010 £0.1m (as at 31 December 2009 £nil) for S&P.

(g) Fair value of investment contracts – guaranteed income and guaranteed growth bonds (CA)

The fair value of investment contract liabilities, in respect of guaranteed income and guaranteed growth bonds, (which are fully described in Note 34 to these financial statements) is established using a valuation technique, which approximates the following methodology:

- (i) The fair value of the contract, measured at inception, is the purchase price paid for it. This price implies a retail market rate of interest prevailing at the inception of the contract, which is used to equate the contractual cash flows payable under the bond to the purchase price, including an allowance for expenses incurred in managing the contract, and
- (ii) Subsequent measurement of the liability at fair value reflects the impact of changes in retail market interest rates for these products. This is accomplished in practice by tracking movements in the less-than-5-year gilt index as the bonds are predominantly less than 5 years in term.

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

As at 31 December 2010, the carrying value of investment contract liabilities in respect of guaranteed income and guaranteed growth bonds was £9.3m (as at 31 December 2009 £22.9m).

(h) Contracts which contain discretionary participation features (S&P)

All S&P with-profits contracts contain a discretionary participation feature ('DPF') which entitles the holder to receive, as a supplement to guaranteed benefits, additional benefits or bonuses:

- that may be a significant portion of the total contractual benefits,
- whose amount or timing is contractually at the discretion of the Group, and
- that are contractually based on realised and/or unrealised investment returns on a specified pool of assets held by the Group.

The terms and conditions of these contracts, together with UK regulations, set out the bases for the determination of the amounts on which the additional discretionary benefits are based and within which the Group may exercise its discretion as to the quantum and timing of their payment to contract holders.

As at 31 December 2010, the carrying value of insurance contract liabilities which contain discretionary participation features was £359.2m (31 December 2009 £nil).

(i) Insurance claim reserves (Movestic)

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

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

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

As at 31 December 2010, the carrying value of the insurance claim reserves, gross of reinsurance, was £63.7m (as at 31 December 2009 £32.4m). The key sensitivities in respect of insurance claim reserves are considered in Note 5.

(j) Insurance claim reserves – reinsurance recoverable (Movestic)

A significant proportion of the insurance claims arising within Movestic are ceded to reinsurers. In preparing the financial statements the Directors have made an assessment as to whether claims ceded to reinsurers are recoverable. As at 31 December 2010, such claims ceded to reinsurers and reflected on the balance sheet were £41.8m (31 December 2009 £27.3m). The application of a 10 per cent bad debt provision on the reinsurance balance would reduce 2010 profit before tax by £4.5m and shareholders' equity by £3.3m.

(k) Accounting for pension plans (Movestic)

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

(l) Income tax expense (Movestic)

Commissions payable and receivable from fund managers in respect of the Movestic unit-linked business have been included as part of the unit-linked funds and subject to fund yield tax (see accounting policy (o)).

Management is aware that the Swedish tax authority has questioned, in respect of other unit-linked businesses, whether such commissions receivable from fund managers should be part of the Group's income and be subject to corporation tax of 26.3 per cent (being the Swedish corporation tax for the year 2010). Management considers that the current accounting treatment remains appropriate.

4 Exchange rates

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

The results and cash flows of these operations have been translated into sterling at an average rate for the year of £1 = SEK 11.1249.

Assets and liabilities have been translated at the year end rate of £1 = SEK10.5250, the business combination of Aspis at the 19 February 2010 acquisition balance sheet date rate of £1 = SEK11.3257.

Total foreign currency exchange rate movements for the year-ended 31 December 2010 resulted in a gain recognised in the Consolidated Statement of Comprehensive Income of £4,285,000 (year ended 31 December 2009 £3,381,000).

5 Management of insurance risk

The Group's management of insurance risk is a critical aspect of its business. The primary insurance activity carried out by the Group comprises the assumption of the risk of loss from persons that are directly subject to the risk. Such risks in general relate to life, accident, health and financial perils that may arise from an insurable event. As such, the Group is exposed to the uncertainty surrounding the timing and severity of claims under the related contracts. The principal risk is that the frequency and severity of claims is adverse to that expected. The theory of probability is applied to the pricing and provisioning for a portfolio of insurance contracts. Insured events are, by their nature, random, and the actual number and size of events during any one year may vary from those estimated using established statistical techniques. The risk under assurance policies is partly naturally hedged by risks under annuity policies where the exposure is to the risk of longevity.

The Group manages its insurance risk through adoption of underwriting strategies, the aim of which is to avoid the assumption of undue concentration of risk, approval procedures for new products, pricing guidelines and adoption of reinsurance strategies, the aim of which is to reinforce the underwriting strategy by avoiding the retention of undue concentration of risk on any one life.

Notwithstanding that the Group pursues common overarching objectives and employs similar techniques in managing these risks, the disparate characteristics of the products and of the market and regulatory environments of the UK and Swedish businesses are such that insurance risk is managed separately for the separate businesses. Accordingly, the information which follows differentiates these businesses. The UK businesses, which are substantially closed to new business, comprise the CA and S&P segments and these are further differentiated in the information provided below, where necessary. The Swedish business, which is open to new business, comprises the Movestic segment.

Certain of the information includes amounts and balances relating to pre-acquisition periods and is provided for illustrative purposes, where it is deemed useful to do so.

UK Businesses

Terms and conditions of insurance contracts

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

	Sums assured - gross and net of reinsurance			
	31 December 2010		31 December 2009	
	Gross £000	Net £000	Gross £000	Net £000
CA				
Long-term without DPF	4,106,300	2,982,098	4,488,927	3,280,348
Long-term with DPF	64,358	-	68,633	204
S&P				
Long-term unit-linked without DPF	632,692	632,291	662,666	662,224
Long-term non-linked without DPF	103,849	88,093	118,677	98,245
Long-term with DPF	492,530	466,897	522,782	494,536

CA

Long-term insurance contracts – without discretionary participation features

Product features

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

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

Management of risks

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

For contracts with fixed and guaranteed benefits and fixed future premiums, there are no mitigating terms and conditions that reduce the insurance risk accepted. This is the case for a small proportion (approximately 4.5% of total sums assured) of the life assurance business sold by CA.

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

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

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

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

Concentration of insurance risk

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

In £000's bands As at 31 December 2010	Total benefits assured			
	Before reinsurance (Gross)		After reinsurance (Net)	
	£m	%	£m	%
0 – 250	4,018	96.3	2,957	99.2
250 – 500	60	1.4	22	0.7
500 – 750	68	1.6	2	0.1
750 – 1,000	15	0.4	-	-
More than 1,000	10	0.3	1	-
	4,171	100.0	2,982	100.0

In £000's bands As at 31 December 2009	Total benefits assured			
	Before reinsurance (Gross)		After reinsurance (Net)	
	£m	%	£m	%
0 – 250	4,407	96.7	3,259	99.3
250 – 500	102	2.3	20	0.6
500 – 750	27	0.6	2	0.1
750 – 1,000	13	0.2	-	-
More than 1,000	8	0.2	-	-
	4,557	100.0	3,281	100.0

In addition to the above CA has, at 31 December 2010, a total of approximately £12.7m per annum of retained PHI sums assured (31 December 2009 approximately £13.8m). CA does not retain PHI sums assured on any one life greater than £25,000 per annum

Long-term insurance contracts – with discretionary participation features

Product features

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

Management of risks

This business is wholly reassured to Guardian and hence the only risk retained by CA for this business is the risk of default by the reinsurer. This risk is detailed in the Credit Risk Management section of Note 6

S&P

Long-term non-linked and unit-linked insurance contracts – without discretionary participation features

Product features

S&P has written both non-linked and unit-linked contracts, which include death and morbidity benefits on a whole life, endowment and term assurance basis

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

Management of risks

Unit-linked insurance contracts are contracts where the primary purpose is to provide an investment return to policyholders. In addition, the policyholder is insured against death and serious injury. Unit-linked contracts

operate by investing the policyholders' premiums into pooled investment funds, the policyholders' share of the fund being represented by units. The benefit is payable on death, or maturity if earlier, the amount payable on death being subject to a guaranteed minimum amount. Therefore, S&P is exposed to insurance risk insofar as the value of the unit-linked fund is lower than the guaranteed minimum death benefit. The maturity or surrender value depends on the investment performance of the underlying fund and on the level of charges levied by S&P for policy administration fees, mortality and other charges.

For contracts with fixed and guaranteed benefits and fixed future premiums, there are no mitigating terms and conditions that reduce the insurance risk accepted. This is the case for a small proportion (approximately 7.4% of total sums assured) of the life assurance business sold by S&P.

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

For units held under unit-linked contracts all of the investment risk is borne by the policyholder.

Concentration of insurance risk

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

Benefits assured for each life assured – without DPF As at 31 December 2010

	Total benefits assured			
	Before reinsurance		After reinsurance	
	(Gross)		(Net)	
	£m	%	£m	%
In £000's bands				
0 – 250	727	98.9	712	98.9
250 – 500	7	0.9	6	0.9
500 – 750	1	0.1	1	0.1
750 – 1,000	-	-	-	-
More than 1,000	1	0.1	1	0.1
	736	100.0	720	100.0

Benefits assured for each life assured – without DPF As at 31 December 2009

	Total benefits assured			
	Before reinsurance		After reinsurance	
	(Gross)		(Net)	
	£m	%	£m	%
In £000's bands				
0 – 250	654.4	98.7	654.0	98.8
250 – 500	6.6	1.0	6.6	0.9
500 – 750	0.5	0.1	0.5	0.1
750 – 1,000	-	-	-	-
More than 1,000	1.1	0.2	1.1	0.2
	662.6	100.0	662.2	100.0

Long-term insurance contracts – with discretionary participation features

Product features

At retirement the with-profits deferred annuity contracts provide for guaranteed minimum pensions and the with-profits endowments provide for guaranteed minimum lump sums. With-profits whole of life policies guarantee a minimum amount payable on death. The guaranteed annuities or lump sums represent investment returns on contributions mainly at 5% p.a. A terminal bonus may be paid at maturity or retirement, and on death, depending on the investment performance of the with-profits policyholder assets when the policyholder receives the higher of the asset share and the minimum guaranteed amount. The asset share is based on the contributions invested plus an allocation of investment return less costs and expenses. In accordance with the Principles and Practices of Financial Management for its with-DPF business S&P may make a deduction of up to 1.5% per annum from the asset shares of with-profits policyholders to meet the future cost of guarantees. The amount deducted remains part of the assets in the with-profits policyholder funds. The size of the deduction is reassessed at least annually. In the event of a policyholder choosing to transfer out, the amount payable is not guaranteed and is based on the asset share.

Management of risks

For life endowment and whole of life policies mortality risk is material. This risk is mitigated to some extent by the use of reinsurance. The risk is to increases in mortality rates, which are most likely to be from epidemics (such as AIDS, SARS or a flu pandemic) or widespread changes in lifestyle, such as eating, smoking and exercise habits, resulting in earlier or more claims than expected.

For deferred annuity contracts, the risk is to improving mortality. The risk is managed through the initial pricing, and technical provisions are assessed allowing for future mortality improvements based on industry available information on mortality experience.

Concentration of insurance risk

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

Benefits assured for each life – with DPF

As at 31 December 2010

In £000's bands	Total benefits assured			
	Before reinsurance (Gross)		After reinsurance (Net)	
	£m	%	£m	%
0 – 250	483	98.2	462	98.9
250 – 500	6	1.2	3	0.7
500 – 750	2	0.4	1	0.2
750 – 1,000	1	0.2	1	0.2
More than 1,000	-	-	-	-
	492	100.0	467	100.0

Benefits assured for each life – with DPF

As at 31 December 2009

In £000's bands	Total benefits assured			
	Before reinsurance (Gross)		After reinsurance (Net)	
	£m	%	£m	%
0 – 250	513.2	98.2	489.3	98.9
1 3253 40 0 7– 500	6.7	1.3	3.4	0.7
500 – 750	2.1	0.4	1.0	0.2
750 – 1,000	0.8	0.1	0.8	0.2
More than 1,000	-	-	-	-
	522.8	100.0	494.5	100.0

Other risks on insurance contracts

Apart from financial risks relating to the financial assets, which support life assurance contracts, as set out in Note 6, there are other significant types of risk pertaining to life insurance contracts written by CA and S&P, as follows:

Expense risk

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

Mortgage endowment misselling complaints

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

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

Persistency risk

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

Assumptions and sensitivities

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

Swedish Business

The terms and conditions of insurance contracts which have a material effect on the amount, timing and uncertainty of future cash flows arising from insurance contracts are set out in the product analyses below, which give an assessment of the main products of Movestic and of the ways in which the associated risks are managed. The breakdown of the insurance products of Movestic, by gross and net premiums written and by claims outstanding, which reflects the scale of business written, is as follows. Certain of the information, relating to the year ended 31 December 2009, includes amounts arising prior to 23 July 2009, the acquisition date of Movestic, and is provided for illustrative purposes.

Premiums

	Before reinsurance		After reinsurance	
	Year ended 31 December		Year ended 31 December	
	2010	2009	2010	2009
	£000	£000	£000	£000
Group				
Sweden	11,694	11,312	3,700	2,652
Norway	2,690	5,291	299	978
Individual				
Death	7,096	471	3,762	53
Waiver of premium	4,825	4,344	938	850
Income protection	11,256	3,213	5,702	623
	37,561	24,631	14,401	5,156

Claims outstanding

	Before reinsurance		After reinsurance	
	As at 31 December		As at 31 December	
	2010	2009	2010	2009
	£000	£000	£000	£000
Group				
Sweden	15,649	12,131	2,512	1,377
Norway	6,396	8,869	1,054	1,450
Individual				
Death	4,294	422	2,857	75
Waiver of premium	5,241	5,931	1,047	1,110
Income protection	32,131	5,000	11,466	1,079
	63,711	32,353	18,936	5,091

Terms and conditions

Product features – Group Contracts

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

The Swedish product provides a maximum coverage of insured benefits up to 40 times a base amount (as at 31 December 2010 SEK 42,400, being approximately £4,030) although most policies are between 7.5 to 20 times the base amount.

The Norwegian product provides a maximum coverage of insured benefits up to 80 times a base amount (as at 31 December 2010 NOK 72,881, being approximately £6,920) although most policies are around 40 times the base amount

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

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

Product features – Individual Contracts

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

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

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

Management of risk

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

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

The key risks are managed through appropriate product design and pricing of the policies to ensure that the potential cost to Movestic of these events (and associated expenses of underwriting and administration) are reflected in the price charged to the policyholder. Key controls implemented include a defined pricing structure based on the characteristics of the policyholder and the regular review of management information on the type and frequency of accidents.

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

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

For both the Group and Individual Contracts, between 80 per cent to 90 per cent of the premiums and claims relating to this product are ceded to a reinsurer which reduces the overall insurance risk exposure to Movestic. The policies and products from the Aspis acquisition are reinsured for approximately 40% of the claims amount.

In addition, for the majority of the Group Contracts, the loss arising from a single event to multiple employees is reinsured. The reinsurance provides indemnity for a single loss between SEK 5m (approximately £0.5m) and SEK 100m (approximately £9.5m).

Concentration of insurance risk

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

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

Total benefits assured

	31 December 2010		31 December 2009	
	Before reinsurance £000	After reinsurance £000	Before reinsurance £000	After reinsurance £000
In £000's bands				
0 – 250	9,244	8,169	5,073	4,286
250 – 500	93	24	14	12
500 – 750	21	3	1	1
750 – 1,000	18	2	1	1
More than 1,000	22	-	-	-
	9,398	8,198	5,089	4,300

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

Assumptions and sensitivities for Group Contract and Individual Contract insurance provisions

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

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

Unearned premiums

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

Outstanding claims

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

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

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

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

The use of different approaches assists in giving greater understanding of the trends inherent in the data being projected and also assists in setting the range of possible outcomes. The most appropriate estimation technique is selected taking into account the characteristics of the policies sold. Where deemed appropriate, an allowance is made for changes or uncertainties which may create distortions in the underlying statistics or which might cause the cost of unsettled claims to increase or reduce when compared with the cost of

previously settled claims. Although claim reserves are considered reasonable, on the basis of information available to Movestic, the ultimate liabilities will vary as a result of subsequent information and events.

Income protection and waiver of premium benefits within Individual Contracts

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

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

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

Sensitivity analysis

The key sensitivities in the measurement of the Group and Individual Contracts insurance claim reserves are a movement in the loss ratio applied to earned premium and the foreign exchange risk arising on business written in Norway. In addition, for the income protection and the waiver of premium benefits within the Individual Contracts, the claims reserves are impacted by the discount rate used. The impact of these sensitivities is shown below. The information, in respect of 2009 includes pre-acquisition amounts arising prior to 23 July 2009, the date of the acquisition of Movestic, and is presented for illustrative purposes.

	Pre-tax profit		Shareholders' equity	
	2010 £000	2009 £000	2010 £000	2009 £000
5% increase in loss ratio				
Gross before reinsurance	(1,721)	(1,193)	(1,361)	(910)
Net after reinsurance	(690)	(174)	(537)	(132)
5% decrease in loss ratio				
Gross before reinsurance	1,721	1,193	1,341	910
Net after reinsurance	690	174	537	132
10% increase in the Norwegian Krone				
Gross before reinsurance	(605)	(857)	(471)	(654)
Net after reinsurance	(100)	(140)	(78)	(107)
10% decrease in the Norwegian Krone				
Gross before reinsurance	605	857	471	654
Net after reinsurance	100	140	78	107
1% increase in discount rate				
Gross before reinsurance	1,986	788	1,547	601
Net after reinsurance	609	156	474	119
1% decrease in discount rate				
Gross before reinsurance	(2,920)	(896)	(2,275)	(683)
Net after reinsurance	(858)	(178)	(668)	(136)

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

Analysis of claims development – gross

	2005	2006	2007	2008	2009	2010
	£000	£000	£000	£000	£000	£000
Estimate of ultimates						
End of accident year	7,780	10,990	17,421	19,619	20,268	50,915
One year later	7,822	9,665	13,204	15,435	13,879	
Two years later	6,923	7,805	11,322	14,077		
Three years later	5,960	7,618	10,133			
Four years later	5,198	6,660				
Five years later	4,772					
Current estimate of ultimate claims	4,772	6,660	10,133	14,077	13,879	50,915
Cumulative payments	(4,330)	(5,578)	(6,896)	(8,557)	(6,116)	(6,746)
In balance sheet	442	1,082	3,237	5,520	7,763	44,169
Provision for prior years						1,497
Liability in balance sheet						63,710

Analysis of claims development – net

	2005	2006	2007	2008	2009	2010
	£000	£000	£000	£000	£000	£000
Estimate of ultimates						
End of accident year	862	1,337	2,711	2,704	3,464	17,287
One year later	843	1,083	1,717	2,349	2,063	
Two years later	740	766	1,642	2,137		
Three years later	543	762	1,485			
Four years later	520	696				
Five years later	519					
Current estimate of ultimate claims	519	696	1,485	2,137	2,063	17,287
Cumulative payments	(446)	(565)	(950)	(1,238)	(832)	(1,574)
In balance sheet	73	131	535	899	1,231	15,713
Provision for prior years						387
Liability in balance sheet						18,969

6 Management of financial risk

The Group is exposed to a range of financial risks, principally through its insurance contracts, financial assets, including assets representing shareholder assets, financial liabilities, including investment contracts and borrowings, and its reinsurance assets. In particular, the key financial risk is that, in the long-term, proceeds from financial assets are not sufficient to fund the obligations arising from its insurance and investment contracts and borrowings. The most important components of this financial risk are market risk (interest rate risk, equity price risk, foreign currency exchange risk and liquidity risk), and credit risk, including the risk of reinsurer default. These risks principally arise from open positions in interest rate, equity and currency products, all of which are exposed to general and specific market movements.

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

For non unit-linked business, the Group's objective is to match the timing of cash flows from insurance and investment contract liabilities with the timing of cash flows from assets subject to identical or similar risks. By matching the cash flows of liabilities with those of suitable assets, market risk is managed effectively, whilst liquidity risk is minimised. These processes to manage the risks, which the Group has not changed from

previous periods, ensure that the Group is able to meet its obligations under its contractual liabilities as they fall due

Notwithstanding that the Group pursues common overarching objectives and employs similar techniques in managing financial risk, the disparate characteristics of the underlying insurance and investment contracts and of the market and regulatory environment of the UK and Swedish businesses are such that the operation of the Group's overall management of financial risk is devolved as between the UK and Swedish businesses. In addition, there is specific foreign currency exchange risk, which arises at the Group corporate level. Accordingly, the description of the specific management of financial risk is set out separately below at the level of the UK businesses, the Swedish business and Other Group Activities. The UK businesses comprise the CA and S&P segments and these are differentiated in the information provided below, where necessary. The Swedish business comprises the Movestic segment.

Certain of the information includes amounts and balances relating to pre-acquisition periods and is provided for illustrative purposes, where it is deemed useful to do so.

UK Businesses

The UK businesses manage their market risks within asset liability management (ALM) frameworks that have been developed to achieve long-term investment returns at least equal to their obligations under insurance and investment contracts, with minimal risk. Within the ALM frameworks the businesses periodically produce reports at legal entity and asset and liability class level, which are circulated to the UK businesses' key management. The principal technique of the ALM frameworks is to match assets to the liabilities arising from insurance and investment contracts by reference to the type of benefits payable to policyholders, with separate portfolios of assets being maintained for each distinct class of liability. With respect to S&P there is significant additional risk insofar as investment returns on policyholder with-profits assets supporting the with-profits business may result in insufficient policyholder assets to meet contractual obligations to with-profits policyholders, because of the impact of contract guarantees, as explained further below.

Terms and conditions of investment contracts

The terms and conditions of insurance contracts that have a material effect on the amount, timing and uncertainty of future cash flows arising from insurance contracts are set out in Note 5. The terms and conditions of investment contracts that have a material effect on the amount, timing and uncertainty of future cash flows arising from investment contracts are set out in the product analyses below.

CA provides three types of investment contract, predominantly written in the UK: unit-linked savings, unit-linked pensions and guaranteed income and growth bonds.

(i) Unit-linked savings are typically single premium contracts, with the premiums invested in a pooled investment fund, where the policyholder's investment is represented by units. The benefits payable at maturity or surrender of the contract are the bid value of these units less surrender penalties, where applicable.

(ii) Unit-linked pensions are single or regular premium contracts with features similar to unit-linked savings contracts. The benefits payable on retirement purchase an open market pension annuity.

(iii) Guaranteed income bonds are mainly single premium contracts for a fixed term offering fixed-income payments plus a return of capital at maturity. A guaranteed growth bond offers no income, but a higher guaranteed payment at maturity date.

S&P provides unit-linked pensions contracts, with the premium invested in a pooled investment fund, where the policyholder's investment in the fund is represented by units. Benefits are payable on transfer, retirement or death.

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

Risks associated with investment contracts

The risks associated with investment contracts are market risk, expense risk, persistency risk and liquidity risk. Market risk is the risk that the fair value of future cash flows will fluctuate because of a change in interest or foreign currency exchange rates or in equity prices and the consequent effect that this has on the value of charges earned by the business and on any guarantees in the contracts. Expense risk is of the same nature as described under other risks on insurance contracts in Note 5. Persistency risk is the risk that the investor cancels the contract or discontinues paying new premiums into the contract, thereby exposing the business to a loss resulting from an adverse movement in the actual experience compared to that expected in the product pricing. Although changes in the levels of persistency would not adversely affect the result in the short term they would reduce future profits available from the contracts.

Market risk management

The notes below explain how market risks are managed using the categories utilised in the UK businesses' ALM frameworks. In particular, the ALM frameworks require the management of interest risk, equity price risk, and liquidity risk at the portfolio level, so that the appropriate risks for each portfolio may be managed in an effective way. The businesses are not significantly exposed to foreign exchange risk as the only assets denominated in foreign currencies are matched by corresponding insurance contract provisions and financial liabilities. To reflect the businesses' risk management approach the required disclosures for interest rate, equity price and liquidity risks, as appropriate, are given separately for each portfolio of the ALM frameworks. The following tables reconcile the segment balance sheets to the classes and portfolios used in the businesses' ALM frameworks and are followed by a portfolio-by-portfolio description of the nature of the related market risk and how that risk is managed, supplemented by sensitivity analysis and statements of contractual cash flows, as appropriate.

CA Segment

31 December 2010

	Total £000	Guaranteed bonds £000	Insurance contracts with DPF £000	Unit-linked contracts £000	Annuities in payment £000	Other non- linked contracts £000	Other £000
Assets							
Intangible assets							
Deferred acquisition costs	6,745	-	-	-	-	-	6,745
Acquired value of in-force business	21,125	-	-	-	-	-	21,125
Property and equipment	67	-	-	-	-	-	67
Reinsurers' share of insurance contract provisions	228,276	-	95,013	129,506	-	3,757	-
Amounts deposited with reinsurers	30,264	-	-	30,264	-	-	-
Investment properties	2,895	-	-	2,445	-	-	450
Financial assets							
Equity securities at fair value through income	467,125	-	2	467,115	-	8	-
Holdings in collective investment schemes at fair value through income	770,772	-	3,820	747,178	-	14,257	5,517
Debt securities at fair value through income	238,857	8,817	-	112,314	87,128	25,704	4,894
Insurance and other receivables	7,359	433	-	-	-	1,630	5,296
Prepayments	1,381	-	-	-	-	-	1,381
Derivative financial instruments	5,594	-	-	5,594	-	-	-
Total financial assets	1,491,088	9,250	3,822	1,332,201	87,128	41,599	17,088
Reinsurers' share of accrued policyholder claims	3,422	-	-	-	-	205	3,217
Cash and cash equivalents	133,716	378	234	33,591	329	7,559	91,625
Total assets	1,917,598	9,628	99,069	1,528,007	87,457	53,120	140,317
	Total £000	Guaranteed bonds £000	Insurance contracts with DPF £000	Unit-linked contracts £000	Annuities in payment £000	Other non- linked contracts £000	Other £000
Liabilities							
Bank overdraft	2,125	-	-	375	-	1,409	341
Insurance contract provisions	1,129,558	-	99,069	903,669	87,457	39,363	-
Financial liabilities							
Investment contracts	646,609	9,265	-	628,789	-	8,555	-
Derivative financial instruments	137	-	-	137	-	-	-
Total financial liabilities	646,746	9,265	-	628,926	-	8,555	-
Provisions	1,822	-	-	-	-	282	1,540
Deferred tax liabilities	7,525	1	-	-	-	17	7,507
Reinsurance payables	1,921	-	-	-	-	205	1,716
Payables related to direct insurance and investment contracts	19,338	362	-	-	-	958	18,018
Deferred income	11,647	-	-	-	-	-	11,647
Income taxes	3,188	-	-	-	-	-	3,188
Other payables	3,098	-	-	-	-	2,330	768
Total liabilities	1,826,968	9,628	99,069	1,532,970	87,457	53,119	44,725

31 December 2009

	Total £000	Guaranteed bonds £000	Insurance contracts with DPF £000	Unit-linked contracts £000	Annuities in payment £000	Other non- linked contracts £000	Other £000
Assets							
Intangible assets							
Deferred acquisition costs	7,683	-	-	-	-	-	7,683
Acquired value of in-force business							
Insurance contracts	14,195	-	-	-	-	-	14,195
Investment contracts	10,593	-	-	-	-	-	10,593
Reinsurers' share of insurance contract provisions	209,604	-	88,880	117,918	-	2,806	-
Amounts deposited with reinsurers	27,056	-	-	26,192	-	-	864
Investment properties	3,355	-	-	2,880	-	-	475
Financial assets							
Equity securities at fair value through income	454,970	-	2	454,961	-	7	-
Holdings in collective investment schemes at fair value through income	697,259	-	3,116	663,148	-	10,247	20,748
Debt securities at fair value through income	245,928	18,026	-	118,239	80,478	23,960	5,225
Insurance and other receivables	9,593	532	-	-	-	3,237	5,824
Prepayments	1,628	-	-	-	-	-	1,628
Derivative financial instruments	4,420	-	-	4,420	-	-	-
Total financial assets	1,413,798	18,558	3,118	1,240,768	80,478	37,451	33,425
Reinsurers' share of accrued policyholder claims	4,728	-	-	-	-	900	3,828
Cash and cash equivalents	120,830	5,757	395	32,889	449	8,912	72,428
Total assets	1,811,842	24,315	92,393	1,420,647	80,927	50,069	143,491

	Total £000	Guaranteed bonds £000	Insurance contracts with DPF £000	Unit-linked contracts £000	Annuities in payment £000	Other non- linked contracts £000	Other £000
Liabilities							
Bank overdraft	2,312	-	-	235	-	1,593	484
Insurance contract provisions	1,044,680	-	92,393	835,884	80,927	35,476	-
Financial liabilities							
Investment contracts	610,930	22,923	-	578,523	-	9,484	-
Borrowings	-	-	-	-	-	-	-
Derivative financial instruments	54	-	-	54	-	-	-
Total financial liabilities	610,984	22,923	-	578,577	-	9,484	-
Provisions	1,452	-	-	-	-	203	1,249
Deferred tax liabilities	9,613	30	-	-	-	19	9,564
Reinsurance payables	2,064	-	-	-	-	225	1,839
Payables related to direct insurance and investment contracts	24,751	1,362	-	-	-	964	22,425
Deferred income	13,132	-	-	-	-	-	13,132
Income taxes	854	-	-	-	-	-	854
Other payables	3,825	-	-	-	-	2,105	1,720
Total liabilities	1,713,667	24,315	92,393	1,414,696	80,927	50,069	51,267

Guaranteed bonds

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

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

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

31 December 2010

Contractual cash flows (undiscounted)

Carrying values and cash flows arising from

	Carrying amounts £000	0-1 year £000	1-2 years £000	2-3 years £000
Assets backing liabilities				
Debt securities at fair value through income	8,817	8,003	1,252	113
Insurance and other receivables	433	433	-	-
Cash and cash equivalents	378	378	-	-
Total	9,628	8,814	1,252	113
Liabilities	9,628	8,478	1,098	126
Difference in expected cash flows	-	336	154	(13)

31 December 2009

Contractual cash flows (undiscounted)

Carrying values and cash flows arising from

	Carrying amounts £000	0-1 year £000	1-2 years £000	2-3 years £000
Assets backing liabilities				
Debt securities at fair value through income	18,026	14,258	7,914	1,248
Insurance and other receivables	532	532	-	-
Cash and cash equivalents	5,757	5,757	-	-
Total	24,315	20,547	7,914	1,248
Liabilities	24,315	15,617	7,938	1,075
Difference in expected cash flows	-	4,930	(24)	173

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

Sensitivity analysis – interest rate risk

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

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

A 100 basis point increase or decrease in interest yields would not have a material effect on either profit for the year ended 31 December 2010 and for the year ended 31 December 2009 or shareholder equity as at those dates.

Insurance contracts with discretionary participation features

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

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

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

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

Unit-linked contracts

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

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

(i) *Surplus units*

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

(ii) *Mortgage endowment mis-selling redress provision*

Market risk arises in two ways in respect of the redress provisions for mortgage endowment mis-selling. The first is that a fall in equity prices directly increases the cost of future redress payments. In addition it is also likely that a large fall in equity prices would increase the propensity for policyholders to make a complaint about their mortgage endowment policies. The sensitivity of the redress provision to equity price changes is disclosed in Note 33 to these financial statements.

(iii) *Guaranteed annuity options*

For a small number of unit-linked contracts guarantees exist regarding the rate at which the policyholder is able to convert the unit fund into an annuity at retirement, as described above. As the policyholders gain the benefit of whichever of the then-current annuity rates and guaranteed annuity rates give them the higher benefits, this creates an interest rate risk, in that yields available at the time the option is taken may be lower than those assumed in the guaranteed rates. A provision of £0.6m is held for the cost of this guarantee (31 December 2009: £0.6m).

(iv) *Guarantees in Timed Investment Funds*

Investment guarantees have been made in respect of policies invested in the business's Timed Investment Funds whereby the price paid to policyholders for their units on death or maturity will always be the highest price that the units have reached during their period of investment in the funds. Although there is a charge paid by policyholders for this guarantee there is a risk to shareholders that this will be insufficient to meet the full cost of this guarantee: this risk is managed within the investment strategy of the fund (see Note 32 for more details). A provision of £0.2m is held to meet the full cost of this guarantee (31 December 2009: £0.1m).

(v) *Change in insurance contract provisions*

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

(vi) *Bonus units*

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

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

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

Sensitivity analysis – equity risk

A decrease of 10% in the value of the assets would reduce asset management fees, which would result in a £0.8m decrease in profit for the year ended 31 December 2010 and to shareholder equity as at 31 December 2010 (year ended 31 December 2009 and as at 31 December 2009 £0.8m decrease)

Annuities in payment

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

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

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

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

31 December 2010

Contractual cash flows (undiscounted)

Carrying values and cash flows arising from	Carrying amounts £000	0-5 years £000	5-10 years £000	10-15 years £000	15-20 years £000	>20 years £000
Assets backing liabilities						
Debt securities at fair value through income	87,128	24,426	27,413	38,240	26,444	51,058
Cash and cash equivalents	329	329	-	-	-	-
Total	87,457	24,755	27,413	38,240	26,444	51,058
Liabilities	87,457	25,996	23,973	21,568	18,790	55,094
Difference in expected cash flows	-	(1,241)	3,440	16,672	7,654	(4,036)

31 December 2009

Contractual cash flows (undiscounted)

Carrying values and cash flows arising from	Carrying amounts £000	0-5 years £000	5-10 years £000	10-15 years £000	15-20 years £000	>20 years £000
Assets backing liabilities						
Debt securities at fair value through income	80,478	26,342	23,738	17,508	28,962	52,216
Cash and cash equivalents	449	449	-	-	-	-
Total	80,927	26,791	23,738	17,508	28,962	52,216
Liabilities	80,927	24,339	22,417	20,177	17,610	52,027
Difference in expected cash flows	-	2,452	1,321	(2,669)	11,352	189

Sensitivity analysis – interest rate risk

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

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

An increase of 100 basis points in interest yields of the matching assets would result in a decrease of £2.3m in profit for the year ended 31 December 2010 and in shareholder equity as at 31 December 2010 (year ended 31 December 2009 and as at 31 December 2009 £0.1m decrease).

A decrease of 100 basis points in interest yields would result in an increase of £0.9m in profit for the year ended 31 December 2010 and in shareholder equity as at 31 December 2010 (year ended 31 December 2009 and as at 31 December 2009 £0.1m increase).

Other non-linked contracts

This category consists of two groups of contracts. The first group, representing £13.5m of liabilities out of the total of £53.1m as at 31 December 2010 (£12.1m out of the total of £50.1m as at 31 December 2009) is operated on a quasi-linked basis, these are contracts for which, while not classed as unit-linked due to the fact that there is no surrender value which depends on unit values, all other aspects of the risk management of these contracts are the same as for unit-linked contracts. As a result the business operates the same risk management processes as described under 'Unit-linked Contracts' above.

The following is a maturity analysis of the contractual liabilities for this group of contracts, prepared on an estimated basis using estimates of mortality. The analysis represents the gross liabilities, before taking into account offsetting linked assets that are scheduled to mature in a similar profile.

Contractual cash flows (undiscounted)					
	0-5 years £000	5-10 years £000	10-15 years £000	15-20 years £000	>20 years £000
As at 31 December 2010	19,204	19,788	14,020	3,898	1,211
As at 31 December 2009	20,796	22,314	18,148	6,655	2,904

Sensitivity analysis – equity risk

An increase or decrease of 10% in the value of the assets which back this group of contracts would not have a material effect on either profit for the year ended 31 December 2010 and the year ended 31 December 2009 or shareholder equity as at those dates.

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

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

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

31 December 2010 Contractual cash flows (undiscounted)						
Carrying values and cash flows arising from	Carrying amounts £000	0-5 years £000	5-10 years £000	10-15 years £000	15-20 years £000	>20 years £000
Assets backing liabilities						
Reinsurers' share of insurance contract provisions	6,643	450	831	1,230	1,563	7,097
Debt securities at fair value through income	22,814	5,515	6,417	8,685	4,240	11,160
Insurance and other receivables	1,630	1,630	-	-	-	-
Cash and cash equivalents	8,517	8,517	-	-	-	-
Total	39,604	16,112	7,248	9,915	5,803	18,257
Liabilities	39,604	15,273	6,914	6,219	6,140	17,935
Difference in expected cash flows	-	839	334	3,696	(337)	322

31 December 2009

Contractual cash flows (undiscounted)

Carrying values and cash flows arising from	Carrying amounts £000	0-5 years £000	5-10 years £000	10-15 years £000	15-20 years £000	>20 years £000
Assets backing liabilities						
Reinsurer's share of insurance contract provisions	5,701	375	694	1,027	1,305	5,926
Debt securities at fair value through income	20,102	5,563	5,583	2,857	5,081	12,392
Insurance and other receivables	3,237	3,237	-	-	-	-
Cash and cash equivalents	8,919	8,919	-	-	-	-
Total	37,959	18,094	6,277	3,884	6,386	18,318
Liabilities	37,959	16,502	7,140	6,283	6,198	19,514
Difference in expected cash flows	-	1,592	(863)	(2,399)	188	(1,196)

Sensitivity analysis – interest rate risk

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

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

An increase of 100 basis points in interest yields would result in an increase of £0.2m in profit for the year ended 31 December 2010 and in shareholder equity as at 31 December 2010 (year ended 31 December 2009 and as at 31 December 2009 £0.2m decrease)

A decrease of 100 basis points in interest yields would result in a decrease of £0.7m in profit for the year ended 31 December 2010 and in shareholder equity as at 31 December 2010 (year ended 31 December 2009 and as at 31 December 2009 increase of £0.1m)

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

Other

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

(i) Intangible assets and deferred income

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

(ii) Other assets and liabilities

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

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

S&P Segment

31 December 2010

	Insurance contracts with DPF £000	Unit-linked contracts £000	Corporate, including non-profit £000	Total £000
Assets				
Reinsurers' share of insurance contract provisions	-	7,692	-	7,692
Investment properties	26,694	91,231	-	117,925
Financial assets				
Equity securities at fair value through income	-	25,196	-	25,196
Holdings in collective investment schemes at fair value through income	204,667	793,708	163,803	1,162,178
Debt securities at fair value through income	64,837	11,126	-	75,963
Insurance and other receivables	2,416	8,320	2,152	12,888
Prepayments	-	36	42	78
Derivative financial instruments	-	-	-	-
Total financial assets	271,920	838,386	165,997	1,276,303
Reinsurers' share of accrued policyholder claims	-	-	256	256
Income taxes	-	-	4,943	4,943
Cash and cash equivalents	2,793	11,549	630	14,972
Manager's box	(426)	(6,774)	7,200	-
Total assets	300,981	942,084	179,026	1,422,091
Liabilities				
Unallocated divisible surplus	(59,542)	-	59,625	83
Bank overdraft	-	29	-	29
Insurance contract provisions	359,209	828,602	22,999	1,210,810
Financial liabilities				
Investment contracts	-	108,862	-	108,862
Total financial liabilities	-	108,862	-	108,862
Deferred tax liabilities	152	1,722	7,903	9,777
Reinsurance payables	-	-	23	23
Payables related to direct insurance and investment contracts	-	-	10,919	10,919
Income taxes	-	-	3,280	3,280
Other payables	1,162	2,869	1,742	5,773
Total liabilities	300,981	942,084	106,491	1,349,556

Unit-linked policyholder funds and the with-profits policyholder funds, which match the liabilities for insurance contracts with DPF, are managed to provide returns in line with expectations of policyholders. Market risk in these funds is normally borne by policyholders as investment returns on these funds are attributed to policyholders. However, where the with-profits assets are insufficient to meet the minimum guaranteed liability, the additional cost is borne by shareholders. The Group's only market risk exposure on unit-linked policyholder funds is to changes in management fees. Market risk on corporate assets, which includes both non-profit non-linked business and assets attributable to the shareholder, are borne by the shareholder. The Group manages these market risks by setting investment guidelines for each fund which restrict market exposures depending on each fund's investment objectives. The Group receives management fees based on the market value of policyholder funds and its fee income is therefore subject to changes in the market value of policyholder assets. Management fee income will therefore be affected by lower market prices and higher volatility.

Insurance contracts with discretionary participation features

The primary investment objective of the with-profits policyholder funds is that the guaranteed minimum benefits of the with-profits policyholders should be met entirely from the policyholder funds. The secondary investment objective is, where possible, to provide a surplus in excess of the guaranteed minimum benefits. The entire surplus in the policyholder fund accrues to the with-profits policyholders. Any deficit in the policyholder fund is ultimately borne by shareholders. Therefore the Group has a significant exposure to market risk in relation to with-profits business should the with-profits policyholder assets be unable to fully meet the cost of guarantees.

To achieve the investment objectives, the funds may invest in a range of asset classes including property, equities, fixed interest securities, convertibles, cash and derivatives, and both in UK and overseas investments. Such exposure may be achieved by investment in collective investment schemes (including such schemes with total or absolute return objectives or which include investments in commodities). Investment guidelines restrict the level of exposure for certain asset categories. In respect of derivatives, these may only be used for the purposes of reduction of investment risks and efficient portfolio management.

The following analysis indicates the estimated amount and timing of the cash flows arising for this group of contracts, prepared on an estimated basis using estimates of mortality. No equivalent analysis is provided for the supporting asset portfolio, as materially all of these would be presented as occurring in the earliest period of the table.

Contractual cash flows (undiscounted)

	0-5 years £000	5-10 years £000	10-15 years £000	15-20 years £000	>20 years £000
As at 31 December 2010					
Death outgo	8,458	6,944	7,500	7,790	7,494
Maturity outgo	97,044	71,879	78,542	79,859	50,988
Total	105,502	78,823	86,042	87,649	58,482
As at 31 December 2009					
Death outgo	8,674	7,038	7,685	8,182	8,093
Maturity outgo	107,300	84,995	85,227	91,386	63,657
Total	115,974	92,033	92,912	99,568	71,750

Sensitivity analysis

At 31 December 2010 there was a deficit in the policyholder funds resulting in a negative unallocated divisible surplus which was eliminated by recognising a shareholder charge, prior to the acquisition of S&P by Chesnara, for the cost of guarantees of £60m (31 December 2009 £38m) as set out on Note 33

It is estimated that a 10% decrease in the value of equities and property within the with-profits policyholder funds as at 31 December 2010, with all other variables held constant, would increase the shareholder charge by approximately £5m (31 December 2009 £22m) and decrease profit for the year ended 31 December 2010 by £4m (year ended 31 December 2009 £16m)

A 10% increase in the value of the with-profits policyholder funds would give rise to decreases in shareholder charges and increases in period profits of identical amounts, as at and for the corresponding periods shown above

It is estimated that a 0.25% increase in the yields on fixed interest assets within the with-profits long-term business provision as at the balance sheet date, with all other variables held constant, would decrease the shareholder charge by approximately £3.7m (31 December 2009 £2.0m) and increase profit for the year ended 31 December 2010 by £2.6m (year ended 31 December 2009 £1.4m)

It is estimated that a 0.25% decrease in the yields on fixed interest assets within the with-profits long-term business provision as at the balance sheet date, with all other variables held constant, would increase the shareholder charge by approximately £3.4m (31 December 2009 £1.3m) and decrease profit for the year ended 31 December 2010 by £2.4m (year ended 31 December 2009 £0.9m)

Unit-linked contracts

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

In practice there remain areas where there is a residual risk as follows

(i) Surplus units

Market risk arises from the existence of surplus units (over and above requirements to match policyholder unit liabilities), which the Group may hold to facilitate the creation and cancellation of units. These positions can result in temporary, but insignificant, market exposures which are monitored on a daily basis against specific limits.

(ii) Change in insurance contract provisions

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

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

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

Sensitivity analysis – equity risk

A decrease of 10% in the value of the assets would reduce asset management fees, which would result in a £0.8m decrease in profit for the year ended 31 December 2010 and in shareholder equity as at 31 December 2010 (year ended and as at 31 December 2009 £0.9m)

Corporate assets including non-profit contracts

This category consists of a small amount of non-linked insurance contracts without DPF and corporate assets representing shareholder equity

Financial risks within corporate assets are borne by the Group. Corporate assets are invested to protect capital and to minimise market and credit risk. These assets are substantially invested in market funds that allow cash to be realised on a daily basis. At 31 December 2010 the value of these funds included in 'Holdings in collective investment schemes' were £164m (31 December 2009 £250m). The Group has a risk of lower returns on these investments, due to changes in short term interest rates, but a limited risk of a fall in fair value.

Sensitivity analysis – interest rate risk

The effect of a 1% decrease/(increase) in money market interest rates at the balance sheet date would be to decrease/(increase) post-tax profit for the year ended 31 December 2010 by approximately £2m (year ended 31 December 2009 £2m).

The Group has little currency risk as all policyholder contracts are sterling denominated. Foreign currency investments may be held in policyholder funds where the currency risk is borne by policyholders.

Use of derivatives is limited but may be used to gain or hedge market exposures or to hedge foreign currency investments in policyholder funds. All derivatives are recorded at fair value as the Group does not use hedge accounting.

Credit risk management

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

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

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

The businesses structure the levels of credit risk they accept by placing limits on their exposure to a single counterparty, or group of counterparties. Such risks are subject to at least an annual review.

Although the businesses hold a significant proportion of their financial assets in securities, the risk of default on these is mitigated to the extent that any losses arising in respect of unit-linked funds backing the insurance and investment contracts which the businesses issue, would effectively be passed on to policyholders and investors through the unit-linked funds backing the insurance and investment contracts.

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

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

CA Segment

	Credit rating-debt securities				Cash balances	Total
	AAA	AA	A	Unrated		
As at 31 December 2010	£000	£000	£000	£000	£000	£000
Debt securities, deposits and cash balances with credit institutions						
Linked	4,379	103	443	-	63,428	68,353
Non-linked	28,694	4,012	2,770	1,198	91,486	128,160
Government or pseudo Government deposits						
Linked	90,070	-	-	-	-	90,070
Non-linked	107,189	-	-	-	-	107,189
Total debt, deposits and cash balances	230,332	4,115	3,213	1,198	154,914	393,772

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

CA retains some residual risks on assets which support annuities, guaranteed investment bonds and shareholder's equity. These risks are monitored; a key aspect of this is the business's current policy of investing new monies only in high-quality bonds of supra-national corporations and in government-backed debt. The business has never purchased assets rated below AA by Standard & Poors. CA's objective is to earn competitive relative returns by investing in a diversified portfolio of securities. Watch lists are maintained for exposures requiring additional review and all credit exposures are reviewed monthly.

For historical reasons CA has a significant exposure of £254.0m as at 31 December 2010 (31 December 2009 £232.9m) to Guardian, which does not have a published credit rating. Of this amount £218.8m (31 December 2009 £204.1m) is in respect of currently guaranteed benefits. The exposure which relates to reinsured insurance contract liabilities, and which relates to amounts deposited with Guardian in respect of investment contract liabilities, was mitigated during 2006 when Guardian granted to CA a floating charge over related investment assets, which ranks that company equally with Guardian policyholders. In order to monitor the ongoing creditworthiness of Guardian, CA reviews the financial statements and regulatory returns submitted by Guardian to the FSA on an annual basis.

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

No credit limits were exceeded during the year ended 31 December 2010. No financial assets are past due or impaired at the reporting date and management expects no significant losses from non-performance by these counterparties.

S&P Segment

	Credit rating-debt securities				Cash balances	Total
	AAA	AA	A	Unrated		
As at 31 December 2010	£000	£000	£000	£000	£000	£000
Holdings in collective investment schemes	-	-	102,192	-	-	102,192
Reinsurance assets						
Reinsurance contract with Phoenix Assurance Company	-	-	-	7,692	-	7,692
Other reinsurance assets	-	-	-	256	-	256
Government or pseudo government deposits	64,837	-	-	-	-	64,837
Derivative contracts	-	-	-	-	-	-
Insurance and other receivables	-	-	-	4,568	-	4,568
Cash and cash equivalents	-	-	-	-	3,423	3,423
Total	64,837	-	102,192	12,516	3,423	182,968

	Credit rating-debt securities				Cash	Total
	AAA	AA	A	Unrated	balances	
As at 31 December 2009	£000	£000	£000	£000	£000	£000
Holdings in collective investment schemes	-	-	101,485	-	-	101,485
Reinsurance assets						
Reinsurance contract with Phoenix Assurance Company	-	-	-	6,936	-	6,936
Other reinsurance assets	-	-	-	329	-	329
Government or pseudo government deposits	64,284	-	-	-	-	64,284
Derivative contracts	-	-	279	-	-	279
Insurance and other receivables	-	-	-	3,579	-	3,579
Cash and cash equivalents	-	-	-	-	9,515	9,515
Total	64,284	-	101,764	10,844	9,515	186,407

In addition to the above S&P bears the credit risk on an investment contract, valued at £102m as at 31 December 2010 (31 December 2009 £nil) with JPMorgan Life Limited (JPML) included in "Holdings in collective investment schemes", as set out in Note 26. The counterparty exposure to JPML is off-set by a counterparty exposure that JPML has to S&P of £10m (31 December 2009 £nil) under a separate investment contract held by JPML with S&P. At 31 December 2010 the net exposure to JPML was £92m (31 December 2009 £nil).

Assets held to cover unit-linked liabilities, with the exception of the investment contract held with JPML and the reinsurers' share of insurance contract provisions, have been excluded in the tables set out above as substantially all the credit risk remains with policyholders. Assets held to cover with-profits liabilities are included as there is a risk that credit risk will be borne by the shareholder where this results in there being insufficient with-profits policyholder assets to fund the minimum guaranteed obligation. However, in normal circumstances (where the asset share is in excess of the minimum guaranteed amount) substantially all the credit risk remains with policyholders. Holdings in collective investment schemes have also been excluded from the tables above as, given the nature of the financial instrument, these do not directly expose S&P to credit risk.

No credit limits were exceeded during the post-acquisition period ended 31 December 2010. No financial assets are past due or impaired at the reporting date and management expects no significant losses from non-performance by these counterparties.

Liquidity risk management

Liquidity risk in policyholder funds is managed by investing only in readily realisable investments with the exception of property investments where property sales and purchases are closely monitored to match net flows with policyholders. The property fund is a small proportion of total assets. It maintains a prudent level of liquidity and there are provisions in the fund particulars to defer redemptions in times of adverse market conditions or where they might be material relative to the fund.

Financial liabilities under unit-linked investment contracts do not have contractual maturity dates and are shown as due in less than one year. These liabilities do not pose a material liquidity risk as there are matching policyholder assets which could be realised to meet surrenders.

The Group's substantial holding of money market funds serves to minimise liquidity risk.

Swedish Business - Movestic Segment

Terms and conditions of unit-linked investment contracts

The insurance and investment elements of unit-linked contracts provided by Movestic have been unbundled. The principal risks associated with the insurance contracts are disclosed in Note 5. The terms and conditions of investment contracts that could have a material effect on the amount, timing and uncertainty of future cash flows arising from investment contracts are set out in the product analyses below.

Movestic provides two types of investment contract:

(i) Unit-linked savings

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

(ii) *Unit-linked pensions*

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

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

Contractual maturity analysis

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

The following table sets out the contractual maturity analysis of the financial assets and financial liabilities of Movestic.

31 December 2010							
Carrying values and cash flows arising from	Carrying amounts £000	0-1 year £000	1-2 years £000	2-3 years £000	3-4 years £000	>4 years £000	Unit linked* £000
Assets							
Collective investment schemes	1,244,315	5,900	-	-	-	-	1,238,415
Deposits	52,337	-	-	-	-	-	52,337
Debt securities at fair value through income	4,695	2,561	2,134	-	-	-	-
Reinsurers' share of insurance contract provisions	44,775	5,860	5,215	4,508	3,898	25,294	-
Insurance and other receivables	12,826	2,820	-	-	-	-	10,006
Accrued income and prepayments	2,303	2,303	-	-	-	-	-
Derivative financial instruments	4,114	1,718	1,113	561	247	475	-
Cash and cash equivalents	24,565	24,565	-	-	-	-	-
Total	1,389,930	45,727	8,462	5,069	4,145	25,769	1,300,758
Liabilities							
Insurance contract provisions	63,711	8,338	7,420	6,414	5,547	35,992	-
Investment contracts	1,299,578	-	-	-	-	-	1,299,578
Other liabilities	60,680	47,488	6,127	3,089	1,360	2,615	-
Total	1,423,969	55,826	13,547	9,503	6,907	38,607	1,299,578
Difference in expected cash flows	(34,039)	(10,099)	(5,085)	(4,434)	(2,762)	(12,838)	1,180

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

31 December 2009Carrying values and
cash flows arising
from

	Carrying amounts £000	0-1 year £000	1-2 years £000	2-3 years £000	3-4 years £000	>4 years £000	Unit linked* £000
Assets							
Collective investment schemes	915,602	5,963	-	-	-	-	909,639
Policyholders' funds held by the group	41,107	-	-	-	-	-	41,107
Debt securities at fair value through income	1,908	1,908	-	-	-	-	-
Reinsurers' share of insurance contract provisions	27,262	15,359	3,733	2,328	922	4,920	-
Insurance and other receivables	10,208	9,548	660	-	-	-	-
Accrued income and prepayments	2,093	2,093	-	-	-	-	-
Derivative financial instruments	3,544	1,051	1,437	863	183	10	-
Cash and cash equivalents	14,776	14,776	-	-	-	-	-
Total	1,016,500	50,698	5,830	3,191	1,105	4,930	950,746
Liabilities							
Insurance contract provisions	32,353	17,893	4,397	2,774	1,151	6,138	-
Investment contracts	918,291	-	-	-	-	-	918,291
Liabilities relating to policyholders' funds held by the group	41,107	-	-	-	-	-	41,107
Other liabilities	46,705	23,876	7,205	6,223	3,436	5,965	-
Total	1,038,456	41,769	11,602	8,997	4,587	12,103	959,398
Difference in expected cash flows	(21,956)	8,929	(5,772)	(5,806)	(3,482)	(7,173)	(8,652)

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

Foreign exchange exposure

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

The following table sets out the foreign exchange exposure of the financial assets and financial liabilities of Movestic.

	31 December		31 December	
	2010	2009	2010	2009
	NOK 000	NOK 000	EUR 000	EUR 000
Foreign assets and liabilities				
Assets				
Reinsurers' share of insurance contract provisions	48,806	85,543	-	-
Deferred acquisition costs	230	327	-	-
Equity securities at fair value through income	-	-	-	-
Debt securities at fair value through income	-	-	-	-
Insurance and other receivables	(687)	(402)	-	-
Loans and other receivables	21	-	784	7,609
Cash and cash equivalents	7,831	12,135	9	16
Total	56,201	97,603	793	7,625
Liabilities				
Insurance contract provisions	(58,434)	(102,262)	-	-
Other liabilities	2,475	(762)	-	-
Total	(55,959)	(103,024)	-	-
Foreign exchange mismatch	242	(5,421)	793	7,625

Credit risk exposure

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

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

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

The business structures the levels of credit risk it accepts by placing limits on its exposure to a single counterparty, or group of counterparties. Such risks are subject to at least an annual review. By far the largest credit risk to the business is in relation to its reinsurance assets.

The business retains some residual risks on assets which support shareholders' equity. The business's objective is to earn competitive relative returns by investing in a diversified portfolio of securities. Watch lists are maintained for exposures requiring additional review and all credit exposures are reviewed monthly.

The exposure to credit risk of Movestic in relation to its debt securities, receivables and cash balances is summarised below.

	Credit rating- debt securities				Total
	AAA	AA	A	Unrated	
As at 31 December 2010	£000	£000	£000	£000	£000
Debt securities at fair value through income	4,695	-	-	-	4,695
Insurance and other receivables	-	-	-	12,826	12,826
Cash balances	-	24,238	26	300	24,564
Total debt, receivables and cash balances	4,695	24,238	26	13,126	42,085

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

Reinsurance credit risk

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

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

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

Reinsurance Credit Risk Exposure

	Credit rating- reinsurers				Total £000
	AAA £000	AA £000	A £000	Unrated £000	
As at 31 December 2010	-	14,439	18,223	12,113	44,775
As at 31 December 2009	-	16,483	38	10,741	27,262

Financial assets that are past due or impaired

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

Sensitivity analysis

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

Sensitivity analysis – interest rate risk

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

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

The interest rate risk for the fixed interest debt securities of Movestic is deemed to be low as these assets are mainly short term (less than two years). A 100 basis point increase or decrease in interest yields would not have a material effect on either profit for the years ended 31 December 2010 and 31 December 2009 or shareholder equity as at those dates.

Sensitivity analysis – equity risk

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

A decrease of 10 per cent in equities markets would result in a £0.4m decrease in profit for the year ended 31 December 2010 and to shareholder equity as at 31 December 2010, (year ended 31 December 2009 and as at 31 December 2009 £0.1m).

An increase of 10 per cent in equities markets would result in a £0.4m increase in profit for the year ended 31 December 2010 and to shareholder equity as at 31 December 2010 (year ended 31 December 2009 and as at 31 December 2009 £0.1m).

Sensitivity analysis – foreign exchange risks

An increase or decrease of 10% in exchange rates in relation to Movestic has no material effect on profit and shareholder equity either for the year ended 31 December 2010 or for the year ended 31 December 2009 or as at those dates

Other Group Activities

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

(i) Cash and cash equivalents

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

(ii) Borrowings

Borrowings issued at variable rates of interest expose the Group to cash flow interest risk. Information on borrowings is set out in Note 36. A 1% increase in interest rates would result in a decrease of £0.4m in profit after tax attributable to shareholders for the year ended 31 December 2010 (year ended 31 December 2009: £0.1m decrease) and in shareholder equity as at 31 December 2010 (31 December 2009: £0.1m decrease).

(iii) Foreign exchange rate risk

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

An increase of 10% in the 31 December 2010 SEK to £ rate from SEK10.5250 to £1 to SEK11.5575 to £1 would result in a reduction in shareholder equity of £4.8m as at 31 December 2010 (as at 31 December 2009: £4.3m).

An increase of 10% in the average SEK to £ rate from SEK10.5250 to £1 to SEK9.4725 to £1 for the year ended 31 December 2010 would result in an increase in the shareholder equity of £5.8m as at 31 December 2010 (as at 31 December 2009: £5.3m).

Financial assets that are past due or impaired

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

During 2010, further interim distributions totalling £250,047 (2009: £326,000) were made from the administrators in respect of the deposit.

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

7 Business combinations

Profit recognised on business combinations arises on acquisition of

	Year ended 31 December	
	2010	2009
	£000	£000
Save & Prosper Insurance Limited	15,488	-
Aspis Forsäkringar Liv AB	376	-
Movestic Livförsäkring AB	-	25,056
	15,864	25,056

(i) Acquisition of Save & Prosper Insurance Limited

On 20 December 2010, Chesnara plc acquired the entire issued share capital (100%) of Save & Prosper Insurance Limited ("S&P") from JPMorgan Asset Management Marketing Limited for a total consideration of £63,524,000, paid in cash.

Save & Prosper Insurance Limited is a UK-based insurance and investment group underwriting primarily life assurance risks and providing a portfolio of contracts for the saving and retirement needs of customers through asset management, and is effectively closed to new business.

In life assurance companies there is a requirement for businesses to hold a level of regulatory capital, whilst the cash flows relating to the policy book generate a profit stream. The inability of a company acquiring a closed book life assurance business to freely distribute the net assets supporting the regulatory capital leads to a value being placed on the business, as a whole, lower than the fair value of the net assets acquired. This was taken into account, during negotiations, by Chesnara in determining a suitable consideration, which was less than the previously-reported value of the net assets of S&P. Subsequent to acceptance of the purchase

offer price, but before completion, investment valuation movements have resulted in significant changes in the valuation of insurance liabilities and related assets which have increased the value of the net assets acquired of S&P at the completion date of 20 December 2010. The key sensitivities relating to the determination of the insurance liabilities, considered within the completion balance sheet, are disclosed in Note 33. The key factors considered in determining the value of the acquired value of in-force business are disclosed in Note 3(b).

The acquisition of this shareholding has given rise to a profit on acquisition of £15,488,000 calculated as follows:

The estimated book and fair values of the assets and liabilities at the date of acquisition were	Book value £000	Provisional fair value adjustments £000	Fair value £000
Assets			
Intangible assets			
Value of in-force contracts	-	9,093	9,093
Investment properties	117,925	-	117,925
Reinsurers' share of insurance contract provisions	7,692	-	7,692
Amounts deposited with reinsurers	-	-	-
Total financial assets	1,261,883	-	1,261,883
Reinsurers' share of accrued policyholder claims	256	-	256
Income taxes	4,943	-	4,943
Cash and cash equivalents	15,217	-	15,217
Total assets	1,407,916	9,093	1,417,009
Liabilities			
Bank overdraft	29	-	29
Insurance contract provisions	1,197,067	-	1,197,067
Investment contracts	108,862	-	108,862
Unallocated divisible surplus	83	-	83
Deferred tax liabilities	9,777	2,455	12,232
Reinsurance payables	23	-	23
Payables related to direct insurance and investment contracts	10,919	-	10,919
Income taxes	3,217	-	3,217
Other payables	5,565	-	5,565
Total liabilities	1,335,542	2,455	1,337,997
Net assets	72,374	6,638	79,012
Net assets acquired (100%)			79,012
Total consideration			(63,524)
Profit arising on acquisition of subsidiary			15,488

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

Within the net assets acquired are receivable balances totalling £12.9m, which are held at fair value. An impairment review conducted as part of the fair value and accounting policy adjustment process has been completed.

The costs in respect of the transaction which have been written off in the Consolidated Statement of Comprehensive Income are £3,169,000 and are included in Administration Expenses.

The results of S&P have been included in the consolidated financial statements of the Group with effect from 20 December 2010, and have contributed revenue of £17.4m over this period, whilst contributing £0.2m profit to the overall consolidated profit before tax.

Had S&P been consolidated from 1 January 2010 the consolidated statement of comprehensive income would have included revenue of £177.7m, and would have contributed £11.7m loss to the overall consolidated profit before tax.

(ii) Acquisition of business relating to Aspis Forsäkringar Liv AB

On 19 February 2010, Chesnara plc's Swedish subsidiary, Movestic Livförsäkring Liv AB ('Movestic'), entered into an agreement with the Swedish Regulatory Authority, Finansinspektionen ('FI') to take over the operational management and certain of the assets and liabilities of Aspis Forsäkringar Liv AB ('Aspis') for a total consideration of SEK 20.75m (£1.8m), paid in cash. Movestic has acquired the in-force business, the personnel, expertise and systems of Aspis and will also manage, but not be responsible for, the payment of in-force claims that had occurred up to 12 November 2009. Movestic had previously, under the terms of an asset transfer agreement entered into on 10 December 2009, acquired the right to offer renewal policies to Aspis policyholders from 12 November 2009.

Movestic acquired the net assets of the business at less than their fair value, because it was in a position, at short notice, to provide the regulatory capital required by the Swedish regulator to back the policyholder liabilities acquired, the previous owner having defaulted on this obligation

The acquisition of this business has given rise to a profit on acquisition of £376,278 calculated as follows

The estimated book and fair values of the assets and liabilities at the date of acquisition were	Book value £000	Provisional fair value adjustments £000	Fair value £000
Assets			
Intangible assets			
Value of in-force insurance contracts	-	235	235
Software assets	-	927	927
Value of customer relationships	-	1,306	1,306
Deferred acquisition costs	235	(235)	-
Property and equipment	154	-	154
Cash and cash equivalents	3,651	-	3,651
Total assets	4,040	2,233	6,273
Liabilities			
Insurance contract provisions	3,911	-	3,911
Other payables	154	-	154
Total liabilities	4,065	-	4,065
Net assets	(25)	2,233	2,208
Net assets acquired			2,208
Total consideration			(1,832)
Profit arising on acquisition of business			376

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

The costs in respect of the transaction which have been written off in the Consolidated Statement of Comprehensive Income are £64,279 and are included in Administration expenses

The results of Aspis have been included in the consolidated financial statements of the Group with effect from 19 February 2010, and have contributed revenue of £7.5m over this period, whilst contributing £1.2m loss to the overall consolidated profit before tax

Had Aspis been consolidated from 1 January 2010 the consolidated statement of comprehensive income would have included revenue of £7.9m, and the results would have contributed £1.3m loss to the overall consolidated profit before tax

(iii) Acquisition of Movestic Livförsäkring AB

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

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

The book value and fair values of the assets and liabilities at the date of acquisition were disclosed in the financial statements for the year ended 31 December 2009, together with the profit arising on acquisition.

Chesnara considers that the primary factor that gave rise to the significant profit arising on acquisition was the desire of Movestic's parent group to divest itself rapidly of Movestic, combined with Chesnara's ability to complete the transaction within a short period of time for a cash consideration. Prior to its acquisition by Chesnara, Movestic was a 100% subsidiary of Moderna Finance AB (MFAB), which in turn was owned by Glitnir Bank in Iceland. This bank was adversely affected by the Icelandic banking crisis and was nationalised by the Government of Iceland in October 2008. MFAB had recently sold its non-life insurance operation, which was the significantly larger part of its business. We understood that it was keen to divest itself quickly of the remaining life insurance and pensions business, Movestic.

As far as we are aware, although we are not able to be 100% certain, there were no other potential purchasers. From the negotiations, we understood that MFAB's primary concern was speed of execution rather than obtaining a fuller value for the disposal. The acquisition of this business gave rise to a profit on acquisition of £25,056,000.

8 Operating segments

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

The segments of the Group as at 31 December 2010 comprise

CA

This segment comprises part of the Group's UK insurance and investment operation, being Countrywide Assured Life Holdings Limited ('CA'), which holds part of the Group's UK insurance and investment assets and liabilities, and is responsible for managing unit-linked and non-linked business. Up until 20 December 2010 it was designated as the 'UK Business' segment.

S&P

This segment, which was acquired on 20 December 2010, comprises the balance of the Group's UK insurance and investment operation, Save & Prosper Insurance Limited (S&P), which holds the balance of the Group's UK insurance and investment assets, and is responsible for managing both unit-linked and non-linked business, including a significant with-profits portfolio, which carries significant additional market risk, as described in Note 6 'Management of financial risk'.

Movestic

This segment comprises the Swedish insurance and investment operation, Movestic Livförsäkring AB ('Movestic'), formerly known as Moderna Försäkringar Liv AB ('Moderna'), which holds the Group's Swedish insurance and investment assets and liabilities, and is responsible for managing both unit-linked and non-linked business. Up until 20 December 2010 it was designated as the 'Swedish Business' segment.

Other Group Activities

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

Apart from the changes set out above, there were no changes to the basis of segmentation during the year ended 31 December 2010.

The accounting policies of the segments are the same as those for the Group as a whole. Any transactions between the business segments are on normal commercial terms in normal market conditions. The Group evaluates performance of operating segments on the basis of the profit before tax attributable to shareholders and on the total assets and liabilities of the reporting segments and the Group. There were no changes to the measurement basis for segment profit during the year ended 31 December 2010.

(i) Segmental income statement for the year ended 31 December 2010

	CA £000	S&P £000	Movestic £000	Other Group Activities £000	Total £000
Insurance premium revenue	80,157	372	34,421	-	114,950
Insurance premium ceded to reinsurers	(14,563)	-	(21,132)	-	(35,695)
Net insurance premium revenue	65,594	372	13,289	-	79,255
Fee and commission income	38,532	77	24,801	-	63,410
Net investment return	178,664	16,949	108,023	214	303,850
Total revenue (net of reinsurance payable)	282,790	17,398	146,113	214	446,515
Other operating income	3,481	201	5,534	-	9,216
Segmental income	286,271	17,599	151,647	214	455,731
Insurance contract claims and benefits incurred					
Claims and benefits paid to insurance contract holders	(124,449)	(3,347)	(11,628)	-	(139,424)
Net (increase)/decrease in insurance contract provisions	(89,773)	(13,820)	(3,025)	-	(106,618)
Reinsurers' share of claims and benefits	37,084	-	8,551	-	45,635
Net insurance contract claims and benefits incurred	(177,138)	(17,167)	(6,102)	-	(200,407)
Change in investment contract liabilities	(71,672)	-	(98,437)	-	(170,109)
Change in liabilities relating to policyholders' funds held by the Group	-	-	(9,912)	-	(9,912)
Reinsurers' share of investment contract liabilities	3,904	-	-	-	3,904
Net change in investment contract liabilities	(67,768)	-	(108,349)	-	(176,117)
Fees, commission and other acquisition costs	(1,252)	-	(13,436)	-	(14,688)
Administrative expenses	(9,524)	(208)	(15,407)	(4,236)	(29,375)
Other operating expenses	(4,897)	-	(11,470)	210	(16,157)
Segmental expenses	(260,579)	(17,375)	(154,764)	(4,026)	(436,744)
Segmental income less expenses	25,692	224	(3,117)	(3,812)	18,987
Share of profit from associates	-	-	597	-	597
Profit recognised on acquisition of subsidiary	-	-	376	15,488	15,864
Segmental operating profit/(loss)	25,692	224	(2,144)	11,676	35,448
Financing costs	-	-	(1,210)	(70)	(1,280)
Profit/(loss) before tax	25,692	224	(3,354)	11,606	34,168
Income tax (expense)/credit	(4,740)	(63)	176	160	(4,467)
Non-controlling interest	-	-	118	-	118
Profit/(loss) after tax attributable to shareholders	20,952	161	(3,060)	11,766	29,819

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

	CA £000	S&P £000	Movestic £000	Other Group Activities £000	Total £000
Insurance premium revenue	88,469	-	11,636	-	100,105
Insurance premium ceded to reinsurers	(15,831)	-	(9,166)	-	(24,997)
Net insurance premium revenue	72,638	-	2,470	-	75,108
Fee and commission income	42,543	-	8,577	-	51,120
Net investment return	233,926	-	92,239	515	326,680
Total revenue (net of reinsurance payable)	349,107	-	103,286	515	452,908
Other operating income	4,689	-	-	-	4,689
Segmental income	353,796	-	103,286	515	457,597
Insurance contract claims and benefits incurred					
Claims and benefits paid to insurance contract holders	(126,737)	-	(2,820)	-	(129,557)
Net (increase)/decrease in insurance contract provisions	(128,064)	-	224	-	(127,840)
Reinsurers' share of claims and benefits	45,630	-	2,267	-	47,897
Net insurance contract claims and benefits incurred	(209,171)	-	(329)	-	(209,500)
Change in investment contract liabilities	(107,524)	-	(92,224)	-	(199,748)
Reinsurers' share of investment contract liabilities	4,710	-	-	-	4,710
Net change in investment contract liabilities	(102,814)	-	(92,224)	-	(195,038)
Fees, commission and other acquisition costs	(1,116)	-	(4,051)	-	(5,167)
Administrative expenses	(9,806)	-	(5,276)	(3,163)	(18,245)
Other operating expenses	(6,105)	-	(3,563)	332	(9,336)
Segmental expenses	(329,012)	-	(105,443)	(2,831)	(437,286)
Segmental income less expenses	24,784	-	(2,157)	(2,316)	20,311
Share of profit from associates	-	-	39	-	39
Profit recognised on acquisition of subsidiary	-	-	-	25,056	25,056
Segmental operating profit/(loss)	24,784	-	(2,118)	22,740	45,406
Financing costs	-	-	(508)	(157)	(665)
Profit/(loss) before tax	24,784	-	(2,626)	22,583	44,741
Income tax credit/(expense)	948	-	(148)	392	1,192
Non-controlling interest	-	-	7	-	7
Profit/(loss) after tax attributable to shareholders	25,732	-	(2,767)	22,975	45,940

(iii) Segmental balance sheet as at 31 December 2010

	CA £000	S&P £000	Movestic £000	Other Group Activities £000	Total £000
Intangible assets	27,870	9,055	80,641	-	117,566
Property and equipment	67	-	604	-	671
Investment in associates	-	-	1,783	-	1,783
Reinsurers' share of insurance contract provisions	228,276	7,692	44,775	-	280,743
Amounts deposited with reinsurers	30,264	-	-	-	30,264
Investment properties	2,895	117,925	-	-	120,820
Financial assets	1,491,088	1,276,303	1,320,645	243	4,088,279
Reinsurers' share of accrued policyholder claims	3,422	256	-	-	3,678
Income tax	-	4,943	-	543	5,486
Cash and cash equivalents	133,716	14,972	24,248	21,198	194,134
Assets held for sale	-	-	380	-	380
Total assets	1,917,598	1,431,146	1,473,076	21,984	4,843,804
Liabilities held for sale	-	-	380	-	380
Bank overdrafts	2,125	29	-	-	2,154
Insurance contract provisions	1,129,558	1,210,810	63,711	-	2,404,079
Unallocated divisible surplus	-	83	-	-	83
Investment contracts at fair value through income	646,609	108,862	1,247,241	-	2,002,712
Liabilities relating to policyholders' funds held by the Group	-	-	52,337	-	52,337
Borrowings	-	-	23,407	39,287	62,694
Derivative financial instruments	137	-	-	-	137
Provisions	1,822	-	-	-	1,822
Deferred tax liabilities	7,525	12,222	779	-	20,526
Reinsurance payables	1,921	23	20,366	-	22,310
Payables related to direct insurance and investment contracts	19,338	10,919	5,551	-	35,808
Deferred income	11,647	-	-	-	11,647
Income taxes	3,188	3,280	455	-	6,923
Other payables	3,098	5,773	6,050	2,002	16,923
Total liabilities	1,826,968	1,352,001	1,420,277	41,289	4,640,536
Net assets	90,630	79,145	52,799	(19,305)	203,269
Non-controlling interest	-	-	-	-	-
Net assets attributable to shareholders	90,630	79,145	52,799	(19,305)	203,269

(iv) Segmental balance sheet as at 31 December 2009

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

9 Fees and commission income

	Year ended 31 December	
	2010 £000	2009 £000
Fee income		
Policy-based fees	8,861	11,210
Fund management-based fees	24,060	10,339
Benefit-based fees	23,967	26,153
Change in deferred income – gross	1,485	1,443
Change in deferred income – reinsurer's share	(51)	(57)
Total fee income	58,322	49,088
Commission income	4,796	2,011
Other income	292	21
Total fee and commission income	63,410	51,120

10 Net investment return

	Year ended 31 December	
	2010 £000	2009 £000
Dividend income	31,090	23,914
Interest income	16,913	17,969
Rental income from investment properties	1,020	135
Net fair value gains and losses		
Equity securities designated as at fair value through income on initial recognition	235,206	277,843
Debt securities designated as at fair value through income on initial recognition	19,253	3,281
Derivative financial instruments	256	3,615
Investment properties	112	(77)
Net investment return	303,850	326,680

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

No amounts included in net fair value gains and losses of financial instruments were estimated using a valuation technique (2009 £nil)

11 Other operating income

	Year ended 31 December	
	2010 £000	2009 £000
Release of unused provisions	71	1,331
Recharge of shared property services to tenants	428	499
Administration fees charged to reinsurers	113	133
Professional indemnity insurance recoveries	4	135
Investment management fee rebate	2,800	2,181
HMRC interest on tax refund	11	235
Charges to policyholder funds for yield tax	5,532	-
Other	257	175
Total other operating income	9,216	4,689

12 Insurance contract claims and benefits

	Year ended 31 December	
	2010 £000	2009 £000
Claims and benefits paid to insurance contract holders	139,424	129,557
Net increase in insurance contract provisions	106,618	127,840
Total insurance contract claims and benefits	246,042	257,397
Recoveries from reinsurers	(45,635)	(47,897)
Net insurance contract claims and benefits incurred	200,407	209,500

13 Change in investment contract liabilities

	Year ended 31 December	
	2010 £000	2009 £000
Net changes in the fair value of investment contracts designated on initial recognition as fair value through income	170,109	198,975
Net changes in the fair value of policyholders' funds held by the Group designated on initial recognition as fair value through income	9,912	773
Reinsurer's share	(3,904)	(4,710)
Net change in investment contract liabilities	176,117	195,038

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

14 Fees, commission and other acquisition costs

	Year ended 31 December	
	2010 £000	2009 £000
Directly expensed costs		
Insurance contracts		
Commission	4,931	1,201
New business and renewal costs	2,084	485
Investment contracts		
Commission	9,178	3,240
New business and renewal costs	3,140	996
Additions to deferred acquisition costs		
Insurance contracts	(4,833)	(1,202)
Investment contracts – gross	(5,517)	(1,600)
Amortisation of deferred acquisition costs		
Insurance contracts	4,453	1,239
Investment contracts-gross	1,283	841
Investment contracts-reinsurance	(31)	(33)
Total	14,688	5,167

15 Administrative expenses

	Year ended 31 December	
	2010 £000	2009 £000
Personnel-related costs	11,475	5,443
Investment management fees	3,517	3,128
Amortisation charge on software assets	1,176	414
Depreciation charge on property and equipment	304	73
Costs paid to third-party administrators	5,062	4,120
Other goods and services	7,841	5,067
Total	29,375	18,245

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

	Year ended 31 December	
	2010 £000	2009 £000
Fees payable to the Company's Auditor for the audit of the company's annual accounts	85	62
Fees payable to the Company's Auditor and its associates for other services		
The audit of the Company's subsidiaries pursuant to legislation	257	189
Other services pursuant to legislation	107	70
Tax services	30	53
Services related to corporate finance transactions	287	20
All other services	2	3
	768	397

16 Other operating expenses

	Year ended 31 December	
	2010	2009
	£000	£000
Charge for amortisation of acquired value of in-force business	8,145	6,953
Charge for amortisation of acquired value of customer relationships	952	188
Increase in provisions	658	1,509
Direct operating expenses of investment properties		
Revenue-generating properties	35	68
Non revenue-generating properties	130	-
Contributions to associate companies immediately expensed	-	97
Recovery of cash deposit	(250)	(326)
Payment of yield tax relating to policyholder funds	5,532	-
Akademiker impairment charge	314	-
Akademiker write-down of AVCR	224	-
Other	417	847
Total	16,157	9,336

The recovery of cash deposit represents interim distributions received from the administrators of Kaupthing Singer & Friedlander relating to a cash deposit, previously written down and charged to operating expenses

The impairment charge and write-down relating to Akademiker are explained in Note 31

17 Financing costs

	Year ended 31 December	
	2010	2009
	£000	£000
Interest expense on bank borrowings	70	157
Interest expense on financial reinsurance	1,022	453
Interest expense on reinsurance deposit	184	51
Other interest	4	4
Total financing costs	1,280	665

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

18 Income tax expense

	Year ended 31 December	
	2010	2009
	£000	£000
Total income tax expense/(credit) comprises		
CA, S&P and Other Group Activities	4,643	(1,340)
Movestic	(176)	148
Total	4,467	(1,192)

	Year ended 31 December	
	2010	2009
	£000	£000
CA, S&P and Other Group Activities		
Current tax expense		
Current year	5,685	3,548
Overseas tax	617	976
Adjustment to prior years	441	(4,681)
Net expense/(credit)	6,743	(157)
Deferred tax credit		
Origination and reversal of temporary differences	(2,100)	(1,183)
Total income tax expense/(credit)	4,643	(1,340)

Reconciliation of effective tax rate on profit before tax

	Year ended 31 December	
	2010 £000	2009 £000
Profit before tax	37,522	47,367
Income tax using the domestic corporation tax rate of 28% (2009 28%)	10,506	13,263
Non-taxable profit on acquisition of subsidiary	(4,337)	(7,016)
Permanent differences	777	304
Effect of UK taxing bases on insurance profits		
Offset of franked investment income	(3,373)	(3,859)
Variation in rate of tax on amortisation of acquired in-force value	72	73
Other	556	576
Under/(over) provided in prior years	442	(4,681)
Total income tax expense/(credit)	4,643	(1,340)

The amount overprovided for the year ended 31 December 2009 relates principally to the writeback of a provision for current tax in Countrywide Assured plc in respect of 2007. This provision had been established because of uncertainty surrounding the interpretation of UK tax legislation relating to that year. In the event, the submission to HMRC of the tax computation for that year has resolved the uncertainty and the provision has, accordingly, been released.

	Year ended 31 December	
	2010 £000	2009 £000
Movestic		
Current tax expense		
Current year	1	12
Adjustment to prior years	(15)	-
	(14)	12
Deferred tax expense		
Origination and reversal of temporary differences	(162)	136
Total income tax (credit)/expense	(176)	148

Reconciliation of effective tax rate on profit before tax

	Year ended 31 December	
	2010 £000	2009 £000
Loss before tax	(3,354)	(2,626)
Income tax using the domestic corporation tax rate of 26.3%	(882)	(691)
Non-taxable income in relation to unit-linked business	202	349
Policyholder tax	-	13
Non-taxable fair value adjustment on acquisition	469	440
Impact of different rate for subsidiaries	22	5
Permanent differences	(22)	(13)
Unrecognised tax recoverable	49	47
Non-deductible expenses	-	8
Overprovided in prior years	(14)	(10)
Total income tax (credit)/expense	(176)	148

19 Deferred acquisition costs

	CA £000	S&P £000	Movestic £000	31 December	
				2010 Total £000	2009 Total £000
Balance at 1 January	7,683	-	1,644	9,327	8,590
Additions – new business	-	-	10,577	10,577	2,802
Amortisation charged to income	(938)	-	(4,798)	(5,736)	(2,080)
Foreign exchange translation difference	-	-	491	491	15
Balance at 31 December	6,745	-	7,914	14,659	9,327
Current	721	-	4,379	1,875	896
Non-current	6,024	-	3,535	12,784	8,431
Total	6,745	-	7,914	14,659	9,327

The amortisation charged to income is recognised in Fees, Commission and Other Acquisition Costs (see Note 14)

20 Acquired value of in-force business (AVIF)

	31 December	
	2010 £000	2009 £000
Cost		
Balance at 1 January	113,480	48,532
Additions – acquisition of subsidiary	9,093	60,526
Foreign exchange translation difference	6,204	4,422
Balance at 31 December 2010	128,777	113,480
Amortisation and impairment losses		
Balance at 1 January	27,017	20,056
Amortisation for the year	8,145	6,953
Foreign exchange translation difference	569	8
Balance at 31 December 2010	35,731	27,017
Carrying amounts		
At 1 January	86,463	28,476
At 31 December	93,046	86,463
Current	9,249	10,581
Non-current	83,797	75,882
Total	93,046	86,463

The amortisation is charged to income and is recognised in Other Operating Expenses (see Note 16)

21 Acquired value of customer relationships (AVCR)

	31 December	
	2010 £000	2009 £000
Cost		
Balance at 1 January	2,871	-
Additions arising on acquisition of subsidiary	1,306	2,349
Additions	-	350
Disposals	(387)	-
Foreign exchange translation difference	374	172
Balance at 31 December	4,164	2,871
Amortisation and impairment losses		
Balance at 1 January	189	-
Amortisation for the year	953	188
Disposals	(83)	-
Foreign exchange translation difference	73	1
Balance at 31 December	1,132	189
Carrying amounts		
At 1 January	2,682	-
At 31 December	3,032	2,682
Current	749	539
Non-current	2,283	2,143
Total	3,032	2,682

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

The amortisation is charged to income and is recognised in Other Operating Expenses (see Note 16)

22 Software assets

	31 December	
	2010 £000	2009 £000
Cost		
Balance at 1 January	5,350	-
Additions – acquisition of subsidiary	-	4,237
Additions	3,484	871
Disposals	(123)	(59)
Foreign exchange translation difference	710	301
Balance at 31 December	9,421	5,350
Amortisation and impairment losses		
Balance at 1 January	1,290	-
Additions – acquisition of subsidiary	-	842
Amortisation charge for the year	1,176	414
Disposals	(64)	(26)
Foreign exchange translation difference	190	60
Balance at 31 December	2,592	1,290
Carrying amounts at 31 December	6,829	4,060
Current	1,757	1,010
Non-current	5,072	3,050
Total	6,829	4,060

23 Property and equipment

	31 December	
	2010 £000	2009 £000
Cost		
Balance at 1 January	840	-
Additions – acquisition of subsidiary	-	713
Additions	483	166
Disposals	(32)	(85)
Reclassification to assets held for sale	(66)	-
Foreign exchange translation difference	102	46
Balance at 31 December	1,327	840
Amortisation and impairment losses		
Balance at 1 January	349	-
Additions – acquisition of subsidiary	-	292
Depreciation charge for the year	304	73
Disposals	(10)	(33)
Reclassification to assets held for sale	(36)	-
Foreign exchange translation difference	49	17
Balance at 31 December	656	349
Carrying amounts at 31 December	671	491
Current	295	162
Non-current	376	329
Total	671	491

24 Investment in associates

	31 December	
	2010 £000	2009 £000
Cost		
Balance at 1 January	1,051	-
Additions – acquisition of subsidiary	-	781
Equity contribution	-	334
Share of profit	597	39
Reclassification from associate to subsidiary	-	(65)
Impairment of investment in associates	-	(96)
Foreign exchange translation difference	135	58
Balance at 31 December	1,783	1,051

Associates at 100%	Assets £000	Liabilities £000	Revenues £000	Profit/(loss) £000
Modernac S A	17,869	14,231	6,353	1,219
Total 31 December 2010	17,869	14,231	6,353	1,219

Associates at 49%	Equity at 100% £000	Equity at 49% £000	49% share of profit/(loss) £000
Modernac S A	3,638	1,783	597
Total 31 December 2010	3,638	1,783	597

AkademikerRådgivning i Sverige AB became a subsidiary in November 2009, having previously been an associate

25 Investment properties

	31 December	
	2010 £000	2009 £000
Balance at 1 January	3,355	3,432
Additions		
Acquisition of subsidiary	117,925	-
Disposals	(572)	-
Fair value adjustments	112	(77)
Impairment losses	-	-
Balance at 31 December	120,820	3,355
Current	2,445	188
Non-current	118,375	3,167
Total	120,820	3,355

Investment properties were bought for investment purposes in line with the investment strategy of the Group. The properties are independently valued in accordance with International Valuation Standards on the basis of determining the open market value of the investment properties on an annual basis. The latest valuations were conducted as at 31 December 2010.

Income arises from investment properties in two streams

- Fair value gains arising as a result of market appreciation in the value of the properties, and
- Rental income arising from leases granted on the properties

Both of these amounts are disclosed in Net Investment Return (see Note 10). Expenses incurred in the operation and maintenance of investment properties are disclosed in Other Operating Expenses (see Note 16).

26 Financial assets

Group

	31 December	
	2010 £000	2009 £000
Financial assets by measurement category		
Fair value through income		
Designated at fair-value through income on initial recognition	4,041,439	2,356,774
Derivative financial instruments	9,707	7,964
Insurance and other receivables	33,225	19,822
Prepayments	3,908	3,784
Total	4,088,279	2,388,344

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

Financial assets at fair value through income

	Fair value measurement at 31 December 2010 using			
	Level 1 £000	Level 2 £000	Level 3 £000	Total £000
Equities				
Listed	492,321	-	-	492,321
Debt securities – fixed rate				
Government Bonds	275,292	-	-	275,292
Listed	44,224	-	-	44,224
Total debt securities	319,516	-	-	319,516
Holdings in collective investment schemes	3,075,073	102,192	-	3,177,265
Policyholders' funds held by the group	52,337	-	-	52,337
Derivative financial instruments	5,593	4,114	-	9,707
Total	3,944,840	106,306	-	4,051,146

Current	359,454
Non-current	3,691,692
Total	4,051,146

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

Current	292,251
Non-current	2,072,487
Total	2,364,738

	Year ended 31 December	
	2010	2009
Company	£000	£000
Balance at 31 January	74,029	52,006
Acquisition of Movestic Livforsakring AB	-	19,956
Acquisition of Save & Prosper Insurance Limited	63,524	-
Equity contributions paid to Movestic Livforsakring AB	3,881	2,067
Balance at 31 December	141,434	74,029
Current	-	-
Non-current	141,434	74,029
Total	141,434	74,029

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

27 Insurance and other receivables and prepayments

Group	31 December	
	2010	2009
	£000	£000
Insurance and other receivables		
Receivables arising from insurance contracts		
Brokers	622	2,856
Policyholders	4,076	3,415
Receivables arising from investment contracts		
Policyholders	1,127	9
Reinsurance receivables	272	328
Commission receivables	575	74
Debtor for professional indemnity insurance	7	2
Other receivables		
Loan to associated company	795	660
Accrued interest income	4,598	3,251
Accrued rent	409	-
Receivables from fund management companies	8,976	7,483
Recoveries relating to unit pricing redress	-	294
Other	3,943	1,450
Initial margin payments on derivatives	7,825	-
Total	33,225	19,822
Current	31,354	19,162
Non-current	1,871	660
Total	33,225	19,822

Recoveries relating to unit pricing redress are explained in Note 37

The carrying amount is a reasonable approximation of fair value

	31 December	
	2010	2009
	£000	£000
Prepayments	3,908	3,784
Current	2,658	2,434
Non-current	1,250	1,350
Total	3,908	3,784

The carrying amount is a reasonable approximation of fair value

Company	31 December	
	2010	2009
	£000	£000
Receivables and prepayments		
Amounts due from subsidiary companies	162	192
Other receivables	22	7
Prepayments	59	63
Total	243	262

Current	184	199
Non-current	59	63
Total	243	262

The carrying amount is a reasonable approximation of fair value

28 Derivative financial instruments

The Group does not hold derivatives outside the unit-linked and with-profits funds, except for an option to repay a financial reinsurance contract early, which comprises an embedded derivative

	31 December 2010		31 December 2009	
	Asset £000	Liability £000	Asset £000	Liability £000
Exchange-traded futures	5,593	(137)	4,420	(54)
Financial reinsurance embedded derivative	4,114	-	3,544	-
Total	9,707	(137)	7,964	(54)
Current	9,707	(137)	7,964	(54)
Non-current	-	-	-	-
Total	9,707	(137)	7,964	(54)

Derivatives within unit-linked funds

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

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

All the contracts are exchange-traded futures, with their fair value being the bid price at the balance sheet date. They are, accordingly, determined at Level 1 in the three-level fair value determination hierarchy set out in Note 26

	31 December 2010		31 December 2009	
Exchange-traded futures (by geographical investment market)	Asset £000	Liability £000	Asset £000	Liability £000
Australia	221	(12)	344	-
Switzerland	-	-	-	-
Europe	1,148	(66)	1,326	-
UK	854	(57)	987	(54)
Hong Kong	152	(2)	102	-
Japan	391	-	142	-
South Korea	360	-	691	-
Singapore	55	-	42	-
USA	2,412	-	786	-
Total	5,593	(137)	4,420	(54)

Financial reinsurance embedded derivative

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

The embedded derivative represents an option to repay the amounts due under the contract early at a discount to the amortised cost, with its fair value being determined by reference to market interest rates at the balance sheet date. It is, accordingly, determined at Level 2 in the three-level fair value determination hierarchy set out in Note 26

Derivatives within the S&P with-profits funds

As part of its investment management strategy, S&P enters into a limited range of derivative instruments to manage its exposure to various risks

S&P uses equity index futures in order to economically hedge equity market risk in the with-profit funds' investments

The change in fair value of the futures contracts is intended to offset the change in fair value of the underlying equities being hedged. S&P settles the market value of the futures contracts on a daily basis by paying or receiving a variation margin. The futures contracts are not discounted as this daily settlement is equal to the change in fair value of the futures. As a result, there is no additional fair value to recognise in relation to these derivatives on the balance sheet at the period end.

S&P also purchases exchange rate futures to mitigate exchange rate risk within its with-profits funds

These contracts are exchange-traded contracts in active markets with their fair value being the bid price at the balance sheet date. They are, accordingly, determined at Level 1 in the three-level fair value determination hierarchy set out in Note 26.

29 Income tax assets

Income tax assets, which are all current, comprise

	31 December	
	2010	2009
Group	£000	£000
Corporation tax recoverable	5,486	395
Company		
Corporation tax recoverable	543	395

The carrying amount is a reasonable approximation of fair value

30 Cash and cash equivalents

	31 December	
	2010	2009
Group	£000	£000
Bank and cash balances	80,176	54,387
Call deposits due within 1 month	70,375	54,555
Call deposits due after 1 month	43,583	46,299
Total cash and cash equivalents	194,134	155,241
Bank overdrafts	(2,154)	(2,312)
Cash and cash equivalents in the statement of cash flows	191,980	152,929

The effective interest rate on short term bank deposits was 0.57% (2009: 0.57%), with an average maturity of 28 days. All deposits included in cash and cash equivalents were due to mature within 3 months of their acquisition.

Included in cash and cash equivalents held by the Group are balances totalling £79,472,000 (2009: £48,417,000) held in unit-linked policyholders' funds.

	31 December	
	2010	2009
Company	£000	£000
Bank and cash balances	85	11
Call deposits due within 1 month	10,080	12,611
Short term deposits	11,033	7,013
Total	21,198	19,635

31 Assets held for sale and liabilities held for sale

As at 31 December 2010, the Group has classified one of the subsidiaries within the Movestric operating segment, AkademikerRådgivning i Sverige AB (Akademiker'), as a disposal group. The Group is actively marketing the business and the Group expects to complete the sale within one year. No gain or loss has been recognised in the Statement of Comprehensive Income since reclassification.

The analysis of the Group assets and liabilities held for sale is as follows

	31 December	
	2010 £000	2009 £000
Assets held for sale		
Software assets	30	-
Property and equipment	30	-
Insurance and other receivables	4	-
Cash and cash equivalents	316	-
Total assets	380	-
Liabilities held for sale		
Borrowings	247	-
Income taxes	(12)	-
Other payables	145	-
Total liabilities	380	-

Prior to reclassification to 'Assets held for sale' and 'Liabilities held for sale', the following impairment charges have been made the related expense is charged to income and is recognised in Other Operating Expenses (Note 16)

	Assets £000
Software assets	(29)
Prepayments	(79)
	(108)
	Liabilities £000
Deferred tax	(206)
Total impairment charge	(314)

In addition, the carrying value of the acquired value of customer relationships ('AVCR') held in respect of Akademiker at the balance sheet date was also written down. This resulted in a net charge to income of £224,000 (net of deferred tax) which has been recognised in Other Operating Expense (Note 16). The net carrying value of the AVCR of £304,000 has been reflected as a disposal as disclosed in Note 21.

32 Capital management

(a) Objective

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

- (i) safeguarding the Group's ability to continue as a going concern so that it can continue to provide returns to shareholders and benefits for other stakeholders,
- (ii) providing an adequate return to shareholders by pricing insurance and investment contracts commensurately with the level of risk, and
- (iii) complying with the insurance capital requirements established by the regulators of the insurance markets where the Group's regulated companies operate.

Prior to 23 July 2009 the Group operated exclusively in the UK, through its UK business, comprising the CA operating segment, the principal operating subsidiary of which is Countrywide Assured plc ('CA plc'), and the Group's regulatory capital requirements were, accordingly, determined exclusively by the regulations established by the Financial Services Authority ('FSA') in the UK. The Swedish business, which was acquired on 23 July 2009, includes a regulated entity, Movestic Livförsäkring AB ('Movestic Liv'), the capital requirements of which are determined by the regulations established by Finansinspektionen, the Swedish regulator. The Movestic Liv group comprises the Movestic operating segment. On 20 December 2010 the Group acquired a further UK business, being the S&P operating segment, which comprises Save & Prosper Insurance Limited, which, together with its subsidiary company, Save & Prosper Pensions Limited (together 'S&P' or 'the S&P companies') is also regulated in the UK by the FSA. Consolidated Group regulatory capital requirements in the UK are assessed in accordance with FSA regulations. The overall capital dynamics of the Group are such that the UK businesses, being substantially in run off, are net contributors of capital, which is reflected in the medium-term by way of dividend distributions to the parent company, while, in the medium-term, the Swedish business, as it expands, and before it achieves economies of scale, is a net consumer of capital, which is reflected by way of additional capital contributions from the parent company.

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

UK Businesses

The operation of FSA regulation with respect to the UK businesses' regulated life assurance entities, CA plc and the S&P companies, is such as to specify the minimum amount of capital that must be held in addition to the insurance liabilities as determined for regulatory purposes. This is established by reference to two calculations, being

- (i) the Pillar 1 calculation, which compares regulatory capital based on the characteristics of the in-force life assurance business with a concomitant measure of capital as prescribed by regulation, and
- (ii) the Pillar 2 calculation, which compares a risk-based assessment of economic capital with a concomitant measure of capital based on a realistic assessment of insurance liabilities

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

CA plc's life assurance business, which falls outside the scope of the FSA's 'realistic capital' regime, is mainly non-profit business, comprising both unit-linked and non-linked business. The with-profits liabilities of the life assurance business are wholly reassured to Guardian. Therefore, notwithstanding the existence of with-profits business, there is no with-profits fund and there is, accordingly, no unallocated divisible surplus.

For the S&P companies as at 31 December 2010, the capital requirement for both regulated companies was determined by the first calculation. The Boards of the S&P companies have not established formal targets for CR cover for total CRR. It is not intended to make dividend distributions from S&P to Chesnara prior to the transfer of the long-term insurance funds of S&P to CA. This process is planned to be completed towards the end of 2011. Set out below, in Section (c) Regulatory Capital Resources and Requirements, the results of the first calculation are presented.

The S&P companies' life assurance businesses, which fall outside the scope of the FSA's 'realistic capital' regime, comprise with-profits business and unit-linked and non-linked non-profit business. An unallocated divisible surplus is maintained.

Swedish Business

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

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

Group

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

(c) Regulatory capital resources and requirements

UK Businesses

CA plc

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

	31 December 2010 £m	31 December 2009 £m
Available capital resources (CR)	44.1	43.6
Long-term insurance capital requirement (LTICR)	19.1	19.8
Resilience capital requirement (RCR)	1.6	2.3
Total capital resource requirements (CRR)	20.7	22.1
Excess of CR over CRR (solvency surplus)	23.4	21.5
Ratio of available CR to CRR	213%	197%
Target capital requirement cover	30.2	32.0
Excess of CR over target requirement	13.9	11.6

Available capital resources as at 31 December 2010 are stated after provision for a dividend of £26.0m which was approved by the CA plc Board subsequent to 31 December 2010 (as at 31 December 2009 £28.5m subsequent to 31 December 2009)

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

S&P Companies

The following table summarises the capital resources and requirements of Save & Prosper Insurance Limited, as determined for UK regulatory purposes. As this statement presents the capital resources and requirements of Save & Prosper Insurance Limited and its subsidiary company, Save & Prosper Pensions Limited, on a combined basis, a stand-alone statement for Save & Prosper Pensions Limited is not presented

	31 December 2010 £m
Available capital resources (CR)	69.7
Long-term insurance capital requirement (LTICR)	24.3
Resilience capital requirement (RCR)	1.7
Total capital resource requirements (CRR)	26.0
Excess of CR over CRR (solvency surplus)	43.7
Ratio of available CR to CRR	268%

Prior period comparatives as at 31 December 2009 are not presented as the S&P companies did not comprise part of the Group at that time

As at 31 December 2010, the excess of the CR of Save & Prosper Pensions Limited was significantly in excess of its CRR on a stand-alone basis

The Boards of Save & Prosper Insurance Limited and of Save & Prosper Pensions Limited have not established formal targets for CR cover for total CRR

Swedish Business

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

	31 December 2010	
	Movestic £m	Modernac £m
Available Capital Resources (CR)	23 3	2 6
Capital Resource Requirements (CRR)	(12 4)	(1 5)
Excess of CR over CRR (solvency surplus)	10 9	1 1
Ratio of available CR to CRR	188%	173%
Target capital requirement cover	18 6	n/a
Excess over target requirement	4 7	n/a

	31 December 2009	
	Movestic £m	Modernac £m
Available Capital Resources (CR)	24 5	2 0
Capital Resource Requirements (CRR)	(8 1)	(1 4)
Excess of CR over CRR (solvency surplus)	16 4	0 6
Ratio of available CR to CRR	302%	143%
Target capital requirement cover	12 1	n/a
Excess over target requirement	12 4	n/a

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

(d) Group capital position statement

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

As at 31 December 2010

	UK Life businesses				Swedish Life and Non-life business	Group Life and Non- life insurance businesses
	With profits £000	Non- participating £000	Shareholder £000	Total £000	Total £000	Total £000
Shareholder funds outside long-term insurance funds – retained earnings	-	-	82,747	82,747	31,188	113,935
Shareholder funds in long-term insurance funds	34,015	5,166	-	39,181	-	39,181
Total shareholder funds	34,015	5,166	82,747	121,928	31,188	153,116
Adjustment onto regulatory basis						
Unallocated divisible surplus	83	-	-	83	-	83
Adjustments to net assets	-	(1,224)	(4,759)	(5,983)	(7,812)	(13,795)
Other	2,553	230	(16,699)	(13,916)	(55)	(13,971)
Total available capital resources	36,651	4,172	61,289	102,112	23,321	125,433

	Group Life and Non-life insurance businesses	Other activities		Consolidation adjustments	Group total	Adjustment for dividend	Group total IFRS basis
	Total £000	UK Business £000	Swedish Business £000	£000	£000	£000	£000
Shareholder funds outside long-term insurance funds	113,935	136,295	1,593	(99,909)	151,914	12,174	164,088
Shareholder funds in long-term insurance funds	39,181	-	-	-	39,181	-	39,181
Total shareholder funds	153,116	136,295	1,593	(99,909)	191,095	12,174	203,269
Adjustment onto regulatory basis							
Unallocated divisible surplus	83	-	-	-	83		
Adjustments to net assets	(13,795)	(52,236)	-	9,172	(56,859)		
Other	(13,971)	-	808	-	(13,163)		
Total available capital resources	125,433	84,059	2,401	(90,737)	121,156		

As at 31 December 2009

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

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

The tables presented above illustrate Group total available capital resources as measured for the purposes of inclusion in the related regulatory returns. As at 31 December 2010 they are stated after provision of a dividend of £12.2m and, as at 31 December 2009, after provision of a dividend of £10.5m, which were

approved by the Chesnara plc Board subsequent to the respective year ends. Provision is not made for such dividends on the IFRS basis accordingly, it is necessary to make adjustment to shareholder funds outside long-term insurance funds as at 31 December 2010, as reflected above, in order to illustrate the relationship with the total shareholder equity included in the consolidated balance sheet prepared on the IFRS basis.

The following tables set out the principal forms of capital, which comprise (i) total available capital resources for the total UK Life Businesses, the total Swedish Life and Non-life Business and the total Group for regulatory purposes and (ii) total shareholder funds for the Group on the IFRS basis.

	Available Capital Resources for Regulatory Purposes				Shareholder Funds IFRS Basis
	CA plc	S&P Companies	Total Swedish Life and Non-life Business	Total Group	Total Group
	£000	£000	£000	£000	£000
Share capital	40,000	20,000	1,235	42,024	42,024
Share premium	-	-	-	42,523	42,523
Treasury shares	-	-	-	(217)	(217)
Other equity contributions	-	-	35,195	-	-
Capital redemption reserve	-	-	-	50	50
Foreign exchange translation	-	-	-	7,666	7,666
Surplus in long-term fund	3,248	20,876	-	-	-
Retained earnings/(accumulated deficit)	816	17,172	(13,109)	29,110	111,223
Total	44,064	58,048	23,321	121,15	203,269

The following tables summarise the movement in the available capital resources of the constituent funds of the life businesses, as determined under the respective regulatory regimes for the year ended 31 December 2010.

UK Businesses

CA plc

	Life business non-participating	Life business shareholder	Total life business
	£000	£000	£000
Year ended 31 December 2010	2,484	41,121	43,605
At beginning of period	2,484	41,121	43,605
Surplus arising in the year, net of the effect of the items shown above	26,764	-	26,764
Net loss arising in shareholder fund	-	(305)	(305)
Transfer from long-term business fund to shareholder fund	(26,000)	26,000	-
Proposed dividend	-	(26,000)	(26,000)
At end of period	3,248	40,816	44,064

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

There were no changes in available capital resources for the 11-day post-acquisition period due to changes in management policy, regulatory changes or external factors. The effect of new business written in the period on available capital resources is not considered to be significant.

S&P Companies

Year ended 31 December 2010	With Profits Funds £000	Non Profit Funds £000	Shareholder Funds £000	Total £000
At beginning of period	-	-	-	-
Arising on acquisition of S&P companies	36,651	924	20,312	57,887
Net profit arising in the shareholders' funds	-	-	161	161
At end of period	36,651	924	20,473	58,048

There were no changes in available capital resources for the year ended 31 December 2010 due to changes in management policy, regulatory changes or external factors. The effect of new business written in the period on available capital resources is not considered to be significant.

Swedish Business

Year ended 31 December 2010	Total £000
At beginning of period	24,460
Loss arising in the period	(4,518)
Equity contributions	3,881
Change in untaxed reserves	990
Change in intangible assets - software assets	(3,829)
Change in deferred tax	-
Change in foreign exchange reserve	2,337
At end of period	23,321

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

There were no changes in available capital resources for the period ended 31 December 2010 due to changes in management policy, regulatory changes or external factors.

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

Group Capital Adequacy

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

	31 December	
	2010 £m	2009 £m
Total available capital resources (CR)	121.2	99.7
Capital resources requirement		
UK-Business - CA plc	20.7	22.1
UK Business - S&P Companies	26.0	-
Swedish Business - Movestic Liv	12.4	8.1
Associate - Modernac SA	1.5	1.4
Total (CRR)	60.6	31.6
Group solvency surplus (CR less CRR)	60.6	68.1
Group solvency ratio	200%	316%

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

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

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

(e) Technical provisions net of reinsurance - UK businesses

CA plc

On 30 June 2006 the long-term business of City of Westminster Assurance Company Limited, a Group subsidiary, acquired on 2 June 2005, was transferred, under the provisions of Part VII of the Financial Services and Markets Act 2000, to the Group's other UK principal operating subsidiary, Countrywide Assured plc (CA plc), in which the whole of the UK business then subsisted. However, within this Note and the following Note 33 Insurance Contract Provisions, reference is made to 'CWA business' and to 'CA business' to continue to identify respectively the long-term business which had been conducted within the respective companies prior to this transfer

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

	31 December	
	2010	2009
	£000	£000
Technical provisions		
Unit-linked		
Unit		
Insurance contracts	755,435	704,794
Investment contracts	602,208	560,350
Non-unit (sterling)		
Insurance contracts	22,206	16,980
Investment contracts	6,595	6,030
Non-participating		
Insurance contracts	123,991	113,654
Investment contracts	19,277	33,680
Total	1,529,712	1,435,488

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

Mortality

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

Morbidity

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

Persistency

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

Discount rates

CA uses appropriate rates of interest, for different product types, in discounting projected liabilities. As at 31 December 2010 for the material product types, these lay between 2.6% and 4.0% (31 December 2009 between 3.4% and 4.1%)

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

- (i) a standard risk deduction, varying by credit rating, of 0.1% for 'AAA'-rated bonds, 0.3% for 'AA'-rated bonds and 0.5% for 'A'-rated bonds, based on ratings according to Standard and Poors credit rating system. No assets are held with a credit rating less than 'A', and
- (ii) an overall maximum margin over the equivalent term government fixed interest security of 0.5%

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

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

Renewal expenses and inflation

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

Taxation

CA plc has assumed that current tax legislation and tax rates will not change.

The sensitivities of technical provisions and of components of capital to changes in assumptions are materially the same as those detailed in Note 5.

S&P Companies

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

Technical provisions	31 December
	2010 £000
Unit-linked	
Insurance contracts	826,869
Investment contracts	108,862
Non-participating	
Insurance contracts	23,778
With discretionary participation features	359,209
Total	1,318,718

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

Mortality

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

Persistency

For non-linked business, no allowance is made for lapses or surrenders within the valuation of insurance contract liabilities. This is a prudent assumption.

For unit-linked business, when assessing additional reserves for expenses and mortality risk, allowance has been made for lapses at a prudent level of 75% of the expected level as indicated by recent experience, the rates used being

Rate of lapse	31 December 2010	
	SPI*	SPP*
Assurances		
Regular premium plans	3.75%	3.00%
Single premium contracts	3.75%	3.75%
Linked TIC**	-	7.50%

* Save & Prosper Insurance Limited ('SPI') and Save & Prosper Pensions Limited ('SPP')

** Trustee Investment Contract, a unit-linked contract ('TIC')

Discount rates

The following rates of interest have been used in discounting the projected liabilities

Rate of interest	31 December 2010	
	SPI*	SPP*
With profit non linked business	2.00%	3.10%
Without profit term assurances	0.36%	0.45%
Without profit annuities	0.36%	0.45%

* The rate of interest depends on the characteristics of the relevant product

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

- (i) a deduction of 40% of the credit spread as at 31 December 2010, and
- (ii) overall maximum margin over the equivalent term government fixed interest security of 2.0% as at 31 December 2010

Technical provisions for with-profits contracts are particularly sensitive to the interest rate used when discounting. Sensitivity analysis is provided in Note 5. For annuities in payment and assurances the provision is sensitive to the assumed future mortality experience of policyholders.

Renewal expenses and inflation

The renewal expenses assumed are based on the charges made to the S&P companies by their third party insurance administration services provider, with appropriate margins. Explicit allowance is also made for those governance expenses which are charged to the long-term funds. As at 31 December 2010, expenses were assumed to inflate at a rate of 4.25%.

Taxation

The S&P companies have assumed that current tax legislation and tax rates will not change.

Sensitivities

The sensitivities of technical provisions and of components of capital to changes in assumptions are materially the same as those disclosed in Note 33.

(f) Valuation of options and guarantees - UK Businesses

CA plc

(i) Stochastically-valued options and guarantees

CA plc has a small number of guaranteed annuity options, which are valued stochastically.

(ii) Deterministically-valued options and guarantees

Timed Investment Funds

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

In respect of this guarantee

- (i) a monthly charge of $\frac{1}{48}\%$ of the fund value is made, and
- (ii) investment conditions were such as to require the establishment of a reserve of £177,770 as at 31 December 2010 (31 December 2009: £113,000).

The reserve for a given fund is derived as the discounted exposure at fund maturity date, the exposure being the difference between the guaranteed Timed Investment Fund value and the projected fund maturity value, with the latter projected value being derived assuming an immediate fall in value of equities within the fund of 25% and allowing for future investment returns, including presumed future equity investment return of 3.95% per annum.

Guaranteed Growth Fund

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

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

The underlying fund at 31 December 2010 was £7.5m (31 December 2009 £7.8m). 799 policies invested in the fund (31 December 2009 837), of which 91 (31 December 2009 102) were paying premiums (for a total of approximately £31,000 per annum (31 December 2009 £35,000)).

For the valuation of contract liabilities the following are projected for each future year:

- the benefit outgo from the fund,
- the investment return from the assets backing the fund, and
- the difference between these items.

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

The following assumptions are used for calculating the loss reserve:

Rate of growth of liability	4.1% pa
Rate of return on cash	0.7% pa
Discount rate	3.1% pa
Retirement age	90% of business with policyholders retiring at age 65 10% of business with policyholders retiring at age 70
Terminations before retirement	3% pa

The reserve for the guarantee as at 31 December 2010 was £1.4m (31 December 2009 £1.8m).

S&P Companies

Deterministically-valued options and guarantees

Deferral of Retirement Ages

Policyholders with a Personal Retirement Account and Guaranteed Plus Retirement Plan may defer their retirement age on terms that may be beneficial to the policyholder. The cost of policyholders exercising this benefit is assessed using a prudent assumption as to the level of take-up of the option and deferral to age 75. The reserve for this option as at 31 December 2010 was £6.0m.

Increase of Premiums on Personal Retirement Account

Policyholders with a Personal Retirement Account may increase their regular premium contribution on terms that can be beneficial to the policyholder. The cost of policyholders exercising this benefit is assessed using a prudent assumption as to the level of take-up of the option. The reserve for this option as at 31 December 2010 was £0.3m.

Insurability Options

Policyholders with certain contracts have the right to increase their sum assured without underwriting, in certain circumstances. The reserve for this option as at 31 December 2010 was £0.3m.

(g) Management of risk

The Group's approach to the management of risk which may have an impact on the measurement of capital resources and requirements, as measured on a regulatory basis, is set out in Notes 5 and 6 to these financial statements.

33 Insurance contract provisions

(a) Analysis of insurance contract provisions by operating segment

	31 December 2010			31 December 2009		
	Gross £000	Reinsurance £000	Net £000	Gross £000	Reinsurance £000	Net £000
CA	1,129,558	228,276	901,282	1,044,680	209,604	835,076
S&P	1,210,810	7,692	1,203,118	-	-	-
Movestic	63,711	44,775	18,936	32,353	27,262	5,091
	<u>2,404,079</u>	<u>280,743</u>	<u>2,123,336</u>	<u>1,077,033</u>	<u>236,866</u>	<u>840,167</u>
Unallocated divisible surplus	83	-	83	-	-	-
Total insurance contract provisions	<u>2,404,162</u>	<u>280,743</u>	<u>2,123,419</u>	<u>1,077,033</u>	<u>236,866</u>	<u>840,167</u>
Current	176,678	15,642	161,036	60,172	20,972	39,200
Non-current	2,227,484	265,101	1,962,383	1,016,861	215,894	800,967
Total	<u>2,404,162</u>	<u>280,743</u>	<u>2,123,419</u>	<u>1,077,033</u>	<u>236,866</u>	<u>840,167</u>

The unallocated divisible surplus arises within the S&P operating segment

(b) Analysis of movement in insurance contract provisions

	2010			2009		
CA	Gross £000	Reinsurance £000	Net £000	Gross £000	Reinsurance £000	Net £000
Balance at 1 January	1,044,680	209,604	835,076	923,506	182,693	740,813
Premiums received	79,791	12,936	66,855	88,154	14,208	73,946
Fees deducted	(27,372)	(3,850)	(23,522)	(30,481)	(4,554)	(25,927)
Reserves released in respect of benefits paid	(90,445)	(13,705)	(76,740)	(90,831)	(13,733)	(77,098)
Investment return	118,449	16,008	102,441	156,410	21,902	134,508
Other movements	4,455	7,283	(2,828)	(2,078)	9,088	(11,166)
Balance at 31 December	<u>1,129,558</u>	<u>228,276</u>	<u>901,282</u>	<u>1,044,680</u>	<u>209,604</u>	<u>835,076</u>
				80		
S&P	Gross £000	Reinsurance £000	Net £000	Gross £000	Reinsurance £000	Net £000
Balance at 1 January	-	-	-	-	-	-
Arising on business combination	1,197,067	7,692	1,189,375	-	-	-
Premiums received	372	-	372	-	-	-
Fees deducted	(77)	-	(77)	-	-	-
Reserves released in respect of benefits paid	(3,347)	-	(3,347)	-	-	-
Investment return	16,795	-	16,795	-	-	-
Balance at 31 December	<u>1,210,810</u>	<u>7,692</u>	<u>1,203,118</u>	-	-	-
Movestic	Gross £000	Reinsurance £000	Net £000	Gross £000	Reinsurance £000	Net £000
Balance at 1 January	32,353	27,262	5,091	-	-	-
Arising on business combination	20,964	14,181	6,783	30,642	25,713	4,929
Reserves released in respect of benefits paid	(4,831)	(4,175)	(656)	(2,820)	(2,412)	(408)
Movement in provisions for contracts sold						
- in current year	20,445	12,485	7,960	6,074	4,858	1,216
- in prior years	(10,213)	(8,673)	(1,540)	(6,201)	(5,116)	(1,085)
Other movements	4,993	3,695	1,298	4,658	4,219	439
Balance at 31 December	<u>63,711</u>	<u>44,775</u>	<u>18,936</u>	<u>32,353</u>	<u>27,262</u>	<u>5,091</u>

Unallocated divisible surplus	Period ended 31 December £000
Balance at start of period	83
Transfer to profit and loss account	-
Balance at end of period	83
The closing balance comprises	
With-profits policyholders' funds	299,667
With-profits long-term business provision	(359,209)
Balance before shareholder charge	(59,542)
Shareholder charge for cost of guarantees	59,625
	83

The whole of the shareholder charge for cost of guarantees arose prior to the acquisition of S&P. The long-term business provision for contracts with discretionary participation features ('DPF') provides for the present value of projected payments to policyholders based on guaranteed minimum investment returns, mainly at 5 per cent per annum. Where the policyholders' funds for contracts with discretionary participation features is greater than the long-term business provision, the Save & Prosper Group establishes an unallocated divisible surplus fund which is eliminated by recognising a shareholder charge for the cost of guarantees. This fund represents unallocated surplus of the with-DPF business that has not been allocated to a specific policyholder, which is eliminated by recognising a shareholder charge for the cost of guarantees.

The actual cost to shareholders, if any, depends on future investment performance of the with-DPF policyholders' assets. Changes in the value of policyholders' assets together with changes in the long-term business provision will result in further charges to, or release from, the profit and loss account until such time as the unallocated divisible surplus becomes positive (after releasing any accumulated shareholder charges to the profit and loss account).

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

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

CA

(i) Process used to determine the assumptions

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

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

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

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

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

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

(ii) Assumptions

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

Mortality

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

Morbidity

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

Persistency

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

Discount rates

The CA business segment uses appropriate rates of interest, for different product types, in discounting projected liabilities. As at 31 December 2010 for the material product types, these lay between 2.6% and 4.0% (31 December 2009 between 3.4% and 4.1%).

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

- (i) a standard risk deduction, varying by credit rating, of 0.1% for 'AAA'-rated bonds, 0.3% for 'AA'-rated bonds and 0.5% for 'A'-rated bonds, based on ratings according to Standard and Poors credit rating system. No assets are held with a credit rating less than 'A', and
- (ii) an overall maximum margin over the equivalent term government fixed interest security of 0.5%.

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

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

Renewal expenses and inflation

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

Taxation

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

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

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

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

As a consequence of the fact that the valuation basis makes no allowance for lapses, when lapses occur it is necessary to allocate fixed expenses across a smaller number of in-force policies. Consequently the per policy expense reserve has increased. This increased the reserves by £0.8m as at 31 December 2010 (31 December 2009 £0.8m).

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

CA re-runs its valuation models on various bases. An analysis of sensitivity around various scenarios provides an indication of the sensitivity of the estimates to changes in assumptions in respect of its life assurance contracts. The table presented below demonstrates the sensitivity of assets and insured liability estimates to particular movements in assumptions used in the estimation process. Certain variables can be

expected to impact on life assurance liabilities more than others, and consequently a greater degree of sensitivity to these variables may be expected

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

	<u>Change in variable</u>	<u>Change in net of tax</u>
	<u>2010</u>	<u>profits and equity</u>
	<u>%</u>	<u>2010</u>
		<u>£m</u>
Investment return	+1	(0.7)
Investment return	-1	4.3
Mortality/morbidity	+10	1.9
Mortality alone	+10	2.6
Morbidity alone	+10	(0.7)
Policy maintenance expenses	+10	(0.4)

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

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

The sensitivities to mortality and morbidity (critical illness) rates shown above are calculated on the assumption that there would be no consequential change in rates to policyholders. In practice, Group policy is to pass costs on to policyholders where it considers that the impact of the change is significant (see Note 5 for further information)

An increase in mortality rates would have a negative impact on the CA business due to the preponderance of assurance business. In contrast, there would be a positive impact occurring in the CWA business due to its preponderance of annuity business. On a consolidated basis the impacts are closely balanced. A decrease in mortality rates would have the contrary effect in each business but the results would remain closely balanced (refer to Note 32(e) above for an explanation of the terms 'CA business' and 'CWA business' in this context)

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

The main expense risk is that of unforeseen changes to third party administration expenses, as discussed in Note 5. The impact shown above quantifies a 10% increase in those expenses

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

The insurance liabilities include an amount of £2.5m as at 31 December 2010 (31 December 2009 £2.9m) in respect of potential compensation payments arising from endowment misselling complaints. The provision for the costs of redress has been estimated on the basis of the Group's experience in respect of policyholders' propensity to complain, complaint uphold rates and average cost of settlement. It is also based on estimation of the in-force endowment policy population exposed to complaint, taking account of estimated future policy cessation, and of the rate at which policies are expected to become time-barred in accordance with FSA rules.

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

The liability for mortgage endowment misselling claims would increase if there were an increase in the number of complaints received, a decrease in the number of policies time-barred, an increase in the complaint uphold rate or an increase in the average amount of redress per settled complaint compared with current assumptions. A decrease in the fund value or the assumed unit growth rate would tend to increase the average redress amount per policy. A 10% increase in assumed propensity to complain would increase insurance contract provisions by £0.2m. A 10% increase in assumed cost of redress to settle each complaint would increase insurance contract provisions by £0.3m.

S&P

(i) Process used to determine the assumptions

The process used to determine the assumptions is intended to result in conservative estimates of the most likely, or expected, outcome. The assumptions that are considered include the expected number and timing of deaths, other claims and investment returns, over the period of risk exposure. A reasonable allowance is made for the level of uncertainty within the contracts.

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

Technical provisions for with-profits contracts are based on the guaranteed minimum benefits. Provision is not made for future bonuses as all bonuses are terminal bonuses. The insurance contract provision is calculated on a gross premium basis, by subtracting the present value of future premiums from the present value of future benefits payable under the policy, until it ceases at maturity, or death if earlier. The gross premium method makes explicit allowance for future policy maintenance costs. If the net present value of the future discounted cash flows is positive, no asset is recognised.

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

For regular premium term assurance contracts the provision is calculated on a net premium basis.

(ii) Assumptions

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

Mortality

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

Persistency

For non-linked business, no allowance is made for lapses or surrenders within the valuation of insurance contract liabilities. This is a prudent assumption.

For unit-linked business, when assessing additional reserves for expenses and mortality risk as at 31 December 2010, allowance has been made for lapses at a prudent level of 75% of the expected level as indicated by recent experience, the rates used being

Rate of lapse

	31 December 2010	
	SPI*	SPP*
Assurances		
Regular premium plans	3.75%	3.00%
Single premium contracts	3.75%	3.75%
Linked TIC**	-	7.50%

* Save & Prosper Insurance Limited ('SPI') and Save & Prosper Pensions Limited ('SPP')

** Trustee Investment Contract, a unit-linked contract ('TIC')

Discount rates

The following rates of interest have been used in discounting the projected liabilities

Rate of interest	31 December 2010	
	SPI	SPP
Assurances		
With profit non linked business	2.00%	3.10%
Without profit term assurances	0.36%	0.45%
Without profit annuities	0.36%	0.45%

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

- (i) a deduction of 40% of the credit spread as at 31 December 2010, and
- (ii) an overall maximum margin over the equivalent term government fixed interest security of 2.0% as at 31 December 2010

Technical provisions for with-profits contracts are particularly sensitive to the interest rate used when discounting. Sensitivity analysis is provided in Note 5. For annuities in payment and assurances the provision is sensitive to the assumed future mortality experience of policyholders.

Renewal expenses and inflation

The renewal expenses assumed are based on the charges made to the S&P companies by their third party insurance administration services provider, with appropriate margins. Explicit allowance is also made for those governance expenses which are charged to the long-term funds. As at 31 December 2010 expenses were assumed to inflate at a rate of 4.25%.

Taxation

S&P has assumed that current tax legislation and tax rates will not change.

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

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

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

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

	Change in variable %	Change in net of tax profits and equity £m
Investment return	+1	7.6
Investment return	-1	(5.9)
Mortality	+10	(1.2)
Policy maintenance expenses	+10	(2.3)

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

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

The sensitivities to mortality rates shown above are calculated on the assumption that there would be no consequential change in rates to policyholders.

The main expense risk is that of unforeseen changes to third party administration expenses, as discussed in Note 5. The impact shown above quantifies a 10% increase in those expenses.

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

(a) Analysis by operating segment

	31 December 2010			31 December 2009		
	Investment contract liability £000	Amount deposited with reinsurer £000	Net £000	Investment contract liability £000	Amount deposited with reinsurer £000	Net £000
CA	646,609	30,264	616,345	610,930	27,056	583,874
S&P	108,862	-	108,862	-	-	-
Movestic	1,247,241	-	1,247,241	918,291	-	918,291
Total	2,002,712	30,264	1,972,448	1,529,221	27,056	1,502,165
Current	230,641	469	230,172	78,093	1,335	76,758
Non-current	1,772,071	29,795	1,742,276	1,451,128	25,721	1,425,407
Total	2,002,712	30,264	1,972,448	1,529,221	27,056	1,502,165

The fair values of the Groups' investment contract liabilities are determined according to a three-level valuation hierarchy which is explained in Note 26, as follows

	Level 1 £000	Level 2 £000	Level 3 £000	Total £000
Investment contract liabilities	1,984,892	17,820	-	2,002,712

The liabilities in Level 1 of the valuation hierarchy represent the fair value of unit-linked liabilities based on the aggregation of prices quoted in active markets of their associated assets

The liabilities in Level 2 of the valuation hierarchy represent the fair value of non-linked and guaranteed income and growth bond liabilities valued using established actuarial techniques utilising market observable data for all significant inputs, such as investment yields

35 Liabilities relating to policyholders' funds held by the Group

	31 December	
	2010 £000	2009 £000
Unit-linked		
Balance at 1 January	41,107	-
Arising on acquisition of subsidiary	-	34,310
Deposits received	6,087	2,662
Fees deducted from account balances	(180)	(87)
Investment yield	9,913	6,345
Foreign exchange translation difference	4,321	2,517
Other movements	(8,911)	(4,640)
Balance at 31 December	52,337	41,107
Current	4,081	2,153
Non-current	48,256	38,954
Total	52,337	41,107

The fair values of the 'Liabilities relating to Policyholders' funds held by the Group' are determined according to a three-level valuation hierarchy, which is explained in Note 26

The fair value of these liabilities is based on the aggregation of prices quoted in active markets of their associated assets (Level 1), as disclosed in Note 26

36 Borrowings

Group	31 December	
	2010 £000	2009 £000
Bank loan	39,287	4,197
Amount due in relation to financial reinsurance	23,406	24,686
Other	1	113
Total	62,694	28,996
Current	13,107	12,474
Non-current	49,587	16,522
Total	62,694	28,996

Company	31 December	
	2010 £000	2009 £000
Bank loan	39,287	4,197
Current	3,807	4,197
Non-current	35,480	-
Total	39,287	4,197

The bank loan subsisting at 31 December 2009, which was drawn down on 2 June 2005 under a facility made available on 4 May 2005, was unsecured and was repayable in five equal annual instalments on the anniversary of the draw down date. Accordingly the loan was fully repaid on 2 June 2010. The outstanding principal on the loan bore interest at a rate based on the London Inter-Bank Offer Rate, payable in arrears over a period which varies between one and six months at the option of the borrower.

The bank loan subsisting at 31 December 2010, which was drawn down on 20 December 2010 under a facility made available on 17 November 2010, is unsecured and is repayable in five increasing annual instalments on the anniversary of the draw down date. The outstanding principal on the loan bears interest at a rate of 2.25 percentage points above the London Inter-Bank Offer Rate and is repayable over a period which varies between one and six months at the option of the borrower.

The fair value of the bank loan at 31 December 2010 was £40,000,000 (31 December 2009 £4,200,000).

The fair value of amounts due in relation to financial reinsurance was £24,590,409 (31 December 2009 £26,415,353).

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

37 Provisions

	MECR £000	Other complaints redress £000	Onerous contracts £000	Unit pricing redress £000	Total £000
Balance at 1 January 2009	66	113	424	2,794	3,397
Provisions made during the year	1	38	159	1,311	1,509
Provisions used during the year	-	(3)	(38)	(2,082)	(2,123)
Provisions reversed during the year	(12)	-	-	(1,319)	(1,331)
Balance at 31 December 2009	55	148	545	704	1,452
Provisions made during the year	36	77	545	-	658
Provisions used during the year	(27)	(3)	(80)	(107)	(217)
Provisions reversed during the year	(3)	(1)	(10)	(57)	(71)
Balance at 31 December 2010	61	221	1,000	540	1,822
31 December 2009					
Current	55	148	92	704	999
Non-current	-	-	453	-	453
Total	55	148	545	704	1,452
31 December 2010					
Current	61	221	224	540	1,046
Non-current	-	-	776	-	776
Total	61	221	1,000	540	1,822

The reversal of provisions during the year was credited to Operating Income as disclosed in Note 11.

(a) Mortgage endowment complaints redress (MECR)

As part of the mortgage endowment complaint redress process (refer to Note 33 Insurance Contract Provisions), if the complaint is upheld an offer of redress is made to the customer where a loss has occurred. These offers are classified as payables for the first 6 months after they are made, subsequent to which they are reclassified as provisions, as the customer loses the right of redress at the level offered, but continues to have a right to enforce a claim, which the Group has the right to reassess. The provision is established at the original offer level.

(b) Other complaints redress

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

(c) Onerous contracts

The Group has a number of onerous operating lease contracts that had been entered into historically, whose activity and current status is described in Note 50 Operating Leases. Given the terms of the contracts the Group has created an onerous contract provision for anticipated future net costs. Over the terms of the contracts this provision takes account of the contract terms, future payments and future mitigating income from sublets, contract by contract, to create a view as to the Group's exposure.

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

Within the provision calculation two estimates or judgements are made:

- (a) The provision model assumes that if the rent is reduced to a lower percentage of the original lease contract, the percentage sublet occupancy of the properties will change accordingly. The rent reduction and occupancy rates vary from property to property, depending on location and prevailing tenancy rates within the various locations. The rents are assumed to be in a range between 40% and 80% of the contractual rental and the occupancy rates are assumed to be in a range between 25% and 80% of the current occupancy rates.
- (b) Future cash flows are discounted within the provision model at 4%.

<i>Sensitivities</i>	Provision at 31 December 2010 £000	Post sensitivity provision £000	Change in provision £000	Change in provision %
Discount rate - decreased by 1% to 4%	1,000	1,022	22	2
Sublease rent mitigation - reduction of 10%	1,000	1,038	38	4
Occupancy mitigation - reduction of 10%	1,000	1,054	54	5

(d) Unit pricing redress

A data error in the indexation of the costs of underlying financial assets in certain of the unit-linked funds was identified during 2007. As a result, the amount of capital gains chargeable to tax had been overestimated for unit pricing purposes and greater deductions were made from these funds than would otherwise have been the case. A provision of £2,994,000 was established at 31 December 2007 to cover the estimated cost of redress and the administration costs of performing the review. Associated recoveries from third parties were established at £494,000 as at the same date and these were included in 'Insurance and other receivables' as at 31 December 2007.

The provision established at 31 December 2007 was estimated insofar as it was not based on specific individual calculations for each policyholder, but was established on the basis of generic data relating to the amount of payments to policyholders who exited from the funds in specific periods, of the unit prices ruling in those periods and of an estimate of the extent of the pricing error pertaining to those periods. Subsequently, a revised estimate was established at £2,794,000 based on specific policy-by-policy data. The residual provision of £540,000 as at 31 December 2010 continues to be subject to uncertainty until all of the associated administration procedures are completed. The Directors consider that the methodology used to establish the provision continues to be prudent.

During the year ended 31 December 2008, £200,000 was received from a third party and the balance of estimated recoveries from third parties of £294,000, which was received during the year ended 31 December 2010, was included in 'Insurance and other receivables' as at 31 December 2009.

38 Deferred tax liabilities

Total deferred tax liabilities comprise

	31 December	
	2010 £000	2009 £000
CA, S&P and Other Group Activities	19,747	9,615
Movestic	779	751
Total	20,526	10,366

CA, S&P and Other Group Activities

(a) Recognised deferred tax assets and liabilities

As at 31 December 2010

	Assets £000	Liabilities £000	Net £000
Insurance contract provisions	-	5,918	(5,918)
Intangible assets			
Deferred acquisition costs	-	1,692	(1,692)
Acquired value of in-force business	-	8,007	(8,007)
Deferred income	2,939	-	2,939
Property and equipment	22	7,091	(7,069)
Total	2,961	22,708	(19,747)
Current	-	-	-
Non-current	2,961	22,708	(19,747)
Total	2,961	22,708	(19,747)

As at 31 December 2009

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

(b) Unrecognised deferred tax assets

	31 December	
	2010 £000	2009 £000
Tax losses arising in pensions business	34,635	44,323
Capital losses	5,424	14,252
Unrelieved expenses	102,157	98,312
Total	142,216	156,887

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

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

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

(c) Movement in temporary differences during the year

	Year ended 31 December 2010				Year ended 31 December 2009		
	Balance at 1 January	Arising on acquisition	Recognised in income	Balance at 31 December	Balance at 1 January	Recognised in income	Balance at 31 December
	£000	£000	£000	£000	£000	£000	£000
Insurance contract provisions	(4,596)	(2,686)	1,364	(5,918)	(4,987)	391	(4,596)
Intangible assets							
Deferred acquisition costs	(2,009)	-	317	(1,692)	(2,253)	244	(2,009)
Acquired value of in-force business	(6,506)	(2,455)	954	(8,007)	(7,456)	950	(6,506)
Deferred income	3,449	-	(510)	2,939	3,837	(388)	3,449
Property and equipment	47	(7,091)	(25)	(7,069)	61	(14)	47
Total	(9,615)	(12,232)	2,100	(19,747)	(10,798)	1,183	(9,615)

Movestic

(a) Recognised deferred tax assets and liabilities

As at 31 December 2010

	Assets £000	Liabilities £000	Net £000
Intangible assets			
Fair value adjustments on acquisition	-	564	(564)
Corporation tax recoverable	50	-	50
Equity accounting for associates	-	270	(270)
Property and equipment	5	-	5
Total	55	834	(779)
Current	55	834	(779)
Non-current	-	-	-
Total	55	834	(779)

As at 31 December 2009

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

(b) Unrecognised deferred tax assets (gross)

	31 December	
	2010	2009
	£000	£000
Corporation tax recoverable – not recognised	191	196
Total	191	196

(c) Movement in temporary differences during the year

Year ended 31 December 2010					
	Balance at 1 January 2010	Impairment arising on disposal	Recognised through income	Foreign exchange translation difference	Balance at 31 December 2010
	£000	£000	£000	£000	£000
Fair value adjustment on acquisition	(512)	-	(2)	(50)	(564)
Other intangible assets	(91)	80	19	(8)	-
Corporation tax recoverable	188	(206)	47	21	50
Equity accounting for associates	(76)	-	(177)	(17)	(270)
Untaxed reserves	(260)	-	270	(10)	-
Property & equipment	-	-	5	-	5
Total	(751)	(126)	162	(64)	(779)

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

39 Reinsurance payables

	31 December	
	2010	2009
	£000	£000
Payable to reinsurers		
Payables in respect of insurance contracts	21,548	7,365
Payables in respect of investment contracts	129	51
Reinsurance claims deposits	-	6,992
Reinsurer's share of deferred acquisition costs and claims deposits	633	631
Total	22,310	15,039
Current	22,310	8,945
Non-current	-	6,094
Total	22,310	15,039

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

40 Payables related to direct insurance and investment contracts

	31 December 2010			31 December 2009		
	Gross £000	Reinsurance £000	Net £000	Gross £000	Reinsurance £000	Net £000
Accrued claims	28,744	3,678	25,066	23,075	4,728	18,347
Intermediaries' liabilities	1,502	-	1,502	441	-	441
Policyholder premium liabilities	3,748	-	3,748	2,639	-	2,639
Other	1,814	-	1,814	4,278	-	4,278
Total	35,808	3,678	32,130	30,433	4,728	25,705
Current	35,808	3,678	32,130	30,433	4,728	25,705
Non-current	-	-	-	-	-	-
Total	35,808	3,678	32,130	30,433	4,728	25,705

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

41 Deferred income

	31 December	
	2010	2009
	£000	£000
Balance at 1 January	13,132	14,575
Release to income	(1,485)	(1,443)
Balance at 31 December	11,647	13,132
Current	1,245	1,371
Non-current	10,402	11,761
Total	11,647	13,132

The release to income is included in Fees and Commission Income (see Note 9)

42 Income tax liabilities

	31 December	
	2010	2009
	£000	£000
Income tax liabilities, which are all current, comprise		
Corporation tax – CA, S&P and Other Group Activities	6,468	854
Corporation tax – Movestic	455	459
	6,923	1,313

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

43 Other payables

Group	31 December	
	2010	2009
	£000	£000
Accrued expenses	6,620	6,500
VAT	321	76
Employee tax	374	266
Other	7,895	2,991
Policyholder property fund creditors	1,713	-
Total	16,923	9,833
Current	16,923	9,833
Non-current	-	-
Total	16,923	9,833

Company	31 December	
	2010	2009
	£000	£000
Accrued expenses	1,090	2,098
Amounts due to Group companies	41	-
Other	871	113
Total	2,002	2,211
Current	2,002	2,211
Non-current	-	-
Total	2,002	2,211

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

44 Share capital and share premium

Group	31 December 2010		31 December 2009	
	Number of shares	Share capital £000	Number of shares	Share capital £000
Share capital	<u>115,047,662</u>	<u>42,024</u>	<u>104,588,785</u>	<u>41,501</u>
		Share Premium £000		Share Premium £000
		<u>42,523</u>		<u>20,458</u>

The number of shares in issue at the balance sheet date included 199,011 shares held in treasury (31 December 2009 3,096,194)

Share capital for the Group includes the impact of "reverse acquisition accounting" associated with Chesnara plc's acquisition of Countrywide Assured Life Holdings Limited ('CALH') from Countrywide plc ('Countrywide') on 24 May 2004. As a result of this, included within share capital of the Group is £41,501,000, which represents the amount of issued share capital of Countrywide Assured Life Holdings Limited (the legal subsidiary) immediately before the acquisition. As a result of this accounting treatment the Group share capital differs from the Chesnara plc company position, which is set out below.

The following sets out changes in Group share capital and share premium during the year ended 31 December 2009

	Issued share capital		Share premium
	Number	£000	£000
Balance at 1 January 2010	104,588,785	41,501	20,458
Issue and allocation on 26 November 2010 arising from non pre-emptive placing	10,458,877	523	20,394
Expenses incurred in connection with non pre-emptive placing	-	-	(962)
Arising on sale of treasury shares	-	-	2,633
Balance at 31 December 2010	<u>115,047,662</u>	<u>42,024</u>	<u>42,523</u>

On 26 November 2010 Chesnara plc launched and completed a bookbuilt, non pre-emptive placing of 10,458,877 new ordinary shares of 5p each with institutional investors and thereby raised gross proceeds of £20,917,754 (£19,955,622 net of expenses of £962,132).

During November 2010 the Chesnara plc sold 2,897,183 ordinary shares held in treasury, thereby raising gross proceeds of £5,794,366. The profit arising of £2,632,670 arising on the sale has been credited to the share premium account.

There were no changes in Group share capital or share premium during the year ended 31 December 2010.

Company	31 December 2010		31 December 2009	
	Number of shares	Share capital £000	Number of shares	Share capital £000
Authorised				
Ordinary shares of 5p each	<u>201,000,000</u>	<u>10,050,000</u>	<u>201,000,000</u>	<u>10,050,000</u>
Issued				
Ordinary shares of 5p each	<u>115,047,662</u>	<u>5,752,383</u>	<u>104,588,785</u>	<u>5,229,439</u>
Share premium		Share Premium £000		Share Premium £000
		<u>42,523</u>		<u>20,458</u>

The number of shares in issue at the balance sheet date included 199,011 shares held in treasury (31 December 2009 3,096,194).

The following sets out changes in share capital and share premium during the year ended 31 December 2010.

	Issued share capital		Share premium
	Number	£000	£000
Balance at 1 January 2010	104,588,785	5,229	20,458
Issue and allocation on 26 November 2010 arising from non pre-emptive placing	10,458,877	523	20,394
Expenses incurred in connection with non pre-emptive placing	-	-	(962)
Arising on sale of treasury shares	-	-	2,633
Balance at 31 December 2010	115,047,662	5,752	42,523

Further details of the share capital and share premium transactions are shown below

There were no changes in share capital or share premium during the year ended 31 December 2009

45 Treasury shares

Group and Company

	31 December	
	2010	2009
	£000	£000
Balance at 1 January	3,379	3,379
Sales during the year	(3,162)	-
Balance at 31 December	217	3,379

During November 2010, the Company sold 2,897,183 ordinary shares held in treasury for a total consideration of £5,794,366. The cost of those shares was £3,161,696 and the consequential profit arising on sale of £2,632,670 has been credited to the share premium account.

46 Other reserves

Group

	31 December	
	2010	2009
	£000	£000
Capital redemption reserve	50	50
Foreign exchange translation reserve	7,666	3,381
Balance at 31 December	7,716	3,431

Company

	31 December	
	2010	2009
	£000	£000
Capital redemption reserve	50	50

47 Retained earnings

Group

	31 December	
	2010	2009
	£000	£000
Retained earnings attributable to equity holders of the parent company comprise		
Balance at 1 January	97,744	67,738
Profit for the year	29,819	45,940
Dividends		
Final approved and paid for 2008	-	(10,200)
Interim approved and paid for 2009	-	(5,734)
Final approved and paid for 2009	(10,453)	-
Interim approved and paid for 2010	(5,887)	-
Balance at 31 December	111,223	97,744

The interim dividend in respect of 2009, approved and paid in 2009, was paid at the rate of 5.65p per share. The final dividend in respect of 2009, approved and paid in 2010, was paid at the rate of 10.30p per share so that the total dividend paid to the equity shareholders of the Parent Company in respect of the year ended 31 December 2009 was made at the rate of 15.95p per share.

The interim dividend in respect of 2010, approved and paid in 2010, was paid at the rate of 5.8p per share to equity shareholders of the Parent Company registered at the close of business on 10 September 2010, the dividend record date

A final dividend of 10.6p per share in respect of the year ended 31 December 2010 payable on 20 May 2011 to equity shareholders of the Parent Company registered at the close of business on 8 April 2011, the dividend record date, was approved by the Directors after the balance sheet date. The resulting total final dividend of £12.2m has not been provided for in these financial statements and there are no income tax consequences

The following summarises dividends per share in respect of the year ended 31 December 2009 and 31 December 2010

	2010	2009
	p	p
Interim – approved and paid	5.80	5.65
Final - proposed	10.60	10.30
Total	16.40	15.95

Company

	Year ended 31 December	
	2010	2009
	£000	£000
Balance at 1 January	65,555	57,683
Profit for the year	24,806	23,806
Dividends paid		
Final approved and paid for 2008	-	(10,200)
Interim approved and paid for 2009	-	(5,734)
Final approved and paid for 2009	(10,453)	-
Interim approved and paid for 2010	(5,887)	-
Balance at 31 December	74,021	65,555

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

48 Employee benefit expense

	Year ended 31 December					
	CA	S&P	Movestic	Other Group Activities	2010	2009
	£000	£000	£000	£000	£000	£000
Wages and salaries	1,394	7	6,030	544	7,975	3,653
Social security costs	156	1	1,895	61	2,113	786
Pension costs-defined contribution plans	176	1	1,124	86	1,387	580
Total	1,726	9	9,049	691	11,475	5,019

Average number of employees

	2010	2009
Company	19	17
Subsidiaries	131	34
Total	150	51

UK-based employees

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

At the end of May 2005 the Group allowed eligible employees to enter a pension scheme known as the Chesnara plc Stakeholder Scheme, on a basis where employer contributions are made to the scheme at the same rate as would be payable had their membership of their predecessor scheme continued, provided that employee contributions also continued to be made at the same rate. The employee may opt to request the Company to pay employer contributions into a personal pension plan, in which instance, employer contributions will be made on the same terms as for the Chesnara plc Stakeholder Scheme

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

The Group has, for the period covered by these financial statements, only made contributions to defined contribution plans to provide pension benefits for employees upon retirement and, otherwise, has no residual obligation or commitments in respect of any defined benefit scheme

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

Swedish-based employees

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

Assets and liabilities are held on a pooled basis and are not allocated by the Trustee to any individual company. Consequently, reliable information is not available to account for the Scheme as a defined benefit scheme and therefore, in accordance with IAS 19 Employee Benefits, the Scheme is accounted for as a defined contribution scheme.

Contributions to the Scheme are based on the funding recommendations of the independent qualified actuary. The contributions paid to the Scheme subsequent to the acquisition of the Swedish Business on 23 July 2009 totalled SEK 3,728,000 (£322,500). The rate of contribution payable to the Scheme was 24% of pensionable pay. There are no employee contributions to the Scheme.

The employers within the Scheme are responsible collectively for the funding of the Scheme as a whole and therefore in the event that other employers exit from the Scheme, remaining employers would be responsible for the ongoing funding. The collective nature of the Scheme results in all participating entities sharing the actuarial risk associated with the Scheme.

Forsakringsbranschens Pensionskassa ("FPK") issue an audited annual report (under Swedish law-limited IFRS) each year. The last available published report was as at 31 December 2009.

The annual report states that the Scheme's surplus is SEK 1,025m (£88.9m) as at 31 December 2009 (SEK 73m (£6.3m) as at 31 December 2008). As at 31 December 2009, the fund had assets under management of SEK 8.9bn (£771.9m), 147 employer insurance companies participating in the Scheme and 24,500 insured individuals.

From the available information, it cannot be determined with certainty as to whether there would be a change in the required employer funding rate, although there is currently no deficit in the Scheme.

49 Earnings per share

Earnings per share are based on the following

	Year ended 31 December	
	2010	2009
Profit for the year attributable to shareholders (£000)	29,819	45,940
Weighted average number of ordinary shares	102,642,750	101,492,591
Basic earnings per share	29.05p	45.26p
Diluted earnings per share	29.05p	45.26p

The weighted average number of ordinary shares in respect of the year ended 31 December 2010 is based on 104,588,785 shares in issue at the beginning of the period less 3,096,194 own shares held in treasury and on 115,047,662 shares in issue at the end of the period, less 199,011 own shares held in treasury, taking account of the timing of the issue of new shares and of the sale of treasury shares.

The weighted average number of ordinary shares in respect of the year ended 31 December 2009 is based on 104,588,785 shares in issue at the beginning of the period and on 104,588,785 shares in issue at the end of the period less 3,096,194 own shares held in treasury as disclosed in Note 45, taking account of the timing of the purchases of own shares.

There were no share options outstanding during the year ended 31 December 2009 or during the year ended 31 December 2010. Accordingly, there is no dilution of the average number of ordinary shares in issue in respect of these periods.

Earnings per share for the year ended 31 December 2010 includes the impact of £15,864,000 of profit recognised on the acquisition of S&P and of the Aspis business. Excluding this item, both the basic and diluted earnings per share for the year ended 31 December 2010 would have been 13 60p

Earnings per share for the year ended 31 December 2009 includes the impact of £25,056,000 of profit recognised on the acquisition of Movestic. Excluding this item both the basic and diluted earnings per share for the year ended 31 December 2009 would have been 20 58p per share

50 Operating leases

Leases as lessee

Non-cancellable operating lease rentals are payable as follows

	31 December 2010			31 December 2009		
	Non-investment properties	Motor vehicles	Total	Non-investment properties	Motor vehicles	Total
	£000	£000	£000	£000	£000	£000
Operating lease rentals						
Less than one year	891	33	924	1,001	-	1,001
Between one and two years	831	23	854	679	-	679
Between two and five years	2,106	11	2,117	1,975	-	1,975
More than five years	1,723	-	1,723	2,276	-	2,276

Expenses recognised in the year in respect of operating leases

	1,514	43	1,557	1,109	-	1,109
--	-------	----	-------	-------	---	-------

The Group leases a property under an operating lease which it occupies in the course of its day-to-day business. The lease expires on 22 July 2019, with an option to renew the lease after that date. Lease payments are reviewed every five years to reflect market rentals. The lease does not include any contingent rentals.

The Group leases a number of office premises which are no longer used for Group purposes. The leases typically run for approximately a further 6 years after the balance sheet date. Lease payments are reviewed every five years to reflect market rentals. None of the leases includes contingent rentals. These leased properties are sublet by the Group. Sublease payments as detailed below are expected to be received during the following years. The Group has recognised a provision of £1,000,000 at 31 December 2010 (31 December 2009 £545,000) in respect of these leases (see Note 37).

Leases as lessor

The Group subleases out both its investment properties from its investment portfolio and the office premises which are no longer used for Group purposes. The future minimum lease payments under non-cancellable leases are as follows

	31 December 2010			31 December 2009		
	Investment properties	Non-investment	Total	Investment properties	Non-investment	Total
	£000	£000	£000	£000	£000	£000
Sub lease rentals						
Less than one year	7,661	331	7,992	187	405	592
Between one and two years	7,646	313	7,959	187	366	553
Between two and five years	20,005	939	20,944	559	1,043	1,602
More than five years	29,965	1,112	31,077	378	1,441	1,819
Rental income recognised in the year	1,020	398	544	135	479	614
Repairs and maintenance costs recognised in the year	35	93	128	68	205	273

51 Contingencies

Past sales

The Group has made provision for the estimated cost of settling complaints in respect of past sales of endowment mortgages. Although the provisions are regularly reviewed, the final outcome could be different from the provisions established as these costs cannot be calculated with certainty and are influenced by external factors beyond the control of management, including future regulatory actions.

52 Capital commitments

There were no capital commitments as at 31 December 2010 or as at 31 December 2009

53 Related party transactions

(a) Identity of related parties

The shares of the Company were widely held and no single shareholder exercised significant influence or control over the Company

The Company has related party relationships with

- (i) key management personnel who comprise only the Directors of the Company,
- (ii) its subsidiary companies,
- (iii) its associated company, and
- (iv) other companies over which the Directors have significant influence

(b) Related party transactions

(i) Transactions with key management personnel

Key management personnel comprise of the Directors of the Company. There are no executive officers other than certain of the Directors. Key management compensation is as follows

	Year ended 31 December	
	2010	2009
	£000	£000
Short-term employee benefits	937	893
Post-employment benefits	132	124
Long-term employment benefits	502	485
Total	1,571	1,502

In addition to their salaries the Company also provides non-cash benefits to Directors, and contributes to a post employment defined contribution pension plan on their behalf

The following amounts were payable to Directors in respect of bonuses and incentives

	31 December	
	2010	2009
	£000	£000
Annual bonus scheme	204	195
Long-term incentive plan	485	1,028
Discretionary bonus	325	300
Total	1,014	1,523

These amounts have been included in Accrued Expenses as disclosed in Note 43

The amounts payable under the annual bonus scheme were payable within one year. At 31 December 2010, £70,467 of the amount payable under the long-term incentive plan was payable within one year (2009 £1,028,000)

(ii) Transactions with subsidiaries

The Company undertakes centralised administration functions, the costs of which it charges back to its operating subsidiaries. The following amounts which effectively comprised a recovery of expenses at no mark up were credited to the income statement of the Company for the respective periods

	Year ended 31 December	
	2010	2009
	£000	£000
Recovery of expenses	2,158	2,154

In addition, the Company has made equity contributions to its subsidiary, Movestic Livforsakning AB as follows

	Year ended 31 December	
	2010	2009
	£000	£000
Equity contribution - Movestic Livforsakning AB	3,881	2,067

(iii) *Transactions with associate*

Movestic Livforsakning AB and its associate Modernac SA

	Year ended 31 December	
	2010 £000	2009 £000
Reinsurance premiums paid	(6,619)	(3,017)
Reinsurance recoveries received	4,343	1,195
Reinsurance commission received	677	302
	(1,599)	(1,520)
Amounts outstanding as at balance sheet date	363	(1,038)

Movestic Livforsakning a subsidiary company, has made shareholder contributions to its associate, AkademikerRådgivning i Sverige AB, totalling £1,475,000. Reinsurance premiums have been paid to its associate Modernac S A, totalling £6,619,000 with reinsurance recoveries received totalling £4,343,000 and reinsurance commission received totalling £677,000.

Movestic Livforsakning AB had the following amounts outstanding at the balance sheet date

	31 December 2010	
	Amounts owed by associate £000	Amounts owed to associate £000
Modernac S A	364	1,698

	31 December 2009	
	Amounts owed by associate £000	Amounts owed to associate £000
Modernac S A	660	1,698

These amounts have been included in Other payables as disclosed in Note 43 and Other receivables as disclosed in Note 27.

54 Group entities

Control of the Group

The issued share capital of Chesnara plc the Group parent company is widely held, with no single party able to control 20% or more of such capital or of the rights which such ownership confers.

Group subsidiary companies

Group subsidiary companies		Ownership interest		
Name	Country of incorporation or registration	31 December		Functional Currency
		2010	2009	
Countrywide Assured plc	England & Wales	100% of all share capital (1)	100% of all share capital (1)	Sterling
Countrywide Assured Life Holdings Limited	England & Wales	100% of all share capital	100% of all share capital	Sterling
Countrywide Assured Services Limited	England & Wales	100% of all share capital (1)	100% of all share capital (1)	Sterling
Countrywide Assured Trustee Company Limited	England & Wales	100% of all share capital (1)	100% of all share capital (1)	Sterling
CWA Trustee Company Limited	England & Wales	100% of all share capital (2)	100% of all share capital (2)	Sterling
CWA Life Holdings plc	England & Wales	100% of all share capital	100% of all share capital	Sterling

Movestic Livförsäkring AB	Sweden	100% of all share capital – acquired 23/7/09	100% of all share capital – acquired 23/7/09	Swedish Krona
Modernac S A	Luxembourg	49% of all share capital (3)	49% of all share capital (3)	Swedish Krona
AkademikerRådgivning i Sverige AB	Sweden	91% of all share capital (3)	91% of all share capital (3)	Swedish Krona
Movestic Kapitalförvaltning AB	Sweden	100% of all share capital (3)	100% of all share capital (3)	Swedish Krona
Save & Prosper Insurance Limited	England & Wales	100% of all share capital	-	Sterling
Save & Prosper Pensions Limited	England & Wales	100% of all share capital (4)	-	Sterling
Amber Lily (Jersey) Limited	Jersey	100% of all share capital	-	Sterling

- (1) Held indirectly through Countrywide Assured Life Holdings Limited
(2) Held indirectly through CWA Life Holdings plc
(3) Held indirectly through Movestic Livförsäkring AB
(4) Held indirectly through Save & Prosper Insurance Limited

55 Post balance sheet event

ECJ ruling

It has been historical practice for insurance companies to consider the gender of the policyholder when pricing contracts as evidence has suggested that gender is a key determinant of insurance risk

On 1 March 2011 the ECJ ruled that a EU directive (which had been subsequently enacted into EU law), which allowed for gender to be a factor when pricing insurance risk, was invalid and contravened other EU law

The ruling means that from 21 December 2012 it will not be possible to continue using gender as a basis of pricing. However, it is not clear from the ruling whether this will apply only to new contracts written at that date or to all contracts in-force at that date. This will not be known with certainty until the judgement is enacted into UK and Swedish law.

On initial assessment, the Group has assessed that the most likely impact will be in respect of new business to be written from a future date, not yet known, but no later than 21 December 2012. For CA and S&P this will primarily impact annuity contracts written for vesting pensions, whilst for Movestic it will impact all new business. The exact date from which new business will be affected will depend on the legislation enacted within the UK and Sweden respectively.

There is uncertainty as to how, if at all, the ruling impacts existing business. In respect of CA and S&P with reviewable mortality or morbidity rates, primarily certain protection policies, the potential impact (if the ruling is deemed to apply to current in-force contracts) will be on the charges suffered by the policyholder from a date to be specified by UK legislation, but no later than 21 December 2012. For Movestic, it is expected that those products written on an annually renewable basis, will be repriced to apply gender neutral rates from a date to be specified by Swedish legislation, but no later than 21 December 2012.

Directors' Responsibility Statement in respect of the EEV Basis Supplementary Information

The Directors have chosen to prepare supplementary information in accordance with the EEV Principles issued in May 2004 by the CFO Forum of European Insurance Companies and expanded by the Additional Guidance on European Embedded Value Disclosures issued in October 2005

When compliance with the EEV Principles is stated, those principles require the Directors to prepare supplementary information in accordance with the Embedded Value Methodology ('EVM') contained in the EEV Principles and to disclose and explain any non-compliance with the EEV guidance included in the EEV Principles

In preparing the EEV supplementary information, the Directors have

- Prepared the supplementary information in accordance with the EEV Principles,
- Identified and described the business covered by the EVM,
- Applied the EVM consistently to the covered business,
- Determined assumptions on a realistic basis, having regard to past, current and expected future experience and to any relevant external data, and then applied them consistently,
- Made estimates that are reasonable and consistent, and
- Described the basis on which business that is not covered business has been included in the supplementary information, including any material departures from the accounting framework applicable to the Group's financial statements

Independent Auditor's Report to the Directors of Chesnara plc on the European Embedded Value (EEV) Basis Supplementary Information

We have audited the EEV Basis Supplementary Information of Chesnara plc for the year ended 31 December 2010 which comprise the summarised EEV consolidated income statement, the summarised EEV consolidated balance sheet and the related notes 1 to 11. The financial reporting framework that has been applied in their preparation is the EEV Principles issued in May 2004 by the CFO Forum of European Insurance Companies and expanded by the Additional Guidance on European Embedded Value Disclosures issued in October 2005 ("the EEV Principles").

We have reported separately on the statutory group financial statements of Chesnara plc for the year ended 31 December 2010. The EEV Basis Supplementary Information should be read in conjunction with the financial statements prepared on an IFRS basis.

This report is made solely to the company's directors in accordance with our engagement letter and solely for the purpose of expressing an opinion on whether the EEV Basis Supplementary Information has been properly prepared in accordance with the EEV principles. Our audit work has been undertaken so that we might state to the company's directors those matters we are required to state to them in an independent auditors' report and for no other purpose. To the fullest extent permitted by law, we will not accept or assume responsibility to anyone other than the company, for our audit work, for this report, or for the opinions we have formed.

Respective responsibilities of directors and auditors

As explained more fully in the Directors' Responsibility Statement for in respect of the EEV Basis Supplementary Information, the directors are responsible for the preparation of the EEV Basis Supplementary Information. Our responsibility is to audit and express an opinion on the EEV Basis Supplementary Information in accordance with relevant legal and regulatory requirements and International Standards on Auditing (UK and Ireland).

Scope of the audit of the EEV Basis Supplementary Information

An audit involves obtaining evidence about the amounts and disclosures in the Supplementary Information sufficient to give reasonable assurance that the Supplementary Information is 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 Supplementary Information. In addition, we read all the financial and non-financial information in the annual report 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

In our opinion, the EEV Basis Supplementary Information for the year ended 31 December 2010 has been properly prepared in accordance with the EEV principles using the methodology and assumptions set out on pages [139 to 144].

Deloitte LLP

Deloitte LLP
Chartered Accountants
Manchester, United Kingdom
30 March 2011

Supplementary Information – European Embedded Value Basis

Summarised EEV consolidated income statement

	Note	Year ended 31 December	
		2010 £000	2009 £000
Operating profit of covered business	6	6,364	19,120
Other operational result	6	(6,114)	868
Operating profit		250	19,988
Variation from longer-term investment return	6	26,941	13,750
Effect of economic assumption changes	6	(4,453)	(9,730)
Profit before tax and before exceptional item		22,738	24,008
Exceptional items			
Profit recognised on business combinations	6,9	41,043	54,187
Effect of modelling improvements	6	13,239	-
Profit before tax		77,020	78,195
Tax	6	(4,014)	12,070
Profit for the year		73,006	90,265
Attributable to			
Shareholders		73,124	90,272
Non-controlling interest		(118)	(7)
		73,006	90,265
Earnings per share			
Based on profit for the period attributable to shareholders		71 24p	88 94p
Diluted earnings per share			
Based on profit for the period attributable to shareholders		71 24p	88 94p

The notes and information on pages 156 to 168 form part of this supplementary information

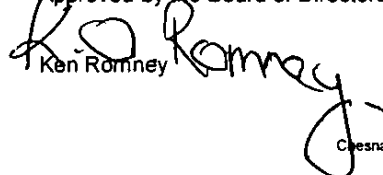
Supplementary Information – European Embedded Value Basis

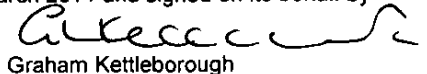
Summarised EEV consolidated balance sheet

		31 December	
		2010	2009
	Note	£000	£000
Assets			
Value of in force business	5,8	265,415	198,312
Deferred acquisition costs arising on unmodelled business		616	197
Acquired value of customer relationships		983	346
Software assets		6,829	4,060
Property and equipment		671	491
Investment in associate		1,783	1,051
Reinsurers' share of insurance contract provisions		247,432	209,537
Amounts deposited with reinsurers		29,002	26,240
Investment properties		120,820	3,355
Deferred tax assets		-	1,972
Financial assets			
Equity securities at fair value through income		492,321	454,970
Holdings in collective investment schemes at fair value through income		3,177,265	1,612,861
Debt securities at fair value through income		319,516	247,836
Insurance and other receivables		33,234	19,822
Prepayments		3,908	3,784
Policyholders' funds held by the Group		52,337	41,107
Derivative financial instruments		9,707	7,964
Total financial assets		4,088,288	2,388,344
Reinsurers' share of accrued policy claims		3,678	4,728
Income taxes		5,486	395
Cash and cash equivalents		194,134	155,241
Assets held for sale		380	-
Total assets		4,965,617	2,994,269
Liabilities			
Liabilities held for sale		380	-
Bank overdraft		2,154	2,312
Insurance contract provisions		2,370,948	1,049,906
Unallocated divisible surplus		14,930	-
Financial liabilities			
Investment contracts at fair value through income		2,010,954	1,543,915
Borrowings		70,148	36,307
Derivative financial instruments		137	54
Liabilities relating to policyholders' funds held by the Group		52,337	41,107
Total financial liabilities		2,133,576	1,621,383
Provisions		1,822	1,452
Deferred tax liabilities		5,578	-
Reinsurance payables		21,830	15,039
Payables related to direct insurance and investment contracts		35,808	30,433
Income taxes		6,923	1,313
Other payables		16,932	9,833
Total liabilities		4,610,881	2,731,671
Net assets		354,636	262,598
Equity			
Share capital		42,024	41,501
Share premium		42,523	20,458
Treasury shares		(217)	(3,379)
Foreign exchange reserve		15,056	5,539
Other reserves		50	50
Retained earnings		255,200	198,416
Total shareholders' equity		354,636	262,585
Non-controlling interest		-	13
Total equity	5,8	354,636	262,598

The notes and information on pages 156 to 168 form part of this supplementary information

Approved by the Board of Directors on 30 March 2011 and signed on its behalf by


Ken Romney


Graham Kettleborough

Notes to the Supplementary Information

1 Basis of preparation

This section sets out the detailed methodology followed for producing these Group financial statements which are supplementary to the Group's primary financial statements which have been prepared in accordance with International Financial Reporting Standards ('IFRS'). These financial statements have been prepared in accordance with the European Embedded Value ('EEV') principles issued in May 2004 by the European CFO Forum and supplemented by Additional Guidance on EEV Disclosures issued by the same body in October 2005. The principles provide a framework intended to improve comparability and transparency in embedded value reporting across Europe.

In order to improve understanding of the Group's financial position and performance, certain of the information presented in these financial statements is presented on a segmental basis. The business segments are the same as those described in Note 8 to the primary financial statements prepared on the IFRS basis. The S&P Business was acquired on 20 December 2010. Accordingly, the results relating thereto, as reflected in segmental analysis are for a period of 11 days. Prior year information in respect of the financial position as at 31 December 2009 and for the year then ended is designated as £nil in respect of the S&P Business, while other prior year data are designated as not applicable ('n/a').

2 Covered business

The Group uses EEV methodology to value the bulk of its long-term business (the 'covered business'), which is written primarily in the UK and Sweden, as follows:

- (i) for the UK businesses (comprising the CA and S&P segments), the covered business comprises the business's long-term business being those individual life insurance, pensions and annuity contracts falling under the definition of long-term insurance business for UK regulatory purposes. The operating expenses of the holding company, Chesnara plc, are treated as an integral part of the UK covered business.
- (ii) for the Swedish business (comprising the Movestic segment), the covered business comprises the business's long-term pensions and savings unit-linked business. Group life and sickness business, including waiver of premium and non-linked individual life assurance policies are not included in the covered business. The result relating to this business is established in accordance with IFRS principles and is included within 'other operational result' within the consolidated summarised income statement.

Under EEV principles no distinction is made between insurance and investment contracts, as there is under IFRS, which accords these classes of contracts different accounting treatments.

3 Methodology

(a) Embedded Value

Overview

Shareholders' equity comprises the embedded value of the covered business, together with the net equity of other Group companies, including that of the holding company which is stated after writing down fully the carrying value of the covered business.

The embedded value of the covered business is the aggregate of the shareholder net worth ('SNW') and the present value of future shareholder cash flows from in-force covered business (value of in-force business) less any deduction for (i) the cost of guarantees within S&P, and (ii) the cost of required capital. It is stated after allowance has been made for aggregate risks in the business. SNW comprises those amounts in the long-term business, which are either regarded as required capital or which represent surplus assets within that business.

New business

CA and S&P

Much of the covered business is in run-off and is, accordingly, substantially closed to new business. The UK businesses do still sell a small amount of new business but, overall, the contribution from new business to the results established using EEV methodology is not material. Accordingly, not all of those items related to new business values, which are recommended by the EEV guidelines, are reported in this supplementary financial information.

Movestic

New business, in relation to the pensions and savings covered business is taken as all business where contracts are signed and new premiums paid during the reporting period, for both new policies and premium increases on existing business, but excluding standard renewals. New business premium volumes as disclosed in the KPIs section on page 17 are not consistent with this definition, as they include non-covered business. New business premium volume for the period which is consistent with the analysis of profit in Note 6 is as follows

New business premium income relating to pensions and savings covered business,	£24.9m *
--	----------

* Basis: annualised premium plus 1/10 single premium translated into sterling at the 2010 average rate of SEK 11 1249 = £1

The new business contribution has been assessed as at the end of the period, using opening assumptions

Value of in-force business

The cash flows attributable to shareholders arising from in-force business are projected using best estimate assumptions for each component of cash flow

The present value of the projected cash flows is established by using a discount rate which reflects the time value of money and the risks associated with the cash flows which are not otherwise allowed for. There is a deduction for the cost of holding the required capital, as set out below

Participating business

For participating business within the S&P business the Group maintains the assets and liabilities in a separate with-profits fund. In accordance with the Principles and Practices of Financial Management, in the first instance all benefits, which in some cases include guaranteed minimum investment returns, are paid from policyholder assets within the fund. The participating business effectively operates as a smoothed unit linked contract subject to minimum benefit guarantees. The with-profits fund contains assets which are attributable to shareholders as well as those attributable to policyholders. Assets attributable to shareholders can only be released from the fund subject to meeting prudent liabilities in respect of minimum benefits and the frictional cost of this restriction has been allowed for in determining the value of the in-force business.

Fundamentally, the value of the with-profits in-force business is driven by the fund management charges levied on the policyholder assets, subject to the effect of minimum benefit guarantees.

Taxation

The present value of the projected cash flows arising from in-force business takes into account all tax which is expected to be paid under current legislation, including tax which would arise if surplus assets within the covered business were eventually to be distributed. For the UK businesses, allowance has been made for planned reductions in corporation tax, as announced by the Chancellor in his budget speech on 22 June 2010. No allowance has been made for the changes announced by the Chancellor in his budget speech on 23 March 2011.

The value of the in-force business has been calculated on an after-tax basis and is grossed up to the pre-tax level for presentation in the income statement. The amount used for the grossing up is the amount of shareholder tax, excluding those payments made on behalf of policyholders, being policyholder tax in the UK businesses and yield tax in Movestic.

Cost of capital

A market-consistent valuation approach requires consideration of 'frictional' costs of holding shareholder capital. In particular, the cost of tax on investment returns and the impact of investment management fees can reduce the face value of shareholder funds. For CA, the expenses relating to corporate governance functions eliminate any taxable investment return in shareholder funds, while investment management fees are not material. The cost of holding the required capital to support the covered business (see 3(b) below) is reflected as a deduction from the value of in-force business.

Financial options and guarantees

CA

The principal financial options and guarantees in CA are (i) guaranteed annuity rates offered on some unit-linked pension contracts and (ii) a guarantee offered under Timed Investment Funds that the unit price available at the selected maturity date (or at death, if earlier) will be the highest price attained over the policy's life. The cost of

these options and guarantees has been assessed, in principle, on a market-consistent basis, but, in practice, this has been carried out on approximate bases, which are appropriate to the level of materiality of the results

S&P

The principal financial options and guarantees in S&P are (i) minimum benefits payable on maturity or retirement for participating business, (ii) the option to extend the term under the Personal Retirement Account contract on terms potentially beneficial to the policyholder, (iii) the option to increase premiums under the Personal Retirement Account contract on terms potentially beneficial to the policyholder, and (iv) certain insurability options offered

The cost of guaranteeing a minimum investment return on participating contracts, being the only material guarantee, has been assessed on a market consistent basis. For the remaining options and guarantees the cost has been assessed on an approximate basis, appropriate to the level of materiality of the results

Movestic

In respect of Movestic, some contracts provide policyholders with an investment guarantee, whereby a minimum rate of return is guaranteed for the first 5 years of the policy, at a rate of 3% per annum. As at 31 December 2010, the total amount guaranteed was approximately £0.1m. Thus, due to low volumes and the limited exposure, the value of the guarantee is ignored as not material to the results

Allowance for risk

Allowance for risk within the covered business is made by

- (i) setting required capital levels by reference to the assessment of capital needs made by the directors of the regulated entities within the respective businesses (the 'Directors'),
- (ii) setting the risk discount rate, which is applied to the projected cash flows arising on the in-force business, at a level which includes an appropriate risk margin (see 3(c) below), and
- (iii) explicit allowance for the cost of financial options and guarantees and, where appropriate, for reinsurer default

Internal group company

EEV Guidance requires that actual and expected profit or loss incurred by an internal group company on services provided to the covered business should be included in allowances for expenses. The covered business in Movestic is partially managed by an internal group fund management company. Not all relevant future income and expenses of that company have been included in the calculation of embedded value. However, the effect is not considered to be material.

Consolidation adjustments

Consolidation adjustments have been made to

- (i) eliminate the investment in subsidiaries,
- (ii) allocate group debt finance against the segment to which it refers, and
- (iii) allocate corporate expenses as explained in note 4(d) below

(b) Level of Required Capital

The level of required capital of the covered business reflects the amount of capital that the Directors consider necessary and appropriate to manage the respective businesses. In forming their policy the Directors have regard to the minimum statutory requirements and an internal assessment of the market, insurance and operational risks inherent in the underlying products and business operations. The capital requirement resulting from this assessment represents

- (i) for CA, 150% of the long-term insurance capital requirement ('LTICR') together with 100% of the resilience capital requirement ('RCR'), as determined by the regulations of the Financial Services Authority in the UK,
- (ii) for Movestic, 150% of the regulatory solvency requirement as determined by Finansinspektionen in Sweden

The boards of the S&P companies have not established a formal internal assessment of the capital requirement for S&P. However, pending this assessment, a provisional requirement has been set at 175% of the long-term insurance capital requirement ('LTICR') together with 100% of the resilience capital requirement ('RCR') as determined by the regulations of the Financial Services Authority in the UK.

The required level of regulatory capital is provided as follows

- (i) for the UK businesses, by the retained surplus within the long-term business fund and by share capital and retained earnings within the shareholder funds of the regulated entities, and
- (ii) for Movestic, by share capital and additional equity contributions from the parent company, net of the accumulated deficit in the regulated entity, these components together comprising shareholder's equity

Movestic is reliant, in the medium term, on further equity contributions from the parent company, Chesnara plc

(c) Discount Rates

The discount rates are a combination of the reference rate and a risk margin. The reference rate reflects the time value of money and the risk margin reflects any residual risks inherent in the covered business and makes allowance for the risk that future experience will differ from that assumed. In order to reduce the subjectivity when setting the discount rates, the Group has decided to adopt a 'bottom up' market-consistent approach to allow explicitly for market risk.

Using the market-consistent approach, each cash flow is valued at a discount rate consistent with that used in the capital markets. In accordance with this, equity-based cash flows are discounted at an equity discount rate and bond-based cash flows at a bond discount rate. In practice a short-cut method known as the 'certainty equivalent' approach has been adopted. This method assumes that all cash flows earn the reference rate of return and are discounted at the reference rate.

In general, and consistent with the market's approach to valuing financial instruments for hedging purposes, the reference rate is based on swap yields. These have been taken as mid swap yields available in the market at 31 December 2010.

Allowance also needs to be made for non-market risks. For some of these risks, such as mortality and expense risk, it is assumed that the shareholder can diversify away any uncertainty where the impact of variations in experience on future cash flows is symmetrical. For those risks that are assumed to be diversifiable, no adjustment has been made. For any remaining risks that are considered to be non-diversifiable risks, there is no risk premium observable in the market and, therefore, a constant margin has been added to the risk margin. The margin added reflects the assumed risks within the businesses and is 50 basis points for CA and S&P and 70 basis points for Movestic. This margin is applied to the basic value of in-force business prior to the deductions for financial options and guarantees and the cost of required capital.

(d) Analysis of Profit

The contribution to operating profit, which is identified at a level which reflects an assumed longer-term level of investment return, arises from three sources:

- (i) new business,
- (ii) return from in-force business, and
- (iii) return from shareholder net worth

Additional contributions to profit arise from:

- (i) variances between the actual investment return in the period and the assumed long-term investment return, and
- (ii) the effect of economic assumption changes

The contribution from new business represents the value recognised at the end of each period in respect of new business written in that period, after allowing for the cost of acquiring the business, the cost of establishing the required technical provisions and after making allowance for the cost of capital, calculated on opening assumptions.

The return from in-force business is calculated using closing assumptions and comprises:

- (i) the expected return, being the unwind of the discount rates over the period applied to establish the value of in-force business at the beginning of the period,
- (ii) variances between the actual experience over the period and the assumptions made to establish the value of business in force at the beginning of the period, and
- (iii) the net effect of changes in future assumptions, made prospectively at the end of the period, from those used in establishing the value of business in force at the beginning of the period, other than changes in economic assumptions

The contribution from shareholder net worth comprises the actual investment return on residual assets in excess of the required capital.

(e) Assumption Setting

There is a requirement under EEV methodology to use best estimate demographic assumptions and to review these at least annually with the economic assumptions being reviewed at each reporting date. The current practice is detailed below.

Each year the demographic assumptions are reviewed as part of year-end processes and hence were reviewed in December 2010.

The detailed projection assumptions, including mortality, morbidity, persistency and expenses reflect recent operating experience. Allowance is made for future improvement in annuitant mortality based on experience and externally published data. Favourable changes in operating experience, particularly in relation to expenses and persistency, are not anticipated until the improvement in experience has been observed. Holding company expenses (for the Chesnara Group such expenses relate largely to listed company functions) are allocated to the CA covered business, except for a relatively small amount of expense, which is assumed to relate to business development functions, to reflect effort expended within the holding company relating to the transaction of life assurance business through the subsidiary companies. Hence the expense assumptions used for the cash flow projections include the full cost of servicing this business.

The economic assumptions are reviewed and updated at each reporting date based on underlying investment conditions at the reporting date. The assumed discount rates and inflation rates are consistent with the investment return assumptions.

In addition, the demographic assumptions used at 31 December 2010 are considered to be best estimate and, consequently, no further adjustments are required. In respect of the CA Business, the assumptions required in the calculation of the value of the annuity rate guarantee on pension business have been set equal to best-estimate assumptions.

(f) Pension Schemes

In Movestic, where the Group participates in a combined defined benefit and defined contribution scheme, future contributions to the scheme are reflected in the value of in-force business.

(g) Financial Reassurance

In respect of Movestic the Group uses financial reinsurance to manage the impact of its new business strain. Whilst this liability is valued at fair value within the IFRS statements, allowing for an option which provides the Group with the right to settle the liability early on beneficial terms, when valuing the shareholder net worth within the EEV it is considered more appropriate to assess this liability at a higher cost, reflecting the likelihood of the option not being utilised.

4 Assumptions

(a) Investment Returns

Investment returns are assumed to be equal to the reference rate, as covered in note 3(c) above. For linked business, the aggregate return has been determined by the reference rate less an appropriate allowance for tax.

	CA		S&P		Movestic	
	31 December		31 December		31 December	
	2010	2009	2010	2009	2010	2009
Investment Return *	3.1% **	3.8% **				
5 year			2.69%	n/a	3.18%	2.87%
10 year			3.70%	n/a	3.61%	3.62%
15 year			4.09%	n/a	3.80%	3.89%
20 year			4.15%	n/a	3.94%	4.01%
25 year			4.12%	n/a	3.94%	4.01%
30 year			4.04%	n/a	3.94%	4.01%
Inflation - RPI	2.95%	2.9%	2.95%	n/a	2.3%	2.0%

* For S&P and Movestic, a full swap curve is used. The rates quoted are presented as indicative spot rates.

** For CA business, a single rate is applied for all durations.

(b) Actuarial Assumptions

The demographic assumptions used to determine the value of the in-force business have been set at levels commensurate with the underlying operating experience identified in the periodic actuarial investigations

(c) Taxation

Projected tax has been determined assuming current tax legislation and rates continue unaltered, except where future tax rates or practices have been announced. The tax rates for CA and S&P allow for changes in Corporation Tax as announced by the Chancellor in his budget speech of 22 June 2010, so reflect a reduction from the current rate of 28% to 24% in steps of 1%. If allowance had only been made for the enacted change to 27%, the embedded value would have been £2.5m lower as at 31 December 2010. The tax rates do not allow for further changes announced by the Chancellor in his budget speech on 23 March 2011 for a reduction in the UK Corporation Tax rate to 26% from April 2011 and to reduce thereafter by annual decrements of 1% to 23%.

(d) Expenses

The expense levels are based on internal expense analysis investigations and are appropriately allocated to the new business and policy maintenance functions.

For CA and S&P, these have been determined by reference to

- (i) the outsourcing agreements in place with our third-party business process administrators,
- (ii) anticipated revisions to the terms of such agreements as they fall due for renewal, and
- (iii) corporate governance costs relating to the covered business.

For Movestic, these have been determined by reference to

- (i) an expense analysis in which all expenses were allocated to covered and uncovered business, with expenses for the covered business being allocated to acquisition and maintenance activities, and
- (ii) expense drivers, being, in relation to acquisition costs, the number of policies sold during the period and, in relation to maintenance expenses, the average number of policies in force during the period.

The expense assumptions for CA also include the expected future holding company expenses which will be recharged to the worldwide covered business.

No allowance has been made for future productivity improvements in the expense assumptions.

(e) Discount Rate

An explicit constant margin is added to the reference rate shown in (a) above to cover any remaining risks that are considered to be non-market, non-diversifiable risks, as there is no risk premium observable in the market. This margin, which is 50 basis points for CA and S&P (CA as at 31 December 2009 50 basis points) and 70 basis points for Movestic (as at 31 December 2009 70 basis points), gives due recognition to the relative sensitivity of the value of in-force business to the discount rate for the different businesses, and to the fact that

a) For CA

- (i) the covered business is substantially closed to new business,
- (ii) there is no significant exposure in the with profit business, which is wholly reinsured,
- (iii) expense risk is limited as a result of the outsourcing of substantially all policy administration and related functions to third-party business process administrators, and
- (iv) for much of the life business the Group has the ability to vary risk charges made to policyholders.

b) For S&P

- (i) the covered business is substantially closed to new business, and
- (ii) expense risk is limited as a result of the outsourcing of substantially all policy administration and related functions to third-party business process administrators.

c) For Movestic

- (i) the covered business remains open,
- (ii) the in-force business is relatively small,

- (iii) reinsurance is used to significantly reduce insurance risks, and
- (iv) a number of the risks provide diversification benefits within the Chesnara Group, in relation to reinsurance counterparties, market exposures and policyholder populations

5 Analysis of shareholders' equity

31 December 2010					
	CA £000	S&P £000	Movestic £000	Other Group Activities £000	Total £000
Regulated entities					
Capital required	30,172	26,056	12,390	-	68,618
Free surplus	40,176	35,904	10,931	-	87,011
Shareholders' net worth of regulated entities	70,348	61,960	23,321	-	155,629
Adjustments to shareholder net worth					
Deferred acquisition costs	-	-	(51,243)	-	(51,243)
Financial reinsurance liability	-	-	(6,145)	-	(6,145)
Other asset / liability adjustments	-	-	8,649	-	8,649
Adjusted shareholder net worth	70,348	61,960	(25,418)	-	106,890
In-force value of covered business	79,360	41,307	144,748	-	265,415
Embedded value of regulated entities	149,708	103,267	119,330	-	372,305
Less amount financed by borrowings	-	(39,287)	-	-	(39,287)
Embedded value of regulated entities attributable to shareholders	149,708	63,980	119,330	-	333,018
Net equity of other Group companies	-	-	1,307	20,311	21,618
Total shareholders' equity	149,708	63,980	120,637	20,311	354,636

31 December 2009					
	CA £000	S&P £000	Movestic £000	Other Group Activities £000	Total £000
Regulated entities					
Capital required	32,042	-	12,123	-	44,165
Free surplus	40,253	-	-	-	52,590
Shareholders' net worth of regulated entities	72,295	-	24,460	-	96,755
Adjustments to shareholder net worth					
Deferred acquisition costs	-	-	(44,721)	-	(44,721)
Financial reinsurance liability	-	-	(5,313)	-	(5,313)
Other asset / liability adjustments	-	-	4,299	-	2,203
Adjusted shareholder net worth	72,295	-	(21,275)	-	48,924
In-force value of covered business	85,559	-	-	-	198,312
Embedded value of regulated entities	157,854	-	91,478	-	249,332
Less amount financed by borrowings	(4,197)	-	-	-	(4,197)
Embedded value of regulated entities attributable to shareholders	153,657	-	91,478	-	245,135
Net equity of other Group companies	-	-	(1,048)	18,498	17,450
Total shareholders' equity	153,657	-	90,430	18,498	262,585

EEV free surplus, as shown above, represents the balance of the shareholder's net worth above the capital required. Movement in the shareholder's net worth broadly follows the movement in available capital resources shown in note 32 to the IFRS statements. That note also shows the components of the capital required.

The movement in the in-force value of covered business comprises

Year ended 31 December 2010				
	CA £000	S&P £000	Movestic £000	Total £000
Value at beginning of period	85,559	-	112,753	198,312
Amount arising on acquisition	-	42,391	-	42,391
Amount credited/ charged to operating profit	(6,199)	(1,084)	31,995	24,712
Value at end of period	79,360	41,307	144,748	265,415

Year ended 31 December 2009

	CA	S&P	Movestic	Total
	£000	£000	£000	£000
Value at beginning of period	84,940	-	-	84,940
Amount arising on acquisition	-	-	95,953	95,953
Amount credited/ charged to operating profit	619	-	16,800	17,419
Value at end of period	85,559	-	112,753	198,312

CA

On 2 June 2005, the Group drew down £21m on a bank loan facility, in order to part fund the acquisition of CWA Life Holdings plc ('CWA'). This effectively represented a purchase of part of the underlying value in force of CWA by way of debt finance and it follows that the embedded value of the UK regulated entity is not attributable to equity shareholders of the Group to the extent of the outstanding balance on the loan account at each balance sheet date. The loan was repayable in five equal annual instalments on the anniversary of the draw down date, the funds for the repayment effectively being provided by way of the realisation of the underlying value of in-force business of the covered business. In accordance with this, £4.2m of the loan was repaid on 2 June 2009 and a further £4.2m was repaid on 2 June 2010, leaving principal outstanding at that date of £nil.

S&P

On 20 December 2010, the Group drew down £40m on a bank loan facility, in order to part fund the acquisition of Save & Prosper Insurance Limited and its subsidiary, Save & Prosper Pensions Limited (together 'S&P'). This effectively represented a purchase of part of the underlying value in force of S&P by way of debt finance and it follows that the embedded value of the UK regulated entity is not attributable to equity shareholders of the Group to the extent of the outstanding balance on the loan account at each balance sheet date. The loan is repayable in five annual instalments on the anniversary of the draw down date, the funds for the repayment effectively being provided, in part, by way of the realisation of the underlying value of in-force business of the covered business. There was a principal outstanding at the balance sheet date of £40m.

Movestic

The adjusted shareholder net worth of Movestic is that of the regulated entity, which includes also the net worth attributable to the non-covered business within the regulated entity. Accordingly, for Movestic, the embedded value of regulated entities comprises the embedded value of covered business and the value of the non-covered business of the regulated entity, the latter component being valued on an IFRS basis.

6 Summarised statement of changes in equity and analysis of profit

(a) Changes in equity may be summarised as

Statement of changes in equity

	Year ended 31 December	
	2010	2009
	£000	£000
Shareholders' equity at beginning of period	262,585	182,708
Effect of modelling improvements	13,239	-
Shareholders' equity at beginning of period restated	275,824	182,708
Profit for the period attributable to shareholders	59,885	90,272
Issue of new shares		
Share capital	523	-
Share premium	22,065	-
Sale of treasury shares	3,162	-
Foreign exchange reserve movement	9,517	5,539
Dividends paid	(16,340)	(15,934)
Shareholders' equity at end of period	354,636	262,585

During 2010, Movestic introduced a new system for modelling value-in-force, which provided the capability for (i) more accurately modelling the impact on commission paid of policies becoming paid-up and (ii) for determining future fee income on a case-by-case investment mix basis, whereas previously it had been necessary to adopt high-level estimates.

The effect of the modelling improvements is classified as an exceptional credit in the consolidated income statement and is presented after operating profit.

(b) The profit for the period is analysed as

Year ended 31 December 2010

	CA £000	S&P £000	Movestic £000	Other Group Activities £000	Total £000
Covered business					
New business contribution	685	-	2,057	-	2,742
Return from in-force business					
Expected return	5,203	6	6,207	-	11,416
Experience variances	11,315	101	(7,942)	-	3,474
Operating assumption changes	(1,985)	-	(10,142)	-	(12,127)
Return on shareholder net worth	736	123	-	-	859
Operating profit/(loss) of covered business	15,954	230	(9,820)	-	6,364
Variation from longer-term investment return	14,880	-	12,061	-	26,941
Effect of economic assumption changes	(7,248)	(1,513)	4,308	-	(4,453)
Profit on covered business before tax	23,586	(1,283)	6,549	-	28,852
Tax thereon	(4,695)	359	-	-	(4,336)
Profit on covered business after tax	18,891	(924)	6,549	-	24,516
Results of non-covered business and of other group companies					
Loss before tax, and exceptional items	-	-	(3,674)	(2,440)	(6,114)
Exceptional profit recognised on					
– business combination of Aspis	-	-	376	-	376
– business combination of S&P	-	-	-	40,667	40,667
Tax	-	-	177	145	322
Profit after tax	18,891	(924)	3,428	38,372	59,767
Non-controlling interest	-	-	118	-	118
Profit for the period attributable to shareholders	18,891	(924)	3,546	38,372	59,885

The exceptional profit recognised on business combinations relates to the acquisition by Movestic of the business of Aspis Forsaknngar Liv AB ('Aspis') and the acquisition by Chesnara plc of Save & Prosper Insurance Limited and its subsidiary company Save & Prosper Pensions Limited (together 'S&P')

The determination of the profit relating to Aspis is set out in Note 7 to the IFRS financial statements and the determination of the profit relating to S&P is set out in Note 9 following

Year ended 31 December 2009

	CA £000	S&P £000	Movestic £000	Other Group Activities £000	Total £000
Covered business					
New business contribution	1,482	-	783	-	2,265
Return from in-force business	-	-	-	-	-
Expected return	7,357	-	1,682	-	9,039
Experience variances	4,499	-	2,060	-	6,559
Operating assumption changes	8,862	-	(7,405)	-	1,457
Return on shareholder net worth	(200)	-	-	-	(200)
Operating profit	22,000	-	(2,880)	-	19,120
Variation from longer-term investment return	6,206	-	7,544	-	13,750
Effect of economic assumption changes	(12,286)	-	2,556	-	(9,730)
Profit on covered business before tax	15,920	-	7,220	-	23,140
Tax thereon	11,893	-	-	-	11,893
Profit on covered business after tax	27,813	-	7,220	-	35,033
Results of non-covered business and of other group companies					
Profit before tax, and exceptional item	-	-	1,623	(755)	868
Exceptional profit arising on combination of Movestic business	-	-	-	54,187	54,187
Tax	-	-	(161)	338	177
Profit after tax	27,813	-	8,682	53,770	90,265
Non-controlling interest	-	-	7	-	7
Profit for the period attributable to shareholders	27,813	-	8,689	53,770	90,272

The results of the non-covered business and of other group companies before tax and before exceptional item are presented as 'other operational result' in the consolidated income statement. For CA, the result of the covered business includes the expenses of the holding company, with an equal and opposite adjustment to the result of the non-covered business and of other group companies.

Included within the effect of economic assumption changes in respect of CA for the year ended 31 December 2009 is an amount of £5,620,000 being a reduction of pre-tax profit relating to a change in the basis of taxation of overseas dividends. This change leads to a reduction in the estimate of future deductions for taxation from policyholder linked funds and is matched by a broadly offsetting reduction in the estimate of future tax payable. This is a significant component of the tax credit of £11,893,000 in respect of tax for CA for the year ended 31 December 2009 as shown above.

7 Sensitivities to alternative assumptions

The following tables show the sensitivity of the embedded value as reported at 31 December 2010, and of the new business contribution of Movestic, to variations in the assumptions adopted in the calculation of the embedded value. Sensitivity analysis is not provided in respect of the new business contribution of CA and S&P for the year ended 31 December 2010 as the reported level of new business contribution is not considered to be material (see Note 3(a) above). It largely relates to guaranteed bond business, where a close asset/liability matching approach leaves values broadly insensitive to changes in experience.

	Embedded Value			New Business Contribution
	CA £m	S&P £m	Movestic £m	Movestic £m
Published value as at 31 December 2010	149.7	103.3	120.6	2.1
Changes in embedded value/new business contribution arising from				
Economic sensitivities				
100 basis point increase in yield curve	(5.7)	16.4	(0.5)	(0.1)
100 basis point reduction in yield curve	4.0	(21.5)	0.4	-
10% decrease in equity and property values	(2.8)	(10.7)	(9.7)	-
Operating sensitivities				
10% decrease in maintenance expenses	2.2	3.7	6.3	0.6
10% decrease in lapse rates	2.8	(1.3)	8.6	0.9
5% decrease in mortality/morbidity rates				
Assurances	1.3	1.2	0.4	-
Annuities	(1.5)	-	-	-
Reduction in the required capital to statutory minimum	0.6	1.3	-	-

The key assumption changes represented by each of these sensitivities are as follows

Economic sensitivities

- (i) 100 basis point increase in the yield curve The reference rate is increased by 1% and the rate of future inflation has also been increased by 1% so that real yields remain constant,
- (ii) 100 basis point reduction in the yield curve The reference rate is reduced by 1% and the rate of future inflation has also been reduced by 1% so that real yields remain constant, and
- (iii) 10% decrease in the equity and property values This gives rise to a situation where, for example, a Managed Fund unit liability with a 60% equity holding would reduce by 6% in value

Operating sensitivities

- (i) 10% decrease in maintenance expenses, giving rise to, for example, a base assumption of £20 per policy pa reducing to £18 per policy pa,
- (ii) 10% decrease in persistency rates giving rise to, for example, a base assumption of 10% of policy base lapsing pa reducing to 9% pa,
- (iii) 5% decrease in mortality/morbidity rates giving rise to, for example, a base assumption of 95% of the parameters in a selected mortality/morbidity table reducing to 90.25% of the parameters in the same table, assuming no changes are made to policyholder charges or any other management actions, and
- (iv) the sensitivity to the reduction in the required capital to the statutory minimum shows the effect of reducing the required capital from that defined in Note 3(b) above to the minimum requirement prescribed by regulation

In each sensitivity calculation all other assumptions remain unchanged except where they are directly affected by the revised economic conditions for example, as stated, changes in interest rates will directly affect the reference rate

8 Reconciliation of shareholders' equity on the IFRS basis to shareholders' equity on the EEV basis

	CA £000	S&P £000	Movestic £000	Other Group Activities £000	Total £000
31 December 2010					
Shareholders' equity on the IFRS basis	90,301	39,858	52,799	20,311	203,269
Adjustments					
Deferred acquisition costs					
Investment contracts	(6,265)	-	(7,298)	-	(13,563)
Deferred income	10,885	-	-	-	10,885
Adjustment to provisions on investment contracts, net of amounts deposited with reinsurers	(10,739)	1,997	-	-	(8,742)
Adjustments to provisions on insurance contracts, net of reinsurers' share	(180)	-	-	-	(180)
Adjustments to provisions on unallocated divisible surplus	-	(14,847)	-	-	(14,847)
Acquired in-force value	(15,563)	(6,610)	(62,866)	-	(85,039)
Acquired value of customer relationships	-	-	(2,049)	-	(2,049)
Adjustment to borrowings	-	-	(7,454)	-	(7,454)
Deferred tax	1,909	2,275	2,757	-	6,941
Shareholder net worth	70,348	22,673	(24,111)	20,311	89,221
Value of in-force business	79,360	41,307	144,748	-	265,415
Shareholders' equity on the EEV basis	149,708	63,980	120,637	20,311	354,636
Shareholder net worth comprises					
Shareholder net worth in regulated entities	70,348	61,960	(25,418)	-	106,890
Shareholders' net equity in other Group companies	-	-	1,307	20,311	21,618
Debt finance	-	(39,287)	-	-	(39,287)
Total	70,348	22,673	(24,111)	20,311	89,221
	CA £000	S&P £000	Movestic £000	Other Group Activities £000	Total £000
31 December 2009					
Shareholders' equity on the IFRS basis	93,561	-	47,696	18,498	159,755
Adjustments					
Deferred acquisition costs					
Investment contracts	(7,173)	-	(1,447)	-	(8,620)
Deferred income	12,319	-	-	-	12,319
Adjustment to provisions on investment contracts, net of amounts deposited with reinsurers	(15,038)	-	-	-	(15,038)
Adjustments to provisions on insurance contracts, net of reinsurers' share	(238)	-	-	-	(238)
Acquired in-force value	(18,282)	-	(61,675)	-	(79,957)
Acquired value of customer relationships	-	-	(2,336)	-	(2,336)
Adjustment to borrowings	-	-	(5,073)	-	(5,073)
Deferred tax	2,949	-	512	-	3,461
Shareholder net worth	68,098	-	(22,323)	18,498	64,273
Value of in-force business	85,559	-	112,753	-	198,312
Shareholders' equity on the EEV basis	153,657	-	90,430	18,498	262,585
Shareholder net worth comprises					
Shareholder net worth in regulated entities	72,295	-	(21,275)	-	51,020
Shareholders' net equity in other Group companies	-	-	(1,048)	18,498	17,450
Debt finance	(4,197)	-	-	-	(4,197)
Total	68,098	-	(22,323)	18,498	64,273

9 Exceptional item

Profit arising on business combinations is presented as an exceptional item in the consolidated income statement and comprises

Arising on business combination with	Year ended 31 December	
	2010 £000	2009 £000
S&P	40,667	-
Aspis business	376	-
Movestic	-	54,187
	41,043	54,187

Details of the combination with the Aspis business are set out in Note 7 to the IFRS financial statements

The profit arising on the combination with S&P arises on the purchase, on 20 December 2010, of 100% of the issued share capital of Save & Prosper Insurance Limited and its subsidiary, Save & Prosper Pensions Limited, comprising the S&P businesses, and is measured as the difference between the purchase consideration of £63,524,000 and the embedded value of the S&P businesses at the purchase date, being £104,191,000, which was established in accordance with the methodology set out in Notes 2 to 4 of these supplementary financial statements

10 Earnings per share

	Year ended 31 December	
	2010	2009
	p	p
Basic earnings per share		
Based on profit for the period attributable to shareholders	<u>71 24</u>	<u>88 94</u>
Based on profit for the period attributable to shareholders before exceptional item	<u>31 26</u>	<u>35 55</u>
Diluted earnings per share		
Based on profit for the period attributable to shareholders	<u>71 24</u>	<u>88 94</u>
Based on profit for the period attributable to shareholders before exceptional item	<u>31 26</u>	<u>35 55</u>

11 Foreign exchange translation reserve

A foreign exchange translation reserve arises on the translation of the financial statements of Movestic, the functional currency of which is the Swedish Krona, into pounds sterling, which is the presentational currency of the Group financial statements. Items in the consolidated income statement are translated at the average exchange rate of SEK11 1249 = £1 ruling in the reported period (Year ended 31 December 2009 SEK11 5594 = £1), while all items in the balance sheet are stated at the closing rates ruling at the reported balance sheet date, being SEK10 5250 = £1 at 31 December 2010 (SEK11 5305 = £1 at 31 December 2009). The differences arising on translation using this methodology are recognised directly in shareholders' equity within the foreign exchange translation reserve.

The reported embedded value is sensitive to movements in the SEK £ exchange rate. Had the exchange rate as at 31 December 2010 been 10% higher at SEK11 5775 = £1, then the reported embedded value of £354.6m as at 31 December 2010 would have been reported as £343.7m.

12 Post balance sheet event

In his budget speech on 23 March 2011, the Chancellor announced changes which will affect the taxation of UK-based Life insurance companies as follows:

- (i) the rate of UK Corporation Tax will reduce to 26% from April 2011 and, thereafter, by annual decrements of 1% to 23%. No allowance has been made for the impact of these changes as disclosed in Note 4(c) above, and
- (ii) the basis of taxation of insurance companies will be changed following the introduction of Solvency II regulations. While the announcement contained the principles to be adopted, key elements of the detailed provisions remain to be finalised. These changes may have a material impact on the embedded value.

Notice of Annual General Meeting

Company No. 4947166

NOTICE OF ANNUAL GENERAL MEETING

Chesnara plc

Notice is given that the 2011 Annual General Meeting of Chesnara plc will be held at the offices of Panmure Gordon (UK) Limited, Moorgate Hall, 155 Moorgate, London EC2M 6XB on 17 May 2011 at 11 a.m. for the business set out below. Resolutions 1 to 11 will be proposed as ordinary resolutions and resolutions 12 to 14 will be proposed as special resolutions.

- 1 To receive and adopt the Financial Statements for the financial year ended 31 December 2010 together with the reports of the directors and auditor thereon
- 2 To declare a final dividend of 10.6 pence per share for the financial year ended 31 December 2010
- 3 To approve the remuneration report set out in the Financial Statements for the financial year ended 31 December 2010
- 4 To re-elect Mike Gordon as a director who retires by rotation in accordance with the Company's Articles of Association
- 5 To re-elect Terry Marris as a director who retires by rotation in accordance with the Company's Articles of Association
- 6 To reappoint Deloitte LLP as auditors of the Company to hold office until the conclusion of the next general meeting of the Company at which accounts are laid before shareholders
- 7 To authorise the directors to fix the auditors' remuneration
- 8 That, from the date of this resolution until the earlier of 16 November 2012 and the conclusion of the Company's next annual general meeting, the Company and all companies which are its subsidiaries at any time during such period are authorised
 - (a) to make donations to political parties or independent election candidates,
 - (b) to make donations to political organisations other than political parties, and
 - (c) to incur political expenditure,up to an aggregate total amount of £100,000, with the amount authorised for each of heads (a) to (c) above being limited to the same total. Any such amounts may comprise sums paid or incurred in one or more currencies. Any sum paid or incurred in a currency other than sterling shall be converted into sterling at such rate as the board may decide is appropriate. Terms used in this resolution have, where applicable, the meanings that they have in Part 14 of the Companies Act 2006 on "Control of political donations and expenditure"
- 9 That the Directors be and are hereby authorised to establish the Chesnara 2011 Long-Term Incentive Plan, a copy of the draft rules of which has been produced to the meeting and initialled by the Chairman for the purpose of identification only and a summary of the main provisions of which is set out in Appendix 1 to the notice of Annual General Meeting

- 10 That the rules of the Chesnara Sharesave Plan produced to the meeting and initialled by the Chairman for the purpose of identification only and a summary of the main provisions of which is set out in Appendix 2 to the notice of Annual General Meeting be and are hereby approved
- 11 That the directors be generally and unconditionally authorised in accordance with section 551 of the Companies Act 2006 to exercise all the powers of the Company to allot shares in the Company to grant rights to subscribe for or to convert any security in to such shares ("Allotment Rights") but so that
- (a) the maximum amount of shares that may be allotted or made the subject of Allotment Rights under this authority are shares with an aggregate nominal value of £3,790,005, of which
 - (i) one-half may be allotted or made the subject of Allotment Rights in any circumstances, and
 - (ii) the other half may be allotted or made the subject of Allotment Rights pursuant to any rights issue (as referred to in the Financial Services Authority's listing rules) or pursuant to any arrangements made for the placing or underwriting or other allocation of any shares or other securities included in, but not taken up under, such rights issue,
 - (b) this authority shall expire 15 months after the passing of this resolution or, if earlier, on the date of the Company's next Annual General Meeting,
 - (c) the Company may make any offer or agreement before such expiry which would or might require shares to be allotted or Allotment Rights to be granted after such expiry,
 - (d) all authorities vested in the directors on the date of the notice of this meeting to allot shares or to grant Allotment Rights, or to allot relevant securities (as defined in the Companies Act 1985), that remain unexercised at the commencement of this meeting are revoked
- 12 That, subject to the passing of resolution 11, the directors be and they are empowered, pursuant to section 570 of the Companies Act 2006, to allot equity securities (as defined in section 560 of that Act) pursuant to the authority contained in the foregoing resolution numbered 11 as if section 561 of that Act did not apply to such allotment, provided that this power shall be limited to
- (a) the allotment of equity securities in connection with any rights issue or open offer (each as referred to in the Financial Services Authority's listing rules) or any other pre-emptive offer that is open for acceptance for a period determined by the directors to the holders of ordinary shares on the register on any fixed record date in proportion to their holdings of ordinary shares (and, if applicable, to the holders of any other class of equity security in accordance with the rights attached to such class), subject in each case to such exclusions or other arrangements as the directors may deem necessary or appropriate in relation to fractions of such securities, the use of more than one currency for making payments in respect of such offer, any such shares or other securities being represented by depositary receipts, treasury shares, any legal or practical problems in relation to any territory or the requirements of any regulatory body or any stock exchange, and
 - (b) the allotment of equity securities for cash (otherwise than as mentioned in sub-paragraphs (a) and (b) above) provided that the maximum aggregate nominal value of equity securities allotted does not exceed £287,619 representing approximately 5% of the issued share capital of the Company,
- and shall expire 18 months after the passing of this resolution or, if earlier, on the date of the Company's next Annual General Meeting save that, before the expiry of this power, the Company may make any offer or agreement which would or might require equity securities to be allotted after such expiry
- 13 That the Company be and is generally and unconditionally authorised for the purposes of section 701 of the Companies Act 2006 to make one or more market purchases (as defined in section 693 of that Act) on the London Stock Exchange of ordinary shares of 5p each in the capital of the Company provided that

- (a) the maximum aggregate number of ordinary shares hereby authorised to be purchased is 11,484,865 (representing 10% of the Company's issued share capital excluding shares held in Treasury),
 - (b) the minimum price (exclusive of expenses) which may be paid for such ordinary shares is 5p per share,
 - (c) the maximum price (exclusive of expenses) which may be paid for such ordinary shares is the maximum price permitted under the Financial Services Authorities listing rules or, in the case of a tender offer (as referred to in those rules), 5% above the average of the middle market quotations for the ordinary shares derived from the Daily Official List of the London Stock Exchange Daily Official List for the five business days before the date on which the terms of the tender offer are announced,
 - (d) the authority hereby conferred shall expire 18 months after the passing of this resolution or, if earlier, on the date of the Company's next Annual General Meeting, and
 - (e) the Company may make a contract or contracts to purchase ordinary shares under the authority hereby conferred prior to the expiry of such authority which will or may be executed wholly or partly after the expiry of such authority, and may make a purchase of ordinary shares in pursuance of any such contract or contracts
- 14 That a general meeting of the Company other than an annual general meeting may be called on not less than 14 clear days' notice

By order of the Board

Mary Fishwick
Company Secretary

Registered office

Harbour House
Portway
Preston
Lancashire
PR2 2PR
Registered in England No 4947166

Dated 30 March 2011

Notes

- 1 **Any Member who is entitled to attend and vote at this meeting is entitled to appoint another person, or two or more person in respect of different shares held by him, as his proxy to exercise all or any of his rights to attend and to speak and to vote at the meeting**
- 2 A member wishing to attend and vote at the meeting in person should arrive prior to the time fixed for its commencement. A member that is a corporation can only attend and vote at the meeting in person through one or more representatives appointed in accordance with section 323 of the Companies Act 2006. Any such representative should bring to the meeting written evidence of his appointment such as a certified copy of a board resolution of, or a letter from, the corporation concerned confirming the appointment. Any member wishing to vote at the meeting without attending in person or (in the case of a corporation) through its duly appointed representative must appoint a proxy to do so. A proxy need not be a member of the Company. A form of proxy for this meeting is enclosed, and in order to be valid, any form of proxy and power of attorney or other authority under which it is signed, or a notanally certified or office copy of such power of attorney, must reach the Company's Registrars, Capita Registrars at 34 Beckenham Road, Beckenham, Kent BR3 4TU or by post to Business Reply Licence No RSBH-UXKS-LRBC, PXS, 34 Beckenham Road, Beckenham, Kent, BR3 4BR by 11 a.m. on Friday 13 May 2011. Alternatively, members may submit their proxy vote electronically via www.capitashareportal.com. From there you can log in to your Capita Shareportal account or register for the Capita share portal if you have not already done so, by following the on-screen instructions. To be a valid proxy appointment, the member's electronic message confirming the details of the appointment completed in accordance with those instructions must be transmitted so as to be received by the same time. The appointment of a proxy will not preclude a shareholder from attending and voting at the meeting.
- 3 CREST members who wish to appoint one or more proxies through the CREST system may do so by using the procedures described in "the CREST voting service" section of the CREST Manual. CREST personal members or other CREST sponsored members, and those CREST members who have appointed one or more voting service providers, should refer to their CREST sponsor or voting service provider(s), who will be able to take the appropriate action on their behalf. In order for a proxy appointment or a proxy instruction made using the CREST voting service to be valid, the appropriate CREST message (a "CREST proxy appointment instruction") must be properly authenticated in accordance with the specifications of CREST's operator, Euroclear UK & Ireland Limited ("Euroclear"), and must contain all the relevant information required by the CREST Manual. To be valid, the message (regardless of whether it constitutes the appointment of a proxy or is an amendment to the instruction given to a previously appointed proxy) must be transmitted so as to be received by the Company's "issuer's agent" RA10 by 11 a.m. on Friday 13 May 2011. After this time any change of instruction to a proxy appointed through the CREST system should be communicated to the appointee through other means. The time of the message's receipt will be taken to be when (as determined by the timestamp applied by the CREST Applications Host) the issuer's agent is first able to retrieve it by enquiry through the CREST system in the prescribed manner. Euroclear does not make available special procedures in the CREST system for transmitting any particular message. Normal system timings and limitations apply in relation to the input of CREST proxy appointment instructions. It is the responsibility of the CREST member concerned to take (or, if the CREST member is a CREST personal member or a CREST sponsored member or has appointed any voting service provider(s), to procure that his CREST sponsor or voting service provider(s) take(s)) such action as is necessary to ensure that a message is transmitted by means of the CREST system by any particular time. CREST members and, where applicable, their CREST sponsors or voting service providers should take into account the provisions of the CREST Manual concerning timings as well as its section on "Practical limitations of the system". In certain circumstances the Company may, in accordance with the Uncertificated Securities Regulations 2001 or the CREST Manual, treat a CREST proxy appointment instruction as invalid.
- 4 Copies of Directors' service contracts and letters of appointment will be available for inspection at the registered office of the Company during normal business hours each business day and at the place of the Annual General Meeting for at least 15 minutes prior to and during the meeting.
- 5 Copies of the rules of The Chesnara 2011 Long-Term Incentive Plan and the Chesnara Sharesave Plan will be available for inspection at the registered office of the Company and at the place of the Annual

General Meeting during normal business hours each business day from the date of this notice until the conclusion of the Annual General Meeting

- 6 Pursuant to Regulation 41 of the Uncertificated Securities Regulations 2001, the time by which a person must be entered on the register of members in order to have the right to attend and vote at the Annual General Meeting (and for the purpose of the determination by the Company of the votes they may cast) is 11 00 a.m. on Friday 13 May 2011. Changes to entries on the register of members after that time will be disregarded in determining the right of any person to attend or vote at the meeting.
- 7 In accordance with section 325 of the Companies Act 2006, the right to appoint proxies does not apply to persons nominated to receive information rights under section 146 of the Companies Act 2006. Persons nominated to receive information rights under section 146 of the Companies Act 2006 who have been sent a copy of this notice of meeting are hereby informed, in accordance with section 149 (2) of the Companies Act 2006, that they may have a right under an agreement with the registered member by whom they were nominated to be appointed, or to have someone else appointed, as a proxy for this meeting. If they have no such right, or do not wish to exercise it, they may have a right under such an agreement to give instructions to the member as to the exercise of voting rights. Nominated persons should contact the registered member by whom they were nominated in respect of these arrangements.
- 8 As at 30 March 2011 (being the last business day prior to the publication of this document) the Company's issued share capital consists of 115,047,662 ordinary shares, carrying one vote each. The total voting rights in the Company as at 30 March 2011 (being the last business day prior to the publication of this document) are 114,848,651.
- 9 Information Regarding this meeting, including information required by section 311A of the Companies Act 2006, is available at www.chesnara.co.uk. Any electronic address provided either in this notice or any related documents (including the proxy form) may not be used to communicate with the Company for any purposes other than those expressly stated.
- 10 In accordance with section 319A of the Companies Act 2006, any member attending the meeting has the right to ask questions. The company must cause to be answered any such question relating to the business being dealt with at the meeting but no such answer need be given if (a) to do so would interfere unduly with the preparation for the meeting or involve the disclosure of confidential information, (b) the answer has already been given on a website in the form of an answer to a question, or (c) it is undesirable in the interests of the Company or the good order of the meeting that the question be answered.
- 11 Under section 527 of the Companies Act 2006 members meeting the threshold requirements set out in that section have the right to require the Company to publish on a website a statement setting out any matter relating to (i) the audit of the Company's accounts (including the auditor's report and the conduct of the audit) that are to be laid before the Annual General Meeting, or (ii) any circumstances connected with an auditor of the Company ceasing to hold office since the previous meeting at which annual accounts and reports were laid in accordance with section 437 of the Companies Act 2006. The Company may not require the shareholders requesting any such website publication to pay its expenses in complying with sections 527 or 528 of the Companies Act 2006. Where the Company is required to place a statement on a website under section 527 of the Companies Act, it must forward the statement of the Company's auditor not later than the time when it makes the statement available on the website. The business which may be dealt with at the Annual General Meeting includes any statement that the Company has been required under section 527 of the Companies Act 2006 to publish on a website.
- 12 Members meeting the threshold requirements in sections 338 and 338A of the Companies Act 2006 have the right to require the Company (i) to give to members entitled to receive notice of the meeting notice of a resolution which may properly be moved and is intended to be moved at the meeting and/or (ii) to include in the business to be dealt with at the meeting any matter (other than a proposed resolution) which may be properly included in the business. A resolution may properly be moved or a matter may properly be included in the business unless (a) (in the case of a resolution only) it would, if passed, be ineffective (whether by reason of inconsistency with any enactment or the Company's constitution or otherwise), (b) it is defamatory of any person, or (c) it is frivolous or vexatious. Such a request may be in hard copy form or in electronic form, must identify the resolution of which notice is to

be given or (as applicable) the matter to be included in the business, must be authenticated by the person or persons making it, must be received by the Company not later than 6 weeks before the meeting, and (in the case of a matter to be included in the business only) must be accompanied by a statement setting out the grounds for the request

EXPLANATORY NOTES TO THE NOTICE OF ANNUAL GENERAL MEETING

The notes on the following pages give an explanation of the proposed resolutions

Resolution 1

Report and accounts

For each financial year the directors are required to present the directors' report, the audited accounts and the auditors' reports to shareholders at a general meeting

Resolution 2

Final dividend

The payment of the final dividend requires the approval of shareholders in general meeting. If the meeting approves resolution 2, the final dividend of 10.6 pence per share will be paid on 20 May 2011 to ordinary shareholders who are on the register of members at the close of business on 08 April 2011 in respect of each ordinary share.

Resolution 3

Approval of the remuneration report

The Company is required by law to seek the approval of shareholders of its annual report on remuneration policy and practice. This does not affect the directors' entitlement to remuneration and the result of this resolution is advisory only.

The remuneration report for the year ended 31 December 2010 is set out in full on pages 44 to 50 of this document.

Your directors are satisfied that the Company's policy and practice in relation to directors' remuneration are reasonable and that they deserve shareholder support.

Resolutions 4 - 5:

Re-election of directors

Under the Company's articles of association directors are obliged to retire by rotation at annual general meetings and may not serve beyond three years without being re-elected by shareholders. The directors who now fall due for retirement and re-election, through separate resolutions numbered 4 to 5 are Mike Gordon and Terry Marnis. Brief biographical details of both directors seeking re-election can be found on page 35 of this document. Following formal performance evaluation of the Board, both continue to be effective and demonstrate commitment to the role. The remaining directors therefore unanimously recommend that each of these directors be re-elected as a director of the Company.

Resolutions 6 – 7

Reappointment and remuneration of auditors

The Company is required to appoint auditors, at each general meeting before which accounts are laid, to hold office until the end of the next such meeting. Deloitte LLP have indicated that they are willing to act as the Company's auditors. You are asked to reappoint them and, following normal practice, to authorise the directors to determine their remuneration. The directors recommend their appointment.

Resolution 8

Political donations

It has always been the Company's policy that it does not make political donations. This remains the Company's policy.

Part 14 of the Companies Act 2006 imposes restrictions on companies making political donations to any political party or other political organisation or to any independent election candidate unless they have been authorised to make donations at a general meeting of the Company. Whilst the Company has no intention of making such political donations, the Act includes broad and ambiguous definitions of the terms "*political donation*" and "*political expenditure*" which may apply to some normal business activities which would not generally be considered to be political in nature.

The directors therefore consider that, as a purely precautionary measure, it would be prudent to obtain the approval of the shareholders to make donations to political parties, political organisations and independent election candidates and to incur political expenditure up to the specified limit. The directors intend to seek renewal of this approval at future annual general meetings but wish to emphasise that the proposed resolution is a precautionary measure for the above reason and that they have no intention of entering into any party political activities.

Resolution 9

Proposed New Long-Term Incentive Plan

This resolution seeks to approve the introduction of the Chesnara 2011 Long-Term Incentive Plan (the "**New LTIP**")

The rationale for introducing the New LTIP is as follows -

- 1 As explained in the remuneration report set out on pages 44 to 50 of this document, during 2010 the Remuneration Committee ("**Committee**") has reviewed the incentive arrangements and believes that the Executive Directors would be more effectively incentivised and their interests better aligned with those of shareholders if a part of their bonus is measured against targets based on the European Embedded Value ("**EEV**") of the Company over a financial year, with deferral for a further period of 3 years. The other part of their annual bonus opportunity (under the Annual Bonus Scheme) will be dependent on achievement of stretching profit targets and any bonuses earned will be paid in cash with no deferral (as more particularly described in the remuneration report).
- 2 Bonus outcomes based on EEV performance will be determined as notional cash amounts following the end of the performance year and these will be converted into an award of "notional shares" based on the price of an ordinary share in the capital of the Company at the end of that year. The awards will be paid in cash at the end of a three year deferral period, based on the share price at that time, together with an amount representing dividends. Participants under the New LTIP will therefore share the risks and benefits of share price performance over that three year period.

The main terms of the New LTIP are summarised in Appendix 1 to these notes. The key terms of the initial awards proposed to be made under the New LTIP are as follows -

- 3 Subject to approval by shareholders, the Committee intends to make the first awards to Executive Directors shortly following the AGM.
- 4 The notional bonus outcome under the New LTIP will be dependent on EEV targets. It is anticipated that the on-target bonus for EEV for 2011 will be 57.16% of the Executive Directors' total bonus opportunity for the year (with the on-target profit related bonus under the Annual Bonus Scheme set at 42.84%). The aggregate on-target bonus opportunity for 2011 is set at 36.84% of basic salary (respectively 15.79% of 2011 basic salary under the Annual Bonus Scheme and 21.05% under the New LTIP). Additional sums will be converted into awards of notional shares under the New LTIP if EEV performance exceeds the on-target level. However, for 2011, the total annual limit under the combination of the notional bonus under the New LTIP and any amount earned under the Annual Bonus Scheme is 100% of the Executive Director's basic salary for the year.

- 5 EEV performance will be measured over the 2011 financial year. The proposed EEV target for 2011 awards is regarded by the Committee as being challenging, in line with the Company's strategy and not encouraging any undue business risk.

The Committee's intention is that the New LTIP will replace the Company's Current Long-Term Incentive Plan (as more particularly described in the remuneration report)

Resolution 10

Proposed New Sharesave Plan

This resolution seeks to formally approve the Company's HMRC-approved Save-As-You-Earn share option plan ("Sharesave Plan"). The Sharesave Plan was put in place back in 2004 and approved as part of the process of demerger from Countrywide Assured Group plc. The Sharesave Plan has never been used, but following recent acquisitions and responding to the interest expressed by employees, the Committee is now considering offering to all UK employees an opportunity to benefit from the Company's share price performance and to acquire shares in the Company in a tax efficient way.

The Sharesave Plan has no unusual features, but given the time that has elapsed since it was first put in place, the Committee believes it is best practice to ask the Company's current shareholders to approve the Sharesave Plan. The main terms of the Sharesave Plan are summarised in Appendix 2 to these notes.

Resolution 11

Power to allot shares

The directors are currently authorised to allot shares and to grant rights to subscribe for or to convert any security into shares of the Company but their authorisation ends on the date of this year's annual general meeting. This resolution seeks to renew the directors' authority to allot shares.

The Association of British Insurers (ABI) published guidance on 31 December 2008 to the effect that ABI Members will regard as routine a request for authorisation to allot new shares in an amount of up to one third of the existing issued share capital and additionally that they will regard as routine requests to authorise the allotment of a further one third, provided that such additional headroom shall be applied to fully pre-emptive rights issues only and the authorisation shall be valid for one year only. This authority was conferred on the directors at last year's annual general meeting and the directors recommend that the Company should have this additional headroom this year. This authority is limited to a maximum nominal amount of £3,790,005 (representing 75,800,100 ordinary shares), which represents approximately two thirds in aggregate of the total ordinary share capital in issue as at 30 March 2011 (being the latest practicable date prior to the publication of this document). Of this amount, 37,900,050 ordinary shares (representing approximately one third in aggregate of the total ordinary share capital in issue) can be only be allotted pursuant to a rights issue.

As at 30 March 2011, the Company held 199,011 treasury shares, being approximately 0.17% of the total ordinary share capital in issue (calculated exclusive of treasury shares). The renewed authority will remain in force until 18 months after the passing of the resolution or, if earlier, at the conclusion of the next annual general meeting in 2012.

The directors have no present intention of exercising this authority. The purpose of giving the directors this authority is to maintain the Company's flexibility to take advantage of any appropriate opportunities that may arise.

Resolution 12

Disapplication of pre-emption rights

This resolution, which will be proposed as a special resolution, seeks to renew the authority conferred on the directors at last year's annual general meeting to issue equity securities of the Company for cash without first offering them to existing shareholders in proportion to their existing shareholdings. Other than in connection with a rights or other similar issue or scrip dividend (where difficulties arise in offering shares to certain overseas shareholders and in relation to fractional entitlements) the authority contained in this resolution will be limited to

an aggregate nominal value of £287,619 (representing 5,752,380 ordinary shares) which represents 5% of the Company's issued equity share capital as at 30 March 2011 (being the latest practicable date prior to the publication of this document) The renewed authority will remain in force until the date of the annual general meeting or 18 months after the passing of the resolution, whichever is the earlier It is a standard resolution for most UK listed companies each year

In accordance with the Statement of Principles on disapplying pre-emption rights issued in 2006 by the Pre-Emption Group (which is supported by the Association of British Insurers, the National Association of Pension Funds Limited and the Investment Managers Association), the board confirms its intention that no more than 7.5% of the issued share capital will be issued for cash on a non pre-emptive basis during any rolling three year period The directors have no present intention of exercising this authority

Resolution 13

Authority to purchase own shares

This resolution, which will be proposed as a special resolution, is to renew the authority granted to the directors at last year's annual general meeting, which expires on the date of the forthcoming annual general meeting, and to give the Company authority to buy back its own ordinary shares in the market as permitted by the Companies Act 2006 The authority limits the number of shares that could be purchased to a maximum of 11,484,865 (representing 10% of the issued ordinary share capital of the Company (excluding treasury shares) as at 30 March 2011 (being the latest practicable date prior to the publication of this document) and sets the minimum and maximum prices This authority will expire no later than 18 months after the date of the annual general meeting

Your directors believe that the Company should continue to have the authority to purchase its own shares The authority will be exercised only if the directors believe that to do so would result in an increase in earnings per share and would promote the success of the Company for the benefit of its shareholders generally To the extent that any shares so purchased are held in treasury (see below), earnings per share will be enhanced until such time, if any, as such shares are resold or transferred out of treasury

Any purchases of ordinary shares would be by means of market purchases through the London Stock Exchange

The Treasury Shares Regulations, which came into force on 1 December 2003, permit the Company to purchase and hold as treasury shares, ordinary shares with an aggregate nominal value not exceeding 10% of the nominal value of the issued ordinary shares of the Company at the relevant time Shares held in treasury in this manner can be cancelled, sold for cash or, in appropriate circumstances, used to meet obligations under employee share schemes Any shares held in treasury would not be eligible to vote nor would any dividend be paid on any such shares If any ordinary shares purchased pursuant to this authority are not held by the Company as treasury shares then such shares would be immediately cancelled in which event the number of ordinary shares in issue would be reduced

The directors believe that it continues to be desirable for the Company to have this choice Holding the repurchased shares as treasury shares gives the Company the ability to re-issue them quickly and cost effectively and provides the Company with additional flexibility in the management of its capital base No dividends will be paid on, and no voting rights will be exercised in respect of, treasury shares In 2011 no shares were purchased into treasury, 2,897,183 were sold and none were cancelled

This resolution also authorises the Company to transfer any treasury shares held by it for the purposes of its employee share plans Treasury shares transferred for these purposes will, so long as required under the guidelines of the Association of British Insurers Investment Committee, count towards the limits in those plans on the number of new shares which may be issued

Resolution 14

Notice of general meetings

The Companies Act 2006 requires the notice period for general meetings of the Company to be at least 21 days The Company is currently able to call general meetings (other than an annual general meeting) on 14 clear days notice In order to be able to preserve this ability, shareholders must have approved the calling of meetings on 14

days' notice. Resolution 14 seeks such approval. The approval will be effective until the Company's next annual general meeting, when it is intended that a similar resolution will be proposed. The Company will also need to meet the requirements for electronic voting under the Directive before it can call a general meeting on 14 days' notice.

The shorter notice period would not be used as a matter of routine for general meetings, but only where the flexibility is merited by the business of the meeting and is thought to be to the advantage of shareholders as a whole.

The directors recommend all shareholders to vote in favour of all the resolutions, as the directors intend to do so in respect of their own shares, and consider that they are in the best interests of the Company and the shareholders as a whole.

APPENDIX 1

SUMMARY OF THE MAIN PROVISIONS OF THE CHESNARA 2011 LONG-TERM INCENTIVE PLAN (THE "NEW LTIP")

6 THE NEW LTIP

The New LTIP will allow the Company to make awards to selected employees in the form of rights to receive cash sums calculated by reference to the price of an ordinary share in the capital of the Company (a "Share") on the date on which they vest at the end of a deferral period ("Awards")

Awards will be made in respect of a financial year (the "Performance Year") of the Company. Awards will be made in respect of a notional bonus amount which will be converted into notional Share awards ("Notional Share Awards") at the end of the Performance Year. The notional bonus will be determined by reference to the growth in the Company's European Embedded Value ("EEV") over the Performance Year against a target set by the Remuneration Committee of the Directors (the "Committee"). Notional Shares entitle a participant to receive a cash sum calculated by reference to the price of a Share, together with an amount representing dividends, on the date that the participant's Award vests.

Awards will not normally vest until after the end of the period of three years from the end of the Performance Year (the "Deferral Period") and participants will normally not be entitled to any payment under the New LTIP before this time. The operation of the New LTIP will be overseen by the Committee. Benefits under the New LTIP will not be pensionable.

7 ELIGIBILITY

A participant must be an employee of the Company or of any of its subsidiaries (the "Group"). Participation in the New LTIP will be at the discretion of the Committee.

8 INDIVIDUAL BONUS LIMIT

The maximum notional bonus that may be converted into Notional Shares that may be awarded to a participant under the New LTIP in respect of a Performance Year will be limited so that the notional bonus amount, together with any other bonus paid or payable to the participant in respect of the Performance Year, will not normally exceed an individual bonus limit of 100 per cent of basic salary. If this limit would otherwise be exceeded, the Committee will scale back on a pro rata basis the notional bonus under the New LTIP and/or any other bonus attributable to that Performance Year so that the individual bonus limit is not exceeded. If the Committee considers that exceptional circumstances exist that justify a higher amount, the individual bonus limit may be increased to up to 200 per cent of basic salary.

9 TIMING OF AWARDS

Awards may only be made during the period of 42 days beginning with the approval of the New LTIP by the shareholders of the Company, or during the period of 42 days beginning with the announcement of the Company's results for any period, or within 28 days of a person first joining the Group or, exceptionally, and subject to the Model Code and other relevant restrictions, on any other day on which the Committee determines that exceptional circumstances exist. No awards may be made more than ten years after the adoption of the New LTIP. No payment will be required for the grant of an Award.

Awards are not transferable and may only be exercised by the persons to whom they were made or their personal representatives.

10 VESTING OF NOTIONAL SHARE AWARDS

Notional Share Awards will normally vest at the end of the three year Deferral Period and payments will be made to participants as soon as practicable thereafter.

If a participant leaves the Group, any unvested portion of his Award will normally be forfeited.

If the participant leaves the Group during the Performance Year and if the reason for leaving is death, injury or disability, redundancy, retirement or the sale of the employing business or company, the Committee may allow a time-apportioned proportion of his Award to be retained (according to the part of the Performance Year which has then elapsed) and to vest at the end of the Deferral Period, or the Committee may determine that such time-apportioned proportion of his Award shall vest early

If the participant leaves during the Deferral Period and the reason for leaving is death, injury or disability, redundancy, retirement or the sale of the employing business or company, the Committee may allow either a time-apportioned proportion of the Award to be retained (according to the part of the Deferral Period which has then elapsed) and to vest at the end of the Deferral Period, or in appropriate circumstances may allow such time-apportioned proportion of the Award to vest immediately. In either case, the Committee may also vary the time pro-rating to allow a greater proportion of the Award to vest

If the participant leaves for any other reason, the Committee may in its absolute discretion determine whether all or any part of the Award may be retained

11 PERFORMANCE TARGET

The target for the growth in the Company's EEV will be set by the Committee at the time that an Award is made. Once set, the performance target may be varied by the Committee, but only if the Committee reasonably considers it to be necessary to ensure that the effectiveness of the Award as an incentive is not undermined

12 PERFORMANCE ADJUSTMENT

The Committee may review an Award in light of appropriate circumstances including the individual performance of the participant or the published results of the Group for the Performance Year subsequently being found to be materially inaccurate and may in their discretion determine that an Award shall lapse or shall be reduced

13 NOTIONAL DIVIDENDS

A participant to whom an Award is made shall be entitled, if and when the Award vests, to receive a cash amount equal to the dividends which would have been paid to the participant during the Vesting Period on the number of Notional Shares that actually vest, as if the participant had been the legal owner of an equivalent number of real Shares during that time, together with interest from the dividend payment date by reference to the rate of the 3 month LIBOR from time to time

14 TAKEOVER OR RECONSTRUCTION ETC

In the event of a takeover of the Company during the Performance Year, cash payments in respect of Awards may be made early, but only in respect of a time-apportioned proportion of such payments unless the Committee in its discretion determines that a higher amount is appropriate. If there is a takeover of the Company during the Deferral Period, Awards will vest in full, by reference to the price of a Share on the takeover date. In the event of a demerger, reconstruction upon a change of control, reorganisation, amalgamation or voluntary winding-up of the Company, the Committee may vary the terms of Awards in such a manner as it determines appropriate

15 ADJUSTMENT OF AWARDS

If there is a rights or capitalisation issue, sub-division, consolidation, reduction, demerger or other variation of the Company's ordinary share capital the Committee may adjust the number of Notional Shares comprised in an Award

16 NOTIONAL SHARES

Participants' Awards are made over Notional Shares only and do not give them any right or interest in, or entitlement to, any Shares

The Committee may amend the New LTIP. However, the provisions governing eligibility requirements or individual participation limits cannot be altered to the advantage of existing or new participants without the prior approval of the Company's shareholders in general meeting. There is an exception for minor amendments to benefit the administration of the New LTIP, to take account of a change in legislation or developments in the law affecting the New LTIP or to obtain or maintain favourable tax, exchange control or regulatory treatment for participants in the New LTIP or for any member of the Group.

This summary does not form part of the rules of the New LTIP and should not be taken as affecting the interpretation of their detailed terms and conditions. The Board reserves the right up to the time of the Annual General Meeting to make such amendments and additions to the rules of the New LTIP as the Committee considers necessary provided that such amendments do not conflict in any material respect with this summary.

APPENDIX 2

SUMMARY OF THE MAIN PROVISIONS OF THE CHESNARA SHARESAVE PLAN (THE "SHARESAVE PLAN")

1 THE PLAN

The Sharesave Plan allows savings related share options to acquire ordinary shares in the capital of the Company ("Shares") to be granted to eligible employees. The Sharesave Plan has been approved by HM Revenue & Customs. The Sharesave Plan is not pensionable.

2 ELIGIBILITY

All executive directors and employees of the Company and its participating subsidiaries are eligible to participate in the Sharesave Plan once they have completed any applicable qualifying period of employment. Other employees may be invited to participate on a discretionary basis. When the Sharesave Plan is operated, all eligible employees must be invited to participate.

3 INVITATIONS FOR GRANT OF OPTIONS

Invitations may be made during the period of 42 days beginning with the approval of the Sharesave Plan by the shareholders of the Company, or during the period of 42 days beginning with the announcement of the Company's results for any period.

4 OPTION PRICE

The option price must not be less than 80 per cent of the market value of a Share on the business day before the date of invitation.

5 SAVINGS CONTRACT

Participants are granted options over Shares and must enter into a savings contract to save between the statutory minimum and maximum monthly savings contribution (currently £5 and £250), by deduction from salary. The number of Shares over which the option is granted is determined by reference to the savings amount.

6 ISSUE OF NEW SHARES

The number of Shares which may be issued pursuant to rights granted in any ten year period under the Sharesave Plan and any other employee share plans established by the Company must not exceed 10 per cent of the Company's share capital from time to time.

The Company intends to comply with institutional and investor guidelines, as amended from time to time, regarding the inclusion of treasury shares when calculating this limit.

Shares issued upon the exercise of options will rank equally in all respects with all other Shares of the Company for the time being in issue (save as regards any rights by reference to a record date prior to the allotment or transfer of such Shares).

7 EXERCISE OF OPTIONS

Options can only be exercised using the proceeds of the savings contract.

Options can normally only be exercised during the six months after the maturity of the savings contract, which may run for 3, 5 or 7 years. Options may however, be exercised early if a participant dies, or his employment ends by reason of redundancy, retirement, injury, disability or as a result of the sale of the business or subsidiary by which the participant is employed. If a participant's employment ends for any other reason within three years of grant, options will normally lapse.

8 TAKEOVER OR RECONSTRUCTION ETC

Early exercise is permitted in the event of a change of control, reconstruction or voluntary winding up of the Company

9 ADJUSTMENT OF AWARDS

If there is a rights or capitalisation issue, sub-division, consolidation, reduction or other variation of the Company's ordinary share capital the Committee may adjust participants' options

10 AMENDMENT

The Committee may amend the Sharesave Plan. However, the provisions governing eligibility requirements, the limit on the number of Shares which may be issued under it, individual participation limits, the basis for determining participants' entitlements to Shares and adjustment of options in the event of a variation in the Company's share capital, cannot be altered to the advantage of existing or new participants without the prior approval of the Company's shareholders in general meeting. There is an exception for minor amendments to benefit the administration of the Sharesave Plan, to take account of a change in legislation or to obtain or maintain favourable tax, exchange control or regulatory treatment for participants in the Sharesave Plan or for any member of the Group. Certain amendments involving key features of the Sharesave Plan are subject to the prior approval of HM Revenue & Customs while the Sharesave Plan retains its approved status.

This summary does not form part of the rules of the Sharesave Plan and should not be taken as affecting the interpretation of their detailed terms and conditions. The Board reserves the right up to the time of the Annual General Meeting to make such amendments and additions to the rules of the Sharesave Plan as the Committee considers necessary provided that such amendments do not conflict in any material respect with this summary.