



Fortis Insurance Ltd  
Directors' Report and  
Financial Statements 2007

# FORTIS INSURANCE LIMITED

## Directors' Report and Financial Statements For the year ended 31 December 2007

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# FORTIS INSURANCE LIMITED

## Directors' Report and Financial Statements For the year ended 31 December 2007

### **Chief Executive**

Barry D Smith

### **Directors**

Shaun D Astley

Paul Chaplain *Resigned* 30.10.07

Christopher Dobson

Jeffrey O Grosvenor

Julian R M Harvey

John W H Miller *Appointed* 20.02.07

Robert Newton *Resigned* 31.07.07

Lyn G Nicholls

Helen A Pickford *Appointed* 30.10.07

Robert J Smale

Barry D Smith

### **Secretary**

Rosemary A Smith

### **Head Office and Registered Address**

Fortis Insurance Limited

Fortis House

Tollgate

Eastleigh

SO53 3YA

### **Registered Number 354568 England**

### **Independent Auditor**

KPMG Audit Plc

8 Salisbury Square

London

EC4Y 8BB

### **Bankers**

National Westminster Bank Plc

Southampton High Street Branch

PO Box 315

Southampton

SO14 2BF

# FORTIS INSURANCE LIMITED

## Report of the Directors

The directors submit their report, together with the audited financial statements for the year ended 31 December 2007.

### Activities

During the year the Company continued to develop its personal lines business, principally motor, travel and household, and its small commercial lines business.

The Company also administered the run-off of its Marine and City business for which it ceased accepting new business in 1991.

### Business review

Full details of the Company's results are contained in the accounts on pages 7 to 47. The results for 2007 were adversely impacted by the serious flooding in the UK during June and July 2007. The directors intend to continue the development of personal and small commercial lines of business.

Fortis Insurance Limited ("Fortis"), is a leading provider of award-winning Personal and Commercial insurance solutions in the UK, insuring in excess of 6.7 million customers in 2007. The Company ranked as the 10th largest insurer in the UK General Insurance market in 2006 and predominantly focussed on personal lines insurance (in 2007, 90.7% (2006: 90.8%) of the Company's gross premiums written were in the personal lines sector). It also ranked as the 5th largest private motor insurer and 9th largest household insurer.

This information is based on reports from the Association of British Insurers analysing 2006 data (the latest period for which market data is available).

The overall objective for the Company is to profitably grow Fortis' presence in the UK's insurance market through:

- The manufacturing and/or delivery of a wide range of insurance solutions focusing on Personal Lines and Commercial Lines for the small business.
- Multi-channel distribution, aligning itself to changing market trends with a focus on increased penetration of the broker and intermediary channel, the affinity partnership market and deployment of internet distribution.

To meet this overall objective the Company's principal strategies in its 5-year plan period are to:

- i. Satisfy more customers' needs with the products Fortis underwrite.
- ii. Retail its products through a wider range of distribution, embedding Fortis within the customer value chain.
- iii. Invest in its people, creating the right environment (skills and culture) for success.
- iv. Deliver customer-centric solutions resulting in service above market norms, eradicating friction for the client and customer.
- v. Maintain and leverage its low cost advantage.
- vi. Increase market awareness of 'what Fortis is and what it can do'.
- vii. Proactively respond to the needs of the regulator, maintaining compliance - legislative, regulatory and governance.
- viii. Deliver the growth in line with shareholder requirements.

The Board considers that the key indicators that will communicate the financial performance and strength of the Company to its members are:

- Premiums written
- Profit before taxation
- Operating ratios
- Return on capital

# FORTIS INSURANCE LIMITED

## Report of the Directors (continued)

The Board also uses a number of other key indicators to assess the performance of individual parts of the business, including details on the number of policies written and various performance ratios.

### Financial performance

Premiums *in millions of pounds*

	2005	2006	2007
Gross premiums written	596.6	688.3	757.8
<i>Percentage change from previous year</i>	<i>3.9%</i>	<i>15.4%</i>	<i>10.1%</i>

The amount of premium written drives the overall size and profitability of the Company. Action is taken to ensure that business is written at rates forecast to achieve a satisfactory return on capital.

Profit before income taxes (Operating profit - after finance costs) *in millions of pounds*

	2005	2006	2007
Profit before income taxes	57.8	63.4	12.7
<i>Percentage change from previous year</i>	<i>18.2%</i>	<i>9.7%</i>	<i>-80.0%</i>

Profit is considered a key performance measure. The Company aims to deliver sustainable growth in profits by careful risk selection, expense control and provision of superior service levels to its policyholders. The results for 2007 were adversely impacted by the serious flooding in the UK during June and July 2007.

Operating ratios *in percentages*

	2005	2006	2007
Operating ratios	89.8	89.6	98.2

The operating ratio is considered a measure of the Company's overall efficiency. It is calculated as incurred claims, commission costs and expenses, less allocated investment income, expressed as a percentage of earned premiums. As with operating profit, the operating ratio will not necessarily immediately reflect management actions and may also be influenced by external factors.

Return on capital *in percentages*

	2005	2006	2007
Return on capital after tax	17.8%	16.9%	3.1%

Return on capital is a measure of the efficiency with which the Company uses its shareholders' equity, which has been provided by its members. Movements in the market value of investments and dividend policy affect this measure.

# FORTIS INSURANCE LIMITED

## Report of the Directors (continued)

### Position at 31 December 2007

#### Shareholders' equity

The Company did not pay a dividend in 2007 and, as a result, all of the profit after tax for the year of £9.0m was retained within Shareholders' equity. There was an increase in the market value of investments compared to their carrying value, which in turn increased the Fair value reserve by £8.9m. Overall, Shareholders' equity increased by £17.9m.

#### Assets

Investments increased by £91.0m during the year. As at 31 December 2007 the investment portfolio was held 100.0% (2006: 96.6%) in fixed rate debt securities and 0% (2006: 3.4%) in equity based unit trusts.

#### Liabilities

Insurance liabilities increased by £102.2m in 2007 (2006: £80.6m) due to growth in business volumes leading to increased unearned premium reserves of £30.8m (2006: £51.5m) and above average outstanding claims reserves of £71.4m (2006: £29.1m) as a result of the flooding in June and July 2007.

The pension scheme deficit reduced by £4.1m during the year, due to additional payments made by the Company to reduce the deficit in the pension scheme.

#### Cash flow

Inclusive of investment in financial assets, cash available to the Company increased by £72.4m (2006: £85.3m) due to an increase in the Company's business volumes.

#### Risks and uncertainties

The Company's principal risks and uncertainties and the way in which these risks are managed are detailed in note 2 to the financial statements. There have not been any significant changes to the risks to which the Company is exposed, or in the procedures used to manage these risks in the year.

### Results and dividends

The result of the year's operation is a profit after taxation of £9.0m (2006: £43.9m). No dividend was paid in 2007 (2006: £nil).

### Directors

The Members of the Board are shown on Page 2. John W H Miller was appointed as a director on 20 February 2007. Robert Newton resigned on 31 July 2007. Paul Chaplain resigned on 30 October 2007. Helen A Pickford was appointed as a director on 30 October 2007. All other directors served throughout the year and to the date of this report. 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 auditors are 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 auditors are aware of that information.

### Directors' shareholdings

None of the directors or their families had any disclosable interest in either the shares of the Company, or of any other group company, or of the ultimate holding company at 31 December 2007 (2006: nil).

### Auditors

Pursuant to a shareholders' resolution, the Company is not obliged to reappoint its auditors annually and KPMG Audit Plc will therefore continue in office.

# FORTIS INSURANCE LIMITED

## Report of the Directors (continued)

### **Creditor payment policy**

The Company agrees terms and conditions under which business transactions with suppliers are conducted. It is the Company's policy that payments to suppliers are made in accordance with these terms, provided that the supplier is also complying with all relevant terms and conditions.

### **Employees**

The average number of persons employed in the United Kingdom by the Company and its subsidiaries during the year was 1,342. The full time equivalent number of employees adjusted for part time staff was 1,174. Their annual aggregate remuneration was £34.1m. An analysis is shown on Page 46.

### **Employee involvement**

Staff are kept informed of matters affecting the Company by means of regular departmental meetings and bulletins from general management. The views of staff are represented by an elected Staff Council, which holds regular meetings with management.

### **Disabled persons**

The Company's procedures comply with the requirements of the Disability Discrimination Act 1995. If an employee were to become disabled during employment with the Company every effort would be made to retrain that employee to perform a job appropriate to their aptitude and skills. The Company's policy to encourage career development for its employees includes the disabled for whom further training would be arranged if necessary to allow for special needs.

### **Charitable donations**

Charitable donations in the year amounted to £47,976 (2006: £42,831).

This Report was approved by the Board of Directors on 20 March 2008 and signed on its behalf by:

R A Smith  
Secretary

# FORTIS INSURANCE LIMITED

## Income statement

For the year ended 31 December 2007

<i>In millions of pounds</i>	Note	2007		2006	
		£m	£m	£m	£m
Gross premiums written	3	757.8		688.3	
Change in the gross provision for unearned premiums		<u>(30.8)</u>		<u>(51.5)</u>	
<b>Gross insurance premium revenue</b>	3		727.0		636.8
Written premiums ceded to reinsurers	3	(34.4)		(28.3)	
Reinsurers' share of change in the provision for unearned premiums		<u>(0.3)</u>	(34.7)	<u>0.3</u>	(28.0)
<b>Net insurance premium revenue</b>			<u>692.3</u>		<u>608.8</u>
Commission income	4		0.9		0.9
Investment income	5		57.1		46.3
Other operating income	6		10.6		8.7
<b>Net income</b>			<u>760.9</u>		<u>664.7</u>
Claims and benefits incurred	7	(620.5)		(462.0)	
Reinsurers' share of claims and benefits incurred		<u>47.6</u>		<u>18.4</u>	
<b>Net policyholder claims and benefits incurred</b>			<u>(572.9)</u>		<u>(443.6)</u>
Acquisition costs	8		(148.6)		(133.4)
Administration costs	9		(26.6)		(24.2)
<b>Operating profit</b>			<u>12.8</u>		<u>63.5</u>
Finance costs	10		(0.1)		(0.1)
<b>Profit before income taxes</b>			<u>12.7</u>		<u>63.4</u>
Income taxes	11		(3.7)		(19.5)
<b>Profit for the year</b>			<u>9.0</u>		<u>43.9</u>

# FORTIS INSURANCE LIMITED

## Statement of recognised income and expense

For the year ended 31 December 2007

<i>In millions of pounds</i>	Note	2007	2006
Gross change in fair value of financial assets available for sale	15	12.7	(13.7)
Tax on unrealised gain / (loss)		(3.8)	4.1
<b>Net income / (loss) recognised directly in equity</b>	25	<u>8.9</u>	<u>(9.6)</u>
<b>Profit for the year</b>	25	9.0	43.9
<b>Total recognised income and expense for the year</b>		<u>17.9</u>	<u>34.3</u>

# FORTIS INSURANCE LIMITED

## Balance sheet

As at 31 December 2007

*In millions of pounds*

	Note	2007	2006
<b>Assets</b>			
Property, plant and equipment	12	4.8	4.1
Deferred acquisition costs	13	80.1	73.3
Investments in subsidiaries	14	0.4	16.3
Financial assets:	15		
- Debt securities - fixed rate		1,085.3	960.4
- Unit trusts		-	33.9
Reinsurance assets	16	93.5	69.0
Deferred tax assets	17	3.2	3.6
Insurance and other receivables	18	161.9	155.0
Cash and cash equivalents	19	39.0	39.6
<b>Total assets</b>		<u>1,468.2</u>	<u>1,355.2</u>
<b>Liabilities</b>			
Insurance contract provisions	16	1,081.6	979.4
Financial liabilities:			
- Loans and borrowings	20	6.0	18.4
- Other (Funds held under reinsurance agreements)		0.5	0.3
Reinsurance payables		9.5	4.5
Insurance payables, other payables and deferred income	21	61.3	53.5
Other provisions	22	1.1	1.2
Employee benefits	23	10.1	14.2
Current tax liabilities	24	2.6	6.1
<b>Total liabilities</b>		<u>1,172.7</u>	<u>1,077.6</u>
<b>Net assets</b>		<u>295.5</u>	<u>277.6</u>
<b>Shareholders' equity</b>			
Share capital	25	71.1	71.1
Share premium		3.9	3.9
Retained earnings		201.2	192.2
Other reserves		19.3	10.4
<b>Total shareholders' equity</b>		<u>295.5</u>	<u>277.6</u>

These financial statements were approved by the board of directors on 20 March 2008 and were signed on its behalf by:

B D Smith  
Chief Executive

J R M Harvey  
Director

# FORTIS INSURANCE LIMITED

## Statement of cash flows

For the year ended 31 December 2007

<i>In millions of pounds</i>	Note	2007	2006
<b>Cash flows from operating activities</b>			
Profit before tax		12.7	63.4
<i>Adjustments for:</i>			
Dividend income	5	(0.5)	(0.9)
Interest income	5	(51.7)	(44.8)
Gain on disposal of investment property	6	(1.3)	-
Finance costs	10	0.1	0.1
Depreciation of buildings, plant and equipment	12	1.6	1.7
Amortisation of deferred acquisition costs	13	(6.8)	(19.9)
Financial assets non cash movements	15	<u>(5.3)</u>	<u>(6.9)</u>
<b>Operating loss before working capital changes</b>		(51.2)	(7.3)
Increase in Financial assets		(73.0)	(73.3)
Increase in Reinsurance assets		(24.5)	(1.9)
Increase in Insurance and other receivables		(6.9)	(19.9)
Increase in Insurance contract provisions, other payables and deferred income		110.0	94.0
Increase in Reinsurance payables		5.0	1.8
Increase (Decrease) in Financial liabilities		3.7	(3.3)
Decrease in Other liabilities and provisions		<u>(4.2)</u>	<u>(5.9)</u>
<b>Cash flows used in operations</b>		(41.1)	(15.8)
Interest received	5	51.7	44.8
Interest paid	10	(0.1)	(0.1)
Income taxes paid		<u>(10.6)</u>	<u>(15.9)</u>
<b>Net cash flows from operating activities</b>		<u>(0.1)</u>	<u>13.0</u>
<b>Cash flows from investing activities</b>			
Dividend income	5	0.5	0.9
Purchase of property, plant and equipment	12	(3.8)	(1.9)
Proceeds from the sale of freehold property	12	<u>2.8</u>	<u>-</u>
<b>Net cash used in investing activities</b>		<u>(0.5)</u>	<u>(1.0)</u>
<b>Net (decrease) increase in cash and cash equivalents</b>			
		(0.6)	12.0
Cash and cash equivalents at 1 January		<u>39.6</u>	<u>27.6</u>
<b>Cash and cash equivalents at 31 December</b>		<u>39.0</u>	<u>39.6</u>
<b>Cash available to the Company</b>			
		38.5	39.1
<b>Cash not available to the Company - Held in trust</b>			
		<u>0.5</u>	<u>0.5</u>
	19	<u>39.0</u>	<u>39.6</u>

# FORTIS INSURANCE LIMITED

## Significant accounting policies

Fortis Insurance Limited is a private company, limited by shares, domiciled and incorporated in England and Wales. The Company is primarily involved in personal and commercial lines insurance.

The financial statements were authorised for issue by the directors on 20 March 2008.

### (a) Statement of compliance

The financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS) and its interpretations issued by the International Accounting Standards Board (IASB) as adopted by the European Union (EU).

In preparing these financial statements, the Company has adopted IFRS 7 Financial Instruments: Disclosures and IAS 1 Presentation of Financial Statements - Capital Disclosures from their required application date of 1 January 2007. The adoption of IFRS 7 and the amendment to IAS 1, has impacted the type and amount of disclosures made in these financial statements, but has had no impact on the reported profits or financial position of the Company. In accordance with the transitional requirements of the standards, the Company has provided full comparative information.

During the period the Company adopted the amendments to IAS 19 Employee Benefits, which increased the level of disclosure in respect of defined benefit plans, but had no impact on the reported profits or financial position of the Company. In accordance with the transitional requirements of the amendments, the Company has provided full comparative information.

IFRIC 14 IAS 19 – The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction clarifies when refunds or reductions in future contributions in relation to defined benefit assets should be regarded as available and provides guidance on the impact of minimum funding requirements (MFR) on such assets. It also addresses when a MFR might give rise to a liability. IFRIC 14 will become mandatory for the Company's 2008 financial statements, with retrospective application required. The Company, in consultation with its actuarial advisers, has determined there will be no potential effect of the interpretation on the 2007 accounts.

In November 2006, the IASB issued IFRS 8 Operating Segments, the requirements of which are applicable for accounting periods beginning on or after 1 January 2009. The Company has not applied IFRS 8 which refers to new disclosures about segment reporting and replaces the disclosures required by IAS 14 Segment Reporting. In accordance with IAS 14, the Company is not required to present segmental information.

The Company presents its balance sheet in order of liquidity in accordance with IAS 1 Presentation of Financial Statements. For each asset and liability line item in the balance sheet that combines amounts expected to be recovered or settled within twelve months, or more than twelve months after the balance sheet date, a classification at the balance sheet date is included within the notes. The disclosure in the notes for these classifications are distinguished as follows:

- Amounts expected to be recovered in less than one year are referred to as current.
- Amounts expected to be recovered in more than one year are referred to as non-current.

### (b) Basis of preparation

The Company has elected not to prepare consolidated financial statements. The accounts as prepared are separate financial statements and the exemption from consolidation, in accordance with IAS 27 Consolidated and Separate Financial Statements, has been used.

#### (i) Basis of measurement

The financial statements have been prepared on the historical cost basis except that financial instruments classified as available for sale are stated at their fair value.

#### (ii) Functional and presentation currency

The financial statements are presented in millions of Pounds Sterling, which is the Company's functional currency. All financial information presented in Pounds Sterling has been rounded to one decimal place.

# FORTIS INSURANCE LIMITED

## Significant accounting policies

### **(b) Basis of preparation (continued)**

#### **(iii) Use of estimates and judgements**

The preparation of financial statements in conformity with IFRS 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 the directors in the application of IFRS that have a significant effect on the financial statements, and estimates with a significant risk of material adjustment in the next year, are discussed in notes 1 and 2.

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

### **(c) Classification of insurance contracts**

Contracts under which the Company accepts significant insurance risk from another party (the policyholder) by agreeing to compensate the policyholder or other beneficiary if a specified uncertain future event (the insured event) adversely affects the policyholder or other beneficiary are classified as insurance contracts. These contracts remain insurance contracts until all rights and obligations are extinguished or expire. Insurance contracts may also transfer some financial risk.

# FORTIS INSURANCE LIMITED

## Significant accounting policies

### (d) Recognition and measurement of revenue

#### Premiums

Gross written premiums comprise the premiums on contracts entered into during the year, irrespective of whether they relate in whole or in part to a later accounting period. Premiums are disclosed gross of commission payable to intermediaries and exclude taxes and levies based on premiums. Premiums written include adjustments to premiums written in prior accounting periods and estimates for “pipeline” premiums. An estimate is made at the balance sheet date to recognise retrospective adjustments to premiums or commissions. The earned portion of premiums received, is recognised as revenue. Pipeline premiums are brought into account, based upon the pattern of booking of renewals and new business. Premiums are earned from the date of attachment of risk, over the indemnity period, based on the pattern of risks underwritten. Outward reinsurance premiums are recognised as a deduction from net insurance revenue in accordance with the contractual arrangements with reinsurers.

#### Unearned premium provision

The provision for unearned premiums comprises the proportion of gross premiums written which is estimated to be earned in the following or subsequent financial years, computed separately for each insurance contract using the daily pro rata method, adjusted if necessary to reflect any variation in the incidence of risk during the period covered by the contract. For schemes this is calculated using the monthly pro rata method.

#### Claims

Claims incurred consist of claims and claims handling expenses paid during the financial year, together with the movement in the provision for outstanding claims.

Claims outstanding comprise provisions for the Company’s estimate of the ultimate cost of settling all claims incurred but unpaid at the balance sheet date whether reported or not, and related internal and external claims handling expenses. Claims outstanding are assessed by reviewing individual claims and making allowance for claims incurred but not yet reported, adjusted for the effect of both internal and external foreseeable events, such as changes in claims handling procedures, inflation, judicial trends, legislative changes and past experience and trends. Anticipated reinsurance recoveries, and estimates of salvage and subrogation recoveries, are presented separately as assets. Reinsurance and other recoveries are assessed in a manner similar to the assessment of claims outstanding.

Whilst the directors consider that the gross provisions for claims and the related reinsurance recoveries are fairly stated on the basis of the information currently available to them, the ultimate liability will vary as a result of subsequent information and events and may result in significant adjustments to the amounts provided. Adjustments to the amounts of claims provisions established in prior years are reflected in the financial statements for the period in which the adjustments are made, and disclosed separately if material. The methods used, and the estimates made, are reviewed regularly.

#### Liability adequacy test (Unexpired risk provision)

Provision is made for unexpired risks arising from business where the expected value of claims and expenses attributable to the unexpired periods of policies in force at the balance sheet date exceeds the unearned premiums provision in relation to such policies after the deduction of any deferred acquisition costs. The provision for unexpired risks is calculated separately by reference to classes of business which are managed together, after taking into account the relevant investment return.

# FORTIS INSURANCE LIMITED

## Significant accounting policies

### (d) Recognition and measurement of revenue (continued)

#### Reinsurance

The Company cedes reinsurance in the normal course of business for the purpose of limiting its net loss potential through the diversification of its risks. Reinsurance arrangements do not relieve the Company from its direct obligations to its policyholders.

Premiums ceded and benefits reimbursed are presented in the income statement and balance sheet on a gross basis.

Only contracts that give rise to a significant transfer of insurance risk are accounted for as insurance contracts. Amounts recoverable under such contracts are recognised in the same year as the related claim. Contracts that do not transfer significant insurance risk (i.e. financial reinsurance), are accounted for as financial instruments.

Reinsurance assets include balances due from reinsurance companies for reinsurance claims. Amounts recoverable from reinsurers' are estimated in a manner consistent with the outstanding claims provision or settled claims associated with the reinsured policy.

Amounts recoverable under reinsurance contracts are assessed for impairment at each balance sheet date. Such assets are deemed impaired if there is objective evidence, as a result of an event that occurred after its initial recognition, that the Company may not recover all amounts due and that the event has a reliably measurable impact on the amounts that the Company will receive from the reinsurer.

#### Deferred acquisition costs

Commission payable to agents and internally generated acquisition costs, which are incurred for acquiring new and renewal insurance business that is primarily related to the production of that business, are deferred. Any balances not considered recoverable are written off.

Such deferred acquisition costs are finite and are amortised by reference to the basis on which the related premiums are earned which is generally one year or less.

#### Other assessments and levies

The Company is obligated to pay various guarantee fund levies or other insurance related assessments. Related provisions are set up where there is a current obligation resulting from a past event.

### (e) Commission income

Commissions received or receivable which do not require the Company to render further service are recognised as revenue by the Company. Reinsurance commissions are deferred and amortised on a pro rata basis over the contract term.

### (f) Investment income

Investment income comprises interest income, dividend income and net realised gains from available-for-sale financial assets earned in the period (see note 5). Interest income is recognised as it accrues in the income statement, using the effective interest method. Dividend income is recognised in the income statement on the date that the Company's right to receive payment is established.

### (g) Expenses

#### (i) Operating lease payments

Payments made under operating leases are recognised in the income statement on a straight-line basis over the term of the lease.

# FORTIS INSURANCE LIMITED

## Significant accounting policies

### (g) Expenses (continued)

#### (ii) Finance lease payments

Leases, under the terms of which the Company assumes substantially all the risks and rewards of ownership, are classified as finance leases. Minimum lease payments are apportioned between the finance charge and the reduction of the outstanding liability. The finance charge is allocated to each year during the lease term so as to produce a constant periodic rate of interest on the remaining balance of the liability. Other leases are classified as operating leases and are not recognised on the Company's balance sheet.

#### (iii) Finance costs

Finance costs comprise interest payable on borrowings calculated using the effective interest rate method and are expensed in the Income Statement in the period to which they relate. No finance costs are capitalised.

### (h) Employee benefits

#### (i) Defined contribution plans

A defined contribution plan is a post-employment benefit plan under which an entity pays fixed contributions into a separate entity and will have no legal or constructive obligation to pay further amounts. Obligations for contributions to defined contribution pension plans are recognised as an employee benefit expense in the income statement when they are due. Prepaid contributions are recognised as an asset to the extent that a cash refund or a reduction in future payments is available.

#### (ii) Defined benefit plans

A defined benefit plan is a post-employment benefit plan other than a defined contribution plan. The Company's net obligation in respect of defined benefit pension plans is calculated by estimating the amount of future benefit that employees have earned in return for their service in the current and prior years; that benefit is discounted to determine its present value, and the fair value of any plan assets is deducted. The discount rate is the yield at the balance sheet date on AAA credit rated bonds that have maturity dates approximating to the terms of the Company's obligations. The calculation is performed by a qualified actuary using the projected unit credit method.

When the benefits of a plan are improved, the portion of the increased benefit relating to past service by employees is recognised as an expense in the income statement on a straight-line basis over the average period until the benefits become vested. To the extent that the benefits vest immediately, the expense is recognised immediately in the income statement.

All actuarial gains and losses as at 1 January 2005, the date of transition to IFRS, were recognised in the balance sheet as at that date. In respect of actuarial gains and losses that arise subsequent to 1 January 2005 in calculating the Company's obligation in respect of a plan, to the extent that any cumulative unrecognised actuarial gain or loss exceeds 10 per cent of the greater of the present value of the defined benefit obligation and the fair value of plan assets, that portion is recognised in the income statement over the expected average remaining working lives of the employees participating in the plan. Otherwise, the actuarial gain or loss is not recognised.

Where the calculation results in a benefit to the Company, the recognised asset is limited to the net total of any unrecognised actuarial losses and past service costs and the present value of any future refunds from the plan or reductions in future contributions to the plan.

#### (i) Income tax

Income tax expense in the income statement for the year comprises current and deferred tax. Income tax is recognised in the income statement except to the extent that it relates to items recognised directly in equity, in which case the related income tax is also recognised in equity.

# FORTIS INSURANCE LIMITED

## Significant accounting policies

### (i) Income tax (continued)

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

Deferred tax is provided in full, 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 following temporary differences are not provided for: goodwill not deductible for tax purposes, the initial recognition of assets or liabilities that affects neither accounting nor taxable profit, and differences relating to investments in subsidiaries to the extent that they will probably not reverse in the foreseeable future. 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.

Deferred tax assets and liabilities are offset if there is a legally enforceable right to offset current tax liabilities and assets, and they relate to income taxes levied by the same tax authority on the same taxable entity, or on different tax entities, but they intend to settle current tax liabilities and assets on a net basis or their tax assets and liabilities will be realised simultaneously.

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 reviewed at each reporting date and are reduced to the extent that it is no longer probable that the related tax benefit will be realised.

Deferred tax assets and liabilities are not discounted.

### (j) Foreign currency transactions

Transactions in foreign currencies are translated to the functional currency of the Company at the foreign exchange rate ruling at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies at the balance sheet date are translated to the presentational currency (pounds sterling) at the foreign exchange rate ruling at that date.

Non-monetary assets and liabilities that are measured in terms of historical cost in a foreign currency are translated using the exchange rate at the date of the transaction. Non-monetary assets and liabilities denominated in foreign currencies that are stated at fair value are translated to pounds sterling at foreign exchange rates ruling at the dates the fair value was determined.

Foreign exchange differences arising on translation are recognised in the income statement.

### (k) Property, plant and equipment

#### (i) Owned assets

Items of property, plant and equipment are stated at cost (or deemed cost) less accumulated depreciation (see below) and impairment losses (see accounting policy p). Cost includes expenditure that is directly attributable to the acquisition of the asset. Purchased software that is integral to the functionality of the related equipment is capitalised as part of that equipment. Borrowing costs related to the acquisition of qualifying assets are recognised in profit or loss as incurred.

Where parts of an item of property, plant and equipment have different useful lives, they are accounted for as separate items of property, plant and equipment.

#### (ii) Leased assets

Leases under the terms of which the Company assumes substantially all the risks and rewards of ownership are classified as finance leases. Upon initial recognition the leased asset is measured at an amount equal to the lower of its fair value and the present value of the minimum lease payments. Lease payments are accounted for as described in accounting policy g(ii). Other leases are classified as operating leases and are not recognised on the Company's balance sheet.

# FORTIS INSURANCE LIMITED

## Significant accounting policies

### (k) Property, plant and equipment (continued)

#### (iii) Depreciation

Depreciation is charged to the income statement on a straight-line basis over the estimated useful lives of each part of an item of property, plant and equipment. Leased assets are depreciated over the shorter of the lease term and their useful lives unless it is reasonably certain that the Company will obtain ownership by the end of the lease term. Land is not depreciated.

Depreciation methods, useful lives and residual values are reviewed at each reporting date.

The estimated useful lives are as follows:

Buildings	Fifty years
Leasehold buildings and improvements	Period of the lease
Equipment and motor vehicles	Two to five years
IT equipment	Three to five years

The gain or loss arising on the disposal of an asset is determined as the difference between the sale proceeds and the carrying value of the asset and is recognised in the income statement.

### (l) Investment in subsidiaries

Investments in group undertakings are stated at the lower of cost or net realisable value. Details of transactions with group companies are included in note 28, Related Party Transactions.

### (m) Financial assets

Financial assets, all of which are non-derivative financial assets, are held as available for sale or are loans and receivables.

Available-for-sale financial assets are recognised initially at fair value without any deduction for transaction costs the Company may incur on disposal. Purchases of available-for-sale financial assets are recognised on the trade date, which is when the Company commits to purchase the assets.

For instruments not recognised at fair value any directly attributable transaction costs are included. The fair value of quoted investments is their quoted bid prices at the balance sheet date.

Realised gains and losses are included in the income statement in the period in which they arise. Unrealised gains and losses arising from changes in the fair value of available-for-sale financial assets are recognised directly in equity, except for foreign exchange gains and losses on monetary items such as debt securities, which are recognised in the income statement. When available-for-sale financial assets are sold or impaired, the cumulative gains or losses previously recognised in equity are recognised in the income statement. Where these investments are interest-bearing, interest calculated using the effective interest method is recognised in the income statement.

Financial assets with fixed or determinable payments that are not quoted in an active market are classified as loans and receivables. The Company classifies cash and short term deposits, insurance and other receivables, including amounts due from related companies, as loans and receivables. The directors have determined that their carrying amounts reasonably approximate their fair values as they are mostly short term in nature or are repriced frequently.

# FORTIS INSURANCE LIMITED

## Significant accounting policies

### **(m) Financial assets (continued)**

Loans and receivables are recognised initially at fair value plus any directly attributable transaction costs. Subsequent to initial recognition, loans and receivables are measured at amortised cost using the effective interest method, less any impairment losses. Loans and receivables are derecognised if the Company's contractual rights to the cash flows from the financial assets expire or if the Company transfers the financial asset to another party without retaining control or substantially all risks and rewards of the asset.

### **(n) Other receivables**

Other receivables are stated at their cost less impairment losses (see accounting policy p).

### **(o) Cash and cash equivalents**

Cash and cash equivalents comprise cash balances and call deposits. Bank overdrafts that are repayable on demand and form an integral part of the Company's cash management are included as a component of cash and cash equivalents for the purpose only of the statement of cash flows.

### **(p) Impairment**

#### **(i) Financial assets**

A financial asset is assessed at each reporting date to determine whether there is any objective evidence that it is impaired. A financial asset is considered to be impaired if objective evidence indicates that one or more events have had a negative effect on the estimated future cash flows of that asset.

An impairment loss in respect of a financial asset measured at amortised cost is calculated as the difference between its carrying amount, and the present value of the estimated future cash flows discounted at the original effective interest rate. An impairment loss in respect of an available-for-sale financial asset is calculated by reference to its fair value.

Individually significant financial assets are tested for impairment on an individual basis. The remaining financial assets are assessed collectively in groups that share similar credit risk characteristics.

All impairment losses are recognised in profit or loss. Any cumulative loss in respect of an available-for-sale financial asset recognised previously in equity is transferred to the income statement.

An impairment loss is reversed if the reversal can be related objectively to an event occurring after the impairment loss was recognised. For financial assets measured at amortised cost and available-for-sale financial assets that are debt securities, the reversal is recognised in the income statement. For available-for-sale financial assets that are equity securities, the reversal is recognised directly in equity.

#### **(ii) Non-financial assets**

The carrying amounts of the Company's non-financial assets, other than deferred tax assets, are reviewed at each reporting date to determine whether there is any indication of impairment. If any such indication exists, then the asset's recoverable amount is estimated.

The recoverable amount of an asset or cash-generating unit is the greater of its value in use and its fair value less costs to sell. 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 and the risks specific to the asset. For the purpose of impairment testing, assets are grouped together into the smallest group of assets that generates cash inflows from continuing use that are largely independent of the cash inflows of other assets or groups of assets (the "cash-generating unit").

# FORTIS INSURANCE LIMITED

## Significant accounting policies

### **(p) Impairment (continued)**

An impairment loss is recognised if the carrying amount of an asset or its cash-generating unit exceeds its estimated recoverable amount. Impairment losses are recognised in the income statement. Impairment losses recognised in respect of cash-generating units are allocated first to reduce the carrying amount of any goodwill allocated to the units and then to reduce the carrying amount of the other assets in the unit (group of units) on a pro rata basis.

Impairment losses recognised in prior periods are assessed at each reporting date for any indications that the loss has decreased or no longer exists. An impairment loss is reversed if there has been a change in the estimates used to determine the recoverable amount. An impairment loss is reversed only to the extent that the asset's carrying amount does not exceed the carrying amount that would have been determined, net of depreciation or amortisation, if no impairment loss had been recognised.

### **(q) Financial liabilities**

Financial liabilities include payables to related parties and interest-bearing loans and borrowings and also bank overdrafts and other payables. Financial liabilities are recognised on the balance sheet when the Company becomes a party to the contractual provisions of the financial instrument. Interest-bearing loans and borrowings are recognised initially at fair value less attributable transaction costs. Subsequent to initial recognition, interest-bearing loans and borrowings are stated at amortised cost with any difference between cost and redemption value being recognised in the income statement over the year of the borrowings on an effective interest basis.

The directors have determined that the carrying amounts of bank overdrafts and other payables reasonably approximate their fair values because these liabilities are mostly short term in nature or are repriced frequently. Financial liabilities are derecognised if the Company's obligations specified in the contract expire or are discharged or cancelled.

### **(r) Derecognition and offset of financial assets and liabilities**

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

- The rights to receive cash flows from the asset have expired.
- The Company retains the right to receive cash flows from the asset, but has assumed an obligation to pay them in full without material delay to a third party under a "pass through" arrangement.
- The Company has transferred its rights to receive cash flows from the asset and has either transferred substantially all the risks and rewards of the asset, or has neither transferred nor retained substantially all the risks and rewards of the asset, but has transferred control of the asset.

A financial liability is derecognised when the obligation under the liability is discharged or cancelled or expires.

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

### **(s) Provisions**

A provision is recognised in the balance sheet if, as a result of a past event, the Company has a present legal or constructive obligation that can be estimated reliably, and it is probable that an outflow of economic benefits will be required to settle the obligation. If the effect is material, provisions are determined by discounting the expected future cash flows at a pre-tax rate that reflects current market assessments of the time value of money and, where appropriate, the risks specific to the liability.

# FORTIS INSURANCE LIMITED

## Significant accounting policies

### **(t) Share capital**

Ordinary shares are classified as equity. Incremental costs directly attributable to the issue of ordinary shares and share options are recognised as a deduction from equity, net of any tax effects.

### **(u) Dividends**

Dividends payable on ordinary shares are recognised when they are paid.

# FORTIS INSURANCE LIMITED

## Notes to the financial statements

### 1 Accounting estimates and judgements

The most critical judgements and estimates made by the Company are those regarding reported and unreported losses, deferred policy acquisition costs and defined benefit obligations.

#### **Outstanding claims and provisions**

The Company establishes reserves in respect of the anticipated losses incurred in respect of business it has written. These reserves reflect the expected ultimate cost of settling claims occurring prior to the balance sheet date, but remaining unsettled at that time, and take into account any related reinsurance recoveries. Such reserves are established separately for each line of business written by the Company and fall into two categories – reserves for reported losses and reserves for losses incurred but not reported as of the balance sheet date.

Reserves for reported losses are established on a case-by-case basis and are based largely on past experience of settlements on similar claims. The reserves are set on an undiscounted basis and reflect the anticipated cost of final settlement, taking into account inflation and other factors which might influence the final outcome. Such reserves are reviewed on a regular basis to take account of changing circumstances, such as changes in the law and changes in costs relating to settlement.

Reserves for losses incurred but not reported as of the balance sheet date are also established on an undiscounted basis. They are estimated based on historical data using various actuarial techniques and statistical modelling methodologies. As with case reserves, reserves for losses incurred but not reported are calculated separately for each line of business written and take into account trends in settlement costs in arriving at the final estimates.

For further details on loss reserves see note 16.

#### **Deferred acquisition costs**

A proportion of the commission expenses and other acquisition costs incurred by the Company in respect of both new and renewal business written in the year are deferred as at the balance sheet date. Such amounts deferred are then amortised over the estimated remaining period of the policies concerned. The extent to which costs are deferred is dependent on the directors' judgement as regards the level of costs incurred which relate to the business written.

For further details on deferred acquisition costs see note 13.

#### **Defined benefit obligations**

The Company's liability for defined benefit obligations is based on various estimates including discount rates, expected returns on plan assets, future salary increases, future pension increases, mortality rates and future staff turnover. Differences in future actual experience may result in the liability recorded in the Company's balance sheet proving to be either too high or too low.

For further details on defined benefit obligations see note 23.

# FORTIS INSURANCE LIMITED

## Notes to the financial statements

### 2 Risk management

#### Objectives and policies for mitigating business risk

The Company's primary insurance business is the assumption of risk of loss from individuals or businesses directly subject to the risk. In addition it is itself exposed to a number of risks, including financial risk, market risk, credit risk and liquidity risk. The Company has various procedures in place to manage these exposures. These include an overall risk management framework, together with a set of clearly defined risk policies which articulate the Company's risk appetite. The Company also maintains a comprehensive risk register which identifies the individual risks faced in each area of the business and the controls in place to mitigate these. The Company's Risk Committee meets regularly to review both the risk policies and the risk register, to ensure they are up-to-date, reflecting the risks currently facing the business, and that corresponding control issues and risk mitigation actions are being addressed in a timely manner. The findings of the Risk Committee are reported to the Company's Board.

Looking at the main areas of risk faced by the Company, and the strategies in place to manage these:

#### (i) Insurance risk

The Company's management of insurance risk is a critical aspect of the business. It manages this through various policies and procedures including underwriting limits, approval procedures for transactions that involve new products or that exceed set limits, pricing guidelines, centralised management of reinsurance and the close monitoring of emerging issues.

The main types of risk insured by the Company are as follows:

- Motor – consisting of both property and liability covers.
- Property – covering claims for damage to buildings or contents, plus losses from business interruption for commercial customers only.
- Travel – providing cover for cancellations of holidays, travel delays, medical cover for illness whilst on holiday, death benefits, and compensation for loss and damage to baggage.
- Liability insurance – offering compensation to employees and members of the public suffering injury and/or property damage.

The Company uses several methods to assess and monitor the risk exposures associated with each of these, both for the individual types of risks insured and the overall risks. These methods include internal risk measurement models, sensitivity analyses, scenario analyses and stress testing.

The theory of probability is applied to the pricing and provisioning for a portfolio of insurance contracts. The principal risks are that the frequency and severity of the claims are greater than expected. Insurance events are, by their nature random and hence the actual number and size of events during any one year may vary from those estimated using established statistical techniques.

The Company reinsures a portion of the risks it underwrites in order to control its exposures to losses and protect capital resources. The Company buys primarily excess of loss (i.e. non-proportional) reinsurance treaties to reduce its net exposure to agreed levels for each line of business in accordance with the Company's risk appetite. In addition, underwriters buy facultative reinsurance on individual risks in certain specified circumstances.

# FORTIS INSURANCE LIMITED

## Notes to the financial statements

### 2 Risk management (continued)

#### Objectives and policies for mitigating business risk (continued)

##### (i) Insurance risk (continued)

#### Concentrations of insurance risk

A key aspect of the insurance risk faced by the Company is the degree of concentration of insurance risk, which may exist where a particular event or series of events could impact significantly upon the Company's liabilities. Such concentrations may arise from a single insurance contract or through a small number of related contracts, and relate to circumstances where significant liabilities could arise.

Concentrations of risk can arise in both high-severity, low frequency events, such as natural disasters and in situations where underwriting is biased towards a particular group, such as a particular geographical concentration or demographic trend.

#### High-severity, low frequency concentrations

By their nature, the timing and frequency of these events are uncertain. They represent a significant risk to the Company because the occurrence of an event, while unlikely in any given accounting period, would have a significantly adverse effect on the Company's cash flows.

The Company's key methods in managing these risks are two-fold. Firstly, the risk is managed through appropriate underwriting. Underwriters are not permitted to underwrite risks unless the expected profits are commensurate with the risks assumed. Secondly, the risk is managed through the use of reinsurance. The Company purchases excess of loss covers for classes of liability, property, motor and travel business. The Company assesses the costs and benefits associated with the reinsurance programme regularly.

#### Geographic and demographic concentrations

Material geographical concentrations of risk can exist in property portfolios such that natural perils of windstorm and floods may give rise to a large number of material damage and business interruption claims. The Company models its exposure to this risk to estimate its probable maximum loss and purchases reinsurance to significantly reduce its exposure to such events.

Material concentrations of risk may be created by specific distribution channels that target at certain age ranges, affinity groups or underwriting strengths in certain geographic locations.

#### Economic downturns

The Company's insurance portfolio exposes it to a potential accumulation of different risks in the event of an economic recession. The Company's strategy in the event of a recession would be to increase premiums and reduce exposure to those areas that would be adversely impacted by an economic downturn. It will also monitor economy related claims closely.

#### Total aggregate exposure

The Company identifies the total aggregate exposure that it is prepared to accept in relation to concentrations of risk. It monitors these exposures on a regular basis by reviewing reports which show the key aggregations to which the Company is exposed. The Company uses a number of modelling tools to monitor aggregation and to simulate catastrophe losses in order to measure the effectiveness of the reinsurance programmes, and to quantify the net exposure to which the Company is exposed. Additional stress and scenario tests are run using these models during the year.

# FORTIS INSURANCE LIMITED

## Notes to the financial statements

### 2 Risk management (continued)

#### Objectives and policies for mitigating business risk (continued)

##### (i) Insurance risk (continued)

#### Claims development

Claims development tables of information are disclosed in note 16 (v) and (vi) in order to illustrate the insurance risk inherent in the Company. The tables compare the claims paid on an accident year basis with the provisions established for these claims. The table in note 16 (v) provides a review of current estimates of cumulative claims gross of reinsurance and demonstrates how the estimated claims have changed at subsequent reporting or accident year-ends. The estimate is increased or decreased as losses are paid and more information becomes known about the frequency and severity of unpaid claims. Data in the table related to acquired businesses are included from the acquisition date onwards. The table in note 16 (vi) provides a reconciliation of the total provision, net of reinsurance included in the balance sheet and the estimate of cumulative claims.

“Provision for prior years” in the tables represents the outstanding liabilities in respect of accident year 2002 and prior.

Various factors may distort the re-estimated provisions and cumulative deficiency or redundancy shown in the tables. For example, a substantial portion of the cumulative deficiencies shown in the accompanying table arise from claims on policies written prior to the mid-1970s involving liability exposures such as asbestos and environmental claims. In the post-1984 period, the Company has developed more stringent underwriting standards and policy exclusions and has significantly reduced or terminated the writing of these risks.

While the information in the tables provides a historical perspective on the adequacy of unpaid claims estimates established in previous years, readers of these financial statements are cautioned against extrapolating redundancies or deficiencies of the past on current unpaid loss balances. The Company believes that the estimate of total claims outstanding as of the end of 2007 are adequate. However, due to the inherent uncertainties in the provisioning process, it cannot be assured that such balances will ultimately prove to be adequate.

##### (ii) Financial risk

The Company is exposed to financial risks through its financial and reinsurance assets. To mitigate these it looks to match its insurance liabilities with assets which redeem at the same time as it is estimated that the liabilities will be settled after taking account of estimated renewals for one year. This is done on a global basis with some of the Company’s assets which represent shareholders funds being allocated as margin over the liability settlement schedule. This policy ensures that the Company is able to meet its obligations under its contractual liabilities as they fall due. Nevertheless, the Company has residual financial risks which arise primarily because:

- It is not possible to perfectly match insurance liabilities with financial assets. This is particularly the case with longer-tail insurance contracts.
- The Company invests a proportion of its capital in financial assets which are not matched with insurance liabilities.

The Company actively manages its assets using an approach that balances quality, diversification, asset/liability matching, liquidity and investment return. The goal of the investment process is to optimise the net of taxes, risk-adjusted investment income and risk-adjusted total return, whilst ensuring that the assets and liabilities are managed on a cash flow and duration basis. The Company’s Investment Committee review target portfolios on a periodic basis, establishing investment guidelines and limits, and providing oversight of the asset/liability management process which is regularly reported to the Board.

# FORTIS INSURANCE LIMITED

## Notes to the financial statements

### 2 Risk management (continued)

#### Objectives and policies for mitigating business risk (continued)

##### (iii) Market risk

Market risk can be described as the risk of change in fair value of a financial instrument due to changes in interest rates, equity prices or foreign currency exchange rates.

##### Interest rate risk

The Company's exposure to market risk for changes in interest rate is primarily concentrated in its investment portfolio. Changes in investment values attributable to interest rate changes are partially mitigated by offsetting changes in the economic value of insurance provisions. The Company monitors this exposure through periodic reviews of its asset and liability positions. Estimates of cash flows, as well as the impact of interest rate fluctuations relating to the investment portfolio and insurance liabilities, are modelled and reviewed quarterly.

The Company often holds its fixed rate debt securities until their maturity. This reduces variations in future cashflows and provides significant certainty over future income and redemption rates.

##### Equity price risk

This risk is defined as the potential loss in market value resulting from an adverse change in prices. The Company currently does not hold any investments that are exposed to an equity price risk.

##### Foreign exchange risk

All premiums are currently received in Sterling.

The Company's records enable the identification of any claim liabilities in US Dollars. These are compared with US Dollar assets each quarter and US Dollars are bought and sold as necessary to approximately match US Dollar assets to liabilities. There were no other material foreign currency assets or liabilities.

##### (iv) Credit risk

The Company's portfolios of fixed income securities and, to a lesser extent, short-term and other investments, are subject to credit risk. This risk is defined as the potential loss in market value resulting from adverse changes in a debtor's ability to repay. The risk is managed based on the Company's investment strategy which clearly articulates its risk appetite in terms of the debt ratings of securities held. This is monitored on a monthly basis by the Company's Investment Committee and regularly reported to the Board.

#### Debt securities - Credit rating analysis

Credit rating	2007	2007	2006	2006
	£m	%	£m	%
AAA	956.6	88.1	844.9	88.0
AA	89.1	8.2	79.8	8.3
A	25.0	2.3	35.7	3.7
A-	14.6	1.4	-	0.0
Total	<u>1,085.3</u>	<u>100.0</u>	<u>960.4</u>	<u>100.0</u>

An analysis of fixed income securities and other investments is shown in note 15.

# FORTIS INSURANCE LIMITED

## Notes to the financial statements

### 2 Risk management (continued)

#### Objectives and policies for mitigating business risk (continued)

##### (iv) Credit risk (continued)

The Company is exposed to credit risks through its reinsurance arrangements, where amounts due under a reinsurance contract may not be paid. The Company manages this risk through using only A- or better grade reinsurers based on S&P ratings, or a group company with the benefit of a parent company guarantee. The ratings of reinsurers are regularly monitored by the Company's Board.

With respect to credit risk arising from the other financial assets of the Company, which comprise cash and cash equivalents, other receivables (including related party balances) and investment securities, the Company's exposure to credit risk arises from default of the counterparty, with a maximum exposure equal to the carrying amount of these instruments.

#### Insurance receivables - Period overdue

	2007	2007	2006	2006
	£m	%	£m	%
Within terms	78.5	88.4	77.0	86.5
0 - 1 month	8.8	10.0	10.5	11.8
2 months	1.0	1.1	1.0	1.1
3 - 5 months	0.4	0.5	0.5	0.6
Total	<u>88.7</u>	<u>100.0</u>	<u>89.0</u>	<u>100.0</u>

Since the Company trades only with recognised and creditworthy third parties, there is no requirement for collateral. There are no significant concentrations of credit risk within the Company.

An analysis of insurance and other receivables is shown in note 18.

##### (v) Liquidity risk

The Company is exposed to liquidity risks arising from daily calls on its cash resources, notably from claims arising on its insurance contracts. There is therefore a risk that cash will not be available to settle liabilities when due. The Company manages this risk by setting minimum limits on the proportion of maturing assets that will be available to settle these liabilities and also maintaining a minimum level of borrowing facilities that could be utilised to cover claims maturities at unusually high levels.

#### Insurance contract provisions - Estimated payment profile

	2007	2007	2006	2006
Payment period	£m	%	£m	%
0 - 1 Year	464.0	42.9	411.4	42.0
2 - 5 Years	510.5	47.2	478.9	48.9
5 Years +	107.1	9.9	89.1	9.1
Total	<u>1,081.6</u>	<u>100.0</u>	<u>979.4</u>	<u>100.0</u>

An analysis of insurance contract provisions is shown in note 16.

# FORTIS INSURANCE LIMITED

## Notes to the financial statements

### 2 Risk management (continued)

#### Objectives and policies for mitigating business risk (continued)

##### (vi) Operational risk

Operational risk arises from inadequate or failed internal processes, people and systems, or from external events. It is diverse in nature and permeates all business activities but remains a distinct form of risk. Operational risk includes for example, information technology, people, strategy, business continuity, regulatory, legal and financial crime.

The identification, assessment and evaluation, management, monitoring and reporting of risks rests with business managers of the different areas. Risks are identified, assessed and scored; the risk committee on a regular basis reviews the risks and for those falling outside the Company's risk appetite monitors the remedial action to ensure compliance with the Company's risk appetite.

##### (vii) Capital management

#### Aims of capital management policy

The Company has established standards for the efficient management of capital, to meet the needs of the business and return on capital requirements of shareholders. This includes the capital required to support the risk appetite identified in the Company's Risk Policies together with a margin for safety, in full compliance with the requirements of the FSA

#### Definitions of capital management (and supporting terms)

Capital Management is the collection of processes and activities undertaken to ensure that sufficient capital is maintained to ensure the organisation's ability to meet its liabilities and ultimately ensure its survival, particularly in case of losses arising from adverse events.

Capital Management includes the assessment of capital required to support the Company's plans and objectives, the structure of its shareholders' funds, arrangements to secure capital, and the ongoing monitoring of capital against business requirements, as well as the assessments required by the FSA, minimum capital requirement (MCR), enhanced capital requirement (ECR) and internal capital assessment (ICA).

#### Approach to capital management

The Company develops a Strategic Plan with a five-year outlook, which is reviewed and revised each year and then formally approved in the fourth quarter of each year by the Company's board.

A key factor in the formulation of the Strategic Plan is the assessment of the capital required to support the business objectives (i.e. growth and profit targets) and the appropriateness of the supporting capital structure.

Overall capital requirements and structure are assessed taking account of the following:

- Capital required to support the planned growth in new business and renewal premiums and profit targets.
- The required rate of return on capital employed.
- The required dividend.
- FSA capital requirements based on ECR and MCR formulae and ICA methodologies.
- Capital required to support the desired credit rating.

For pricing/underwriting purposes, capital is allocated to different classes of business using a risk-based methodology. Where product lines do not have the potential to achieve the required return on capital within the plan period the Company will consider divestment.

# FORTIS INSURANCE LIMITED

## Notes to the financial statements

### 2 Risk management (continued)

#### Objectives and policies for mitigating business risk (continued)

##### (viii) Sensitivity to key business drivers

*In millions of pounds*

	Interest rates decrease 1.0%	Expenses increase 5.0%	Gross loss ratio increase 1.0%
<b>Impact - 2007</b>			
Decrease in profit before tax	(1.6)	(3.4)	(6.8)
Increase / (decrease) in net assets before tax	4.7	(3.4)	(6.8)
<b>Impact - 2006</b>			
Decrease in profit before tax	(1.8)	(3.0)	(6.1)
Increase / (decrease) in net assets before tax	4.0	(3.0)	(6.1)

The impact of the changes in key business drivers is each assumed to be a discrete change. All other factors will be unchanged.

Some of these changes cannot be guaranteed to have a linear effect and as a whole range of other factors will impact the results they cannot be guaranteed to predict the result detailed. In addition the risk management that the Company operates will ensure that corrective action is implemented to mitigate or reverse the changes.

#### Interest rates decrease by 1.0%

The Company will be exposed to the impact of interest rate changes on its financial assets and liabilities. There would be a reduction in income on short-term cash balances plus a capital gain on the value of fixed interest debt securities. As the Company often holds its fixed interest debt securities until maturity then it does not suffer any reduction in its future cash flow. It will suffer a reduction in the yield on any future fixed interest debt securities that it purchases from surplus funds and redemption of existing funds.

#### Impact of 1.0% decrease in interest rates

*In millions of pounds*

	2007	2006
Reduction in profit	(1.6)	(1.8)
Increase in net assets	6.3	5.8
<b>Total increase in net assets before tax</b>	<b>4.7</b>	<b>4.0</b>

# FORTIS INSURANCE LIMITED

## Notes to the financial statements

### 2 Risk management (continued)

#### Objectives and policies for mitigating business risk (continued)

#### (viii) Sensitivity to key business drivers (continued)

##### Expenses increase by 5.0%

If all three expense areas, acquisition, administration and claims were to increase by 5.0% each, in addition to the impact on profit of the additional costs it will also increase the claims handling provision and the deferred acquisition costs to the extent that these will be recovered by unearned premiums.

##### Impact of 5.0% increase in expenses

*In millions of pounds*

	2007	2006
Additional general expenses	3.5	3.1
Deferred acquisition costs - expenses	(0.5)	(0.4)
Claims handling reserve	0.4	0.3
<b>Total increase in expenses</b>	<u>3.4</u>	<u>3.0</u>
<b>Total impact on profit before tax</b>	<u>3.4</u>	<u>3.0</u>
<b>Total impact on net assets before tax</b>	<u>3.4</u>	<u>3.0</u>

##### Gross loss ratio increases by 1.0%

If the cost of claims were to increase the gross loss ratio (gross incurred claims as a proportion of gross earned premium) by 1.0% there would be a reduction in profits. It is assumed that a similar portion of claims costs would be recoverable from insurers. There would also be an increase in claims handling reserve as a proportion of the claims would be unpaid at the balance sheet date.

##### Impact of 1.0% increase in gross loss ratio

*In millions of pounds*

	2007	2006
<b>Analysis of net claims incurred</b>		
Claims paid and movement in reserves	7.3	6.3
Claims handling costs	-	-
Movement in claims handling reserve	0.1	0.1
Gross claims incurred	<u>7.4</u>	<u>6.4</u>
Reinsurance recoveries	(0.6)	(0.3)
<b>Net increase in claims incurred</b>	<u>6.8</u>	<u>6.1</u>
<b>Total impact on profit before tax</b>	<u>6.8</u>	<u>6.1</u>
<b>Total impact on net assets before tax</b>	<u>6.8</u>	<u>6.1</u>

# FORTIS INSURANCE LIMITED

## Notes to the financial statements

### 3 Premiums

*In millions of pounds*

	2007	2006
Gross premiums written	757.8	688.3
Change in the gross provision for unearned premiums	<u>(30.8)</u>	<u>(51.5)</u>
<b>Gross insurance premium revenue</b>	<b>727.0</b>	<b>636.8</b>
less: written premiums ceded to reinsurers	(34.4)	(28.3)
Reinsurers' share of change in the provision for unearned premiums	<u>(0.3)</u>	<u>0.3</u>
<b>Ceded earned premiums</b>	<b>(34.7)</b>	<b>(28.0)</b>
<b>Net insurance premium revenue</b>	<b>692.3</b>	<b>608.8</b>

### 4 Commission income

*In millions of pounds*

	2007	2006
Reinsurance commission	<u>0.9</u>	<u>0.9</u>
<b>Total commission income</b>	<b>0.9</b>	<b>0.9</b>

### 5 Investment income

*In millions of pounds*

	2007	2006
Interest Income:		
- Available-for-sale interest income	49.5	42.6
- Loans and receivables interest income	2.2	2.2
Dividend income	0.5	0.9
Net realised gains from available-for-sale financial assets	<u>4.9</u>	<u>0.6</u>
<b>Total investment income</b>	<b>57.1</b>	<b>46.3</b>

### 6 Other operating income

*In millions of pounds*

	2007	2006
Release of unused provisions	0.1	0.1
Other income – miscellaneous	9.2	8.6
Realised gain on disposal of freehold property	<u>1.3</u>	<u>-</u>
<b>Total other operating income</b>	<b>10.6</b>	<b>8.7</b>

### 7 Claims and benefits incurred

*In millions of pounds*

	2007	2006
Current year claims paid	(347.2)	(241.5)
Change in prior years claims	45.5	25.1
Claims handling costs	(21.3)	(16.7)
Additional liabilities arising during the year	(297.3)	(227.0)
Net foreign exchange differences	<u>(0.2)</u>	<u>(1.9)</u>
<b>Total claims and benefits incurred</b>	<b>(620.5)</b>	<b>(462.0)</b>

# FORTIS INSURANCE LIMITED

## Notes to the financial statements

### 8 Acquisition costs

*In millions of pounds*

	2007	2006
Commission expenses payable	(133.0)	(132.0)
Other acquisition costs payable	(22.4)	(21.4)
Changes in deferred acquisition costs	6.8	20.0
<b>Total acquisition costs</b>	<b>(148.6)</b>	<b>(133.4)</b>

### 9 Operating expenses

*In millions of pounds*

	2007	2006
Depreciation and amortisation:		
- Equipment and motor vehicles	(0.2)	(0.4)
- IT equipment	(1.4)	(1.3)
Personnel expenses:		
- Wages and salaries	(28.9)	(24.8)
- Compulsory social security contributions	(2.7)	(2.2)
- Contributions to defined benefit plans	(5.5)	(8.0)
- Contributions to defined contribution plans	(1.1)	(0.9)
- Reduction in liability for defined benefit plans	4.1	5.8
Goods and services	(12.2)	(11.9)
Software costs	(4.9)	(4.1)
Other costs	(17.5)	(14.5)
<b>Total operating expenses</b>	<b>(70.3)</b>	<b>(62.3)</b>

#### Operating expenses are analysed as:

Acquisition costs	(22.4)	(21.4)
Administration costs	(26.6)	(24.2)
Claims handling costs	(21.3)	(16.7)
	<b>(70.3)</b>	<b>(62.3)</b>

Goods and services includes auditors remuneration of £220,000 (2006: £195,000) for audit fees. The auditors did not perform any other services.

### 10 Finance costs

*In millions of pounds*

	2007	2006
Interest expense	(0.1)	(0.1)
<b>Total finance costs</b>	<b>(0.1)</b>	<b>(0.1)</b>

# FORTIS INSURANCE LIMITED

## Notes to the financial statements

### 11 Income taxes

#### Recognised in the income statement

*In millions of pounds*

	2007	2006
<b>Current tax expense</b>		
Current year – operations	(5.6)	(17.6)
Adjustments for prior years	<u>(0.2)</u>	<u>2.3</u>
	<u>(5.8)</u>	<u>(15.3)</u>
<b>Deferred tax expense</b>		
Origination and reversal of temporary differences	<u>2.1</u>	<u>(4.2)</u>
<b>Total income tax expense</b>	<u>(3.7)</u>	<u>(19.5)</u>

#### Reconciliation of effective tax rate

The tax assessed on the year is higher (2006: lower) than the standard rate of Corporation tax in the United Kingdom of 30%. The differences are explained below:

*In millions of pounds*

	2007	2006
Profit before tax	<u>12.7</u>	<u>63.4</u>
Income tax using the domestic corporation tax rate (30%)	(3.8)	(19.0)
Non deductible expenses and provisions	0.4	(0.3)
Tax exempt revenues	0.1	0.3
Charge in respect of discounting of reserves	-	(0.7)
Depreciation for the year in excess of capital allowances	0.2	(0.1)
Equalisation provision	(4.1)	1.6
Other	<u>1.6</u>	<u>0.6</u>
	(5.6)	(17.6)
Adjustments in respect of prior years	<u>(0.2)</u>	<u>2.3</u>
	<u>(5.8)</u>	<u>(15.3)</u>

#### Tax recognised directly in equity

*In millions of pounds*

Deferred tax	(2.5)	2.8
Corporation tax	<u>(1.3)</u>	<u>1.3</u>
	<u>(3.8)</u>	<u>4.1</u>

# FORTIS INSURANCE LIMITED

## Notes to the financial statements

### 12 Property, plant and equipment

*In millions of pounds*

	Leasehold land and buildings	Land and buildings	Equipment and motor vehicles	IT equipment	Total
<b>Cost</b>					
Balance at 1 January 2006	-	1.9	1.1	5.3	8.3
Acquisitions	-	-	0.2	1.7	1.9
Disposals	-	-	(0.5)	(1.7)	(2.2)
Balance at 31 December 2006	-	1.9	0.8	5.3	8.0
Acquisitions	0.3	-	1.5	2.0	3.8
Disposals	-	(1.9)	-	-	(1.9)
Balance at 31 December 2007	0.3	-	2.3	7.3	9.9
<b>Depreciation and impairment losses</b>					
Balance at 1 January 2006	-	0.4	0.8	3.2	4.4
Depreciation charge for the year	-	-	0.4	1.3	1.7
Disposals	-	-	(0.5)	(1.7)	(2.2)
Balance at 31 December 2006	-	0.4	0.7	2.8	3.9
Depreciation charge for the year	-	-	0.2	1.4	1.6
Disposals	-	(0.4)	-	-	(0.4)
Balance at 31 December 2007	-	-	0.9	4.2	5.1
<b>Carrying amounts</b>					
At 31 December 2006	-	1.5	0.1	2.5	4.1
At 31 December 2007	0.3	-	1.4	3.1	4.8

### 13 Deferred acquisition costs

As part of the Company's insurance business, certain acquisition costs are deferred.

An analysis of these deferred costs is set out below:

*In millions of pounds*

	2007	2006
Balance at 1 January	73.3	53.4
Acquisition costs incurred in year	155.4	153.3
Amortisation charged to income	(148.6)	(133.4)
Balance at 31 December	80.1	73.3

# FORTIS INSURANCE LIMITED

## Notes to the financial statements

### 14 Investments in Subsidiaries

*In millions of pounds*

2007 2006

Investments in subsidiaries are stated at cost.

At 1 January and 31 December

0.4 16.3

The following companies, which are incorporated in the United Kingdom, were subsidiaries at 31 December 2007 and 31 December 2006. During the year the Company's wholly owned subsidiary Northern Star Insurance Company Limited was liquidated.

Company	Activity	% Owned
Fortis Services (UK) Ltd	Administrative services	100
Bishopsgate Head Office Ltd	Property holding	100

### 15 Financial assets

#### Available-for-sale

*In millions of pounds*

2007 2006

#### Debt securities - fixed rate

UK Government bonds	524.7	515.4
Non UK Government bonds	12.0	11.6
Supranational / Agency bonds	372.3	274.6
Corporate bonds	156.9	158.8
Certificates of deposit	19.4	-
	<u>1,085.3</u>	<u>960.4</u>

#### Unit trusts

Listed	-	33.9
	<u>-</u>	<u>33.9</u>

#### Total financial assets

1,085.3 994.3

#### Available-for-sale

The movements in financial assets are as follows:

*In millions of pounds*

2007 2006

<b>At 1 January</b>	994.3	927.8
Translation differences	(0.2)	(1.7)
Additions	378.1	420.5
Sales and redemptions	(305.1)	(347.2)
Fair value unrealised gains and losses	12.7	(13.7)
Amortisation of premiums and discounts	5.5	8.6
<b>At 31 December</b>	<u>1,085.3</u>	<u>994.3</u>

As at 31 December 2007 the current portion of financial assets is £245.9m (2006: £255.5m) and the non-current portion is £839.4m (2006: £738.8m).

The effective interest rate at the balance sheet date on sterling assets available for sale is 5.1% (2006: 4.7%) and on US dollar assets is 4.5% (2006: 4.5%).

# FORTIS INSURANCE LIMITED

## Notes to the financial statements

### 16 Insurance contract provisions and reinsurance assets

*In millions of pounds*

	2007			2006		
	Gross	Reinsurance	Net	Gross	Reinsurance	Net
Unearned premiums	355.9	(1.5)	354.4	325.1	(1.8)	323.3
Claims reported by policy holders	551.4	(97.9)	453.5	445.4	(62.5)	382.9
Claims incurred but not reported	174.3	5.9	180.2	208.9	(4.7)	204.2
<b>Total insurance contract provisions</b>	<b>1,081.6</b>	<b>(93.5)</b>	<b>988.1</b>	<b>979.4</b>	<b>(69.0)</b>	<b>910.4</b>

Recoveries are not included above. For details see subsection (iii).

Liability insurance contracts underwritten by the Company in the past expose the Company to claims in the US from industrial diseases caused by exposure to asbestos. These liabilities comprise two percent of the Company's general insurance liabilities at 31 December 2007. The assumptions used in determining the liabilities are included in analysis (iv).

#### (i) Analysis of movements in insurance provisions

*In millions of pounds*

	2007			2006		
	Gross	Reinsurance	Net	Gross	Reinsurance	Net
Balance at 1 January	979.4	(69.0)	910.4	898.8	(67.1)	831.7
Claims paid/recovered from reinsurers	(529.6)	22.9	(506.7)	(415.4)	16.8	(398.6)
Movement in claims incurred but not reported	(34.5)	10.6	(23.9)	4.2	(2.8)	1.4
Claims reported in the period	635.5	(58.3)	577.2	440.3	(15.6)	424.7
Change in gross provision for unearned premiums	30.8	0.3	31.1	51.5	(0.3)	51.2
Balance at 31 December	<b>1,081.6</b>	<b>(93.5)</b>	<b>988.1</b>	<b>979.4</b>	<b>(69.0)</b>	<b>910.4</b>

#### (ii) Analysis of movements in provision for gross unearned premium

*In millions of pounds*

	2007	2006
Balance at 1 January	325.1	273.6
Premiums written during the year	757.8	688.3
Less: premiums earned during the year	(727.0)	(636.8)
Balance at 31 December	<b>355.9</b>	<b>325.1</b>

# FORTIS INSURANCE LIMITED

## Notes to the financial statements

### 16 Insurance contract provisions and reinsurance assets (continued)

#### (iii) Analysis of movements in outstanding claims

*In millions of pounds*

	2007	2006
<b>Gross outstanding claims</b>		
Balance at 1 January	654.3	625.2
Current year claims	662.7	485.1
Change in prior year claims	(61.7)	(40.6)
Current year claims paid	(347.2)	(241.4)
Previous year claims paid	(182.4)	(174.0)
Balance at 31 December	<u>725.7</u>	<u>654.3</u>

#### Salvage and subrogation recoveries (note 18)

Balance at 1 January	(20.6)	(19.4)
Current year claims	(18.2)	(16.6)
Change in prior year claims	16.2	15.4
Balance at 31 December	<u>(22.6)</u>	<u>(20.6)</u>

#### Gross claims outstanding net of recoveries

Balance at 1 January	633.7	605.8
Current year claims	644.5	468.4
Change in prior year claims	(45.5)	(25.1)
Current year claims paid	(347.2)	(241.4)
Previous year claims paid	(182.4)	(174.0)
Balance at 31 December	<u>703.1</u>	<u>633.7</u>

#### (iv) Process used to determine the assumptions

The sources of data used as inputs for the assumptions behind insurance provisions are internal, using detailed studies that are carried out annually. The assumptions are checked to ensure that they are consistent with observable market prices or other published information. There is more emphasis on current trends, and where in early years there is insufficient information to make a reliable best estimate of claims development, prudent assumptions are used.

The nature of the business makes it very difficult to predict with certainty the likely outcome of any particular claim and the ultimate cost of notified claims. Each notified claim is assessed on a separate, case by case basis with due regard to the claim circumstances and historical evidence of the size of similar claims. Case estimates are reviewed regularly and are updated as and when new information arises. The provisions are based on information currently available. However, the ultimate liabilities may vary as a result of subsequent developments. The impact of many of the items affecting the ultimate costs of the loss is difficult to estimate. The degree of complexity involved will also differ by book of business due to differences in the underlying insurance contract, claim complexity, the volume of claims and the individual severity of claims, determining the occurrence date of a claim, and reporting lags.

# FORTIS INSURANCE LIMITED

## Notes to the financial statements

### 16 Insurance contract provisions and reinsurance assets (continued)

#### (iv) Process used to determine the assumptions (continued)

For the Company's exposure to asbestos, environmental pollution and latent injury damage, claims arise from policies written under which the Company has assumed liabilities, on an indemnity or assumption basis. The Company's estimate of its ultimate liability for such exposures includes case estimate provisions and a provision for liabilities incurred but not reported. The provision for liabilities incurred but not reported is established based on various methods such as loss development patterns and frequency and severity trends.

Estimation of ultimate liabilities for asbestos and environmental exposures is inherently difficult due to several significant issues surrounding such exposures. Among the issues are: (a) the long period between exposure and manifestation of an injury; (b) difficulty in identifying the sources of asbestos or environmental contamination; (c) difficulty in allocating responsibility or liability for asbestos or environmental damage; (d) changes in underlying laws and judicial interpretation of those laws; and (e) uncertainty regarding the identity and number of parties insured with potential asbestos or environmental exposure.

For all other risks, the cost of outstanding claims and the IBNR provisions are estimated using various statistical methods. Such methods extrapolate the development of paid and incurred claims, average cost per claims and ultimate claim numbers for each accident year based upon observed development of earlier years and expected loss ratios.

The key methods, which remain unchanged from prior years, are:

- chain ladder methods, which use historical data to estimate the paid and incurred to date proportions of the ultimate claim cost;
- expected loss ratio methods, which use the Company's expectation of the loss ratio for a class of business;
- benchmarking methods, which use the experience of comparable, more mature, classes to estimate the cost of claims.

The actual method or blend of methods used varies by accident year being considered, the class of business and observed historical claims development.

To the extent that these methods use historical claims development information they assume that the historical claims development pattern will occur again in the future. There are reasons why this may not be the case, which, insofar as they can be identified, have been allowed for by modifying the methods. Such reasons include:

- changes in processes that affect the development / recording of claims paid and incurred (such as changes in claim reserving procedures).
- economic, legal, political and social trends (resulting in, for example, a difference in expected levels of inflation);
- changes in mix of business;
- random fluctuations, including the impact of large losses.

IBNR provisions are initially estimated at a gross level and a separate calculation is carried out to estimate the size of reinsurance recoveries. The Company is covered by a variety of excess of loss reinsurance programmes. The method used by the Company takes historical data, gross IBNR estimates and details of the reinsurance programme, to assess the expected size of reinsurance recoveries.

# FORTIS INSURANCE LIMITED

## Notes to the financial statements

### 16 Insurance contract provisions and reinsurance assets (continued)

#### (iv) Process used to determine the assumptions (continued)

The Company's reserves for asbestos and environmental related losses arise from business written for accident years 1985 and prior. The Company has minimal exposure in the more recent accident years. The key assumptions affecting the measurement of the provisions are (a) continued growth in the number of claims filed due to a more aggressive plaintiff's bar; (b) increase in claims involving defendants formerly regarded as peripheral.

The Company believes that the liability for claims reported in the balance sheet is adequate. However, it recognises that the process of estimation is based upon certain variables and assumptions, which could differ when claims arise.

The reserves are net of recoveries from salvage and subrogation. These recoveries are estimated on the probability of the recovery being made and are subject to regular review.

#### (v) Analysis of claims development – gross of reinsurance and net of salvage and subrogation recoveries

<i>In millions of pounds</i>	Accident year					Total
	2003	2004	2005	2006	2007	
<b>Gross estimate of cumulative claims</b>						
At end of accident year	370.7	412.8	430.3	468.4	644.5	2,326.7
- one year later	(8.7)	(7.0)	(8.5)	(4.0)	-	(28.2)
- two years later	(3.2)	(5.6)	(3.6)	-	-	(12.4)
- three years later	(4.8)	(13.7)	-	-	-	(18.5)
- four years later	(15.7)	-	-	-	-	(15.7)
Estimate of cumulative claims	338.3	386.5	418.2	464.4	644.5	2,251.9
Cumulative payments to date	295.0	327.4	320.4	350.4	347.2	1,640.4
Provision for prior years	-	-	-	-	-	91.6
<b>Gross outstanding claims liabilities</b>	<b>43.3</b>	<b>59.1</b>	<b>97.8</b>	<b>114.0</b>	<b>297.3</b>	<b>703.1</b>

#### (vi) Analysis of claims development – net of reinsurance and net of salvage and subrogation recoveries

<i>In millions of pounds</i>	Accident year					Total
	2003	2004	2005	2006	2007	
<b>Net estimate of cumulative claims</b>						
At end of accident year	363.3	405.1	424.7	458.8	597.8	2,249.7
- one year later	(8.2)	(6.6)	(15.1)	(5.6)	-	(35.5)
- two years later	(3.4)	(6.1)	(3.6)	-	-	(13.1)
- three years later	(4.6)	(13.3)	-	-	-	(17.9)
- four years later	(15.7)	-	-	-	-	(15.7)
Estimate of cumulative claims	331.4	379.1	406.0	453.2	597.8	2,167.5
Cumulative payments to date	293.0	320.3	318.8	348.5	338.7	1,619.3
Provision for prior years	-	-	-	-	-	62.9
<b>Net outstanding claims liabilities</b>	<b>38.4</b>	<b>58.8</b>	<b>87.2</b>	<b>104.7</b>	<b>259.1</b>	<b>611.1</b>

# FORTIS INSURANCE LIMITED

## Notes to the financial statements

### 17 Deferred tax assets

#### Recognised deferred tax assets

Deferred tax assets are attributable to the following:

<i>In millions of pounds</i>	2007	2006
Property, plant and equipment	0.6	0.8
Unrealised appreciation:		
- Financial assets	(2.2)	0.3
Equalisation provision	-	(4.1)
Employee benefits	3.7	5.3
Provisions	<u>1.1</u>	<u>1.3</u>
Tax assets	<u>3.2</u>	<u>3.6</u>

There are no unrecognised deferred tax assets or liabilities.

#### Movement in temporary differences during the year

*In millions of pounds*

	Balance 1 January 2006	Recognised in income	Recognised in equity	Balance 31 December 2006
Property, plant and equipment	0.8	-	-	0.8
Unrealised appreciation:				
- Financial assets	(2.5)	-	2.8	0.3
Equalisation provision	-	(4.1)	-	(4.1)
Employee benefits	6.0	(0.7)	-	5.3
Provisions	<u>0.8</u>	<u>0.5</u>	<u>-</u>	<u>1.3</u>
Tax assets / (liabilities)	<u>5.1</u>	<u>(4.3)</u>	<u>2.8</u>	<u>3.6</u>

*In millions of pounds*

	Balance 1 January 2007	Recognised in income	Recognised in equity	Balance 31 December 2007
Property, plant and equipment	0.8	(0.2)	-	0.6
Unrealised appreciation:				
- Financial assets	0.3	-	(2.5)	(2.2)
Equalisation provision	(4.1)	4.1	-	-
Employee benefits	5.3	(1.6)	-	3.7
Provisions	<u>1.3</u>	<u>(0.2)</u>	<u>-</u>	<u>1.1</u>
Tax assets / (liabilities)	<u>3.6</u>	<u>2.1</u>	<u>(2.5)</u>	<u>3.2</u>

The deferred income tax recognised in equity during the year relates to unrealised movements on available for sale financial assets.

# FORTIS INSURANCE LIMITED

## Notes to the financial statements

### 18 Insurance and other receivables

*In millions of pounds*

	2007	2006
Receivables arising from insurance contracts:		
- contract holders	24.3	25.1
- agents, brokers and intermediaries	63.5	61.1
- reinsurers	0.9	2.8
<b>Total receivables arising from insurance contracts</b>	<u>88.7</u>	<u>89.0</u>
Amounts due from group undertakings	25.8	25.5
Salvage and subrogation recoveries	22.6	20.6
Other receivables and pre-payments	5.2	1.6
Accrued interest income	17.8	16.9
Deferred other charges	1.7	1.4
Other	0.1	-
<b>Total insurance and other receivables</b>	<u>161.9</u>	<u>155.0</u>

Amounts due from group undertakings includes an unsecured loan facility to Bishopsgate Head Office Limited which is repayable on demand in cash. The interest rate on the loan is 6.75% (2006: 6.25%). All other amounts due from group undertakings are unsecured, interest free and repayable on demand in cash.

### 19 Cash and cash equivalents

*In millions of pounds*

	2007	2006
Bank and cash balances	39.0	39.6
<b>Cash and cash equivalents</b>	<u>39.0</u>	<u>39.6</u>

The effective interest rate at 31 December 2007 on short term bank deposits was 5.3% (2006: 5.0%), with an average maturity of one day.

Included in cash and cash equivalents held by the Company as at 31 December 2007 are balances totalling £0.5m (2006: £0.5m) not available for use by the Company because they are held in trust to guarantee claims liabilities.

### 20 Loans and borrowings

*In millions of pounds*

	2007	2006
<b>Non-current liabilities</b>		
Due to group undertakings	-	15.9
	<u>-</u>	<u>15.9</u>
<b>Current liabilities</b>		
Unsecured bank facility	6.0	2.5
	<u>6.0</u>	<u>2.5</u>
<b>Total loans and borrowings</b>	<u>6.0</u>	<u>18.4</u>

The unsecured bank facility bears interest at 6.5% (2006: 6.5%).

# FORTIS INSURANCE LIMITED

## Notes to the financial statements

### 21 Insurance payables, other payables and deferred income

*In millions of pounds*

	2007	2006
Amounts due to group undertakings	9.9	4.9
Direct insurance contract payables	7.0	10.4
Other payables and accrued expenses	31.2	25.5
IPT, VAT and other taxes payable	12.7	12.1
Deferred income	0.5	0.6
Total insurance payables, other payables and deferred income	<u>61.3</u>	<u>53.5</u>

Deferred income represents amounts deferred under investment management service contracts that are recognised as revenue as the investment management services are provided.

Amounts due to group undertakings are unsecured, interest free and repayable on demand in cash.

### 22 Other provisions

*In millions of pounds*

Balance at 1 January 2007	1.2
Provisions reversed during the year	<u>(0.1)</u>
Balance at 31 December 2007	<u>1.1</u>
Non-current – payable after one year	0.7
Current – payable within one year	<u>0.4</u>
	<u>1.1</u>

Other provisions include a liability for the cost of Company staff on long term sickness, together with a liability in relation to the unused Company staff annual leave entitlements.

### 23 Pension schemes

The Company operates a funded defined benefit pension scheme, the Fortis Insurance Staff Pension Scheme, in respect of staff who were members of the scheme on 31st December 1997 and staff of group companies who had contractual rights to join the scheme after this date. In 2001 active members of the Northern Star Insurance Company Limited Superannuation Fund whose employment transferred to Fortis Insurance Limited joined the scheme for future service on a benefit structure mirroring that in their previous scheme and were granted past service benefits in respect of a bulk transfer payment received from that scheme.

The assets of the scheme are held in a separate trust fund. Assets are invested in unit trusts and bank deposits under trustee guidelines. Contributions to the scheme are charged to the Income Statement so as to spread the cost of pensions over employees' working lives with the Company. The contributions are determined by a qualified actuary on the basis of triennial valuations using the projected unit method. The most recent formal triennial valuation was at 1st April 2006. At that date, the market value of the assets of the scheme amounted to £60,510,000 and was sufficient to cover 82% of the benefits that had accrued to members, after allowing for the expected future increases in earnings.

The Company also operates a defined contribution scheme called Fortis Insurance Limited Group Pension Scheme in respect of other staff. The assets of the scheme are held separately from those of the Company in an independently administered fund. The pension cost in respect of members of this fund represents contribution payable by the Company to the fund and amounted to £1,147,450 (2006: £866,000).

The Company accounts for pension costs in accordance with IAS 19, Employment Benefits.

# FORTIS INSURANCE LIMITED

## Notes to the financial statements

### 23 Pension schemes (continued)

A full actuarial valuation was carried out at 1st April 2006 and updated by a qualified independent actuary on an IAS 19 basis at 31st December 2007. The major assumptions used by the actuary were:

Valuation Method		2007 Projected unit	2006 Projected unit	2005 Projected unit
		%	%	%
Rate of increase in salaries		5.0	3.9	2.0
Rate of increase in pensions in payment:				
- Post 1988 Non GMP (ex Bishopsgate members)		5.0	5.0	5.0
- Post 1988 Non GMP (ex Northern Star members)		3.0	1.9	1.8
Discount Rate		5.6	4.9	4.5
Inflation assumption		3.0	1.9	1.8
Expected return on scheme assets:	Asset mix - fair value	Low	Central	High
	%	%	%	%
Equities	84.2	8.4	8.6	8.9
Bonds	15.4	5.4	5.6	5.9
Cash	0.4	6.2	6.4	6.7

The assumptions used by the actuary are the best estimates chosen from a range of possible actuarial assumptions, which, due to the timescale covered, may not necessarily be borne out in practice. The expected rates of return of the scheme assets are based on the central scenario.

The scheme is closed to new members. Under the projected unit method of valuing the liabilities of the scheme, the current service cost will increase as the members of the scheme approach retirement.

<i>In millions of pounds</i>	2007	2006
Present value of funded obligations	81.3	76.5
Fair value of plan assets	<u>72.4</u>	<u>63.3</u>
Present value of net obligations	8.9	13.2
Unrecognised actuarial gains and losses	<u>1.2</u>	<u>1.0</u>
Recognised liability for defined benefit obligations (see below)	<u>10.1</u>	<u>14.2</u>

# FORTIS INSURANCE LIMITED

## Notes to the financial statements

### 23 Pension schemes (continued)

#### Movements in the net liability for defined benefit obligations recognised in the balance sheet

<i>In millions of pounds</i>	2007	2006
Net liability for defined benefit obligations at 1 January	14.2	20.0
Contributions received	(5.5)	(8.1)
Expense recognised in the income statement (see below)	<u>1.4</u>	<u>2.3</u>
Net liability for defined benefit obligations at 31 December	<u>10.1</u>	<u>14.2</u>

#### Expense recognised in the income statement

<i>In millions of pounds</i>	2007	2006
Current service costs	2.6	2.8
Interest on obligation	3.9	3.4
Expected return on plan assets	<u>(5.1)</u>	<u>(3.9)</u>
	<u>1.4</u>	<u>2.3</u>

The expense is recognised in the following line items in the income statement:

<i>In millions of pounds</i>	2007	2006
Claims and benefits incurred	0.5	0.9
Acquisition costs	0.5	0.8
Administration costs	<u>0.4</u>	<u>0.6</u>
	<u>1.4</u>	<u>2.3</u>
Actual return on plan assets	<u>4.7</u>	<u>5.8</u>

The Management estimate of contributions expected to be paid to the plan during the annual period beginning on 1 January 2008 is £5.5m.

### 24 Current tax liabilities

The current tax liability of £2.6m (2006: £6.1m) represents the amount of income taxes payable in respect of the current year plus an adjustment in respect of prior years.

# FORTIS INSURANCE LIMITED

## Notes to the financial statements

### 25 Capital and reserves

#### Reconciliation of movement in capital and reserves Attributable to equity holders

<i>In millions of pounds</i>	Share capital	Share premium	Retained earnings	Other reserves		Total
				Fair value reserve	Statutory reserve	
Balance at 1 January 2007	71.1	3.9	192.2	(3.6)	14.0	277.6
Profit for the year	-	-	9.0	-	-	9.0
Fair value gains/(losses)	-	-	-	8.9	-	8.9
Dividends to shareholders	-	-	-	-	-	-
Balance at 31 December 2007	<u>71.1</u>	<u>3.9</u>	<u>201.2</u>	<u>5.3</u>	<u>14.0</u>	<u>295.5</u>

<i>In millions of pounds</i>	Share capital	Share premium	Retained earnings	Other reserves		Total
				Fair value reserve	Statutory reserve	
Balance at 1 January 2006	71.1	3.9	148.3	6.0	14.0	243.3
Profit for the year	-	-	43.9	-	-	43.9
Fair value gains/(losses)	-	-	-	(9.6)	-	(9.6)
Dividends to shareholders	-	-	-	-	-	-
Balance at 31 December 2006	<u>71.1</u>	<u>3.9</u>	<u>192.2</u>	<u>(3.6)</u>	<u>14.0</u>	<u>277.6</u>

#### Share capital

<i>In thousands of shares</i>	Ordinary shares		Deferred shares	
	2007	2006	2007	2006
In issue at 1 January	<u>68,109</u>	<u>68,109</u>	<u>3,000</u>	<u>3,000</u>
In issue at 31 December – fully paid	<u>68,109</u>	<u>68,109</u>	<u>3,000</u>	<u>3,000</u>

At 31 December 2007, the authorised share capital comprised 68,108,985 ordinary shares (2006: 68,108,985) and 3,000,000 (2006: 3,000,000) deferred shares. The ordinary and deferred shares have a par value of £1.

The holders of ordinary shares are entitled to receive dividends as declared from time to time and are entitled to one vote per share at meetings of the Company. Deferred shares do not carry the right to vote and are not entitled to participate in profits of the Company. All shares rank equally with regard to the Company's residual assets, except that deferred shareholders participate only to the extent of the face value of the shares. On winding up, the deferred shares would rank second, repaying the holders the amount of capital paid up.

#### Fair value reserve

The fair value reserve includes the cumulative net change in the fair value of available-for-sale investments, net of tax, until the investment is derecognised.

# FORTIS INSURANCE LIMITED

## Notes to the financial statements

### 26 Operating leases

#### Leases as lessee

Non-cancellable operating lease rentals are payable as follows:

*In millions of pounds*

	2007	2006
Less than one year	-	-
Between one and five years	0.6	0.6
More than five years	23.8	9.6
Total	<u>24.4</u>	<u>10.2</u>

The Company leases office premises and warehouse storage under operating leases. During the year the Company entered into a new fifteen year lease for the Gloucester office premises and a ten year lease for warehouse storage in Gloucester. The Company entered into two ten year leases for office premises and warehouse storage in Eastleigh. The leases typically have an option to renew the lease after the expiry date. Lease payments are increased every five years to reflect market rentals. None of the leases includes contingent rentals.

During the year ended 31 December 2007, £1.8m was recognised as an expense in the income statement in respect of operating leases (2006: £1.3m).

### 27 Staff numbers and costs

The total number of persons employed by the Company (including executive directors) at the year-end, analysed by category, was as follows:

	2007	2006
Business acquisition	415	359
Claims handling	706	636
Administration	286	260
	<u>1,407</u>	<u>1,255</u>

The full time equivalent number of employees was as follows:

	2007	2006
Business acquisition	379	265
Claims handling	603	592
Administration	255	230
	<u>1,237</u>	<u>1,087</u>

The average number of persons employed by the Company during the year was as follows:

	2007	2006
Total number of employees	<u>1,342</u>	<u>1,205</u>
Full time equivalent number of employees	<u>1,174</u>	<u>1,044</u>

# FORTIS INSURANCE LIMITED

## Notes to the financial statements

### 27 Staff numbers and costs (continued)

The aggregate payroll costs in respect of these persons were as follows:

<i>In millions of pounds</i>	2007	2006
Wages and salaries	28.9	24.8
Social security costs	2.7	2.2
Other pension costs	2.5	3.1
	<u>34.1</u>	<u>30.1</u>

### 28 Related party transactions

The Company has a related party relationship with its key management personnel who are all directors of the Company.

#### Transactions with directors

In addition to their salaries, the Company also provides non-cash benefits to directors and contributes to a post-employment defined benefit plan on their behalf. The directors' compensations are as follows:

<i>In millions of pounds</i>	2007	2006
Short-term employee benefits	2.4	1.8
Post-employment benefits	0.4	0.2
Equity compensation benefits	0.1	0.1
	<u>2.9</u>	<u>2.1</u>
In respect of the highest paid director	<u>0.7</u>	<u>0.5</u>

Under the defined benefit scheme, the highest paid director's accrued pension at the year-end was £12,000 (2006: £10,000).

The directors are able to obtain discounted personal insurance at the same rates as all other staff.

In the ordinary course of business the Company carries out transactions with related parties as defined in IAS 24, Related Party Disclosures. Material transactions are set out below:

<i>In millions of pounds</i>	2007 Income Statement	2007 Balance Sheet	2006 Income Statement	2006 Balance Sheet
Immediate parent and ultimate holding company transactions and assets held in the balance sheet	-	-	(0.2)	-
Fellow subsidiary company transactions and assets held in the balance sheet	93.9	21.0	52.9	20.2
Subsidiary company transactions and assets held in the balance sheet	1.0	(5.1)	0.6	0.4
Pension scheme transaction and liability	(5.5)	(10.1)	(8.0)	(14.2)
Other related party transactions and assets / liabilities held in the balance sheet	<u>(23.0)</u>	<u>184.4</u>	<u>(11.5)</u>	<u>61.4</u>
Grand total	<u>66.4</u>	<u>190.2</u>	<u>33.8</u>	<u>67.8</u>

# FORTIS INSURANCE LIMITED

## Notes to the financial statements

### 28 Related party transactions (continued)

The Company's immediate parent undertaking is Fortis (UK) Ltd to which the Company provides administration and management services. The amount for these transactions is outstanding at the balance sheet date. The transactions with the ultimate holding company relate to share option costs.

Fellow subsidiary company transactions and assets relate to insurance policies sold by RIAS plc and The OutRight Company UK Limited, insurance brokers which are both wholly owned by Fortis (UK) Ltd.

The Company provides administration and claims settlement services to its subsidiary, Fortis Services (UK) Ltd, in addition to loan facilities for which interest is charged. The Company also bears the cost of rent charged by its subsidiary, Bishopsgate Head Office Ltd.

Other related party transactions consist of investment management charges with Fortis Investments, interest on deposits held by Fortis Bank SA/NV & NV and also an asset in relation to reinsured claim recoverables with Fortis Re. All of these companies are within the Fortis Group.

### 29 Capital commitments

<i>In millions of pounds</i>	2007	2006
Authorised and contracted for	0.2	1.3
Authorised but not contracted for	-	0.7
	<u>0.2</u>	<u>2.0</u>

### 30 Parent company

The Company's results are consolidated into the accounts of Fortis Insurance International N.V.; a Company incorporated in the Netherlands.

The Company's ultimate holding company is Fortis Utrecht NV which is incorporated in the Netherlands and is jointly owned by Fortis N.V., incorporated in the Netherlands and Fortis SA/NV, incorporated in Belgium.

Copies of the above accounts can be obtained from the Company Secretary, Fortis Insurance Limited, Fortis House, Tollgate, Eastleigh, Hants SO53 3YA.

### 31 Events after the balance sheet date

There were no material adjusting or non-adjusting events after the balance sheet date.

# FORTIS INSURANCE LIMITED

## Statement of Directors' Responsibilities in respect of the Directors' Report and the Financial Statements

The directors are responsible for preparing the directors' 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 they have elected to prepare the financial statements in accordance with IFRS as adopted by the EU.

The financial statements are required by law to present fairly the financial position and the performance of the company; the Companies Act 1985 provides in relation to such financial statements that references in the relevant part of that Act to financial statements giving a true and fair view are references to their achieving a fair presentation.

In preparing these financial statements, the directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgements and estimates that are reasonable and prudent;
- state whether they have been prepared in accordance with IFRS as adopted by the EU; and
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the company will continue in business.

The directors are responsible for keeping proper accounting records that disclose with reasonable accuracy at any time the financial position of the company and enable them to ensure that its financial statements comply with the Companies Act 1985. They have general responsibility for taking such steps as are reasonably open to them to safeguard the assets of the company and to prevent and detect fraud and other irregularities.

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

# FORTIS INSURANCE LIMITED

## Independent Auditor's Report to the Members of Fortis Insurance Limited

We have audited the financial statements of Fortis Insurance Limited for the year ended 31 December 2007 which comprise the income statement, the balance sheet, the cash flow statement, the statement of recognised income and expense and the related notes. These financial statements have been prepared under the accounting policies set out therein.

This report is made solely to the company's members, as a body, in accordance with section 235 of the Companies Act 1985. Our audit work has been undertaken so that we might state to the company's members those matters we are required to state to them in an 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**

The directors' responsibilities for preparing the financial statements in accordance with applicable law and International Financial Reporting Standards (IFRSs) as adopted by the EU are set out in the Statement of Directors' Responsibilities on page 48.

Our responsibility is to audit the financial statements in accordance with relevant legal and regulatory requirements and International Standards on Auditing (UK and Ireland).

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

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

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

### **Basis of audit opinion**

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

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

### **Opinion**

In our opinion the financial statements:

- give a true and fair view, in accordance with IFRS as adopted by the EU, of the state of the company's affairs as at 31 December 2007 and of its profit for the year then ended; and
- have been properly prepared in accordance with the Companies Act 1985.
- The information given in the Directors' Report is consistent with the financial statements.

**KPMG Audit Plc**  
Chartered Accountants  
Registered Auditor  
London

20 March 2008