CX Reinsurance Company Limited

Annual Report & Accounts 2002

CX RE

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CHIEF EXECUTIVE OFFICER'S REVIEW

Introduction

I am delighted to be able to present my first report as Chief Executive of CX RE.

31 October 2002 was a notable day for the Company:

- the sale of the Company to Tawa UK Limited was completed;
- the Company became a member of the Financiere Pinault group;
- its name was changed from CNA Reinsurance Company Limited to CX Reinsurance Company Limited ("CX RE"); and
- CX RE entered into a management agreement with Tawa Management Limited.

Since then the management and staff of CX RE, working closely with Tawa Management, have wholeheartedly applied themselves to the tasks involved in addressing the challenges that come with the management of a very substantial and varied portfolio of predominantly London Market liabilities; and of transforming the Company from one designed for and engaged in active underwriting, to one wholly engaged in the business of run-off.

Objective

I am acutely conscious that as a company in run-off CX RE has finite assets with which to meet the cost of uncertain liabilities. As a company in run-off CX RE has no access to a future income stream from new business, its only assets are those to be found on the face of its balance sheet. As a company in run-off CX RE owes a duty to its policyholders, its cedants and its reinsurers to ensure that only properly payable claims are paid in order that the funds available to the Company will be sufficient to ensure that the last claim is paid.

Managing a company in run-off is a complex exercise in risk management. Many things can go wrong during the course of a run-off that will adversely affect a company's financial condition and it is vital that steps are taken both to recognise and manage those risks over the entire course of the run-off. Principal among the steps that must be taken is limiting the period over which things can go wrong thus reducing the exposure to risk. Among the steps that CX RE will be taking to manage and mitigate risk will be:

- the acceleration of the natural period of run-off by execution of a series of commutations of inwards insurance and reinsurance liabilities and outwards reinsurance protections, with a view to the closure of the run-off in the shortest practicable time;
- the prudent stewardship of the Company's finite assets and resources;
- the application of diligent scrutiny in the management and assessment of claims;
- development of the Company's systems, procedures and employees to provide the infrastructure and support required to achieve the Company's objectives.

Challenges

The principal risks faced by the Company are further development of its ultimate liabilities and deterioration of its reinsurance asset.

The Company underwrote a varied book of insurance and reinsurance risks for twenty five years from its base in London and through a small number of international branches. Consequently, the liabilities are derived from many different lines of business and, if allowed to run off without an active programme of commutations, will be exposed to potentially unfavourable judicial and legislative developments. Following a rigorous year end reserving exercise taking account of development experienced, underlying exposures and appropriate market benchmarks, the reserves were strengthened for a number of categories of business, including asbestos, directors and officers and motor liability risks.

As part of the sale, a number of significant reinsurance treaties with CNA Financial Corporation were commuted, as described in the Financial Review. However, the Company retains substantial reinsurance assets that require careful management.

A number of developments in the market give cause for concern. While many active reinsurers are experiencing improved operating results, a number have also recently increased prior year reserves and tightened their approach to the payment of claims. This in turn places additional pressures upon their own reinsurers at a time when many are already facing increased levels of exposure to World Trade Centre claims. We have also noted an increasing incidence of late loss notifications especially in relation to medical malpractice and directors and officers classes, leading to an increased reserving requirement.

CHIEF EXECUTIVE OFFICER'S REVIEW (CONTINUED)

Traditionally, the insurance market has relied upon investment income to offset underwriting losses. However, uncertainty over future investment returns in an environment of low interest rates is restricting the ability of companies to earn an adequate investment return while at the same time limiting the extent to which reserves may be discounted.

One of the unfavourable legislative developments to which the Company and the rest of the international insurance and reinsurance market will be exposed in the future is the risk created by the introduction of the EU's directive on the Reorganisation and Winding-up of Insurance Undertakings. Under the new legislation, which comes into effect on 20 April 2003, creditors under policies of insurance issued by an insolvent UK insurer will have priority over creditors under contracts of reinsurance issued by the same company. Mindful of this risk, the Company has conducted a review of its UK reinsurers to ascertain which of them wrote both insurance and reinsurance risks and would be subject to the new legislation in the event of their insolvency.

Progress

We have made a very encouraging start in preparing the Company to address the challenges and risks of run-off. We have appointed BlackRock Financial Management Inc. as the lead investment manager. The investment portfolio has been adjusted so that its overall credit quality has improved and its maturity profile matches that of the liabilities. Steps have also been taken to match assets to foreign currency exposures. We have instituted an in depth business process review which has identified a number of key projects that will significantly enhance the infrastructure and provision of information when completed.

I am proud of the way in which our management and staff have emerged from a protracted sale process with admirable enthusiasm and commitment to the future. I am enormously grateful to every member of staff and to the members of the Tawa Management team for their support and expertise. I look forward to working with everyone as we face the challenges and maximise the opportunities that the coming year will present.

Philip Singer
Chief Executive Officer

FINANCE REVIEW

Overview

2002 was a year of transformation. The sale of the Company's parent company, CX Management Company Limited, by CNA Financial Corporation ("CNAF") to Tawa UK Limited ("Tawa") was completed in October following regulatory approval. This event heralded the acceleration of the process to convert the Company from one of the London Market's leading active reinsurers to the custodian of a very significant, diverse and complex portfolio of international liabilities. These liabilities relate to the Company's underwriting activities in London since the mid 1970s and, to a lesser extent, from the operations in its branches in Amsterdam, Singapore and Zurich and its contact office in Milan. Activities at these locations were wound up during 2001 and 2002. At the date of sale, the Company changed its name from CNA Reinsurance Company Limited to CX Reinsurance Company Limited.

The principal financial consequences of the sale on the Company were:

- commutation of various reinsurance protections previously provided by CNAF;
- acquisition of two new reinsurance arrangements;
- implementation of a new investment strategy and realignment of the Company's portfolio of fixed income investments to match the payment profile of the liabilities. Such investments are marked to market and technical liabilities are now discounted to take account of the future investment income to be generated prior to settlement of claims. An estimate of expenses related to the run-off of the Company is provided and discounted;
- reassessment and strengthening of the Company's claims outstanding and provisions for doubtful reinsurance recoverables; and
- injection of $20.8 million of additional share capital after the financial year-end.

Other significant features of the Company's financial performance during 2002 were:

- the expiry of the last of the Company's material underwriting exposures following the cessation of underwriting in August 2001;
- strong performance from the investment portfolio throughout the year against the background of cascading equity markets and economic and geo-political uncertainty;
- foreign exchange losses arising from the weakening of the US dollar during the year; and
- injection of $120.0 million of share capital on 25 March 2002 to bring the Company's capital and reserves above the FSA's required minimum solvency margin.

An additional product of the sale was the access afforded to the members of the management team from Tawa. They bring a wide range of experience and expertise in run-off operations and a number of initiatives are underway to develop and implement strategies to effect the efficient management of the Company's finite resources.

Change in reinsurance arrangements

A key feature of the sale was the unwinding of certain significant reinsurance protections with CNAF. The following contracts were commuted upon completion of the sale:

- the whole account stop loss treaty covering the 1987 and prior underwriting years;
- the whole account stop loss providing $125.0 million of cover for the 1997 to 1999 underwriting years; and
- two smaller reinsurance treaties covering professional liability risks written in part of the 1999 underwriting year and a predominantly property reinsurance facility which was utilised in a number of underwriting years.

In addition, the Company's participation in certain whole account stop loss arrangements which were shared with the CNAF was terminated at the sale of the Company. These changes produced reinsurers' share of claims paid of $328.9 million.

At the same time, the following additional reinsurance protections were acquired from Continental Casualty Company, a CNA group company:

- excess of loss cover for the 2001 underwriting year; and
- additional quota share reinsurance to remove the Company's exposure to risks within the IGI portfolio which is described in note 16.

The impact on the Technical Account was an increase in outwards reinsurance premiums written of $62.4 million.

FINANCE REVIEW (CONTINUED)

Technical account

Net earned premium for the year was $(49.4 million) (2001: $201.4 million), representing the earning of the premium unearned at the end of 2001 as adjusted for changes following the reassessment of ultimate premiums, and the impact of the reinsurance transactions referred to above.

Gross claims paid during 2002 were $518.6 million (2001: $503.1 million) and reinsurers' share of claims paid were $512.2 million (2001: $103.7 million). The significant increase in the reinsurers' share of paid claims was due to the proceeds from the commutations of reinsurance protections referred to above.

Net claims incurred prior to discounting (see note 2h) were $339.4 million (2001: $425.5 million) and reflect the impact of the commutations and the strengthening of claims reserves following the year-end reassessment. The strengthening was particularly marked in the following categories: asbestos, directors & officers reinsurance and certain motor liability accounts. The ultimate claims for asbestos have been determined using industry benchmarks based on survival ratios. This strengthening was partly offset by an improvement in the ultimate claims for losses relating to the tragic events of 11 September 2001 net of reinsurance.

The discounting of claims outstanding and the reinsurers' share of claims outstanding has been reintroduced by the Company to reflect the time value of money (that is, investment income earned between provision for a claim and its anticipated date of payment) since the claims will be paid out over a considerable period. The Directors consider that this accounting policy represents the most appropriate approach to the valuation of liabilities and the identification of the true economic position of the Company. The essence of the asset and liability management of the Company is to provide an investment portfolio which comprises securities with a maturity profile matching that of the liabilities. US strip yields in line with the maturity profile of the liabilities are used to discount liabilities. The average mean term of liabilities at the balance sheet date was 7.44 years and the equivalent US strip yield was 3.68%. The effects of discounting on the financial statements were:

- restatement of the opening balance sheet as at 1 January 2002 to reflect discounted claims outstanding which gave rise to a net decrease in claims outstanding net of reinsurance and a consequent increase in net assets of $89.4 million at that date;
- unwind of the discount during 2002 of $36.7 million, reflecting the fact that for claims provided for at the start of the year but not paid during the year, the period over which the liabilities are discounted has been reduced by a year; and
- further increase in discounted net assets of $301.8 million attributable to 2002, due to reassessment of the expected payment pattern of claims, the strengthening of claims reserves and the change in reinsurance arrangements outlined above.

Estimated future costs of the run-off are provided in full and discounted.

Administrative costs during 2002 were $51.1 million (2001: $48.6 million). As in 2001, a significant proportion of the charge is represented by an increase to the provision for doubtful reinsurance recoveries.

Investment return

The investment yield including realised and unrealised gains and losses during the year was 8.0% (2001: 5.8%). This improved return was a function of the performance of US treasuries in a year when uncertainty induced considerable transfer of capital from equities to high grade fixed income investments compounded by reductions in interest rates. In the opinion of the Directors, by the end of the year, the investments and liabilities were appropriately matched in terms of duration to minimise exposure to further movements in interest rates. On review of the Company's investment strategy, following its acquisition by Tawa, the average security rating of the portfolio was increased to AA.

Shareholders' funds and solvency

At 31 December 2002, the Company's shareholders' funds were $157.4 million (2001: $33.9 million). Subsequent to the year end, on 30 January 2003, the Company made the following issues of share capital:

- 12,654,013 £1 shares (equivalent to $20.8 million) at par to strengthen the capital base of the Company; and
- 1 £1 share (at a premium equivalent to $11.3 million) representing a capitalisation of part of the profit and loss account balance at the year end.

Colin Bird
Director and Treasurer

REPORT OF THE DIRECTORS

The Directors present their thirtieth annual report together with the financial statements for the year ended 31st December 2002.

Principal activity

The principal activity of CX Reinsurance Company Limited is the carrying out of reinsurance contracts written prior to August 2001 when the Company ceased underwriting new business.

Business review

In connection with the Company's transition to formal run-off status, the Financial Services Authority approved the Company's application to vary its Part IV permission to remove permission to effect contracts of insurance. On 31 October 2002 Tawa became a controller of the Company as a result of its acquisition of the entire issued share capital of the Company's immediate parent company. A review of the Company's business is set out in the Chief Executive Officer's Review and the Financial Review on pages 2 to 5, and the results for the year are set out on pages 11 and 12.

The Directors do not recommend that a final dividend be paid (2001: Nil). The balance from the profit and loss account is to be transferred to reserves.

Capital

On 25 March 2002 a share issue of $120.0 million was made. Subsequent to the year end, on 30 January 2003, the Company made the following issues of share capital:

- 12,654,013 £1 shares (equivalent to $20.8 million) at par to strengthen the capital base of the Company; and
- 1 £1 share (at a premium equivalent to $11.3 million) representing a capitalisation of part of the profit and loss account balance at the year end.

Directors and Directors' interests

The Directors of the Company are listed on page 8 and, unless otherwise shown, served throughout the year.

None of the Directors held an interest in the shares of the Company. Certain of the Directors are also directors of Tawa group companies and their interests are disclosed in the accounts of those companies.

None of the Directors had any interest in any material contract entered into or subsisting during the year and relating to the business of the Company.

The Company made no political or charitable donations during the year (2001: Nil).

Statement of Directors' responsibilities

United Kingdom company law requires the Directors to prepare financial statements for each financial year which give a true and fair view of the state of affairs of the Company as at the end of the financial year and of the profit or loss of the Company for that period. In preparing those 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 applicable accounting standards have been followed; and
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the Company will continue in business.

The Directors are responsible for keeping proper accounting records which disclose with reasonable accuracy at any time the financial position of the Company and to enable them to ensure that the financial statements comply with the Companies Act 1985. They are also responsible for the system of internal control, for safeguarding the assets of the Company and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

REPORT OF THE DIRECTORS (CONTINUED)

Auditors

Deloitte & Touche have expressed their willingness to continue in office as auditors in accordance with the provisions of the Companies Act 1985.

By order of the Board

C H E Jones

Company Secretary

31 March 2003

CORPORATE INFORMATION

Directors

G M J Erulin (France) Chairman - Appointed 31 October 2002
C G Bird – Appointed 31 October 2002
P J Singer Chief Executive Officer – Appointed 31 October 2002

W J Adamson (USA) - Resigned 1 February 2002
D K Davies – Appointed 9 April 2002; Resigned 31 October 2002
D P Lofe, Jr. (USA) – Appointed 13 June 2002; Resigned 31 October 2002
D L McClenahan (USA) - Resigned 31 October 2002
R R Mueller (USA) - Resigned 31 October 2002
S J Riley - Resigned 30 April 2002

Head Office & Registered Office

The Corn Exchange
55 Mark Lane
London
EC3R 7NE

Registered Number: 1086556

(England and Wales)

Company Secretary

C H E Jones FCIS

REPORT OF THE INDEPENDENT AUDITORS

To the members of CX Reinsurance Company Limited

We have audited the financial statements of CX Reinsurance Company Limited for the year ended 31 December 2002 which comprise the profit and loss account, the balance sheet and the related notes 1 to 21. These financial statements have been prepared under the accounting policies set our therein.

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

Respective responsibilities of directors and auditors

As described in the statement of directors' responsibilities, the Company's Directors are responsible for the preparation of the financial statements in accordance with applicable United Kingdom law and accounting standards. Our responsibility is to audit the financial statements in accordance with relevant United Kingdom legal and regulatory requirements and auditing standards.

We report to you our opinion as to whether the financial statements give a true and fair view and are properly prepared in accordance with the Companies Act 1985. We also report if, in our opinion, the Directors' Report is not consistent with the financial statements, if the Company has not kept proper accounting records, if we have not received all the information and explanations we require for our audit, or if information specified by law regarding directors' remuneration and transactions with the Company is not disclosed.

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

Basis of opinion

We conducted our audit in accordance with United Kingdom auditing standards issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the financial statements. It also includes an assessment of the significant estimates and judgements made by the Directors in the preparation of the financial statements, and of whether the accounting policies are appropriate to the Company's circumstances, consistently applied and adequately disclosed.

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

Equalisation reserves

Our evaluation of the presentation of information in the financial statements has had regard to the statutory requirement for insurance companies to maintain equalisation reserves. The nature of equalisation reserves, the amounts set aside at 31 December 2002, and the effect of the movement in those reserves during the year on the general business technical account and profit before tax are disclosed in note 2g.

Fundamental uncertainty arising from the terrorists' attacks in the US on 11 September 2001

In forming our opinion, we have considered the adequacy of the disclosures made in note 16a to the accounts concerning uncertainties relating to the assessment of ultimate liabilities associated with the events of 11 September 2001, and the impact on the reinsurance assets included within the financial statements. This matter gives rise to significant uncertainty, in respect of the extent of the ultimate gross liabilities and the impact on reinsurance assets held at 31 December 2002. The resolution of these issues may result in material, but presently unquantifiable adjustments to the liabilities and the reinsurance assets included in the financial statements. Our opinion is not qualified in this respect.

Fundamental uncertainty affecting personal accident business written from 1997 to 1999

In forming our opinion, we have considered the adequacy of the disclosures made in note 16b to the accounts concerning uncertainties relating to the assessment of ultimate liabilities associated with certain personal accident business and reinsurance recoveries thereon. This matter gives rise to significant uncertainty in respect of the extent of the ultimate gross

REPORT OF THE INDEPENDENT AUDITORS (CONTINUED)

liabilities and reinsurance recoveries held at 31 December 2002. The resolution of these issues may result in material, but presently unquantifiable adjustments to the liabilities and the related assets included in the financial statements. Our opinion is not qualified in this respect.

Opinion

In our opinion the financial statements give a true and fair view of the state of the Company's affairs as at 31 December 2002 and of its loss for the year then ended and have been properly prepared in accordance with the Companies Act 1985.

31 March 2003

Deloitte & Touche

Deloitte & Touche
Chartered Accountants and Registered Auditors
London

PROFIT AND LOSS ACCOUNT

For the year ended 31 December 2002

Technical Account – General Business

	Notes	2002 US$000	2002 US$000	2001 US$000 Restated	2001 US$000 Restated
Gross premiums written	4		**3,669**		185,763
Outward reinsurance premiums			**(85,549)**		(68,376)
Net premiums written			**(81,880)**		117,387
Change in the provision for unearned premiums					
Gross amount		**40,039**		107,563	
Reinsurers' share		**(7,598)**		(23,596)	
			32,441		83,967
Earned premiums, net of reinsurance	4		**(49,439)**		201,354
Allocated investment income from the Non-Technical Account			**99,110**		66,632
Claims paid					
Gross amount		**(518,637)**		(503,069)	
Reinsurers' share		**512,195**		103,686	
		(6,442)		(399,383)	
Change in the provision for claims					
Gross amount		**300,592**		(113,406)	
Reinsurers' share		**(633,483)**		87,342	
Impact of discounting	16	**265,018**		(23,660)	
		(67,873)		(49,724)	
Net claims incurred	4		**(74,315)**		(449,107)
Net operating expenses	4,5		**(61,561)**		(113,519)
Balance on the Technical Account – General Business	4		**(86,205)**		(294,640)

Since the Company ceased underwriting in August 2001, the results of the operations relate to discontinued activities. However, the Company continues to manage its general insurance and reinsurance business.

The notes on pages 15 to 24 form part of these financial statements.

PROFT AND LOSS ACCOUNT

For the year ended 31 December 2002

Non-Technical Account

	Notes	2002 US$000	2002 US$000	2001 US$000 Restated	2001 US$000 Restated
Balance on the Technical Account – General Business			**(86,205)**		(294,640)
Investment return					
Investment income and realised gains	6	**79,647**		53,592	
Unrealised investment gains	6	**19,781**		13,234	
Investment expenses and charges	6	**(318)**		(194)	
Allocated to the Technical Account		**(99,110)**		(66,632)	
			-		-
Other income			**250**		1,711
Loss on ordinary activities before tax			**(85,955)**		(292,929)
Tax on loss on ordinary activities	10		**-**		-
Loss for the financial year	15		**(85,955)**		(292,929)

STATEMENT OF TOTAL RECOGNISED GAINS AND LOSSES

For the year ended 31 December 2002

	Notes	2002 US$000	2001 US$000 Restated
Loss for the financial year		**(85,955)**	(292,929)
Prior year adjustment	16	**89,496**	-
Total recognised gains and losses since the last annual report		**3,541**	(292,929)

The notes on pages 15 to 24 form part of these financial statements.

BALANCE SHEET
As at 31 December 2002

	Notes	2002 US$000	2001 US$000 Restated
Assets			
Investments			
Other financial investments	12	**1,423,143**	1,153,226
Reinsurers' share of technical provisions			
Provision for unearned premiums		**-**	7,571
Claims outstanding	16	**414,350**	904,138
		414,350	911,709
Debtors			
Debtors arising out of direct insurance operations		**349**	549
Debtors arising out of reinsurance operations		**174,530**	323,036
Other debtors	13	**48,254**	22,575
		223,133	346,160
Other assets			
Cash at bank and in hand		**4,868**	9,940
Prepayments and accrued income			
Deferred acquisition costs		**-**	10,654
Other prepayments and accrued income		**15,906**	17,269
		15,906	27,923
Total assets		**2,081,400**	2,448,958

The notes on pages 15 to 24 form part of these financial statements.

BALANCE SHEET
As at 31 December 2002

	Notes	2002 US$000	2001 US$000 Restated
Liabilities			
Capital and reserves			
Called up share capital	14	**492,419**	372,419
Profit and loss account	15	**(335,007)**	(249,052)
Shareholders' funds attributable to equity interests		**157,412**	123,367
Technical provisions			
Provision for unearned premiums		**-**	38,738
Claims outstanding	16	**1,737,705**	2,088,445
		1,737,705	2,127,183
Creditors			
Creditors arising out of direct insurance operations		**27**	912
Creditors arising out of reinsurance operations		**73,996**	182,675
Deferred reinsurance commissions		**-**	3,143
Other creditors including tax and social security	18	**112,260**	11,678
		186,283	198,408
Total liabilities		**2,081,400**	2,448,958

The notes on pages 15 to 24 form part of these financial statements.

These financial statements were approved by the board of directors on 27 March 2003 and were signed on its behalf on 31 March 2003 by:

Philip Singer
Chief Executive Officer

NOTES TO THE ACCOUNTS

1. Basis of preparation

The financial statements have been prepared in accordance with the provisions of Section 255 of, and Schedule 9A to, the Companies Act 1985 and in accordance with applicable Accounting Standards in the United Kingdom. The financial statements have been prepared in accordance with the historical cost convention, as modified by the revaluation of certain assets, and comply with the Statement of Recommended Practice on Accounting for Insurance Business issued in December 1998 by the Association of British Insurers.

The Company is exempt under Financial Reporting Standard No. 1 (Revised) from the requirement to disclose a cash flow statement.

2. Accounting policies

A summary of the more important accounting policies, which have been applied consistently unless otherwise stated, is set out below.

a) Basis of accounting for underwriting activities
All classes of business are accounted for on an annual basis, whereby the incurred cost of claims, commissions and expenses are charged against the earned proportion of premiums, net of reinsurance arising in the financial year.

b) Premiums
Written premiums, gross of commission payable to intermediaries, comprise the Company's share of written premiums on contracts entered into during a financial year, regardless of whether such amounts may relate in whole or in part to a later financial year, exclusive of taxes and duties levied on premiums. Premiums written include adjustments to premiums written in prior accounting periods and estimates for pipeline premiums. For inwards proportional reinsurance treaties and certain binding authorities and lineslips, written premium is included in line with anticipated writing patterns of cedants and agents. Outward reinsurance premiums are accounted for in the same accounting period as the premiums for the related direct insurance or inwards reinsurance business.

c) Unearned premiums
Provision for unearned premiums comprises those elements of gross premiums written and outward reinsurance premiums which are estimated to be earned in the following or subsequent financial years, computed separately for each insurance or reinsurance contract using the daily pro rata method and taking into account the risk profile of the contracts.

d) Acquisition costs
Acquisition costs comprise the expenses, both direct and indirect, of acquiring insurance policies written during the financial year. Deferred acquisition costs represent the proportion of acquisition costs incurred which corresponds to the proportion of gross premiums written which are unearned at the balance sheet date.

e) Claims incurred
Claims incurred include all claims and internal and external claims settlement expense payments made in respect of the financial year, together with the movement in the provision for claims outstanding and internal and external claims settlement expenses, including claims incurred but not reported.

Outwards reinsurance recoveries are accounted for in the same accounting period as the claims for the related direct or inwards reinsurance business being reinsured.

f) Claims outstanding
Claims outstanding comprise provisions for the estimated cost of settling all claims incurred up to, but not paid at, the balance sheet date, whether reported or not, together with all future costs related to the management of the run-off of the portfolio of claims. Where applicable, prudent estimates are made for salvage and subrogation recoveries.

The gross claims outstanding provisions and related reinsurance recoveries, net of specific provision for doubtful recoveries, are determined on the basis of information currently available. Adjustments to the amount of the provisions are reflected in the financial statements for the period in which the adjustments are made. The methods used and the estimates made are reviewed regularly.

g) Equalisation provisions
Equalisation provisions are established in accordance with the requirements of UK legislation. These provisions, which are in addition to the provisions required to meet the anticipated ultimate cost of settlement of outstanding claims at the balance sheet date, are required by Schedule 9A to the Companies Act 1985 to be included within technical provisions in the balance sheet, notwithstanding that they do not represent liabilities at the balance sheet date. These provisions have no effect on the financial statements for the year (2001: nil).

2. Accounting policies (continued)

h) Discounting
The Company's net technical provisions, estimated as set out in note 3 below, will be paid over a period of many years dependent upon the nature of the underlying risk, the claims outstanding and the related reinsurance recoveries. The net future liabilities have been reduced or "discounted" by an amount representing a prudent estimate of future investment income from income producing assets set aside to meet net claims liabilities. The Company's investment portfolio has been structured to minimise interest rate exposure such that the maturity profile of the fixed income investments matches the maturity profile of the technical provisions. The discount rate, hence anticipated future investment income, has been calculated with reference to relevant dates on the US strip yield curve for US government Treasury bonds. This is consistent with a marked-to-market value for the invested assets of the Company at the balance sheet date.

Accordingly, the use of discounted technical provisions in representing the economic position of the Company necessarily depends upon the accuracy of the Company's estimate of:

- (i) future claims payments and associated reinsurance recoveries;
- (ii) the payment profiles attributable to claims payments and related reinsurance recoveries; and
- (iii) the future rate of return expected on invested assets.

i) Foreign currencies
The Company has chosen to represent its financial statements in US dollars as the Directors consider this more closely reflects the trading activities of the business. Premium, claim and commission transactions during the year are recorded in ledgers denominated in the recognised settlement currencies and translated into US dollars at the exchange rates prevailing at the balance sheet date. Other revenue transactions are recorded at average rates of exchange during the year. Monetary assets and liabilities are converted into US dollars at the exchange rates prevailing at the balance sheet date. Differences on exchange are dealt with in the Non-Technical Account.

The Company pursues a strategy of matching its estimate of the discounted net liability in each significant currency of exposure with currency or currency denominated instruments.

j) Investment income, expenses and charges
Investment income is accounted for on a receivable basis, excluding the imputed tax credit. Interest is accrued up to the balance sheet date. Realised gains or losses represent the difference between net sales proceeds and purchase price.

k) Unrealised gains and losses on investments
Unrealised gains and losses represent the difference between the valuation of investments at the balance sheet date and their purchase price. The movement in unrealised gains and losses comprises the increase/decrease in the year in the value of the investments held at the balance sheet date, together with the reversal of unrealised gains and losses recognised in earlier accounting periods in respect of investments disposed of in the current period.

l) Taxation
Taxation is provided for by reference to the profits and losses recognised in these accounts after taking account of group relief. Deferred taxation is provided in full on timing differences between recognition of gains and losses in the financial statements and the recognition for taxation purposes. Deferred taxation liabilities are provided in relation to transactions that have occurred by the balance sheet date. Deferred taxation assets are recognised to the extent that it is regarded as more likely than not that they will be recovered.

m) Investments
Investments are shown in the financial statements at market value at the balance sheet date.

n) Restatement of comparatives
The Company has reintroduced discounting of claims outstanding during the year. As a consequence, it has been necessary to restate the following comparatives in order to provide information relating to 2001 on a consistent basis with that for 2002:

- (i) restatement of the profit and loss account to reflect the impact of discounting;
- (ii) restatement of claims outstanding and reinsurers share of claims outstanding to show discounted values;
- (iii) restatement of the profit and loss account within capital and reserves to reflect the prior year adjustment; and
- (iv) allocation of the investment return from the Non-Technical Account to the Technical Account.

3. Bases of claims reserving

As stated in note 2, the Company sets its provision for claims outstanding based on the estimated ultimate cost of all claims notified but not settled by the balance sheet date, together with the provision for related claims handling costs and net of salvage and subrogation recoveries. The provision also includes the estimated cost of claims incurred but not reported at the balance sheet date based on statistical methods and market benchmarks, as appropriate.

The adequacy of the claims outstanding provisions is assessed by reference to actuarial projections of the ultimate development of claims in respect of each accident year. This provision is derived through extensive analysis by the Company's in-house actuaries. The methods used, and the estimates made, are reviewed regularly.

Whilst the Directors consider that the gross provision for claims and the related recoveries are fairly stated on the basis of the information currently available to them, there is inherent uncertainty in relation to the insurance industry by its nature. This uncertainty is such that the ultimate liability, which will vary as a result of subsequent information and events, may result in adjustments to the amount provided. Adjustments to the amount of the provisions are reflected in the financial statements for the period in which the adjustments are made.

Significant delays occur in the notification of certain claims and a substantial measure of experience and judgement is involved in assessing outstanding liabilities, the ultimate cost of which cannot be known with certainty at the balance sheet date. In particular estimates of technical provisions inevitably contain inherent significant uncertainties because extensive periods of time may elapse between the occurrence of an insured loss, the claim triggering the insurance under a claims-made coverage, the reporting of that claim and the payment of the claim and the receipt of reinsurance recoveries.

Following the commutation during the year of the whole account stop loss reinsurance contract with Continental Casualty Company protecting the 1987 and prior underwriting years referred to in note 19 (i) below, the Company has net exposure to claims and claims related expenses emanating from exposures to asbestos, environmental pollution and other latent injuries. In determining the reserves for such claims, the Company's actuaries have taken account of paid and incurred development, suitable industry benchmarks and the nature of the Company's exposure without undertaking a full exposure analysis. Such claims are frequently subject to disputes such as the extent of coverage and definitions of occurrence and possible legislative changes. Consequently, reserves for claims of this type cannot be determined using traditional actuarial techniques and the uncertainty surrounding the ultimate cost of settlement is greater than for more standard claims within the Company's portfolio. Significant adverse development may have a material impact on the Company's future results and net assets.

The level of uncertainty inherent in the recoverability of reinsurance recoveries is enhanced at this point in time due to the fact that losses resulting from September 11, coming on top of several years of poor results in the reinsurance industry, have stressed reinsurers' resources. Included in the Company's balance sheet are substantial reinsurance recoveries. The Directors have assessed exposure to bad debts arising from reinsurance dispute or failure and, following careful review, have made a provision against bad debts based on current information available.

The provision for claims outstanding and the provision for all future expenses related to the run-off of the liabilities are discounted to take account of future investment income which will be generated prior to settlement of the claims, as outlined in note 2h above.

The significant current issues causing uncertainties which are greater than normal in the provisions are disclosed in note 16.

4. Segmental reporting

	Insurance Operations 2002 US$000	Reinsurance Operations 2002 US$000	Total 2002 US$000	Insurance Operations 2001 US$000 Restated	Reinsurance Operations 2001 US$000 Restated	Total 2001 US$000 Restated
Gross premiums written	**(3,822)**	**7,491**	**3,669**	14,476	171,287	185,763
Outward reinsurance premiums	**1,778**	**(87,327)**	**(85,549)**	2,716	(71,092)	(68,376)
Net premiums written	**(2,044)**	**(79,836)**	**(81,880)**	17,192	100,195	117,387
Gross earned premiums	**(2,102)**	**45,790**	**43,688**	36,096	257,230	293,326
Outward reinsurance premiums	**2,409**	**(95,536)**	**(93,127)**	(3,940)	(88,032)	(91,972)
Net earned premiums	**307**	**(49,746)**	**(49,439)**	32,156	169,198	201,354
Allocated investment income from the Non-Technical Account	**15,247**	**83,863**	**99,110**	11,888	54,744	66,632
Gross claims incurred	**(5,310)**	**(212,735)**	**(218,045)**	(84,569)	(531,906)	(616,475)
Reinsurers' share	**(51,737)**	**(69,551)**	**(121,288)**	53,931	137,097	191,028
Impact of discounting	**40,772**	**224,246**	**265,018**	(4,221)	(19,439)	(23,660)
Net claims incurred	**(16,275)**	**(58,040)**	**(74,315)**	(34,859)	(414,248)	(449,107)
Gross operating expenses	**(7,114)**	**(55,525)**	**(62,639)**	(13,465)	(113,402)	(126,867)
Reinsurers' share	**463**	**615**	**1,078**	378	12,970	13,348
Net operating expenses	**(6,651)**	**(54,910)**	**(61,561)**	(13,087)	(100,432)	(113,519)
Balance on the Technical Account – General Business	**(7,372)**	**(78,833)**	**(86,205)**	(3,902)	(290,738)	(294,640)

Gross written premium by geographical segment (calculated by domicile of ceding company):	2002 US$000	2001 US$000
USA	**3,669**	63,659
UK	**-**	53,136
Other EU	**-**	44,948
Rest of the world	**-**	24,020
	3,669	185,763

Net assets are maintained to meet the solvency requirements of the Company as a whole and, as a consequence, segmental analysis of net assets has not been provided.

5. Net operating expenses

	2002 US$000	2001 US$000
Acquisition costs	**684**	54,332
Change in gross deferred acquisition costs	**10,876**	23,945
Administrative expenses	**51,071**	48,590
Gross operating expenses	**62,631**	126,867
Reinsurance commissions and profit participation	**2,033**	(8,999)
Change in deferred reinsurance commissions	**(3,103)**	(4,349)
	61,561	113,519

6. Investment return

	2002 US$000	2001 US$000
Investment income	**55,504**	48,610
Realised investment gains	**24,143**	4,982
	79,647	53,592
Unrealised investment gains	**19,781**	13,234
Investment management expenses	**(318)**	(194)
Investment return	**99,110**	66,632

7. Employees' remuneration

Members of staff are employed by CX Management Company Limited, the Company's immediate parent company. The Company's share of the total remuneration and numbers of employees, which are recharged to the Company, including the Directors and Directors' emoluments in note 8 below, are as follows:

	2002 US$000	2001 US$000
Wages and salaries	**6,349**	11,571
Social security costs	**1,350**	1,312
Other pension costs	**1,451**	1,533
	9,150	14,416
Average number of employees	**68**	141

8. Directors' emoluments

	2002 US$000	2001 US$000
Highest paid director		
Emoluments	**146**	465
Contributions to defined contribution pension scheme	**43**	62
	189	527
All directors		
Emoluments	**146**	613
Contributions to defined contribution pension scheme	**43**	78
	189	691
Number of directors qualifying for:		
(i) defined contribution pension scheme	**1**	2
(ii) defined benefit pension scheme	**-**	-

The pension scheme for CX Management Company Limited group is funded by CX Management Company Limited. Details of the scheme are disclosed in that company's accounts.

9. Auditors' remuneration

Profit on ordinary activities before tax is stated after charging auditors' remuneration as follows:

	2002 US$000	2001 US$000
Audit services		
Current year	**212**	**260**
Non-audit services	**285**	**154**
	497	**414**

10. Taxation

	2002 US$000	2001 US$000
UK corporation tax at 30%		
Based on the loss for the year	-	-
	-	-

The difference between available tax credit on the loss for the year, at the taxation rate of 30%, and the actual tax recognised in the current year financial statements, is due to deferred taxation not being recognised since it is not expected to be realised in the foreseeable future.

11. Rates of exchange

The rates of exchange used to translate items denominated in foreign currency relative to US$1 for significant currencies are as follows:

	2002	2001
United Kingdom	**£0.63**	£0.70
Euro	**€1.02**	€1.12

12. Investments

	Market Value		Cost	
	2002 US$000	2001 US$000	2002 US$000	2001 US$000
Listed variable yield securities and unit trusts	**11,563**	10,036	**10,881**	9,535
Listed debt securities and other fixed interest securities	**1,106,600**	1,070,918	**1,074,911**	1,052,398
Deposits with credit institutions	**304,980**	72,272	**304,980**	72,080
	1,423,143	1,153,226	**1,390,772**	1,134,013

All the listed investments are quoted on a recognised investment exchange.

In accordance with normal market practice, Citibank N.A. and Barclays Bank PLC have issued letters of credit for unearned premiums and outstanding losses. The collateral against these letters of credit includes a pledge to the value of $120.0 million (2001: $120.0 million) against an investment portfolio, and charges to the value of $1.9 million (2001: $1.9 million) against certain bank deposits.

The Company has established trust funds for the benefit of its US reinsurance and US surplus lines policyholders. The values of the trust investments in the respective trusts included above, are $828.4 million (2001: $762.4 million) and $62.8 million (2001: $60.4 million). The $828.4 million for the US reinsurance trust fund includes the $102.4 million mortgage-backed security referred to in note 18.

13. Other debtors

	2002 US$000	2001 US$000
Corporation tax recoverable	**1,417**	6,043
Amounts due from group companies	**32,307**	15,091
Other debtors	**14,530**	1,441
	48,254	22,575

14. Called up share capital and shareholders' funds

Called up share capital	2002	2001
Authorised 400,000,000 ordinary shares of £1 each (2001: 250,000,000)	**400,000,000**	250,000,000
Allotted, called up and fully paid 331,270,266 (2001: 246,911,742) ordinary shares of £1 each	**$492,419,000**	$372,419,000

Shareholders' funds attributable to equity interests	**2002 US$000**	**2001 US$000 Restated**
Loss for the financial year	**(85,955)**	(292,929)
Issue of share capital	**120,000**	75,000
Net increase/(reduction) in shareholders' funds	**34,045**	(217,929)
Opening shareholders' funds as previously reported	**33,871**	228,140
Prior period adjustment	**89,496**	113,156
At 31 December	**157,412**	123,367

On 25 March 2002 the Company issued 84,358,524 £1 shares (equivalent to $120 million) at par to mitigate the impact of underwriting losses on its capital base.

Subsequent to the year end, on 30 January 2003, the Company made the following issues of share capital:

- 12,654,013 £1 shares (equivalent to $20.8 million) at par to strengthen the capital base of the Company; and
- 1 £1 share (at a premium equivalent to $11.3 million) representing a capitalisation of part of the profit and loss account balance at the year end.

15. Profit and loss account

	Profit & loss account 2002 US$000
At 1 January as reported	**(338,548)**
Prior period adjustment	**89,496**
	(249,052)
Retained loss for the year	**(85,955)**
At 31 December 2002	**(335,007)**

16. Claims outstanding

	Gross claims 2002 US$000	**Reinsurance 2002 US$000**	**Net 2002 US$000**	**Gross Claims 2001 US$000**	**Reinsurance 2001 US$000**	**Net 2001 US$000**
Provision before discounting	**2,202,137**	**524,268**	**1,677,869**	2,429,602	1,155,799	1,273,803
Discount	**464,432**	**109,918**	**354,514**	341,157	251,661	89,496
Net of discount	**1,737,705**	**414,350**	**1,323,355**	2,088,445	904,138	1,184,307

All claims outstanding and the provision for future administrative expenses are discounted to reflect the investment income which will be generated prior to settlement of the underlying claims and expenses.

16. Claims outstanding (continued)

The average mean term of the total portfolio of net liabilities is 7.44 years. The mean terms of gross claims outstanding and related reinsurance recoveries are projected separately taking into account historic payment patterns and the expected impact of the Company's cessation of underwriting activities and the implementation of the Company's run-off strategy.

The rate of investment return used for discounting is 3.68%.

Prior period adjustment

In recent years, claims outstanding have not been discounted. This policy was changed during the year so that the accounts now take account of the time value of money and disclose the shareholders' funds on a more economic basis. This change has the following implications for the financial statements:

	2002	2001
Profit and Loss Account	**US$000**	**US$000**
Increase in opening balance	**89,496**	113,156
Change in loss for financial year		
Impact of discounting	**265,018**	(23,660)
Increase in closing balance	**354,514**	89,496
Balance sheet		
Decrease in claims outstanding	**464,432**	341,157
Decrease in reinsurers' share of claims outstanding	**(109,918)**	(251,661)
	354,514	89,496

a.) 11 September 2001

The Company has material exposure to claims arising from the tragic events in the United States on 11 September 2001. Due to the size and complexity of these losses, the ultimate outcome of the gross claims is subject to greater uncertainty than has been the case with other catastrophes to which the Company has been exposed. Similarly, as a consequence of the issues relating to the gross claims, there is uncertainty surrounding the quantum of retrocessional recoveries accruing to the Company on these losses. The Company has undertaken a careful review of all contracts with exposure to losses from the terrorist attacks and the Directors consider that the reserves and the related reinsurance recoveries have been established on an appropriate basis. The results for the year reflect gross undiscounted reserves of $126.7 million and undiscounted reinsurance recoveries of $49.0 million. As a result of the uncertainty implicit within these claims, these estimates may be subject to potentially significant adjustments in future years.

b.) Personal accident programme

In 1997, the Company entered into an arrangement with IOA Global, Ltd. ("IOA"), an independent managing general agent based in Philadelphia, Pennsylvania, to develop and manage a book of accident and health coverages. Pursuant to this arrangement, IGI Underwriting Agencies, Ltd. ("IGI"), a personal accident reinsurance managing general underwriter, was appointed to underwrite and market the book under the supervision of IOA. Between April 1, 1997 and December 1, 1999, IGI underwrote a number of reinsurance arrangements with respect to personal accident insurance worldwide ("the IGI Program"). Under various arrangements, the Company both assumed risks as a reinsurer and also ceded a substantial portion of those risks to other companies. With effect from 1 January 2002, the Company acquired additional reinsurance protection so that from that date the Company has no remaining net liability from risks written through IGI.

The Company has determined that a portion of the premiums assumed under the IGI Program related to United States workers compensation "carve-out" business. Some of these premiums were received from John Hancock Financial Services, Inc. ("John Hancock"). The Company is aware that a number of reinsurers with workers compensation carve-out insurance exposure, including John Hancock, have disavowed their obligations under various legal theories. If one or more such companies are successful in avoiding or reducing their liabilities, then it is likely that the Company's potential liability will also be reduced. Moreover, based on information known at this time, the Company believes it has strong grounds to challenge successfully its alleged exposure on a substantial portion of its United States workers compensation carve-out business, including all purported exposure derived from John Hancock, through legal action.

16. Claims outstanding (continued)

The Company has gross established reserves for its estimated exposure under the program (net zero after taking account of reinsurance), other than that derived from John Hancock. The Company has not established any reserve for any exposure derived from John Hancock because, as indicated, the Company believes the contract will be rescinded. The Company is pursuing a number of loss mitigation strategies with respect to the entire IGI portfolio. Although the expected results of these various actions supports the recorded provisions, the estimates of the Company's ultimate gross losses are subject to considerable uncertainty. As a result of this uncertainty, these estimates may be subject to potentially material adjustments in future years.

17. Changes to prior year estimates

In the normal course of business the Company's ultimate projections of accident year premiums, commissions and claims are estimated using actuarial methodologies (see note 3). The impact of movements during the year on prior year estimates, reflected in the Technical Account - General Business, prior to the impact of discounting, was a net loss of $381.4 million (2001: loss of $127.8 million), comprising movements in net earned premiums of (loss) $62.8 million, net incurred commissions of (loss) $0.4 million and net incurred claims (loss) of $318.2 million.

18. Other creditors

	2002 US$000	**2001 US$000**
Cost of financial investment acquired prior to year end	**102,406**	-
Sundry creditors	**9,854**	11,678
	112,260	11,678

The cost of financial investment acquired prior to year end relates to a mortgage-backed security which was acquired as part of the strategy to adjust the investment portfolio. Settlement occurred after the year end.

19. Related party transactions

Up to 2002, the Company entered into a number of reinsurance agreements with Continental Casualty Company ("CCC"), a member of the CNA Financial Corporation Group and an intermediate parent company of the Company prior to the sale of the Company on 31 October 2002. The material arrangements relevant to the current year are summarised below. All transactions were prior to 31 October 2002 and were conducted on normal commercial terms.

(i) Up to and including the 1990 underwriting year, closed underwriting years under the three-year accounting convention were reinsured by CCC on 1 January of the year following their close. The cost of this protection approximated to expected future payments taking account of the time value of money. With effect from 1 July 1999, the 1988, 1989 and 1990 underwriting years under this reinsurance agreement were commuted.

(ii) The Company retroceded to CCC between 70% and 80% of the business written through IGI Underwriting Agencies Limited, as described in note 16.

(iii) In December 1999, the Company entered into a whole account stop loss contract with CCC which, in summary, provided $125 million of reinsurance protection for the 1997, 1998 and 1999 underwriting years.

(iv) The Company also retroceded risks to CCC under various treaties which form an integral part of the Company's outwards reinsurance programme. None of these transactions was individually material to these financial statements.

As part of the sale of the Company, the following changes in the reinsurance agreements were made:

(v) The contracts referred to in (i), (iii) and (iv) were all commuted.

(vi) The reinsurance cover referred to in (ii) was extended so that all remaining exposure of the Company to contracts written through IGI Underwriting Agencies Limited is reinsured by CCC.

(vii) In addition, excess of loss cover for the 2001 underwriting year was purchased from CCC.

Following its sale, the Company entered into a management agreement with Tawa Management Limited for the provision of management services to the Company.

20. Contingent liabilities

Guarantees have been given by the Company in favour of The Prudential Assurance Company Limited and The Royal Bank of Scotland (Industrial Leasing) Limited in respect of leases granted to Market Building Limited. The fire that occurred in August 1991, in the course of fitting out the London Underwriting Centre, gave rise to the likelihood of a shortfall of rental income and finance lease payments.

The Company's immediate parent, CX Management Company Limited, has undertaken to meet any liability arising, pursuant to the granting of these guarantees, during the period up to March 2006 and has made full provision for this in its own accounts.

21. Parent company

The Company's immediate parent company is CX Management Company Limited, a company registered in England and Wales, and copies of the financial statements are obtainable from The Registrar of Companies, Companies House, Cardiff. Following the sale of the Company's immediate parent company to Tawa UK Limited on 31 October 2002, the Company became a member of the Financiere Pinault group. The ultimate holding company is incorporated in France.

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