

# CIS General Insurance Limited

## **Financial Statements 2007**

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CIS General Insurance Limited (CISGIL) was incorporated in September 2005 and capitalised on 15 January 2006 as part of the restructure of Co-operative Insurance Society Limited (CIS). CISGIL is an Industrial and Provident Society established to transact all new and renewing general insurance business formerly written by CIS. CISGIL has also assumed responsibility for the benefits and burdens arising from the run off of general insurance liabilities of CIS under the terms of an indemnification agreement.

### Highlights

The performance of CISGIL in 2007 was significantly better than in the previous year, despite the considerable costs arising from exceptional weather events during the first half of the year and has resulted in the first underwriting profit for General Insurance within the Group since 1994. The main driver for the improvement is claims management activities, including improved and faster claims settlements. In addition, considerable activity has taken place over the last two years designed to improve our underwriting and pricing. New rating engines and more modern products have been launched, coupled with improved payment systems resulting in lower levels of default. Claims performance has also been improved through stricter underwriting and the deliberate withdrawal from writing Motor "Any Driver" business.

	<b>2007</b>	2006	Change
	<b>£m</b>	£m	£m
Technical profit before exceptional weather events	<b>102.2</b>	23.7	78.5
Exceptional weather events	<b>(37.9)</b>	–	(37.9)
Operating profit	<b>64.3</b>	23.7	40.6
Gross written premiums	<b>412.8</b>	1,693.1	(1,280.3)
Effect of indemnification agreement	–	(1,221.7)	1,221.7
Gross written premiums (net of indemnification agreement)	<b>412.8</b>	471.4	(58.6)
Net earned premiums	<b>419.5</b>	1,442.3	(1,022.8)
Effect of indemnification agreement	–	(954.5)*	954.5*
Net earned premiums (net of indemnification agreement)	<b>419.5</b>	487.8*	(68.3)*
Claims ratio	<b>64.3%</b>	73.6%*	(9.3%)*
Commission & expense ratio (excluding non-recurring expenses)	<b>33.3%</b>	33.8%*	(0.5%)*
Combined ratio (excluding non-recurring expenses)	<b>97.6%</b>	107.4%*	(9.8%)*

\* Restated for classification changes

CISGIL is operating in a competitive marketplace, with aggregator sites taking a growing share of the market demonstrating consumers' increasing propensity to purchase insurance products over the web. During the year we have focused on developing a distribution strategy which enhances our ability to meet and react to these changes in customer buying habits and we have delivered an increase in sales through our direct channels.

This included launching the ecoinsurance motor product on the price comparison website Tesco Compare and confused.com and our home insurance product on confused.com which increases our presence in the fast growing aggregator market.

We launched a new system for customers using our Internet site to obtain a quote for a home or motor insurance policy. The new streamlined online form provides customers with a 'quick quote', which enables CFS to compete fairly with other market-leading insurers.

The new system will help to decrease the number of customers dropping out during the quote process and will ultimately lead to an increase in sales as more customers will have an opportunity to purchase. With the new 'quick quote' system in place, customers will experience a much-improved Internet service if they choose to take out CFS policies via the Internet.

General Insurance premiums earned in the period (net of reinsurance) fell to £419.5m, compared with £487.8m for 2006 (net of indemnification agreement). This reduction in business volumes is reflective of our changing distribution strategy, with a major shift towards our new direct channels, which we are continuing to grow coupled with a planned exit from higher risk and loss making segments of the portfolio, such as 'Any Driver' policies. The CFS-wide investment programme mentioned earlier includes far-reaching development of our general insurance capabilities in areas such as web technology and pricing flexibility.

We have also focused on improved product propositions including a new home insurance product, which gives customers greater flexibility when choosing the level of cover to suit their needs.

## Business and financial review

During 2006, we modernised our entire claims handling process, which has resulted in a significant improvement in the motor claims ratio in 2007. The improvements also enabled us to continue providing excellent service and assistance to customers when the processes were severely tested in 2007 with storms in January and exceptional flooding in June and July. The additional claims cost of £37.9m from the exceptional weather events was more than offset by the reduction in claims experience generated from the modernisation process and underwriting improvements.

Our commitment to providing excellent customer service and improving service levels has been demonstrated by our reaction to the recent floods and storms. We are committed to providing support to our customers and this included providing cash advances for urgent requirements and assisting those customers displaced by the floods in finding alternative accommodation until they could return to their own homes. We established a dedicated team of professional claims handlers to deal with all flood claims until they were settled, to expedite the settlement of claims as quickly as possible. We also utilised our extensive supply chain network to proactively manage claims and ensure they were settled as efficiently as possible. While every effort was taken to settle as many as claims as possible, unfortunately, due to the extent of damage caused to their homes, some 500 households were still in alternative accommodation over the Christmas period. As a consequence, Co-operative Insurance looked to bring a little Christmas cheer to those worst affected and made a payment of £100 to each household who were still in alternative accommodation.

The performance of the claims area was recognised as Co-operative Insurance was named as 'Customer Claims Champions for 2007' for motor claims. Our new Claims Fraud Management Strategy has begun to deliver real benefits, realising savings of more than £20 million during 2007.

The General Insurance claims ratio, despite the exceptional weather events, was 64.3%, a significant improvement of 9.3% compared to 2006 as the claims transformation initiatives continue to improve efficiency and customer service.

Further modernisation initiatives have targeted savings in operating costs, including commission charges and the expense ratio of 33.3% has decreased compared with 33.8% in 2006.

General Insurance customer satisfaction for December 2007 stands at 75.4%, an increase of 4.2% compared to December 2006 (71.2%).

### Investment in the future

On 20 July, CFS announced plans to improve its operational business performance for the benefit of its six million customers. This next stage of development will see investment of £250m being made in the business to support planned growth across the business. The investment plans include enhanced relationship products, a new web offering for general insurance, new technology for CFS financial advisers, a doubling in the number of corporate banking centres, significant new Partnership arrangements, people development, and further investment in our brand, which will be a key priority. Our proposed 2008 campaign will bring "Good With Money" to life at the heart of our brand. Progress made in 2007 as part of this programme is set out below.

In order to improve the return on this investment and to ensure it serves customers in the most cost effective way, CFS announced in July 2007 its plans to reduce annualised operational costs by £100m by the end of June 2008 and to reduce the workforce by approximately 1,000 during 2007. We have worked constructively with our trade unions to manage this change without impacting business performance and achieved the targeted reduction in roles through a combination of voluntary and compulsory redundancies, as well as the removal of a number of vacancies throughout the organisation.

People in our customer-facing roles, specifically those who service or sell to our customers by telephone, financial advisers and customer-facing advisers within bank branches, have been unaffected by these changes. The benefits of the reduced cost base will be shared between CFS' operating entities.

The extensive restructuring and modernisation of the business has necessitated substantial investment resulting in significant items of £29.5m in 2007.

2006 significant items relate to the CIS modernisation programme of £13.0m and £4.0m gain on implementation of the Co-operative Group PACE pension scheme.

After taking account of significant items, the General Insurance profit before tax was £34.1m compared to £13.9m in 2006.

### Summary and outlook

CISGIL, as a significant element of CFS, has seen in 2007 the early impact on our performance of the change programme, including more web sales and better targeted marketing. In 2007 CFS showed its determination to tackle its cost base. The underlying outcome of what was a year of change and market upheaval is that our business is now showing clear signs of progress towards our vision of becoming the UK's most admired financial services business.

The Society's key performance indicators are derived from the success measures on the CFS Group's journey towards our aspirational vision "to be the UK's most admired financial services business" and the performance criteria in staff and Executive incentive schemes.

### 1. Profit generation to create a sustainable model

The key financial performance measure is profitability. Additional supplementary measures are general insurance claims ratio and expense ratio.

Profitability is defined as profit before significant items and tax and is the key financial performance measure in the Group.

Claims ratio is calculated as net claims incurred divided by net earned premium.

Combined ratio is the ratio of net claims incurred, commission and expenses to net earned premium.

### 2. Market leading colleague satisfaction

We measure Colleague Satisfaction using a core set of questions via our annual survey of all colleagues, called the ECHO survey (Every Colleague Has Opinions).

These questions measure three key elements of colleague opinion:

- Emotional attachment to the organisation.
- Willingness to stay with the organisation.
- Discretionary effort – how much colleagues are motivated to go beyond their normal duties to help the organisation achieve its aims.

Sometimes known as "Say, Stay and Strive", these are standard measures used across many businesses and organisations to measure engagement. They have two clear advantages as key people measures. Firstly, because they are used generally across many other organisations, we can easily benchmark our organisation's performance in engaging colleagues against others. Secondly, they measure outcomes within an organisational culture, such as pride and advocacy. They are, therefore, very difficult to influence by specific or short-term activities – for example, if response rates were used, this could be incentivised in some areas, skewing the figures.

The score for Colleague Engagement is determined by reviewing the responses to the engagement questions asked in the ECHO survey. The average proportion of favourable responses (eg "Agree" or "Strongly Agree") across the whole of the organisation provides our Engagement Index, which was 52% in 2007. Our strategic target is to improve this figure year on year until we reach the High Performance Norm level of 73% by 2010/11.

### 3. Market leading customer satisfaction

Our current measurement of overall customer satisfaction is derived from GFK NOP's syndicated Financial Research Survey (FRS). The FRS is the largest survey in the marketplace (with 60,000 Financial Services customers interviewed each year).

Customers register their satisfaction levels with their providers at product level on a seven point scale – Extremely, Very, Fairly, Neither/Nor, Fairly Dissatisfied, Very Dissatisfied, Extremely Dissatisfied. Product level scores (based on Extremely & Very Satisfied responses) are then weighted by customer numbers to produce Business Unit level scores and an overall measure for CFS. To ensure a statistically robust sample per CFS product area and to even out any seasonal variations in scores a rolling 12 month's worth of data is used.

General Insurance has a continued trend of improvement maintaining a gap ahead of the market (Top Five by Market Share) with a score of 75.4% compared to the market of 70.7%.

Our ultimate aim is to have the UK's most satisfied customers.

### 4. Market leading social responsibility approach

In 2007 CISGIL (as part of the overall CFS Group) measured its progress towards its goal of a market leading social responsibility approach using the following three indicators. Two of the three targets set for attainment in 2007 have been achieved, and one has been partially achieved.

The first indicator looks at unprompted public awareness of the Bank and Co-operative Insurance as financial services businesses that take social responsibility into account. This measure derives from an independent survey of 1,000 members of the general public, which, in 2007, was undertaken in February. Targets set for 2007 sought a number one ranking for the Bank and number two ranking for Co-operative Insurance. Against these, the Bank retained the number one ranking, with a score of 11% (2006: 12%), and Co-operative Insurance fell to number three, recording unprompted awareness of 3% (2006: 6%). In 2008, the Bank is seeking to maintain its position, whilst Co-operative Insurance is seeking to regain its number two positioning.

## Key performance indicators

The second and third indicators look at performance in Business in the Community's Corporate Responsibility Index and Environment Index. The indexes are voluntary self-assessment surveys that benchmark Corporate Responsibility and Environmental strategy (and their integration), management, reporting and performance across a range of issues. The 2007 targets were to seek a Platinum (leading group) ranking for Co-operative Financial Services by achieving a score of 95% or more in both indexes. In the Corporate Responsibility Index 2006, which was published in May 2007, Co-operative Financial Services achieved a Platinum Group ranking, attaining a score of 98% and emerging as a sector leader. In the Environment Index, Co-operative Financial Services achieved a Platinum ranking, attaining a score of 99.79%. In 2008, CFS will be seeking to maintain its Platinum rankings in both indexes by achieving a score of 95% or above.

### **5. Membership growth**

CISGIL, as part of the Co-operative Group, is ultimately jointly owned and democratically controlled by its members. Members of The Co-operative enjoy a share in the profits and can exercise their democratic control, with equal rights and benefits. The importance of growing a strong and committed membership base is integral to our vision and beliefs and is an integral part of our Brand. Growing engagement with our customers via Membership is a key element in delivering Competitive Advantage and Social Goals.

Whilst we are committed to growing our membership base, we recognise the importance of ensuring that our members are engaged with The Co-operative. True engagement will be reflected in both transactional and democratic participation. The focus for 2008 is therefore to drive active engagement from our members. This will be demonstrated by increasing participation rates across the diverse range of businesses offered by the Co-operative Group, so that individual members transact with multiple businesses. Inevitably, this type of activity will also attract new members.

# CIS General Insurance Limited

## Non-Executive Directors:

- Simon Butler** Age 53. Occupation – Photographer. Chair of CIS General Insurance Limited and Co-operative Insurance Society Limited. Member of the Co-operative Group Central & Eastern Regional Board. Non-Executive Director of Co-operative Group Limited, Co-operative Financial Services Limited and The Co-operative Bank p.l.c. First appointed to the CISGIL Board in 2005.
- Graham Bennett** Age 57. Occupation – Chief Executive Officer and Secretary, Southern Co-operatives, Chair of The Co-operative Bank p.l.c. Non-Executive Director of Co-operative Group Limited, Co-operative Financial Services Limited and Co-operative Insurance Society Limited. First appointed to the CISGIL Board in 2005.
- Bob Burlton** Age 59. Occupation – Strategic Projects Executive, The Midcounties Co-operative. Chair of Co-operative Financial Services Limited. Non-Executive Director of Co-operative Insurance Society Limited and The Co-operative Bank p.l.c. First appointed to the CISGIL Board in 2005.
- David Davies** Age 60. Senior Independent Director. Occupation – Independent Professional Non-Executive Director. Holds this position on the Boards of Co-operative Financial Services Limited, Co-operative Insurance Society Limited and The Co-operative Bank p.l.c. He is Chair of Sun Life Assurance Company of Canada (UK) Limited and Hermes Fund Managers Limited. First appointed to the CISGIL Board in 2005.
- Paul Hewitt** Age 52. Occupation – Professional Non-Executive Director. Holds this position on the Boards of Co-operative Financial Services Limited, Co-operative Insurance Society Limited and The Co-operative Bank p.l.c. and a number of organisations not connected with the Co-operative Group. Previously Deputy Chief Executive of Co-operative Group Limited. First appointed to the CISGIL Board in 2005.
- Terry Morton** Age 62. Occupation – Managing Secretary, Durham Alliance for Community Care. Chair of the Co-operative Group North Eastern & Cumbrian Regional Board. Non-Executive Director of Co-operative Group Limited, Co-operative Financial Services Limited, Co-operative Insurance Society Limited and The Co-operative Bank p.l.c. First appointed to the CISGIL Board in 2005.
- Robert Newton** Age 58. Occupation – Independent Professional Non-Executive Director. Holds this position on the Boards of Co-operative Financial Services Limited, Co-operative Insurance Society Limited and The Co-operative Bank p.l.c. First appointed to the CISGIL Board in 2007.
- Kathryn Smith** Age 48. Occupation – Public Relations Consultant. Member of the Co-operative Group South East Regional Board. Non-Executive Director of Co-operative Group Limited, Co-operative Financial Services Limited, Co-operative Insurance Society Limited and The Co-operative Bank p.l.c. First appointed to the CISGIL Board in 2006.
- Graham Stow** Age 63. Occupation – Independent Professional Non-Executive Director. Holds this position on the Boards of Co-operative Financial Services Limited, Co-operative Insurance Society Limited and The Co-operative Bank p.l.c. Chair of the Audit and Regulatory Compliance Committee and a member of the Co-operative Group Food Retail Board. Previously Group Chief Executive of Britannia Building Society from 1999 until 2003. First appointed to the CISGIL Board in 2005.
- Len Wardle** Age 63. Occupation – University Fellow. Member of the Co-operative Group South East Regional Board. Chair of Co-operative Group Limited. Non-Executive Director of Co-operative Financial Services Limited, Co-operative Insurance Society Limited and The Co-operative Bank p.l.c. First appointed to the CISGIL Board in 2005.
- Martyn Wates** Age 41. Occupation – Chief Financial Officer, Co-operative Group Limited. Non-Executive Director of Co-operative Financial Services Limited, Co-operative Insurance Society Limited and The Co-operative Bank p.l.c. First appointed to the CISGIL Board in 2007.
- Stephen Watts** Age 56. Occupation – Business Studies Lecturer. Member of the Co-operative Group Central & Eastern Regional Board. Non-Executive Director of Co-operative Group Limited, Co-operative Financial Services Limited, Co-operative Insurance Society Limited and The Co-operative Bank p.l.c. First appointed to the CISGIL Board in 2005.
- Piers Williamson** Age 46. Occupation – Chief Executive, The Housing Finance Corporation. Independent Professional Non-Executive Director. Holds this position on the Boards of Co-operative Financial Services Limited, Co-operative Insurance Society Limited and The Co-operative Bank p.l.c. First appointed to the CISGIL Board in 2005.

## Executive Directors:

- David Anderson** Age 52. Chief Executive. Also Chief Executive of Co-operative Financial Services Limited, Co-operative Insurance Society Limited and The Co-operative Bank p.l.c. First appointed to the CISGIL Board in 2005.
- Stephan Pater** Age 56. Chief Operating Officer. Also Executive Director of Co-operative Financial Services Limited, Co-operative Insurance Society Limited and The Co-operative Bank p.l.c. First appointed to the CISGIL Board in 2006.
- John Reizenstein** Age 51. Chief Financial Officer during the year. Also Executive Director of Co-operative Financial Services Limited, Co-operative Insurance Society Limited and The Co-operative Bank p.l.c. First appointed to the CISGIL Board in 2005.

# Report of the Board of Directors

## Business review

CIS General Insurance Limited (CISGIL) was incorporated on 29 September 2005 to transact general insurance business formerly transacted by CIS, a fellow subsidiary society forming part of the CFS Group. CISGIL commenced trading on 15 January 2006 following a restructuring of the Group. A full Business Review of the development and performance of CISGIL during the 2007 financial year and any significant events since the year end, are set out on pages 1 and 2 of this report. The key financial and non-financial performance indicators adopted by CISGIL are described on pages 3 and 4. The principal risks and uncertainties facing CISGIL are set out on pages 17 to 23.

## Principal activities

The principal activity of CISGIL is the provision of general insurance business.

## Changes to the board

The names of the present members of the Board and their biographies and details of length of service are set out on page 5. Robert Newton was appointed to the Board with effect from 1 August 2007. Tony Lancaster resigned from the Board on 13 June 2007. Martin Beaumont resigned on 31 July 2007 and Craig Shannon resigned on 20 August 2007.

## Election of Directors

The Directors of the Board are elected by the members in accordance with the Rules of the Society.

## Results and distributions

General insurance gross written premiums were £412.8m (2006: £1,693.1m including £1,221.7m from CIS, a fellow subsidiary society forming part of the CFS Group). The 2006 premium from CIS covers the reinsurance by CISGIL, under the terms of an indemnification agreement, of all liabilities arising from the run off of general insurance business previously written by CIS. Net earned premiums were £419.5m (2006: £1,442.3m).

After making provision for premium rebates to co-operative societies, profits of £24.2m (2006: £7.6m) have been transferred to reserves.

No interim dividend was paid during 2007 (2006: £nil). The Directors recommend the payment of a final dividend of £41.0m on 30 May 2008.

## Directors and their interests

No Director had a material interest at any time during the year in any contract of significance with CISGIL.

## Staff

The Society does not have any employees. All sales are effected through financial advisers and staff of CFS Management Services Limited (CFSMS), a fellow subsidiary of the CFS Group, which also provides administrative and other services. A management charge is payable to cover the costs of these services.

## Corporate responsibility and the environment

The CFS Sustainability Report, which will be published towards the latter half of the financial year, describes how CFS, CIS, CISGIL and the Bank manage their social, ethical and environmental impacts.

## Political and charitable donations

CISGIL is not directly responsible for the making of charitable donations; this would be undertaken by CFSMS. CISGIL contributes to the cost through the recharge of costs and services provided by CFSMS.

It is the policy of CISGIL and CFSMS that no donations are made for political purposes.

## Supplier payment policy and practice

All supplies and services are sourced through CFSMS. A management charge is payable to cover the costs of these services.

## Statement of Directors' responsibilities in respect of the Directors' report and the financial statements

The Directors are responsible for preparing the Annual Report and CISGIL's financial statements in accordance with applicable law and regulations.

Industrial and Provident Society Law, as modified by the Insurance Accounts Directive (Miscellaneous Insurance Undertakings) Regulations 1993 (the Regulations), requires the Directors to prepare financial statements for each financial year. In accordance with the Regulations the Directors have elected to prepare CISGIL's financial statements in accordance with IFRS as adopted by the EU.

CISGIL's financial statements are required by law and IFRS as adopted by the EU to present fairly the financial position of CISGIL and the performance for that period. The Regulations, which apply the provisions of Part VII of the Companies Act 1985, provide in relation to such financial statements that references in the relevant part of the Regulations to financial statements giving a true and fair view are references to their achieving a fair presentation.

In preparing CISGIL's 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 CISGIL 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 CISGIL and enable them to ensure that its financial statements comply with the Insurance Accounts Directive (Miscellaneous Insurance Undertakings) Regulations 1993, which modified the Industrial and Provident Societies Acts 1965 to 2003. They have general responsibility for taking such steps as are reasonably open to them to safeguard the assets of the CISGIL and to prevent and detect fraud and other irregularities. Under applicable law, the Directors are also responsible for preparing a Directors' Report that complies with the Insurance Accounts Directive (Miscellaneous Insurance Undertakings) Regulations 1993, which modified the Industrial and Provident Societies Acts 1965 to 2003.

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

### **Financial statements**

So far as the Directors are aware, there is no relevant information that has not been disclosed to CISGIL's auditors and the Directors believe that all steps have been taken that ought to have been taken to make them aware of any relevant audit information and to establish that CISGIL's auditors have been made aware of that information. A statement by the Directors as to their responsibilities for preparing the financial statements is included in the statement of Directors' responsibilities.

### **Statement on going concern**

After making all appropriate enquiries, the Directors have a reasonable expectation that CISGIL has adequate resources to continue in operational existence for the foreseeable future. For this reason, they continue to adopt the going concern basis in preparing CISGIL's financial statements.

### **Auditor**

In accordance with Section 5 of the Friendly and Industrial and Provident Societies Act 1968, a resolution for the re-appointment of KPMG Audit Plc as auditor of CISGIL and a resolution to authorise the Directors to fix their remuneration are to be proposed at the next Annual General Meeting.

By Order of the Board

Moira Lees, Secretary  
1 April 2008

## Independent auditors' report

### **Independent auditors' report to the members of CIS General Insurance Limited (the Society)**

We have audited the financial statements of the Society for the 52 week period ended 12th January 2008 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 Society's members, as a body, in accordance with the Insurance Accounts Directive (Miscellaneous Insurance Undertakings) Regulations 1993, which modified the Industrial and Provident Societies Acts 1965 to 2003. Our audit work has been undertaken so that we might state to the Society'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 Society and its members, as a body, for our audit work, for this report, or for the opinions we have formed.

### **Respective responsibilities of Directors and auditors**

As described in the statement of Directors' responsibilities on pages 6 and 7, the Society's Directors are responsible for the preparation of the Annual Report and the financial statements in accordance with applicable law and International Financial Reporting Standards (IFRS) as adopted by the EU.

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

We report to you our opinion as to whether the financial statements give a true and fair view and are properly prepared in accordance with the Insurance Accounts Directive (Miscellaneous Insurance Undertakings) Regulations 1993, which modified the Industrial and Provident Societies Acts 1965 to 2003. We also report to you if, in our opinion, the Directors' report is not consistent with the financial statements, if the Society has not kept proper accounting records or if we have not received all the information and explanations we require for our audit.

We read the other information contained in the Annual Report and consider whether it is consistent with the audited financial statements. We consider the implications for our report if we become aware of any apparent mis-statements or material inconsistencies with the financial statements. Our responsibilities do not extend to any other information.

### **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 Society'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 mis-statement, 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 as applied in accordance with the provisions of the Insurance Accounts Directive (Miscellaneous Insurance Undertakings) Regulations 1993, which apply the provisions of Part VII of the Companies Act 1985, of the state of the Society's affairs as at 12 January 2008 and of its profit for the 52 week period then ended;
- the financial statements have been properly prepared in accordance with the Insurance Accounts Directive (Miscellaneous Insurance Undertakings) Regulations 1993, which modified the Industrial and Provident Societies Acts 1965 to 2003; and
- the information given in the Directors' report is consistent with the financial statements.

KPMG Audit Plc  
Chartered Accountants  
Registered Auditor  
Manchester

1 April 2008

# Income statement

For the year ended 12 January 2008

All amounts are stated in £m unless otherwise indicated

	Notes	52 weeks ended 12 January 2008			68 weeks ended 13 January 2007*		
		Before significant items	Significant items	After significant items	Before significant items	Significant items	After significant items
<b>Income</b>							
Gross earned premiums		<b>436.6</b>	–	<b>436.6</b>	1,468.9	–	1,468.9
Less premiums ceded to reinsurers		<b>(17.1)</b>	–	<b>(17.1)</b>	(26.6)	–	(26.6)
<b>Net earned premiums</b>	2	<b>419.5</b>	–	<b>419.5</b>	1,442.3	–	1,442.3
Fee and commission income	3	<b>0.4</b>	–	<b>0.4</b>	2.0	–	2.0
Investment income	4	<b>61.4</b>	–	<b>61.4</b>	61.9	–	61.9
Gains less losses arising from financial and other assets	5	<b>(1.4)</b>	–	<b>(1.4)</b>	(2.6)	–	(2.6)
Other operating income	6	<b>0.1</b>	–	<b>0.1</b>	3.0	–	3.0
<b>Net income</b>		<b>480.0</b>	–	<b>480.0</b>	1,506.6	–	1,506.6
<b>Benefits, losses and expenses</b>							
Claims paid and benefits		<b>(421.7)</b>	–	<b>(421.7)</b>	(470.8)	–	(470.8)
Less amounts receivable from reinsurers		<b>5.6</b>	–	<b>5.6</b>	0.4	–	0.4
<b>Net policyholder claims paid and benefits</b>	7	<b>(416.1)</b>	–	<b>(416.1)</b>	(470.4)	–	(470.4)
Change in insurance contract liabilities	19	<b>141.8</b>	–	<b>141.8</b>	(847.7)	–	(847.7)
Change in reinsurance assets	19	<b>4.6</b>	–	<b>4.6</b>	4.6	–	4.6
<b>Net policyholder claims and benefits incurred</b>		<b>(269.7)</b>	–	<b>(269.7)</b>	(1,313.5)	–	(1,313.5)
Fees and commissions	8	<b>(12.5)</b>	–	<b>(12.5)</b>	(22.3)	–	(22.3)
Operating expenses	9	<b>(127.3)</b>	<b>(29.5)</b>	<b>(156.8)</b>	(142.7)	(9.0)	(151.7)
Finance costs		<b>(6.2)</b>	–	<b>(6.2)</b>	(4.4)	–	(4.4)
<b>Operating profit before profit based payments</b>		<b>64.3</b>	<b>(29.5)</b>	<b>34.8</b>	23.7	(9.0)	14.7
Profit based payments to individual members of the Co-operative Group		<b>(0.7)</b>	–	<b>(0.7)</b>	(0.8)	–	(0.8)
<b>Operating profit before income tax</b>		<b>63.6</b>	<b>(29.5)</b>	<b>34.1</b>	22.9	(9.0)	13.9
Income tax expense	10	<b>(18.8)</b>	<b>8.9</b>	<b>(9.9)</b>	(10.1)	3.8	(6.3)
<b>Profit for the financial period</b>		<b>44.8</b>	<b>(20.6)</b>	<b>24.2</b>	12.8	(5.2)	7.6

Profits for the financial period are attributable to the equity holder of the parent.

2007 Significant items relate to non-recurring expenditure associated with a Group programme of restructuring.

2006 Significant items relate to non-recurring expenditure associated with a Group programme of restructuring and gains on implementation of PACE.

\*CISGIL commenced trading on 15 January 2006.

## Balance sheet

At 12 January 2008

All amounts are stated in £m unless otherwise indicated

		2007	2006
	Notes		
<b>Assets</b>			
Deferred acquisition cost	11	28.5	26.0
Reinsurance assets	19	12.0	7.6
Financial assets at fair value through profit or loss	12	115.9	99.8
Financial assets available for sale	13	1,076.0	1,164.1
Insurance receivables and other assets	14	206.5	223.2
Current tax	23	–	6.6
<b>Total assets</b>		<b>1,438.9</b>	<b>1,527.3</b>
<b>Capital and reserves attributable to the equity holders</b>			
Share capital	16	183.0	183.0
Retained earnings	17	(0.6)	(24.8)
Other reserves	17	117.3	107.7
<b>Total equity</b>		<b>299.7</b>	<b>265.9</b>
<b>Liabilities</b>			
Other borrowed funds	18	105.0	75.0
Insurance contract liabilities	19	959.8	1,135.1
Deferred tax	23	2.7	1.0
Current tax	23	11.8	–
Other provisions	20	1.0	4.0
Insurance and other payables	21	41.3	25.4
Other reinsurance liabilities	22	4.5	7.4
Overdrafts	15	13.1	13.5
<b>Total liabilities</b>		<b>1,139.2</b>	<b>1,261.4</b>
<b>Total equity and liabilities</b>		<b>1,438.9</b>	<b>1,527.3</b>

Approved by the Board on 1 April 2008 and signed on its behalf by:

*Simon Butler, Chair*

*David Anderson, Chief Executive*

*Moirá Lees, Secretary*

## Statement of recognised income and expense

For the year ended 12 January 2008

All amounts are stated in £m unless otherwise indicated

	Notes	2007	2006
Valuation gains/(losses) on available for sale investments taken to equity	17	<b>13.8</b>	(26.2)
Actuarial losses on employee benefits		–	(46.3)
Tax on items taken directly to statement of recognised income and expense		<b>(4.2)</b>	21.8
<b>Net income and expense recognised directly in equity</b>		<b>9.6</b>	(50.7)
Profit for the financial period		<b>24.2</b>	7.6
<b>Total recognised income and expense for the financial period</b>		<b>33.8</b>	(43.1)

The total recognised income and expense is attributable to the equity holder of the parent.

## Cash flow statement

For the year ended 12 January 2008

All amounts are stated in £m unless otherwise indicated

	2007	2006
<b>Cash flows from operating activities</b>		
Operating profit before income taxes	<b>34.1</b>	13.9
Adjustments for:		
– Interest payable	<b>6.2</b>	4.4
– Amortisation of investments	<b>6.3</b>	9.3
– Effect of non cash pension costs	–	(5.9)
Decrease/(Increase) in financial assets – available for sale	<b>95.6</b>	(1,199.5)
Increase in financial assets at fair value through profit or loss	<b>(16.1)</b>	(99.8)
Increase in deferred acquisition costs	<b>(2.5)</b>	(26.0)
Increase in reinsurance assets	<b>(4.4)</b>	(7.6)
Decrease/(Increase) in insurance receivables and other assets	<b>16.7</b>	(223.3)
Increase in employee benefit surplus acquired from related party	–	(40.4)
(Decrease)/Increase in insurance contract liabilities	<b>(175.3)</b>	1,135.1
(Decrease)/Increase in other provisions	<b>(3.0)</b>	4.0
Increase in insurance and other liabilities	<b>15.9</b>	25.4
(Decrease)/Increase in other reinsurance liabilities	<b>(2.9)</b>	7.4
Income tax recovered/(paid)	<b>6.0</b>	(0.1)
Settlement in respect of deferred tax liability from related party	–	10.0
<b>Net cash flows from operating activities</b>	<b>(23.4)</b>	(393.1)
<b>Net cash flows from investing activities</b>	–	–
<b>Cash flows from financing activities</b>		
Proceeds on issue of subordinated loan	<b>30.0</b>	75.0
Capital contributions	–	126.0
Issue of share capital	–	183.0
Interest paid	<b>(6.2)</b>	(4.4)
<b>Net cash flows from financing activities</b>	<b>23.8</b>	379.6
<b>Net increase/(decrease) in cash and cash equivalents</b>	<b>0.4</b>	(13.5)
Cash and cash equivalents at the beginning of the financial period	<b>(13.5)</b>	–
<b>Cash and cash equivalents at the end of the financial period</b>	<b>(13.1)</b>	(13.5)

### Cash flows from operating activities

CISGIL classifies the cash flows for the acquisition and disposal of financial assets as operating cash flows, as the purchases are funded from the cash flows associated with the origination of insurance contracts, net of the cash flows for payments of benefits and claims incurred for insurance contracts, which are respectively treated under operating activities.

Bank overdrafts are included within cash and cash equivalents for the purpose of the cash flow statement.

CISGIL is a co-operative society registered in England under the Industrial and Provident Societies Acts and not a company registered under the Companies Act. The financial statements were authorised for issue by the Directors on 1 April 2008. The insurance specific accounting policies are set out on pages 15 and 16.

### Statement of compliance

The financial statements have been prepared in accordance with the Insurance Accounts Directive (Miscellaneous Insurance Undertakings) Regulations 1993, which modified the Industrial and Provident Societies Acts 1965 to 2003. The Regulations require CISGIL to prepare its financial statements substantially as though it were a company registered under the Companies Act 1985 (the Act), and they apply, with certain exemptions, the provisions of Part VII of the Act.

The financial statements have been prepared and approved by the Directors in accordance with International Financial Reporting Standards (IFRS) adopted by the EU ("Adopted IFRS"). The financial statements also follow the provisions of the Revised Statement of Recommended Practice on Accounting for Insurance Business (SORP) issued by the Association of British Insurers in December 2005 insofar as these are compatible with the requirements of IFRS.

### Basis of preparation

The financial statements are prepared on the historical cost basis except that the following assets are stated at their fair value: derivative financial instruments, investments valued at fair value through profit or loss and investments designated as available for sale.

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

### Standards and interpretations issued but not yet effective

The Group has not adopted the following standard:

- IFRS 8 *Operating Segments*

This standard introduces the 'management approach' to segment reporting. IFRS 8 will require the disclosure of segment information based on the internal reports regularly reviewed by the Group's Chief Operating Decision Maker in order to assess each segment's performance and to allocate resources to them.

The Group is not expecting the standard to have an impact on the segmental information reported in the financial statements.

The amendments are effective for accounting periods on or after 1 January 2009.

### Accounting date

CISGIL was incorporated on 20 September 2005 and commenced trading with effect from 15 January 2006. The financial statements relate to 52 week period to 12 January 2008 (2006: 68 week period from incorporation to 13 January 2007). As the financial year is virtually coterminous with the calendar year 2007, figures in respect of the financial year are headed 2007 and comparatives are headed 2006.

#### (a) Segment reporting

Segment information is presented in respect of CISGIL business segments in line with CISGIL's management and internal reporting structure.

#### (b) Foreign currencies

The functional and presentational currency for CISGIL is sterling. Transactions in foreign currencies are translated 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 sterling at the foreign exchange rate ruling at that date. Foreign exchange differences arising on translation are recognised in the income statement. Non-monetary assets and liabilities denominated in foreign currencies that are stated at fair values are translated to sterling at the exchange rates ruling at the dates the values were determined.

#### (c) Financial instruments

##### i) Financial assets designated as available for sale

CISGIL classifies all holdings in debt securities as available for sale. Initial measurement is at fair value, being purchase price upon the date on which CISGIL commits to purchase plus directly attributable transaction costs. Subsequent valuation is at fair value with differences between fair value and carrying value recognised in equity as they arise. On disposal, gains or losses previously recognised in equity are transferred to the income statement.

##### ii) Financial assets at fair value through profit or loss

Investments, other than those in debt securities, are classified as financial assets at fair value through profit or loss. Initial measurement is at fair value being purchase price upon the date on which CISGIL commits to purchase. Directly attributable transaction costs are expensed immediately on recognition. Subsequent valuation is at fair value with changes in fair value being recognised within gains less losses within the income statement in the period in which they arise. On disposal, gains or losses (being proceeds less carrying amount) are recognised in gains and losses within the income statement.

## Basis of preparation and significant accounting policies

For the year ended 12 January 2008

### iii) Financial liabilities

Financial liabilities primarily represent borrowed funds. Initial measurement is at fair value being consideration received plus any directly attributable transaction costs. Subsequently financial liabilities are measured at amortised cost using the effective interest method.

### iv) Recognition of financial assets and financial liabilities

Financial assets and financial liabilities are recognised by CISGIL on the date upon which it commits to purchase or sell the instruments.

### v) Derecognition of financial assets and financial liabilities

A financial asset is derecognised when the right to receive cash flows from the asset have expired or transferred through the sale of the asset or a transfer of substantially all the risks and rewards and/or control of the financial asset has occurred.

A financial liability is derecognised when the obligation under the liability is discharged, cancelled or expired. When an existing liability is replaced by the same counterparty on substantially different terms or the terms of an existing liability are substantially modified, the original liability is derecognised and a new liability is recognised, with any difference in carrying amounts recognised in the income statement.

CISGIL operates approved stock lending schemes whereby its securities are loaned to other institutions in accordance with the terms of agreements with those institutions. Under these arrangements, ownership of the securities passes to the borrower but CISGIL has the right to demand the return of the loaned securities at any time. It also retains the right to receive the income to which it would have been entitled had the securities not been loaned. Accordingly, the securities continue to be recognised as investments in the balance sheet.

CISGIL also participates in sale and repurchase (repo) arrangements in connection with its portfolio of government guaranteed securities (gilts). Under these arrangements, CISGIL sells gilts but is contractually obliged to repurchase them at a fixed price on a fixed future date. Securities which are the subject of repo arrangements at the balance sheet date are included in investments at their bid value and the associated liability is recognised, being the capital amount owing under the repo arrangement.

CISGIL requires all stock lending and repo transactions to be fully collateralised in an agreed form for their duration and equivalent collateral is returned at the completion of the loan period. Authorised collateral for stock lending arrangements comprises DBV or certificates of deposit. For repo arrangements, collateral is required in the form of cash.

### (d) Cash and cash equivalents

Cash and cash equivalents comprise cash balances and call deposits of less than 90 days. Bank overdrafts that are repayable on demand and form an integral part of CISGIL's cash management are included as a component of cash and cash equivalents for the purpose of the cash flow statement.

### (e) Impairment

The carrying values of CISGIL's assets are reviewed at the balance sheet date to determine whether there is any indication of impairment. If impairment is indicated, the asset's recoverable amount (being the greater of fair value less cost to sell and value in use assessed by reference to discounted future cash flows) is estimated. An impairment loss is recognised in the income statement to the extent that the carrying value of an asset exceeds its recoverable amount.

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 of the asset's carrying amount that would have been determined, net of depreciation or amortisation, if no impairment loss had been recognised.

For debt securities designated as available for sale, any decline in fair value which is considered to reflect impairment would be recognised in the income statement (rather than directly in equity). Any subsequent reversal of this impairment would also be recognised in the income statement.

Impairment is not considered for those assets held at fair value through profit or loss.

### (f) Income tax

Tax on the profit or loss for the year comprises current and deferred tax which is recognised in the income statement except to the extent that it relates to items recognised directly in equity (in which case it is recognised in equity).

Deferred tax is provided for 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 tax purposes. The amount of deferred tax provided for 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.

Temporary differences arising from the initial recognition of assets or liabilities that affect neither accounting nor taxable profits are not provided for.

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

**(g) Employee benefits – pension obligations****Defined benefit basis**

On 15 January 2006, CISGIL assumed responsibility for a portion of the liability arising in connection with a defined benefit pension plan operated by CIS, a fellow subsidiary within the CFS Group. A defined benefit plan is a plan that defines an amount of pension benefit that employees will receive on retirement, usually dependent on one or more factors such as age, years of service and compensation.

CISGIL's net obligation in respect of the defined benefit plan was calculated by estimating the amount of future benefit that employees have earned in return for their service in current and prior periods. That benefit was discounted to determine the present value and the fair value of any plan assets was deducted. The discount rate used represented the yield at the balance sheet date on AAA credit rated bonds that have maturity dates approximating the duration profile of CISGIL's obligations. The calculation was determined by a qualified actuary using the projected unit method.

Actuarial gains and losses are recognised in the period in which they occur outside the income statement and presented in the statement of recognised income and expense.

**Defined contribution basis**

Subsequent to 5 April 2006 CISGIL has accounted for pension costs on a defined contribution basis. Obligations for contributions are borne by CFSMS, a fellow subsidiary within CFS Group, and recharged to other Group companies as part of management recharges. The cost is recognised in the income statement as incurred.

**(h) Provisions**

A provision is recognised in the balance sheet if CISGIL has a legal or constructive obligation as a result of a past event 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.

**(i) Revenue recognition**

Revenue principally comprises:

*Premium income from insurance contracts*

CISGIL's accounting policy in respect of revenue arising from insurance contracts is set out within the insurance specific accounting policies.

*Fee and commission income*

Fees and commission received relate primarily to commission on outward reinsurance contracts and are earned over the lifetime of the related policy.

*Investment income*

Interest income on assets designated as available for sale is recognised in the income statement based upon an effective yield over the life of the asset inclusive of any discount/premium on purchase. Interest income on assets designated as fair value through profit and loss is recognised in the income statement as it accrues on an effective interest basis.

**(j) Borrowed funds**

Borrowings are recognised initially at issue proceeds and are subsequently stated at amortised cost; any difference between proceeds and redemption value is recognised in the income statement over the period of the borrowing using the effective interest method.

**(k) Insurance accounting policies****Classification of contracts**

Contracts under which CISGIL 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.

**General insurance business**

All contracts of general insurance business are classified as insurance contracts. General insurance business is accounted for on an annual basis.

**(i) Premiums**

Gross premiums written comprise premiums receivable on those contracts which inceptioned during the financial year, irrespective of whether they relate in whole or in part to a later accounting period, together with any necessary adjustments to amounts reported in prior periods.

Gross premiums written:

- are stated gross of commission and exclude any taxes or levies based on premiums; and
- include an estimate of the premiums receivable on those contracts which inceptioned prior to the year end but which have not been notified by the balance sheet date ('pipeline premium'). When calculating pipeline premiums it is assumed, where appropriate, that options to renew contracts automatically will be exercised.

## Basis of preparation and significant accounting policies

For the year ended 12 January 2008

Written premium is earned evenly over the period of the contract (usually 12 months). The treatment of outward reinsurance premiums is analogous to gross premiums written.

### (ii) Unearned premium provision

For general insurance business, the proportion of written premiums relating to periods of risk beyond the year end is carried forward to future accounting periods. The relevant proportion is calculated, for the overwhelming majority of contracts, using the daily pro-rata basis with the remainder being determined according to the risk profile of the business.

Outward reinsurance premiums are treated as earned in accordance with the profile of the reinsured contracts.

### (iii) Claims

Claims paid are stated net of salvage and subrogation recoveries.

### (iv) Claims outstanding

Claims outstanding comprise provisions representing the estimated ultimate cost of settling:

- claims notified but not settled by the balance sheet date ('outstanding claims'); and
- claims incurred as a result of events prior to the balance sheet date but not notified as at that date ('IBNR' claims).

Claims provisions include attributable claims handling expenses and are set at a level such that no adverse run-off deviations are envisaged. Adverse run-off deviations, which are material in the context of the business as a whole, would be separately disclosed.

Anticipated reinsurance recoveries and estimates of salvage and subrogation recoveries are disclosed separately within assets under the headings of 'reinsurance assets' and 'insurance receivables and other assets' respectively.

### (v) Unexpired risk provision

Additional provision is made for unexpired risks where the claims and expenses likely to arise after the end of the financial year in respect of contracts concluded before that date are expected to exceed the unearned premiums carried forward for those contracts. Provision for unexpired risks is calculated separately for categories of business managed together and is determined after taking account of future investment income. Such provisions ensure that the carrying amount of unearned premiums provision less related deferred acquisition costs is sufficient to cover the current estimated future cash flows including claims handling expenses and therefore meets the minimum requirements of the liability adequacy test as set out in IFRS 4 *Insurance Contracts*.

### (vi) Acquisition costs

Costs directly associated with the acquisition of new business including commission payable are capitalised and amortised in accordance with the rate at which the gross premiums written associated with the underlying contract are earned.

The Society issues contracts that transfer insurance risk and is exposed to financial risk through its holdings of financial assets and liabilities. This section summarises these risks and the way CISGIL manages them.

**Our approach to risk management**

CISGIL operates in regulated markets and is subject to significant government regulation.

The CFS group of companies including Co-operative Financial Services Limited, Co-operative Insurance Society Limited, CIS General Insurance Limited and The Co-operative Bank p.l.c. have a common Board composition.

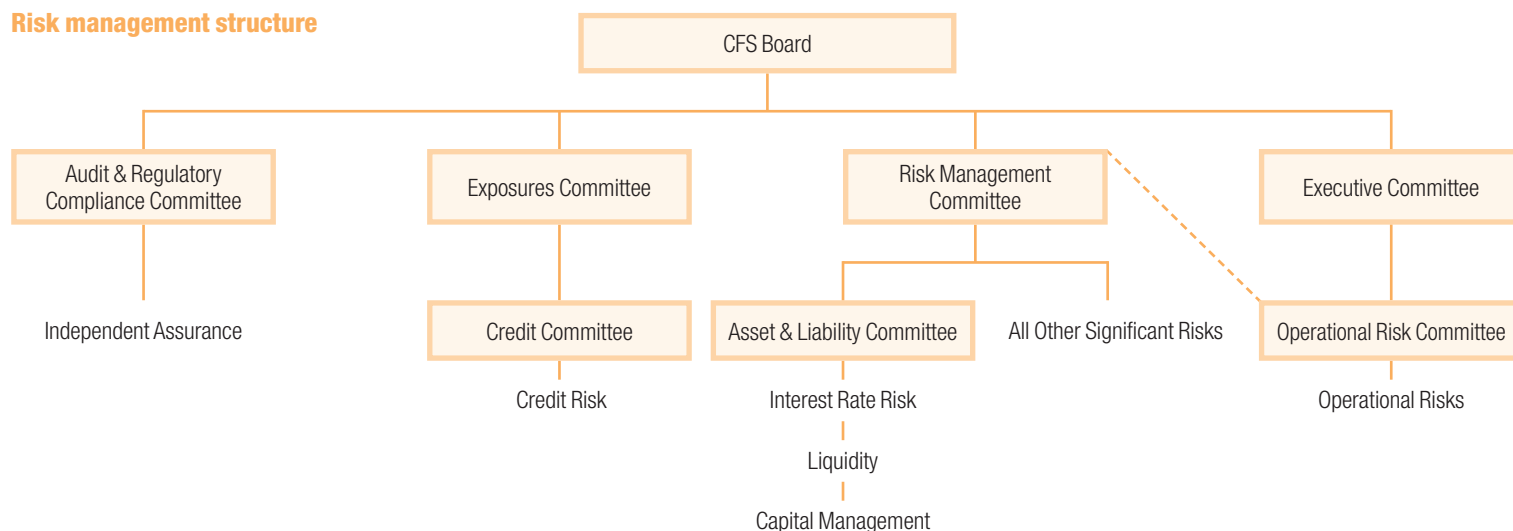
The Board sub-committees also work on a CFS-wide basis, with the same committee structure supporting each Board within the CFS group.

The CFS Board has ultimate responsibility for the management of all risks across CFS.

The Board is responsible for approving the Bank’s strategy, its principal markets and the level of acceptable risks articulated through its statement of risk appetite. It is also responsible for overall corporate governance which includes ensuring that there is an adequate system of risk management and that the level of capital held is consistent with the risk profile of the business.

The Board has established Board Committees and Senior Management Committees to administer, oversee and challenge the risk management process, identifying the key risks facing the business and assessing the effectiveness of planned management actions. Specific Board authority has been delegated to Board Committees and the Chief Executive who may, in turn, delegate elements of his discretions to appropriate Executive Directors and their senior line managers.

**Risk management structure**



**CFS Risk Management Committee (RMC):** this committee is the most senior forum within the organisation that focuses in depth on risk management activity. It reviews and challenges risk management information and processes, approving risk policy and credit models and setting standards.

**CFS Audit & Regulatory Compliance Committee (ARCC):** this committee provides independent oversight in relation to financial reporting; internal control and risk management; regulatory compliance; external audit and internal audit.

**CFS Exposures Committee:** this committee ensures that Non-Executive Directors are actively involved in major credit decisions (including sanctioning large counterparty transactions) and monitoring large exposures.

**CFS Credit Committee:** this committee is chaired by the Director of Banking Risk and Capital Management. The Chair has delegated authority for approving credit facilities within approved strategies and delegated authorities.

**CFS Shareholder Asset & Liability Committee (ALCO):** this committee is chaired by the Chief Executive. It is primarily responsible for overseeing the management of interest rate, market, liquidity and funding risks and to advise on the composition and sourcing of adequate capital.

**CFS Executive Committee:** this committee manages the business in line with the Board Risk Appetite Statement. It also maintains oversight of risk management processes and management information.

**CFS Operational Risk Committee:** this committee is chaired by the Head of Operational Risk. It monitors significant operational risks and controls as well as the management actions taken to mitigate them to an acceptable level and/or transfer them. This includes business continuity arrangements and insurance cover to protect the CFS business. Each division within CFS is represented on the committee.

## Risk management

All amounts are stated in £m unless otherwise indicated

### **(a) Insurance risk**

The risk under any one insurance contract is the possibility that the insured event occurs and the uncertainty of the amount of the resulting claim. By the very nature of an insurance contract, this risk is random and therefore unpredictable.

The principal risk that CISGIL faces under its insurance contracts is that the actual claims and benefit payments exceed the carrying amount of the insurance liabilities. This could occur because the frequency or severity of claims and benefits are greater than estimated. Insurance events are random and the actual number and amounts of claims and benefits will vary from year to year from the estimates established.

### **Principal risks covered**

The major classes of general insurance business written are motor and property, together with some liability, pecuniary loss and personal accident risks. Almost all risks under general insurance policies cover a 12 month duration and all risks directly underwritten are confined to the UK market.

Motor cover provided is principally in respect of private vehicles or to small businesses, with limited underwriting of fleet business. Principal risks under motor policies are bodily injury to third parties, accidental damage to property including policyholders' and third parties' vehicles and theft of or from policyholders' vehicles.

Property cover is predominately household with some commercial property business. Principal risks under property policies are damage to domestic and commercial properties from storm and flood, fire, escape of water and subsidence and theft of or accident damage to contents.

CISGIL has entered into an indemnification agreement with CIS, a fellow subsidiary within the CFS Group, to assume financial responsibility for the run-off of general insurance business formerly written by CIS. In return CISGIL has received a premium, settled by transfer of assets, equivalent to the net technical liabilities of this business included in CIS' financial statements at 2005 year end. This exposes CISGIL to the risk of these assets being insufficient to cover the claims arising from this business.

### **Frequency and severity of claims**

The frequency and severity of property claims can be affected by several factors, the most significant being weather events. In addition, there is a possibility of a very large individual commercial property claim arising from fire and/or consequential loss. The most significant factors affecting the frequency and severity of motor claims are judicial, legislative and inflationary changes.

### **Risk management objectives and strategy**

CISGIL's objective in managing general insurance risk is to ensure that insurance risks are understood and accepted in accordance with its documented underwriting policy and that policy pricing appropriately reflects the underlying risk. General insurance risk is managed through the underwriting strategy, reinsurance arrangements, proactive claims handling and the claims provisioning process.

The underwriting strategy attempts to ensure that the underwritten risks are well diversified in terms of type and amount of risk, industry/demographic profile and geography and only those risks which conform with underwriting criteria are accepted. Exposure mix and the frequency and average costs of claims are monitored throughout the year and where significant deviations from expectation are identified remedial action is taken. A programme of reinsurance is in place which sets retention levels in accordance with the risk appetite of the business.

The overriding objective in claims handling is to ensure all claims are properly scrutinised and paid where they fall within the terms and conditions of the policy. The proper scrutiny of claims is facilitated by the use of various technical aids such as a pricing database, weather validation and fraud databases and the use of claims specialists.

The basis for assessing claims provisions is set out in note 19.

### **Concentration of risk**

The bias of the portfolio towards personal contracts reduces the risk of large single losses and there is no significant concentration of risk in any geographical area of the UK. Excess of loss reinsurance cover is used to mitigate losses from individual large claims, particularly large commercial losses.

Statistical modelling with specialised software is produced to assess CISGIL's exposure to natural hazards such as windstorm and flood events, including a large east coast flood, which would significantly affect the property portfolio. Weather event catastrophe reinsurance cover is the most important component of the reinsurance programme and is set to restrict losses from a single event to exposure equivalent to a 1 in 8 year likelihood for events up to 1 in 150 expected occurrence.

### **Sources of uncertainty in the estimation of future benefit payments and premium receipts**

The nature of insurance contracts is that the obligations of the insurer are uncertain as to the timing or quantum of liabilities arising from contracts. CISGIL takes all reasonable steps to ensure that it has appropriate information regarding its claims exposures. However, given the uncertainty in establishing claims provisions, it is likely that the final outcome will prove to be different from the original liability established.

Uncertainty over the timing of claims relates to liabilities which have occurred but are not yet reported (IBNR) and the interval between claim notification and settlement. Recognised statistical methods are used to assess both the number of claims which are likely to be notified after the balance sheet date but which occurred prior to that date and the expected period to settlement. Bodily injury claims and associated legal costs, which are a significant element of outstanding claims on the motor and liability accounts, have a longer period to settlement, potentially several years. There is a higher degree of uncertainty associated with these long tail claims than property damage claims which are settled more quickly. By their nature, the statistical methods used to assess both IBNR claim numbers and the average duration to settlement rely, to some extent, on past patterns of claims being repeated in future.

In terms of monetary values placed on claims liabilities, uncertainty arises from a number of sources. Inflation assumptions, to which long tail claims are sensitive, are set with regard to current conditions and expectations for economic influences relevant to the claim type but future experience may diverge. Bodily injury claims in particular are sensitive to changes in the legislative and regulatory environments where court decisions, guidance from the Lord Chancellor or statutory changes can affect unsettled liabilities.

In addition to cost inflation and other external factors referred to above, the amount and timing of claim payments will be affected by changes in the organisation's claims handling processes. The claims handling function is currently undergoing significant change in terms of the service proposition and the claims processes. As a result, claims data patterns are being affected, leading to greater uncertainty in interpreting the development of costs and the average period to settlement.

Estimations are also made in respect of pipeline premiums and non-recoverable premium debts. In calculating the pipeline premiums, projections are based on past patterns of premium processing. Changes in processing cycles and in attrition rates could alter these past trends.

### **(b) Financial risk**

CISGIL is exposed to financial risk through its financial assets, financial liabilities (including borrowings and derivatives), reinsurance assets and insurance liabilities. In particular a key financial risk is that the proceeds from financial assets are insufficient to fund the obligations arising under general insurance contracts. CISGIL manages financial risk according to the sub-categories of market risk, credit risk and liquidity risk.

#### **Financial risk management objective and strategy**

The principal objective of CISGIL's financial risk management strategy is to optimise the return on investments commensurate with an acceptable level of financial and insurance risk. Financial risk is managed within an asset and liability management framework (ALM) to ensure this objective is achieved. An over-riding constraint on the fund's investment strategy is to ensure that at all times the fund has sufficient assets to meet its solvency and capital requirements.

The Board has a sub-committee to specifically monitor ALM exposures and control the effectiveness of the market and credit policies. Exposures to financial risk are managed through diversifying investments across asset classes, issuers and markets.

The principal ALM technique used is to invest in assets which are predominantly fixed interest securities with a similar duration profile to the liabilities under the general insurance contracts.

As part of its ALM framework, CISGIL sets a strategic asset allocation range with reference to a suitable benchmark for each asset class taking account of the short-term insurance and investment liabilities and the financial risks. Controls and limits are set for each risk and sub-risk type and managed within the risk management procedures accordingly. CISGIL considers the capital adequacy and solvency of the fund when establishing and controlling the assets and risk limits.

#### **Market risk**

Market risk includes the risks that arise from fluctuations in values of, or income from assets or in interest rates or exchange rates to the extent that there is a mismatch between assets and liabilities. CISGIL has matched the insurance liabilities arising under its short-term general insurance contracts with a portfolio of fixed interest debt securities of a similar average duration to the liabilities arising under those contracts. To enhance certainty over the investment return generated from these assets, management practice is generally to maintain holdings to maturity. Short-term insurance liabilities are not directly sensitive to the level of money market rates, as they are contractually non-interest-bearing. However, interest rate risk arises because of the time value of money and the potential duration to settlement of claims. The value of assets held is subject to volatility from changes in short term money market interest rates and proceeds from maturing investments are subject to risk over the future return on reinvestment.

CISGIL matches cash flows of assets and liabilities in this portfolio by estimating their mean duration. The mean duration of liabilities is calculated using historical claims data to determine the expected settlement pattern for claims arising from insurance contracts in force at the balance sheet date (both incurred claims and future claims arising from the unexpired risks at the balance sheet date). Mean durations are:

	<b>2007</b>	2006
Net insurance liabilities	<b>2.70 years</b>	2.73 years
Financial assets	<b>2.45 years</b>	2.37 years

CISGIL writes contracts of insurance in the United Kingdom and insurance liabilities and borrowings are denominated in sterling. Funds are invested solely in assets denominated in sterling and consequently there is no significant exposure to currency risk.

## Risk management

All amounts are stated in £m unless otherwise indicated

### Sensitivity analysis

The only significant aspect of market risk to which CISGIL is exposed is interest rate risk. The market value of CISGIL's assets is subject to volatility from changes in short term money market interest rates, furthermore proceeds from maturing investments are subject to risk over the future return on reinvestment. An increase of 25 basis points in interest yields would reduce the carrying value of CISGIL's assets at the end of the financial year by £5.8m (2006: £6.8m). CISGIL invests predominantly in fixed rate securities and has adopted a policy of recognising investment assets on an 'available for sale' basis, therefore the impact upon profit during the period would not be material and would instead be recognised directly in equity as a reduction of £4.0m net of tax (2006: £4.8m). Conversely the impact of a decrease of 25 basis points in interest yields would be recognised directly in equity as an increase of £4.0m net of tax (2006: £4.8m).

The sensitivity analysis above assumes a reasonably possible movement in one variable with all other variables held constant. Furthermore the calculation assumes that a change in base rate would have an immediate and equal impact at all points on the yield curve.

CISGIL has issued £105m of subordinated debt at varying margins above 3 month LIBOR. The effect on profit of a 1% movement in 3 month LIBOR would be £1.05m per annum

### Credit risk

CISGIL's principal credit risk exposure arises in connection with default of debt securities and reinsurance counterparties, either failing to meet financial obligations when due or entering into restructuring arrangements that may adversely affect the market value of the debt security or reinsurance recoverable.

A credit policy and exposure framework has been established to monitor counterparty and credit risk exposures on an ongoing basis through the use of appropriate risk limits. CISGIL structures the levels of counterparty risk and asset concentration risk it accepts by placing limits and controls over the exposure to a single debt instrument and counterparty, or counterparty group, and seeks to actively diversify investment holdings and counterparty exposures across markets and economic segments. Counterparty exposures are subject to review at least annually and where concern exists over counterparty credit quality, watch lists are maintained and actively managed.

Where reinsurance is used to manage insurance risk this creates a risk that the reinsurer fails to meet its obligations in the event of a claim. Creditworthiness of reinsurers is considered regularly together with reinsurer exposures.

Other risk mitigation techniques employed to manage exposure to counterparty default include transacting only through a diversified range of authorised counterparties/brokers and the requirement for derivative transactions (including investment and trading in futures, stock lending and gilt repo transactions) to be fully collateralised on a daily basis.

At the balance sheet date there were no significant concentrations of credit risk. The table provides an analysis at the balance sheet date of the credit rating of those assets subject to credit risk.

	AAA	AA	A	BBB	Not rated	Total
<b>As at 12 January 2008</b>						
Financial assets – at fair value through profit or loss:						
Deposits with approved credit institutions (fixed rate)	–	115.9	–	–	–	115.9
Financial assets – available for sale:						
Listed debt (fixed rate)*	325.8	302.2	369.2	73.9	–	1,071.1
Unlisted debt (fixed rate)	–	–	4.9	–	–	4.9
Reinsurance assets	2.1	3.7	2.3	–	3.9	12.0
Insurance receivables and other assets	7.6	7.3	12.8	2.3	176.5	206.5
	<b>335.5</b>	<b>429.1</b>	<b>389.2</b>	<b>76.2</b>	<b>180.4</b>	<b>1,410.4</b>

\*Includes £116.1m of gilt edged securities

	AAA	AA	A	BBB	Not rated	Total
<b>As at 13 January 2007</b>						
Financial assets – at fair value through profit or loss:						
Deposits with approved credit institutions (fixed rate)	–	19.8	40.0	40.0	–	99.8
Financial assets – available for sale:						
Listed debt (fixed rate)*	367.9	416.5	302.5	72.3	–	1,159.2
Unlisted debt (fixed rate)	–	–	4.9	–	–	4.9
Reinsurance assets	0.1	0.8	3.0	–	3.7	7.6
Insurance receivables and other assets	7.6	9.1	8.0	2.6	195.9	223.2
	<b>375.6</b>	<b>446.2</b>	<b>358.4</b>	<b>114.9</b>	<b>199.6</b>	<b>1,494.7</b>

\*Includes £154.7m of gilt edged securities

The maximum exposure to credit risk is represented by the carrying value of each financial asset in the table.

CISGIL makes provisions for the possible impairment of policyholder debts where these are more than three months overdue. The maximum exposure to credit risk is represented by the carrying value of each financial and reinsurance balance in the balance sheet.

### Liquidity risk

CISGIL is exposed to calls on its available cash resources mainly from claims arising. Liquidity risk is the risk that cash may not be available to pay obligations when due at a reasonable cost. The Board sets limits on the minimum proportion of maturing funds available to meet such calls and on the minimum level of borrowing facilities in place to cover claims at unexpected levels of demand.

A liquidity risk policy has been established and risk is managed through the requirement to hold a proportion of financial assets in cash and liquid fixed interest stocks to pay claims for a specified time period in stressed conditions. The minimum financial assets proportion is determined using CISGIL's internal economic capital assessment, the estimated extreme case net outflows and regularly reviewing the nature, cause, effect and probability of extreme case scenarios in the light of changing natural, social and economic conditions.

CISGIL is active in the gilt repo market to facilitate liquidity risk management and maintains short-term borrowing facilities to enable settlement.

The following table indicates the time profile of undiscounted cash flows arising from financial liabilities (based upon contractual maturity) and insurance liabilities (based upon estimated timing of amounts recognised in the balance sheet).

	Carrying value	Gross nominal outflow	Up to 1 year	1 – 2 years	2 – 3 years	3 – 4 years	4 – 5 years	More than 5 years
<b>As at 12 January 2008</b>								
Insurance contract liabilities	959.8	959.8	503.1	172.2	111.7	69.8	44.9	58.1
Financial liabilities at amortised cost:								
Subordinated debt	105.0	159.4	7.8	7.8	7.8	7.8	36.8	91.4
Insurance and other payables	33.2	33.2	33.2	–	–	–	–	–
Other reinsurance liabilities	4.5	4.5	4.5	–	–	–	–	–
Cash and cash equivalents	13.1	13.1	13.1	–	–	–	–	–
	<b>1,115.6</b>	<b>1,170.0</b>	<b>561.7</b>	<b>180.0</b>	<b>119.5</b>	<b>77.6</b>	<b>81.7</b>	<b>149.5</b>
Other liabilities	23.6							
Total recognised liabilities	<b>1,139.2</b>							
<b>As at 13 January 2007</b>								
Insurance contract liabilities	1,135.1	1,135.1	653.9	235.5	130.9	68.1	21.2	25.5
Financial liabilities at amortised cost:								
Subordinated debt	75.0	116.4	4.6	4.6	4.6	4.6	4.6	93.4
Loans and borrowings	2.8	2.8	2.8	–	–	–	–	–
Insurance and other payables	16.2	16.2	16.2	–	–	–	–	–
Other reinsurance liabilities	7.4	7.4	7.4	–	–	–	–	–
Cash and cash equivalents	10.7	10.7	10.7	–	–	–	–	–
	<b>1,247.2</b>	<b>1,288.6</b>	<b>695.6</b>	<b>240.1</b>	<b>135.5</b>	<b>72.7</b>	<b>25.8</b>	<b>118.9</b>
Other liabilities	14.2							
Total recognised liabilities	<b>1,261.4</b>							

### (c) Operational Risk

Operational risk is defined within CFS as the risk of loss resulting from inadequate or failed internal processes, people and systems or external events. This encompasses the effectiveness of risk management techniques and controls to minimise these losses.

## Risk management

All amounts are stated in £m unless otherwise indicated

### Operational risk framework

Operational Risks are identified, managed and mitigated through ongoing risk management practices including risk assessments; formal internal control procedures; training; segregation of duties; delegated authorities; and contingency planning. Operational Risks are formally reviewed on a regular basis. Significant Operational Risks are regularly reported to Executive Directors, the Operational Risk Committee (a management committee), and the Risk Management Committee (a formal Board sub-committee). These meet regularly to monitor the suitability of the risk management framework and management of significant risks within CFS.

CFS continues to develop its approach to managing Operational Risk. 2007 has seen significant enhancements in the process for quantifying operational risks, providing a means of translating operational risk exposures into capital requirements. In addition the Incident Reporting process has been revised and relaunched, incorporating a centralised reporting hotline, and supported by the Integrated Risk System.

### Responsibilities

Whilst the Board is ultimately responsible for Operational Risks across CISGIL and the wider CFS organisation, this is delegated to the Chief Executive and Executive Directors within CFS who are responsible for controlling the Operational Risks in their direct areas of accountability and for compliance with CFS policies.

Each Executive has a nominated Divisional Risk Owner who is a member of the Operational Risk Committee and is responsible for ensuring the consistent application of the Operational Risk framework within their division. Divisional Risk Owners are supported from within their business divisions.

The central Operational Risk team facilitate the consistent identification, management and reporting of Operational Risks across CFS in line with regulatory and business requirements; support development and testing of business continuity arrangements for the business; and manage the CFS Corporate Insurance programme.

### Risk themes

CFS categorises Operational Risk into a number of distinct themes for internal management, monitoring and reporting. Key Operational Risk themes managed by CFS include:

#### Financial Crime

This relates to the effectiveness of controls to minimise financial losses arising from the fraudulent activities of employees, customers and third parties.

The organisation recognises the increasing concerns of customers, regulatory authorities and the media in respect of the loss or theft of confidential customer information. It has responded pro-actively to these concerns by reviewing, in detail, its arrangements for the security of confidential customer files. Whilst these were found to be robust, enhancements to provide additional customer protection continue to be assessed and implemented where appropriate.

Controls include: training and awareness to develop an anti-fraud culture, IT security infrastructure, tools and specialists to protect CFS systems and customer details, documented procedures, controls and automated solutions to detect/prevent fraud, Know Your Customer (KYC) procedures, employee pre-recruitment vetting and screening, dual control and segregation of duties where appropriate and Security and Major Investigations function working closely with Internal Audit and Operational Risk management.

#### Compliance (with regulatory and legal requirements)

As a regulated business, CFS places great emphasis on maintaining compliance with our regulatory and legal obligations by:

- Regulatory – supporting CFS's business objectives through the provision of advice, and the recommendation of solutions where appropriate, in respect of the regulatory implications of business developments, and assisting the business in assessing and addressing new and enhanced regulatory expectations. This is supported by appropriate and effective monitoring, aimed at influencing the business to mitigate or eliminate regulatory risk and demonstrate that we are meeting our regulatory obligations.
- Legal – seeking to pro-actively manage legal issues in relation to commercial, contractual, employment and litigation activities.

#### Employee Practices/Workplace Safety

It is acknowledged that our people are a key asset. The Financial Services sector as an industry is reliant on its people and the skills, knowledge and experience they provide. The risk of failure to maintain employee relations, or provide a safe environment in line with legislative requirements and with the ethical, diversity and discrimination rules is managed with support from our Human Resources department.

#### Property & Facilities

The risk of unforeseen operational disruption caused through the denial of access to major occupancies or other interruptions to business operations is managed through our business continuity framework and corporate insurance programme.

#### Customer Service

As a financial services business providing fair and high-quality customer service is a must. Controls that could prevent such risks occurring are regularly assessed and monitored. These include customer service levels, getting things right first time, availability of customer facing systems, together with trained and skilled resource to service customer demand.

### Supplier

CFS looks to source cost-effective and quality services, both internal and external to the Co-operative Group. Given the reliance on our business partners who provide services and products, a major or prolonged disruption to the supply of their services and products would impact on CFS. Risks are monitored relating to the effectiveness of contracts and relationship management to ensure that CFS' expected performance levels are achieved.

### Major IT Systems/Major Payments Systems Failure

Financial service providers have a heavy reliance on the availability and performance of underlying systems and applications, and the processes and frameworks which underpin these. Consequently the effectiveness of controls over the IT systems and infrastructure supporting IT processes and controls, major payment systems and clearing and business processes are monitored on a regular basis.

### Change Management

Given the integration of The Co-operative Bank and the Co-operative Insurance Society businesses, and the ongoing business transformation to integrate and improve the service offerings, competitiveness and efficiency of CFS in our journey to become the UK's most admired financial services business, there is a substantial change programme in place. In order to ensure delivery to time, cost or quality, and minimise risks arising from this there is a dedicated Change Risk & Governance team in place.

### Principal risks

As part of CFS' ongoing preparation for Solvency 2 for CIS and CISGIL, a review of CFS' Risk Management Framework was conducted in the latter part of 2006. A revised CFS Risk Management Framework was introduced in Quarter 1 2007.

In addition to the significant risks covered above, the following risks are also reported in the new CFS Risk Management Framework.

- Group wide risks, to include pensions, reputational and group risk
- Business risk

**Pensions risk:** arises from the volatility of future pension contributions required from CISGIL to fund the Co-operative Group PACE scheme. These contributions may be affected by valuations of the PACE scheme for which the key assumptions are mortality, inflation, rate of salary/pension increase and the investment return.

Pensions Risks are identified at the Co-operative Group level, with the impact of any potential changes to contribution assessed under the CFS Risk Management Framework.

**Reputational risk:** is the current or prospective risk to CISGIL's earnings and capital arising from adverse perception of CISGIL's or another member of the Co-operative Group's image on the part of customers, counterparties, shareholders, investors or regulators.

Reputational Risks are identified at entity level. As part of the assessment of this risk, we consider the impact of other CFS entities and Co-operative Group entities to CISGIL.

**Group risk:** includes contagion risk, being the risk that losses or liabilities from one part of the group deplete or divert financial resources from another part of the Group.

Group Risks are identified at CISGIL level. As part of the assessment of this risk, consideration is given to the impact of other CFS and Co-operative Group entities on CISGIL.

**Business risk:** arises from changes to CISGIL's business, specifically the risk of not being able to carry out CISGIL's business plan and desired strategy, including the ability to provide suitable products and services to customers. In a narrow sense, business risk is the risk CISGIL suffers losses because income falls or is volatile relative to the fixed cost base. However, in a broader sense, it is CISGIL's exposure to a wide range of macro-economic, geopolitical, industry, regulatory and other external risks.

## Capital management

All amounts are stated in £m unless otherwise indicated

### Objectives when managing capital

For regulatory solvency purposes CISGIL defines capital as share capital and reserves plus subordinated debt and its strategy in respect of capital management is to ensure that the following objectives are met:

- It has sufficient capital to meet all regulatory requirements.
- It has sufficient capital now and in the future to support all the risks in the business to the internally agreed level of confidence, thus ensuring policyholder protection.
- Subject to the above objectives being met, the company aims to generate an agreed level of return on capital employed (being allocated risk based equity plus subordinated debt).

Although CISGIL is part of a larger organisation, the principle adopted is that it will be managed as if it is a self sufficient company, i.e. that there will not be any guarantee of extra capital from elsewhere in the Group, and that any losses that arise should aim to be absorbed by CISGIL. Further information is available within the risk management section.

### Required capital

CISGIL is required to hold regulatory capital for its general insurance business in compliance with the rules issued by the FSA.

#### (i) Internal required capital

In accordance with INSPRU, each firm must have internal models to calculate its own capital requirements. The Individual Capital Assessment (ICA) is a risk based economic capital assessment. The ICA is owned by Actuarial Risk and Capital Management team and is presented at least annually to the Risk Management Committee, or more frequently if necessary. The FSA review the ICA calculation every two to three years to assess whether they believe the models and controls surrounding the models are adequate and, if they deem it necessary, they apply an "add-on" to reflect risks that were inadequately captured. The total ICA plus add on is known as Individual Capital Guidance (ICG).

#### (ii) Regulatory required capital

In accordance with GENPRU 2.1, CISGIL must hold capital in excess of its capital resources requirement. For a company writing general insurance this is termed the minimum capital requirement (MCR) and is defined as being the higher of a base capital resource requirement and the general insurance capital requirement (a formulaic hurdle where the calculation is based upon premiums or claims).

CISGIL must, at all times, hold assets in excess of the higher of the MCR and the ICG in order to meet all regulations. In order to be sure of meeting these commitments, CISGIL has articulated a risk appetite. This defines the confidence level with which the Board want to meet the above requirements, which in turn can be used to calculate the additional capital that is required over and above the minimum.

In July and August 2007, CISGIL raised an additional £30m of subordinated debt from its immediate parent undertaking, CFS, to ensure that following the company's exposure to exceptional weather events, it would be able to comply with all externally imposed solvency requirements.

#### (iii) Capital composition

CISGIL capital comprises total shareholders' equity, excluding inadmissible assets, subordinated debt and equalisation provisions recognised in equity.

	<b>2007</b>	2006
Capital and reserves per the accounts	<b>299.7</b>	265.9
Subordinated debt	<b>105.0</b>	75.0
Inadmissible assets	<b>(15.9)</b>	(8.6)
Statutory claims equalisation reserve	<b>(13.3)</b>	(9.3)
Proposed dividend	<b>(41.0)</b>	–
Regulatory capital	<b>334.5</b>	323.0

### **Critical judgement**

CISGIL makes estimates and assumptions that affect the reported amounts of assets and liabilities within the following financial year. Estimates and judgements are continually evaluated based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances but which may not necessarily be borne out in practice. The most significant area of estimation and judgment relates to the determination of the ultimate liability arising from claims made under insurance contracts. Details of the methodology, key assumptions and sensitivities are provided in note 19.

### **Fair values**

The following summarises the major methods and assumptions used in estimating the fair values of financial instruments reflected in the financial statements:

#### **(a) Securities**

Fair value of listed debt securities is based on clean bid prices at the balance sheet date without any deduction for transaction costs.

Fair value of unlisted debt securities represents the discounted expected principal and interest cash flows.

#### **(b) Derivatives**

Index futures are valued at clean bid prices at the balance sheet date without any deduction for transaction costs.

#### **(c) Convertible loan notes**

Fair value is based on clean bid prices, if available. Otherwise, a valuation technique is used.

#### **(d) Interest rates used for determining fair values**

Interest rate assumptions used in the valuation of unlisted debt and loan receivables are based upon gilt yields of appropriate maturity.

In all instances fair values equate to carrying values.

#### **(e) Borrowed funds**

Fair value measurement is based on a discounted cash flow basis using prevailing market interest rates.

# Notes to the financial statements

All amounts are stated in £m unless otherwise indicated

## 1. Segmental analysis

Segmental information is presented in respect of CISGIL's business segments in line with CISGIL's management and internal reporting structure.

There is no geographic segmental reporting as all business is conducted in the UK.

Segmental results, assets and liabilities include items directly attributable to a segment as well as those that can be allocated on a reasonable basis. Unallocated items comprise mainly deferred tax.

### Business segments

CISGIL comprises the following segments:

- (a) **Motor** – Private motor car and motor cycle, individual commercial vehicles
- (b) **Home** – Domestic buildings, contents and personal possessions
- (c) **Other** – Commercial risks covering property, liability, financial loss and motor fleet. Other minor personal risks and run off of inwards reinsurance liabilities.

### Segment income statement for the year ended 12 January 2008

	Before significant items			Total	Significant items	Total after significant items
	Motor	Home	Other			
<b>Income</b>						
Gross earned premiums	256.7	149.6	30.3	436.6	–	436.6
Less premiums ceded to reinsurers	(4.9)	(9.2)	(3.0)	(17.1)	–	(17.1)
<b>Net earned premiums</b>	<b>251.8</b>	<b>140.4</b>	<b>27.3</b>	<b>419.5</b>	<b>–</b>	<b>419.5</b>
Fee and commission income	–	–	0.4	0.4	–	0.4
Investment income	48.1	8.2	5.1	61.4	–	61.4
Gains less losses arising from financial and other assets	(1.1)	(0.2)	(0.1)	(1.4)	–	(1.4)
Other operating income	0.1	–	–	0.1	–	0.1
<b>Net income</b>	<b>298.9</b>	<b>148.4</b>	<b>32.7</b>	<b>480.0</b>	<b>–</b>	<b>480.0</b>
<b>Benefits, losses and expenses</b>						
Claims paid and benefits	(283.0)	(108.4)	(30.3)	(421.7)	–	(421.7)
Less amounts receivable from reinsurers	1.2	1.8	2.6	5.6	–	5.6
<b>Net policyholder claims paid and benefits</b>	<b>(281.8)</b>	<b>(106.6)</b>	<b>(27.7)</b>	<b>(416.1)</b>	<b>–</b>	<b>(416.1)</b>
Change in insurance contract liabilities	127.7	(4.0)	18.1	141.8	–	141.8
Change in reinsurance assets	4.6	1.5	(1.5)	4.6	–	4.6
<b>Net policyholder claims and benefits incurred</b>	<b>(149.5)</b>	<b>(109.1)</b>	<b>(11.1)</b>	<b>(269.7)</b>	<b>–</b>	<b>(269.7)</b>
Fees and commissions	(7.0)	(4.2)	(1.3)	(12.5)	–	(12.5)
Operating expenses	(64.9)	(55.5)	(6.9)	(127.3)	(29.5)	(156.8)
Finance costs	(4.8)	(0.8)	(0.6)	(6.2)	–	(6.2)
<b>Operating profit</b>	<b>72.7</b>	<b>(21.2)</b>	<b>12.8</b>	<b>64.3</b>	<b>(29.5)</b>	<b>34.8</b>
Profit based payments to individual members of the Co-operative Group	(0.5)	(0.1)	(0.1)	(0.7)	–	(0.7)
<b>Operating profit before income tax</b>	<b>72.2</b>	<b>(21.3)</b>	<b>12.7</b>	<b>63.6</b>	<b>(29.5)</b>	<b>34.1</b>
Income tax expense				(18.8)	8.9	(9.9)
<b>Profit for the financial year</b>				<b>44.8</b>	<b>(20.6)</b>	<b>24.2</b>

2007 significant items relate to non-recurring expenditure associated with a Group programme of restructuring.

## 1. Segmental analysis (continued)

### Segment income statement for the 68 week period from incorporation to 13 January 2007

	Before significant items			Total	Significant items	Total after significant items
	Motor	Home	Other			
<b>Income</b>						
Gross earned premiums	1,149.8	237.8	81.3	1,468.9	–	1,468.9
Less premiums ceded to reinsurers	(4.8)	(19.1)	(2.7)	(26.6)	–	(26.6)
<b>Net earned premiums</b>	<b>1,145.0</b>	<b>218.7</b>	<b>78.6</b>	<b>1,442.3</b>	<b>–</b>	<b>1,442.3</b>
Fee and commission income	–	–	2.0	2.0	–	2.0
Investment income	50.7	7.7	3.5	61.9	–	61.9
Gains less losses arising from financial and other assets	(2.2)	(0.3)	(0.1)	(2.6)	–	(2.6)
Other operating income	2.7	0.3	–	3.0	–	3.0
<b>Net income</b>	<b>1,196.2</b>	<b>226.4</b>	<b>84.0</b>	<b>1,506.6</b>	<b>–</b>	<b>1,506.6</b>
<b>Benefits, losses and expenses</b>						
Claims paid and benefits	(351.8)	(94.8)	(24.2)	(470.8)	–	(470.8)
Less amounts receivable from reinsurers	–	0.1	0.3	0.4	–	0.4
<b>Net policyholder claims paid and benefits</b>	<b>(351.8)</b>	<b>(94.7)</b>	<b>(23.9)</b>	<b>(470.4)</b>	<b>–</b>	<b>(470.4)</b>
Change in insurance contract liabilities	(735.7)	(55.8)	(56.2)	(847.7)	–	(847.7)
Change in reinsurance assets	–	2.2	2.4	4.6	–	4.6
<b>Net policyholder claims and benefits incurred</b>	<b>(1,087.5)</b>	<b>(148.3)</b>	<b>(77.7)</b>	<b>(1,313.5)</b>	<b>–</b>	<b>(1,313.5)</b>
Fees and commissions	(13.0)	(7.5)	(1.8)	(22.3)	–	(22.3)
Operating expenses	(87.7)	(43.2)	(11.8)	(142.7)	(9.0)	(151.7)
Finance costs	(3.6)	(0.5)	(0.3)	(4.4)	–	(4.4)
<b>Operating profit</b>	<b>4.4</b>	<b>26.9</b>	<b>(7.6)</b>	<b>23.7</b>	<b>(9.0)</b>	<b>14.7</b>
Profit based payments to individual members of the Co-operative Group	(0.5)	(0.3)	–	(0.8)	–	(0.8)
<b>Operating profit before income tax</b>	<b>3.9</b>	<b>26.6</b>	<b>(7.6)</b>	<b>22.9</b>	<b>(9.0)</b>	<b>13.9</b>
Income tax expense				(10.1)	3.8	(6.3)
<b>Profit for the financial year</b>				<b>12.8</b>	<b>(5.2)</b>	<b>7.6</b>

2006 significant items relate to non-recurring expenditure associated with a Group programme of restructuring and gains on implementation of PACE.

### Segment balance sheet as at 12 January 2008

	Motor	Home	Other	Unallocated balances	Total
<b>Assets</b>					
Deferred acquisition costs	15.5	11.6	1.4	–	28.5
Reinsurance assets	6.1	4.2	1.7	–	12.0
Financial assets at fair value through profit or loss	92.1	15.5	8.3	–	115.9
Financial assets available for sale	855.0	143.5	77.5	–	1,076.0
Other assets	141.6	46.1	18.8	–	206.5
<b>Total assets</b>	<b>1,110.3</b>	<b>220.9</b>	<b>107.7</b>	<b>–</b>	<b>1,438.9</b>
<b>Liabilities</b>					
Insurance contract liabilities	751.3	136.9	71.6	–	959.8
Other liabilities	19.9	6.9	0.6	152.0	179.4
<b>Total liabilities</b>	<b>771.2</b>	<b>143.8</b>	<b>72.2</b>	<b>152.0</b>	<b>1,139.2</b>

## Notes to the financial statements

All amounts are stated in £m unless otherwise indicated

### 1. Segmental analysis (continued)

#### Segment balance sheet as at 13 January 2007

	Motor	Home	Other	Unallocated balances	Total
<b>Assets</b>					
Deferred acquisition costs	16.4	8.0	1.6	–	26.0
Reinsurance assets	1.4	2.7	3.5	–	7.6
Financial assets at fair value through profit or loss	81.8	12.1	5.9	–	99.8
Financial assets available for sale	954.0	140.9	69.2	–	1,164.1
Other assets	133.7	37.6	10.8	47.7	229.8
<b>Total assets</b>	<b>1,187.3</b>	<b>201.3</b>	<b>91.0</b>	<b>47.7</b>	<b>1,527.3</b>
<b>Liabilities</b>					
Insurance contract liabilities	922.8	139.1	73.2	–	1,135.1
Other liabilities	–	–	–	126.3	126.3
<b>Total liabilities</b>	<b>922.8</b>	<b>139.1</b>	<b>73.2</b>	<b>126.3</b>	<b>1,261.4</b>

### 2. Net earned premiums

	2007	2006
<b>Gross premiums</b>		
Premium written	<b>412.8</b>	1,693.1
Change in unearned premium provision	<b>23.8</b>	(224.2)
Gross earned premium	<b>436.6</b>	1,468.9
<b>Outwards reinsurance premiums</b>		
Premium ceded	<b>(16.9)</b>	(29.6)
Change in unearned premium provision	<b>(0.2)</b>	3.0
Premiums ceded to reinsurers	<b>(17.1)</b>	(26.6)
<b>Net earned premiums</b>	<b>419.5</b>	1,442.3

#### Premiums

On 15 January 2006 CISGIL assumed responsibility for the benefits and burdens arising from the run off of the general insurance liabilities of CIS under the terms of an indemnification agreement. Included within the 2006 gross written premiums is £1,221.7m representing re-insurance premiums received from CIS under this agreement.

### 3. Fee and commission income

	2007	2006
Reinsurance commission earned	<b>0.4</b>	2.0

#### 4. Investment income

	2007	2006
Fair value income from:		
Deposit with credit institutions	<b>2.7</b>	6.8
Interest income from financial assets designated available for sale:		
Listed debt securities	<b>58.3</b>	54.8
Unlisted debt securities	<b>0.4</b>	0.3
	<b>58.7</b>	55.1
	<b>61.4</b>	61.9

#### 5. Gains less losses arising from financial assets

	2007	2006
Net losses arising on financial assets designated available for sale:		
Listed debt securities	<b>(1.4)</b>	(2.6)

#### 6. Other operating income

Other operating income of £0.1m represents a volume related rebate from external salvage and subrogation contracts. In 2006, other operating income of £3.0m represented a payment from a fellow subsidiary of Co-operative Group Limited for exclusive rights to provide certain policyholder services.

#### 7. Net policyholder claims paid and benefits

	2007	2006
<b>Gross claims paid</b>		
Current year claims	<b>178.6</b>	522.9
Prior year claims	<b>282.7</b>	–
Gross claims paid and benefits	<b>461.3</b>	522.9
<b>Salvage and subrogation</b>		
Current year claims	<b>(12.1)</b>	(52.1)
Prior year claims	<b>(27.5)</b>	–
Salvage and subrogation	<b>(39.6)</b>	(52.1)
Claims paid and benefits	<b>421.7</b>	470.8
<b>Less recovered from reinsurers</b>		
Current year claims	<b>(4.0)</b>	(0.4)
Prior year claims	<b>(1.6)</b>	–
Amounts recovered from reinsurers	<b>(5.6)</b>	(0.4)
<b>Net claims paid and benefits</b>	<b>416.1</b>	470.4

#### Claims

On 15 January 2006 CISGIL assumed responsibility for the benefits and burdens arising from the run off of the general insurance liabilities of CIS under the terms of an indemnification agreement. Included in the gross claims paid figure for 2006 is £361.4m which relates to claims paid by CISGIL on policies written by CIS prior to 15 January 2006.

## Notes to the financial statements

All amounts are stated in £m unless otherwise indicated

### 8. Fees and commissions

	2007	2006
Commission	<b>10.1</b>	29.3
Change in unearned commission	<b>2.4</b>	(7.0)
	<b>12.5</b>	22.3

### 9. Operating expenses

	2007	2006
Administration expenses	<b>82.3</b>	89.2
Acquisition expenses	<b>44.2</b>	51.6
Non-recurring expenses	<b>29.5</b>	9.0
Rebates and discounts	<b>0.8</b>	1.9
	<b>156.8</b>	151.7

Items included on the face of the income statement in the column headed 'significant items' relate to CISGIL's share of non-recurring expenses associated with a Group programme of restructuring.

Operating expenses include the following payments to auditors and their associates:

	2007 £000	2006 £000
Audit of these financial statements	<b>124</b>	120
Other services:		
Other services pursuant to legislation	<b>41</b>	38
Services relating to information technology	<b>–</b>	20
All other services	<b>14</b>	81
	<b>179</b>	259

CISGIL does not have any employees, all sales are effected by staff of CFSMS which also provides administration and other services. CFSMS is also responsible for the remuneration of all Directors of the CFS Group, including Directors of CISGIL. CISGIL's share is charged to the company, at cost, by way of a management service charge from CFSMS.

### 10. Income tax expense

	2007	2006
<b>Current tax expense</b>		
UK tax for the current year	<b>8.6</b>	1.4
UK tax adjustments in respect of prior years	<b>(0.4)</b>	–
Total current tax expense	<b>8.2</b>	1.4
<b>Deferred tax expense</b>		
Origination and reversal of temporary differences	<b>1.6</b>	4.9
Adjustment in respect of prior years	<b>0.1</b>	–
Total deferred tax expense	<b>1.7</b>	4.9
Total tax expense recognised in the income statement	<b>9.9</b>	6.3

Further information about deferred income tax is presented in note 23.

## 10. Income tax expense (continued)

### Reconciliation of effective tax rate

The tax charge in the income statement differs from the theoretical amount that would arise using the corporation tax rate in the UK as follows:

Profit before tax	<b>34.1</b>	13.9
Tax calculated at domestic corporation tax rate of 30% (2006: 30%)	<b>10.2</b>	4.2
Effect of:		
Income not subject to tax	–	(0.9)
Interest adjustment re technical liabilities	–	3.2
Tax rate change on deferred tax	<b>(0.2)</b>	–
Other adjustments	<b>(0.1)</b>	(0.2)
Income tax expense	<b>9.9</b>	6.3

The tax expense included in the income statement is attributable to the shareholder. The rate of corporation tax applicable is 30% (2006: 30%).

## 11. Deferred acquisition cost

	<b>2007</b>	2006
At the beginning of the financial period	<b>26.0</b>	–
Balance acquired from other Group company	–	34.5
Deferred acquisition costs	<b>28.5</b>	26.0
Amortisation	<b>(26.0)</b>	(34.5)
At the end of the financial period	<b>28.5</b>	26.0

Deferred acquisition costs will be realised within one year.

## 12. Financial assets at fair value through profit or loss

	<b>2007</b>	2006
Deposits with credit institutions	<b>115.9</b>	99.8

This category comprises short term fixed rate deposits. There has been no reclassification of financial assets between fair value and cost/amortised cost during the current or previous financial year.

All amounts fall due for settlement within one year.

## 13. Financial assets – available for sale

	<b>2007</b>	2006
Listed debt securities	<b>1,071.1</b>	1,159.2
Unlisted debt securities	<b>4.9</b>	4.9
	<b>1,076.0</b>	1,164.1

All debt securities in this category are fixed rate instruments, of which £116.1m (2006: £154.7m) are listed government bonds. Of the total, £215.4m (2006: £185.4m) falls due for settlement within one year, the remainder is non-current.

At the balance sheet date CISGL had securities with a market value of £231.6m (2006: £146.3m) on loan under approved stock lending arrangements. Eligible collateral totalling £238.3m (2006: £154.5m) was held as security.

At the 2006 balance sheet date maturity proceeds of £1.7m from one unlisted debt security were overdue by a period of less than three months. The balance was not considered to be impaired and was subsequently settled in full. At the 2007 balance sheet date, no amounts were overdue.

## Notes to the financial statements

All amounts are stated in £m unless otherwise indicated

### 14. Insurance receivables and other assets

	2007	2006
Receivables arising from insurance:		
Arising from insurance operations	<b>122.2</b>	125.0
Salvage and subrogation recoveries	<b>53.5</b>	63.2
Reinsurance operations	<b>1.1</b>	2.8
Other receivables:		
Accrued interest	<b>29.7</b>	27.1
Prepayments and accrued income	–	3.0
Amounts receivable from group companies	–	2.1
	<b>206.5</b>	223.2

All amounts fall due for settlement within one year.

Receivables arising from insurance operations are stated net of an impairment provision of £nil (2006: £nil). The provision is calculated by reference to net policyholder debt (excluding certain commercial and broker arrangements) in excess of three months overdue. Any adjustment to the level of the provision is recorded within the income statement as an adjustment to written premium.

In addition, insurance receivables and other assets include amounts totalling £17.6m (2006: £6.9m) which are overdue but not considered to be impaired, age analysed as follows:

	2007	2006
<i>Amounts overdue:</i>		
Less than 3 months	<b>14.7</b>	5.1
3 to 6 months	<b>1.6</b>	–
6 to 12 months	<b>1.3</b>	1.7
More than 12 months	–	0.1

Assets past due but not impaired typically comprise high volume / low value balances for which CISGIL does not seek collateral but continues to work with counterparties to secure settlement.

### 15. Cash and cash equivalents

Bank overdrafts are repayable on demand and form an integral part of CISGIL's cash management and, as such, are included as cash and cash equivalents for the purpose of the cash flow statement.

Loans and borrowings represent overnight borrowings from Group undertakings. These borrowings are on normal commercial terms and represent an unsecured, uncollateralised obligation of CISGIL.

### 16. Share capital

	2007	2006
<i>Authorised</i>		
183,000,000 ordinary shares of £1 each	<b>183.0</b>	183.0
<i>Allotted, called up and fully paid</i>		
183,000,000 ordinary shares of £1 each	<b>183.0</b>	183.0

Each shareholder has one vote and an additional vote for every 50 shares or fraction or part held by it in excess of the first 50 shares held.

## 17. Reserves

	2007	2006
<b>Retained earnings</b>		
At the beginning of the financial period	<b>(24.8)</b>	–
Actuarial losses on employee benefit	–	(46.3)
Tax on items taken direct to equity	–	13.9
Net income recognised directly in equity	<b>(24.8)</b>	(32.4)
Profit for the period	<b>24.2</b>	7.6
At the end of the financial period	<b>(0.6)</b>	(24.8)

Any surplus of retained earnings would represent amounts available for dividend distribution to the equity shareholder of CIS.

	2007 Available for sale reserve	2007 Capital reserves	2007 Total	2006 Available for sale reserve	2006 Capital reserves	2006 Total
<b>Other reserves</b>						
At the beginning of the financial year	<b>(18.3)</b>	<b>126.0</b>	<b>107.7</b>	–	–	–
Gains less losses on available for sale investments	<b>15.2</b>	–	<b>15.2</b>	(28.8)	–	(28.8)
Cumulative (losses)/gains transferred to the income statement on sale	<b>(1.4)</b>	–	<b>(1.4)</b>	2.6	–	2.6
Tax on items taken directly to equity	<b>(4.2)</b>	–	<b>(4.2)</b>	7.9	–	7.9
Net income recognised directly in equity	<b>9.6</b>	–	<b>9.6</b>	(18.3)	–	(18.3)
Capital contribution received	–	–	–	–	126.0	126.0
At the end of the financial period	<b>(8.7)</b>	<b>126.0</b>	<b>117.3</b>	(18.3)	126.0	107.7

Reserves include £9.3m (2006: £6.5m) being an amount (net of tax) calculated in compliance with Chapter 1.4 of the Prudential Sourcebook for Insurers (INSPRU) which requires general insurers to maintain equalisation provisions.

### Capital reserves

During the previous financial period a non-refundable capital contribution of £126m was received from the parent, CFS. This amount is distributable.

## 18. Other borrowed funds

	2007	2006
Subordinated debt	<b>105.0</b>	75.0

£75.0m of subordinated debt was issued to the immediate parent, Corporate Financial Services Limited (CFS), on 15 January 2006 at par. The debt has a fifteen year term with an option to repay in full at the tenth anniversary. Interest is payable quarterly at 1% above 3 month LIBOR up to the tenth anniversary and at 2% above 3 month LIBOR for the remainder of the term.

During 2007, £30.0m of additional perpetual subordinated debt was issued to CFS in two tranches. £20m was issued on 30 July 2007 followed by a further £10.0m on 15 August 2007. In both cases issue was at par. Both tranches provide for interest payable at 1.5% above 3 month LIBOR for the first five years and 2% above 3 month LIBOR thereafter. The agreements provide the option of full repayment at the fifth anniversary or at quarterly intervals thereafter subject to certain conditions.

Financial liabilities in respect of subordinated debt are unsecured, uncollateralised obligations. In the event of the winding up of CISGIL, payment obligation is subordinated in favour of claims from all other unsubordinated creditors.

Finance costs of £6.2m (2006: £4.4m) incurred during the financial period relate to interest on the subordinated debt of £6.2m (2006: £4.3m)

There have been no defaults or breaches of contractual obligations attaching to the subordinated debt during the financial year.

**19. Insurance contracts liabilities and reinsurance assets****(a) Analysis of insurance contract liabilities**

	<b>2007</b>	2006
<b>Gross</b>		
Claims reported	<b>698.3</b>	841.0
Claims incurred but not reported	<b>33.1</b>	37.2
Claims settlement expenses	<b>22.3</b>	28.1
Unearned premiums	<b>200.4</b>	224.2
Provision for unexpired risks	<b>5.7</b>	4.6
Total gross insurance liabilities	<b>959.8</b>	1,135.1
<b>Recoverable from reinsurers</b>		
Claims reported	<b>(6.7)</b>	(2.8)
Claims incurred but not reported	<b>(2.5)</b>	(1.8)
Unearned premiums	<b>(2.8)</b>	(3.0)
Total reinsurers' share of insurance liabilities	<b>(12.0)</b>	(7.6)
<b>Net</b>		
Claims reported	<b>691.6</b>	838.2
Claims incurred but not reported	<b>30.6</b>	35.4
Claims settlement expenses	<b>22.3</b>	28.1
Unearned premiums	<b>197.6</b>	221.2
Provision for unexpired risks	<b>5.7</b>	4.6
Total net insurance liabilities	<b>947.8</b>	1,127.5

**Claims**

On 15 January 2006 CISGIL assumed responsibility for the benefits and burdens arising from the run off of general insurance liabilities of CIS under the terms of an indemnification agreement. Insurance contract liabilities at the end of the year include the following liabilities from the policies written by CIS.

Outstanding claims	<b>413.5</b>	712.0
Claims incurred but not reported	<b>10.0</b>	18.5
	<b>423.5</b>	730.5

Reinsurance is used to limit risk to the balance sheet for the various classes of general insurance direct business. Proportional and non proportional types of reinsurance cover have been purchased in accordance with assumptions made regarding the possible levels of losses and required returns on equity.

**(b) General insurance contracts – assumptions, changes in assumptions and sensitivity****i) Basis of assessing liabilities**

CISGIL has been established to write new and renewing general insurance business formerly written by CIS, a fellow subsidiary within the CFS Group.

CISGIL has access to historical data and trends relating to the general insurance business of CIS for which it has now assumed responsibility.

CISGIL uses a combination of recognised actuarial and statistical techniques to assess the ultimate cost of claims. These include:

- Projecting historic claims payment and recoveries data
- Projecting numbers of claims
- Adjusting case estimates for future inflation and onto a provisioning basis
- Deriving average costs per claim to apply to claim numbers
- Chain Ladder techniques

Extensive use of detailed claims data including individual case estimates is made to derive patterns in average claims costs and timings between occurrence and notification and between notification and settlement. The most common method used is the Chain Ladder method. This technique involves the analysis of historical claims development trends and the selection of estimated development factors based on this historical pattern. The selected development factors are then applied to cumulative claims data for each accident year which is not yet fully developed to produce an estimated ultimate claims cost for each accident year. A degree of judgement is required in selecting the most appropriate development factors.

**19. Insurance contracts liabilities and reinsurance assets (continued)**

The work is undertaken and supervised by suitably qualified personnel. Claims provisions are separately computed for each claim type such as bodily injury, accidental damage, storm, flood and subsidence. All provisions are calculated gross with explicit allowance for reinsurance and subrogation recoveries. Provisions are not discounted for investment return other than any required additional provision for unexpired risks.

As outlined within the risk management section on pages 17 to 23, there is significant uncertainty in the assessment of liabilities and provisions are set to be adequate to cover the eventual cost. Sensitivity analysis is performed to assist the selection of key parameters and, hence, the provisions adopted. There is a governance process in place to ensure that provisions are subject to detailed review regarding the appropriateness of key assumptions and the quantum of the provisions established.

## ii) Key assumptions

Principal assumptions underlying the claims provisions include:

- Explicit allowance for future inflation at rates varying from 0% pa to 7% pa according to the claim type. The range of future inflation rates is largely unchanged from that used at the previous year end but some modest increases have been applied to rates for certain claim types based on more recent indices and expectations for future levels of inflation.
- For bodily injury claims allowance has been made for:
  - i. Use of the Ogden Tables at a discount rate of 1.75%.
  - ii. Increased awards for general damages in accordance with the 8th edition of the JSB guidelines.
  - iii. A small proportion of large claims being settled by periodic payments.
  - iv. The average cost of bodily injury claims for the last three accident years on the motor account reflecting the increased proportion of similar claims relating to whiplash, and the known incidence of large claims.

The gross insurance provision for claims and loss adjustment expenses arising in respect of prior years of £522.0m (2006: £nil) includes a movement of £101.6m (2006: £nil) arising from changes in assumptions and release of surplus, details are as follows:

- Reduction in volume of motor claims, £13.6m
- Reduction in severity of motor claims, £86.6m
- Reduction in the run off pattern of fire and accident claims, £1.4m

CISGIL's first year of operation was 2006 and hence there was no provision for prior year claims at the end of 2006 financial year.

## iii) Sensitivity analysis

There is greater uncertainty over motor claims provisions than other provisions as they typically involve claims for bodily injury and associated legal costs and therefore typically have a longer period to settlement. Motor provisions represent the most significant proportion of the total general insurance outstanding claims liabilities (gross of salvage and subrogation). Sensitivity information is given for motor claims provisions together with limited information for all other classes. The following table indicates the effect on gross claims provisions (gross of reinsurance and salvage and subrogation) and the net provisions (net of reinsurance but gross of salvage and subrogation) of changes in key assumptions. Impacts to net technical provisions have an equivalent impact to profitability.

Assumption	Change in parameter	Effect on gross provision	% Effect	Effect on net provision	% Effect
<b>Motor</b>					
Average cost of claims for last 3 years – bodily injury	+10%	+24.9	4.6%	+24.9	4.8%
Average cost of claims for last 3 years – legal	+10%	+16.5	3.0%	+16.5	3.1%
Average cost of claims for last 3 years – third party property damage	+10%	+11.2	2.0%	+11.2	2.1%
Mean term to settlement – bodily injury	+½ year	+11.5	2.1%	+11.3	2.1%
Mean term to settlement – legal	+½ year	+5.0	0.9%	+5.0	0.9%
Rate of future inflation – bodily injury	+1%	+10.6	1.9%	+10.4	2.0%
Ogden discount rate – bodily injury	-½%	+8.4	1.5%	+6.7	1.3%
<b>Other Classes</b>					
Mean term to settlement (liability)	+½ year	+0.7	2.7%	+0.7	2.7%
Mean term to settlement (non-liability)	+½ year	+0.9	1.6%	+0.9	1.6%
Rate of future inflation (liability)	+1%	+0.5	2.0%	+0.5	2.0%
Rate of future inflation (non liability)	+1%	+0.5	0.9%	+0.5	0.9%
Ogden discount rate (liability)	-¼%	+0.3	1.2%	+0.3	1.2%

**c. Change in general insurance liabilities and reinsurance assets****i) Change in insurance contact liabilities (net of salvage and subrogation)**

	<b>Gross</b>	<b>Unexpired risk provision</b>	<b>Salvage &amp; subrogation</b>	<b>Net</b>
At the beginning of the financial period	906.3	4.6	(63.2)	847.7
Movement in the year	(152.6)	1.1	9.7	(141.8)
At the end of the financial period	<b>753.7</b>	<b>5.7</b>	<b>(53.5)</b>	<b>705.9</b>

Salvage and subrogation is included within assets as part of insurance receivables (note 14).

**ii) General insurance – claims and loss adjustment expenses**

	<b>2007 Gross</b>	<b>2007 Reinsurance</b>	<b>2007 Net</b>	2006 Gross	2006 Reinsurance	2006 Net
Notified outstanding claims	<b>841.0</b>	<b>(2.8)</b>	<b>838.2</b>	–	–	–
Claims incurred but not reported	<b>37.2</b>	<b>(1.8)</b>	<b>35.4</b>	–	–	–
Claims settlement expenses	<b>28.1</b>	–	<b>28.1</b>	–	–	–
At the beginning of the financial period	<b>906.3</b>	<b>(4.6)</b>	<b>901.7</b>	–	–	–
Claims paid during the financial period	<b>(461.3)</b>	<b>5.6</b>	<b>(455.7)</b>	(522.9)	0.4	(522.5)
Increase in liabilities:						
– arising from current year claims	<b>410.3</b>	<b>(11.9)</b>	<b>398.4</b>	1,429.2	(5.0)	1,424.2
– arising from prior year claims	<b>(101.6)</b>	<b>1.7</b>	<b>(99.9)</b>			
Total movement	<b>(152.6)</b>	<b>(4.6)</b>	<b>(157.2)</b>	906.3	(4.6)	901.7
Notified claims	<b>698.3</b>	<b>(6.7)</b>	<b>691.6</b>	841.0	(2.8)	838.2
Incurred but not reported	<b>33.1</b>	<b>(2.5)</b>	<b>30.6</b>	37.2	(1.8)	35.4
Claims settlement expenses	<b>22.3</b>	–	<b>22.3</b>	28.1	–	28.1
At the end of the financial period	<b>753.7</b>	<b>(9.2)</b>	<b>744.5</b>	906.3	(4.6)	901.7

**iii) General insurance – provisions for unearned premiums**

	<b>2007 Gross</b>	<b>2007 Reinsurance</b>	<b>2007 Net</b>	2006 Gross	2006 Reinsurance	2006 Net
At the beginning of the financial period	<b>224.2</b>	<b>(3.0)</b>	<b>221.2</b>	–	–	–
Increase in the financial period	<b>200.4</b>	<b>(2.8)</b>	<b>197.6</b>	224.2	(3.0)	221.2
Release in the financial period	<b>(224.2)</b>	<b>3.0</b>	<b>(221.2)</b>	–	–	–
Movement in the financial period	<b>(23.8)</b>	<b>0.2</b>	<b>(23.6)</b>	224.2	(3.0)	221.2
At the end of the financial period	<b>200.4</b>	<b>(2.8)</b>	<b>197.6</b>	224.2	(3.0)	221.2

**iv) General insurance – provisions for unexpired risk**

	<b>2007 Gross</b>	<b>2007 Reinsurance</b>	<b>2007 Net</b>	2006 Gross	2006 Reinsurance	2006 Net
At the beginning of the financial period	<b>4.6</b>	–	<b>4.6</b>	–	–	–
Increase in the financial period	<b>5.7</b>	–	<b>5.7</b>	4.6	–	4.6
Release in the financial period	<b>(4.6)</b>	–	<b>(4.6)</b>	–	–	–
Movement in the financial period	<b>1.1</b>	–	<b>1.1</b>	4.6	–	4.6
At the end of the financial period	<b>5.7</b>	–	<b>5.7</b>	4.6	–	4.6

Additional provision is made for unexpired risks where the claims and expense, likely to arise after the end of the financial period, in respect of contracts concluded before that date, are expected to exceed the unearned premiums at the end of the financial period. The provision primarily relates to the motor class of business.

## 19. Insurance contracts liabilities and reinsurance assets (continued)

### v) Analysis of claims development

Gross of reinsurance	Accident year		Total
	2006	2007	
At end of accident year	1,367.9	384.5	1,752.4
– one year later	1,264.7	–	1,264.7
Estimate for cumulative claims	1,264.7	384.5	1,649.2
Cumulative payments to date	(751.9)	(165.9)	(917.8)
Gross outstanding claims liabilities	<b>512.8</b>	<b>218.6</b>	<b>731.4</b>
Gross claims reported			698.3
Gross claims incurred but not reported			33.1
Gross outstanding claims liabilities			<b>731.4</b>

Net of reinsurance	Accident year		Total
	2006	2007	
At end of accident year	1,362.9	372.6	1,735.5
– one year later	1,261.4	0.0	1,261.4
Estimate for cumulative claims	1,261.4	372.6	1,634.0
Cumulative payments to date	(749.9)	(161.9)	(911.8)
Net outstanding claims liabilities	<b>511.5</b>	<b>210.7</b>	<b>722.2</b>
Net claims reported			691.6
Net claims incurred but not reported			30.6
Net outstanding claims liabilities			<b>722.2</b>

## 20. Other provisions

	2007	2006
At the beginning of the financial period	<b>4.0</b>	–
Provision utilised	<b>(3.0)</b>	–
Additional provisions during the financial period	–	4.0
Release of provisions	–	–
At the end of the financial period	<b>1.0</b>	4.0

The movement in provisions during the year includes the settlement for the termination of a supplier contract.

## Notes to the financial statements

All amounts are stated in £m unless otherwise indicated

### 21. Insurance and other payables

	2007	2006
Arising out of direct insurance operations	4.2	3.7
Accruals and deferred income	2.4	0.6
Other taxation and social security	8.1	9.2
Amounts due to Group companies	8.5	–
Other payables	18.1	11.9
	<b>41.3</b>	25.4

All amounts fall due for settlement within one year.

### 22. Other reinsurance liabilities

	2007	2006
Deposits received from reinsurers	0.1	0.7
Arising from reinsurance operations	4.4	6.7
	<b>4.5</b>	7.4

All amounts fall due for settlement within one year.

### 23. Income tax

	2007	2006
<b>Current tax</b>		
At the beginning of the financial period	6.6	–
Tax charged to the income statement	(8.2)	(1.4)
Tax credited directly to the statement of recognised income and expense:		
– valuation gains/(losses) on available-for-sale investments taken to equity	(4.2)	7.9
Tax paid during the financial period	(6.0)	0.1
At the end of the financial period	<b>(11.8)</b>	6.6

Deferred taxes are calculated on all temporary differences under the liability method using an effective tax rate of 28% (2006: 30%).

#### Deferred tax liability

At the beginning of the financial period	(1.0)	–
Tax transferred within Group on re-organisation	–	(10.0)
Tax charged to the income statement	(1.7)	(4.9)
Tax credited directly to the statement of recognised income and expense:		
– IAS 19 pension obligation	–	13.9
At the end of the financial period	<b>(2.7)</b>	(1.0)

#### Analysis of deferred tax liability

Claims equalisation reserve	(3.8)	(2.8)
Other timing differences	1.1	1.8
	<b>(2.7)</b>	(1.0)

## 24. Employee benefits

CIS, a fellow subsidiary within the CFS Group, operated a funded pension scheme of the defined benefit type up until 5 April 2006. This provided benefits based on final pensionable pay. On 15 January 2006 CISGIL assumed responsibility for a portion of the liability arising in connection with this defined benefit plan under the terms of an asset transfer agreement with CIS.

Pension charges were assessed in accordance with the advice of a qualified actuary. The latest full actuarial valuation of the funded scheme was at 31 December 2004. The actuarial valuation was updated to 5 April 2006.

Actuarial gains and losses were recognised in the period in which they occurred. Actuarial gains and losses were recognised outside the income statement, in the statement of recognised income and expense, up to 5 April 2006.

In common with the majority of other UK employers, the Group faces increasing costs and risk in provisions of occupational pension schemes for its employees, including Executives. In view of this, a strategic review of employee pension provision was completed during 2005. The review covered pension arrangements for all employees, including Executives, in the Group and its financial services subsidiaries, Co-operative Financial Services Limited, Co-operative Insurance Society Limited and The Co-operative Bank p.l.c.

As a consequence of this review, some significant changes to the Group's occupational pension arrangements were implemented with effect from 6 April 2006, with the approval of the Trustees of the Co-operative Group Pension Fund, the CIS Employees' Pension Scheme and the Co-operative Bank Pension Scheme (the former schemes).

The key changes were:

- i) the former schemes transferred into a new pension scheme on 6 April 2006.
- ii) The new scheme, the Co-operative Group Pension Average Career Earnings Scheme (PACE), is available to all employees of the Trading Group and Financial Services businesses. It provides pensions and other benefits based on career average earnings, revalued for inflation, in respect of pensionable services from 6 April 2006.
- iii) Executives and employees are provided with benefits from PACE on the same terms.
- iv) Accrual benefits under the existing schemes as at 5 April 2006 will continue to be linked to final pensionable salary at the Executive's or employee's actual date of leaving or retirement, whichever is earlier.
- v) PACE members contribute 6% of their pensionable salary.

	<b>2007</b>	2006
<i>The amounts recognised in the income statement are as follows:</i>		
Current service cost	–	3.7
Interest on liabilities	–	9.9
Expected return on scheme assets	–	(14.1)
Gains on settlement and curtailment	–	(4.0)
Total included in 'employee benefits expense'	–	(4.5)
Actual return on scheme assets	–	27.9
<i>Changes in the present value of the scheme liabilities are as follows:</i>		
Opening defined benefit liabilities	–	–
Transfer from other group company	–	977.5
Current service cost	–	3.7
Interest on liabilities	–	9.9
Contributions by members	–	1.1
Actuarial losses	–	60.1
Benefits paid	–	(10.4)
Transferred on implementation of PACE	–	(1,041.9)
Closing defined benefit liabilities	–	–

Actuarial losses arose in the period to 5 April 2006 as the mortality assumptions used were strengthened to the PA92 mortality table with the medium cohort projections and an age rating of plus one year. This was in line with the market median.

## Notes to the financial statements

All amounts are stated in £m unless otherwise indicated

### 24. Employee benefits (continued)

	2007	2006
<i>Changes in the fair value of the scheme assets are as follows:</i>		
Opening fair value of scheme assets	-	-
Transfer from other Group company	-	1,017.9
Expected return on scheme assets	-	14.1
Actuarial gains	-	13.8
Contributions by employer	-	1.4
Contributions by members	-	1.1
Benefits paid	-	(10.4)
Assets transferred to PACE scheme	-	(1,037.9)
Closing fair value of scheme assets	-	-

All members retiring in normal health have been assumed to retire at age 60.

*The amounts recognised in the statement of recognised income and expenses are as follows:*

Actuarial losses on scheme liabilities during period	-	(60.1)
Actuarial gains on scheme assets during period	-	13.8
Total scheme losses during period	-	(46.3)

*Amounts for the current period are as follows:*

Defined benefits liabilities	-	-
Scheme assets	-	-
Surplus/(deficit)	-	-

Experience adjustments on scheme liabilities	-	(1.4)
Experience adjustments on scheme assets	-	13.8

### Post PACE

With effect from 6 April 2006 CISGIL, along with other businesses within the Co-operative Group, has participated in the Co-operative Group Pension (Average Career Earnings) Scheme (the PACE scheme). This Scheme is a defined benefit scheme, the assets of which are held in a separate fund administered by trustees. As a Group-wide pension scheme, the PACE scheme exposes the participating businesses to actuarial risks associated with the current and former employees of other Group companies, with the result that there is no consistent and reliable basis for allocating the liabilities, assets and costs to individual companies participating in the Scheme. Therefore the pension cost shown in these accounts in respect of the Scheme for the period after 6 April 2006 are the actual contributions paid by CISGIL. A surplus of £438m (2006: £295m) in respect of the PACE scheme is recognised within the Group's consolidated accounts as at 12 January 2008.

### 25. Contingent assets and liabilities

No contingent assets or liabilities have been identified at 12 January 2008 (2006: £nil).

### 26. Commitments

No commitments are in place as at 12 January 2008 (2006: £nil).

### 27. Parent undertaking

CIS General Insurance Limited, a wholly-owned subsidiary of Co-operative Financial Services Limited, is incorporated in Great Britain as an Industrial and Provident Society and is registered in England and Wales.

Co-operative Group Limited (formerly known as Co-operative Group (CWS) Limited) is the ultimate parent and is incorporated in Great Britain as an Industrial and Provident Society and is registered in England and Wales. The results of CISGIL are consolidated in the group headed by the Co-operative Group Limited. The financial statements of the immediate and ultimate holding organisations are available from New Century House, Manchester, M60 4ES.

## 28. Related party transactions

A number of transactions have been entered into during the course of the year with related parties. These have been conducted in the normal course of business and on normal commercial terms. These include the provision of insurance products to members of the wider Co-operative Group and key management personnel. Key management are considered to include the Board and Executive members of the Group. Details of transactions and balances during the financial period are provided below.

### Balances with related parties

	<b>Balances with parent undertaking</b>	<b>Balances with other related parties</b>
At the beginning of the period	(72.0)	(742.5)
Movement in capital value	(33.0)	297.4
At the end of the period	<b>(105.0)</b>	<b>(445.1)</b>

On 15 January 2006 CISGIL received £1,221.7m from CIS under the terms of an indemnification agreement to reinsure the general insurance liabilities of CIS in run off.

During the financial period CISGIL has settled claims of £191.1m (2006: £361.4m) under this agreement, gross technical provisions in the balance sheet include £423.5m (2006: £731.2m), being outstanding claims liabilities of £423.5 (2006: £730.5m) and £nil (2006: £0.7m) in respect of unearned premiums.

During the financial year CISGIL has issued subordinated debt to its intermediate parent CFS. Interest during the financial period amounted to £6.2m (2006: £4.3m).

CISGIL paid a membership dividend to its ultimate parent, Co-operative Group Limited, during the year of £0.7m (2006: £0.8m).

CISGIL have bank accounts with The Co-operative Bank p.l.c. a fellow subsidiary. At the end of 2007, aggregate overdraft balance stood at £13.1m (2006: overdraft of £13.5m).

Included within the balance sheet heading of 'insurance receivables and other assets' CISGIL has accrued income of £nil (2006: £3m) from Co-operative Legal Services Limited, a fellow subsidiary of Co-operative Group Limited.

During the year management fees of £189.1m (2006: £185.8m) included in operating expenses and claims incurred were charged to CISGIL from CFSMS.









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CIS General Insurance Limited  
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