CX Reinsurance Company Limited

Annual Report & Accounts 2003

CONTENTS

CHIEF EXECUTIVE OFFICER'S REVIEW

Introduction

With effect from 1 January 2004, Philip Singer became CEO of Tawa Management Limited, the company which now has the contract to provide management and run-off services to CX RE. I was appointed CEO and Philip stood down from that position; however I am pleased that Philip continues to serve as a director.

A significant amount has been achieved during the year to ensure that the Company is properly positioned to benefit from the implementation of its strategy to accelerate the run-off of its liabilities. However, the spectre of reserve deterioration has once again emphasised the risks and challenges inherent within the Company's complex, international portfolio of liabilities, derived from writing principally in the London Market for approximately 25 years, and the need to act decisively with a clear strategy.

Objectives

As set out in last year's report, at CX RE we are very much aware of the risks that a company in run-off faces and of our responsibilities towards the Company's policyholders, cedants and reinsurers. Since the Company stopped underwriting in August 2001, its premium income stream has all but dried up and the Company is left with a finite set of assets out of which to meet all its obligations.

The key parts of the strategy for the run-off continue to be to:

- accelerate the natural period of run-off by the 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;
- protect the Company's finite assets and resources;
- assess the validity of claims presented to the Company with due rigour; and
- develop the systems, procedures and human resources available to the Company to provide the infrastructure and support required to achieve the Company's objectives.

Risks

The Profit and Loss Account on page 11 discloses a loss for the year of $93.9 million. $38.8 million of this is attributable to the settlement of intra group balances. A further $11.3 million relates to the reversal of income recognised in 2002 that related to a capital contribution made in that year by the Company's former parent company, CNA Financial Corporation, through a hedging arrangement that protected the Company from deterioration in rates of exchange. The reversal is due to the capitalisation during 2003 of this contribution. The balance includes the strengthening of provisions for future claims and for doubtful reinsurance recoveries.

As a result of this loss, the Company's surplus has deteriorated from $157.4 million to $95.7 million despite the injection of an additional $20.8 million capital during the year. Consequently the ratio of reinsurance recoverables to surplus has deteriorated by some 42% from 2.6 : 1 to 3.7 : 1, increasing the Company's need to ensure that it recovers all its reinsurance balances. This means that it is more important than ever to ensure that only properly supportable claims are paid.

The Company has introduced minimum claims documentation and information requirements to ensure that claims presentations meet the Company's needs. We have clearly explained these requirements to the market, however the quality of claims presentations remains variable. In particular, we are still identifying frequent instances of late reporting of claims development.

Claims deterioration generally has been driven by increased levels of claims notifications being received by the Company. This has been most notable in the medical malpractice, UK motor liability, US proportional liability and London Market Excess of Loss liability classes. While this level of strengthening is not unusual for such a portfolio of predominantly casualty business, particularly from the underwriting years 1999 and 2000, which were around the nadir of the cycle, the Company cannot benefit from profits from later underwriting years. This means that such deterioration directly reduces the Company's surplus. Also of concern for a reinsured, as pointed out last year, is EU legislation, which became effective on 20 April 2003 and which provides that 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.

Another factor militating against the Company during 2003 was the turbulence in the US fixed income markets which severely restricted the investment return. As a consequence, no significant contribution to the surplus was provided from this source, although it was adequate to cover the unwinding of the discount on reserves. We have kept the discount at risk free rates appropriate to the currencies of the reserves.

CHIEF EXECUTIVE OFFICER'S REVIEW (CONTINUED)

Progress in 2003

Many encouraging developments have occurred during the first full year for the Company as a member of the Tawa group. These include:

- a significant investment in systems, reporting capabilities and the recruitment of experienced staff, following an extensive business process review;
- an improved approach to the handling of claims and assessing the adequacy of their presentation;
- the commutations programme that has been developed and is being implemented; and
- an asset and liability management programme implemented to ensure that assets match liabilities both as regards duration and currency, as well as minimising investment and interest rate risk. This programme protected the surplus from interest rate volatility in 2003 and will be continued. The Company's asset portfolio has an average credit quality of AA.

There is a clear sense of a common purpose and enthusiasm throughout the Company, which bodes well for the future. I am indebted to all Tawa Management employees for their commitment, hard work and positive spirit throughout a year of considerable change. I look forward to the challenges and opportunities that 2004 has already begun to present.

Colin Bird
Chief Executive Officer

FINANCIAL REVIEW

Overview

Following the sale of the Company's parent company by CNA Financial Corporation to Tawa UK Limited in October 2002, the focus for 2003 has been the refinement and implementation of various aspects of the strategy for the run-off of the Company's significant, diverse portfolio of insurance and reinsurance liabilities. Implementation is progressing according to plan, however, we have been unable to mitigate claims deterioration across a number of the Company's business classes. The resulting strengthening of claims reserves, combined with the impact of the decision to settle the Company's inter-company balances with its former parent company CX Management Company Limited generated a loss for the financial year of $93.9 million. Despite an injection of capital of $20.8 million in January 2003, the result for the year caused a reduction in the Company's surplus to $95.7 million.

Technical account

Net earned premium for the year was $(15.8 million) (2002: $(49.4 million)). This negative development was attributable to the results of the reassessment of ultimate premiums, particularly in the proportional property and warranty accounts. Net commissions improved by $6.2 million as a result of the same exercise (2002: a charge of $10.5 million).

Gross claims paid during 2003 were $343.7 million (2002: $518.6 million) and reinsurers' share of claims paid was $51.1 million (2002: $512.2 million). The decrease in paid claims was principally a function of the reduction in the number of shorter tail property claims being presented for payment and also the result of the more stringent claims verification procedures introduced in the year. As a consequence, reinsurance billings have been affected by the decrease in payments of gross claims with attaching reinsurance. The figure for 2002 is distorted by the proceeds from the very substantial commutations performed at the completion of the sale.

Net claims incurred prior to discounting (see note 2h) were $38.3 million (2002: $339.3 million) and reflect the impact of the strengthening of claims reserves following the year-end reassessment. The strengthening was particularly marked in the following categories: medical malpractice, UK motor liability, US proportional liability and US casualty insurance. Conversely, improvement has been identified in the ultimates for a number of proportional property classes accounts. As last year, the reserves for asbestos and pollution exposures have been determined using a selection of industry benchmarks. The Company plans to reduce the volatility across its liability classes through a programme of commutations in 2004.

The basis of discounting has remained very similar to the approach used last year when discounting was reintroduced into the Company's accounts to provide a balance sheet which more closely resembles the economic position of the Company. Treasury strip yields in line with the maturity profile of the liabilities and the currency of the interest bearing investments are used to discount liabilities. The average mean term of liabilities at the balance sheet date was 7.71 years (2002: 7.44 years) and the equivalent average weighted yield was 4.28% (2002: 3.68%).

Net operating expenses during 2003 were $10.2 million (2002: $61.6 million). The reasons for this reduction include the improvement in net commissions referred to above, the exclusion of run-off expenses from net operating expenses, as described below, and the lower level of increases required to provisions for doubtful reinsurance recoveries in 2003.

Estimated future costs of the run-off have been provided in full and discounted with effect from 31 December 2002. Prior to that date, such expenses were charged to the Technical Account as incurred and disclosed as part of net operating expenses. The provision for unallocated loss adjustment expenses and subsequent adjustments to the provision are included within net claims incurred in 2002 and 2003 respectively.

Investment return

Investment yield for 2003 was 2.1% (2002: 8.0%). This depressed return was attributable to the volatile conditions that prevailed in the US bond markets for much of the middle of 2003 and the Company's decision to adopt a defensive strategy against likely increases in US interest rates. At the end of the year, despite the increasingly positive economic statistics and indicators, the apparent reluctance of the Federal Reserve to increase rates had caused the 10 year US Treasury yield to fall to 4.48% by the year end from 4.77% at the end of August. The Company will continue with an asset portfolio that is slightly shorter in duration than its liabilities, in line with the advice of its investment managers. However, the essence of the investment policy remains the mitigation of the principal risks impacting the Company's asset portfolio, namely interest rate, foreign exchange, credit, and liquidity. Control is imposed by broadly matching the duration and currency of the liabilities and maintaining a high quality and readily realisable portfolio of securities (average rating AA). During the year the Company changed its benchmark portfolio to include a slightly greater proportion of corporate instruments as part of a managed strategy to improve overall returns.

Exceptional item

As referred to above and in note 6, the respective boards of directors of the Company and its former parent company agreed to settle the inter-company balances that had accumulated between the two companies in different currencies. The settlement

FINANCIAL REVIEW (CONTINUED)

Exceptional item (continued)

was agreed on a discounted basis since the net debt to the Company would not be repaid in full for several years and involved a charge to the Non-Technical Account of $38.8 million.

Shareholders' funds and solvency

At 31 December 2003, the Company's shareholders' funds were $95.7 million (2002 $157.4 million). 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 contribution by the Company's former parent company, CNA Financial Corporation, which was taken into account in 2002, through a hedging arrangement that protected the Company from deterioration of rates of exchange. The contribution, which was accounted for as income in 2002, has been capitalised in 2003 with a corresponding charge to Other charges within the Profit and Loss Account.

Parent company

Following a restructure of the Tawa group, with effect from 16 March 2004, the Company's immediate parent company became Tawa UK Limited.

Charles Thresh
Treasurer

REPORT OF THE DIRECTORS

The Directors present their thirty-first annual report together with the financial statements for the year ended 31 December 2003.

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

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 10 and 11.

The Directors do not recommend that a final dividend be paid (2002: Nil). The balance from the Profit and Loss Account is to be transferred to reserves.

Capital

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 contribution made in 2002 by the Company's former parent company, CNA Financial Corporation, through a hedging arrangement that protected the Company from deterioration of rates of exchange. The contribution was accounted for as income in 2002 and has been capitalised in 2003.

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 (2002: 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

On 1 August 2003, Deloitte & Touche, the Company's auditors, transferred their business to Deloitte & Touche LLP, a limited partnership incorporated under the Limited Liability Partnerships Act 2000. The Company's consent has been given to treating the appointment of Deloitte & Touche as extending to Deloitte & Touche LLP with effect from 11 August 2003 under the provisions of section 26 (5) of the Companies Act 1989.

By order of the Board

C H E Jones
Company Secretary
30 March 2004

CORPORATE INFORMATION

Directors

G M J Erulin (France) - Chairman
C G Bird - Chief Executive Officer (Appointed CEO 12 January 2004)
P J Singer – Chief Executive Officer until 12 January 2004
P A Jardine - Non-Executive (Appointed 17 July 2003)
G Pagniez (France) - Non-Executive (Appointed 21 May 2003)
J-C Damerval (France) - Non-Executive (Appointed 17 July 2003; Resigned 18 December 2003)
A J Hamilton - Non-Executive (Appointed 17 July 2003; Resigned 22 March 2004)

Head Office & Registered Office

The London Underwriting Centre
3 Minster Court
Mincing Lane
London
EC3R 7DD

Registered Number: 1086556

(England and Wales)

Company Secretary

C H E Jones FCIS

INDEPENDENT AUDITORS' REPORT 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 2003 which comprise the profit and loss account, the balance sheet, and the related notes numbered 1 to 21. These financial statements have been prepared under the accounting policies set out therein.

This report is made solely to the Company's members, as a body, in accordance with section 235 of the Companies Act 1985. Our audit work has been undertaken so that we might state to the Company's members those matters we are required to state to them in an 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. They are also responsible for the preparation of the other information contained in the annual report. 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 whether the financial statements have been properly prepared in accordance with the Companies Act 1985. We also report to you 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 and the other information contained in the annual report for the above year as described in the contents section and consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the financial statements.

Basis of audit 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 circumstances of the Company, 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.

Uncertainties and estimation techniques
In forming our opinion we have considered the adequacy of the disclosures made in Note 3 to the financial statements concerning the principal estimation techniques adopted by the Company and the uncertainties relating to the assessment of provisions for outstanding claims and related reinsurance recoveries. These uncertainties are such that the ultimate liability, which will vary as a result of subsequent information and events, may result in material, but presently unquantifiable, adjustments to the amounts provided. Adjustments to the amount of the provisions are reflected in the financial statements for the period in which the adjustments are made. 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 affairs of the Company as at 31 December 2003 and of its loss for the year then ended, and have been properly prepared in accordance with the Companies Act 1985.

Deloitte & Touche LLP
Chartered Accountants and Registered Auditors
London
30 March 2004

PROFIT AND LOSS ACCOUNT

For the year ended 31 December 2003

Technical Account – General Business

	Notes	2003		2002	
		US$000	**US$000**	**US$000**	**US$000**
Gross premiums written	4		**(13,501)**		3,669
Outward reinsurance premiums			**(2,327)**		(85,549)
Net premiums written			**(15,828)**		(81,880)
Change in the provision for unearned premiums					
Gross amount		**-**		40,039	
Reinsurers' share		**-**		(7,598)	
			-		32,441
Earned premiums, net of reinsurance	4		**(15,828)**		(49,439)
Allocated investment income from the Non-Technical Account			**26,817**		99,110
Claims paid					
Gross amount		**(343,739)**		(518,637)	
Reinsurers' share		**51,068**		512,195	
		(292,671)		(6,442)	
Change in the provision for claims					
Gross amount		**313,975**		300,592	
Reinsurers' share		**(59,641)**		(633,483)	
Impact of discounting	17	**(8,672)**		265,018	
		245,662		(67,873)	
Net claims incurred	4		**(47,009)**		(74,315)
Net operating expenses	4,5		**(10,154)**		(61,561)
Balance on the Technical Account – General Business	4		**(46,174)**		(86,205)

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 13 to 22 form part of these financial statements.

PROFT AND LOSS ACCOUNT

For the year ended 31 December 2003

Non-Technical Account

	Notes	2003 US$000	2003 US$000	2002 US$000	2002 US$000
Balance on the Technical Account – General Business			**(46,174)**		(86,205)
Exceptional item	6		**(38,808)**		-
Investment return					
Investment income and realised gains	7	**64,786**		79,647	
Unrealised investment gains	7	**(36,575)**		19,781	
Investment expenses and charges	7	**(1,394)**		(318)	
Allocated to the Technical Account		**(26,817)**		(99,110)	
			-		-
Other (charges)/income	15		**(8,893)**		250
Loss on ordinary activities before tax			**(93,875)**		(85,955)
Tax on loss on ordinary activities	11		**-**		-
Loss for the financial year	16		**(93,875)**		(85,955)

A statement of total recognised gains and losses is not presented as there have been no gains and losses other than as shown above.

The notes on pages 13 to 22 form part of these financial statements.

BALANCE SHEET
As at 31 December 2003

	Notes	2003 US$000	2002 US$000
Assets			
Investments			
Other financial investments	13	**1,222,412**	1,423,143
Reinsurers' share of technical provisions			
Claims outstanding	17	**350,125**	414,350
Debtors			
Debtors arising out of direct insurance operations		**4,645**	349
Debtors arising out of reinsurance operations		**105,944**	174,530
Other debtors	14	**2,499**	48,254
		113,088	223,133
Other assets			
Cash at bank and in hand		**3,292**	4,868
Prepayments and accrued income			
Other prepayments and accrued income		**14,189**	15,906
Total assets		**1,703,106**	2,081,400
Liabilities			
Capital and reserves			
Called up share capital	15	**513,226**	492,419
Share premium account	15	**11,330**	-
Profit and loss account	16	**(428,882)**	(335,007)
Shareholders' funds attributable to equity interests		**95,674**	157,412
Technical provisions			
Claims outstanding	17	**1,503,053**	1,737,705
Creditors			
Creditors arising out of direct insurance operations		**188**	27
Creditors arising out of reinsurance operations		**98,358**	73,996
Other creditors including tax and social security	19	**5,833**	112,260
		104,379	186,283
Total liabilities		**1,703,106**	2,081,400

The notes on pages 13 to 22 form part of these financial statements.

These financial statements were approved by the board of directors on 22 March 2004 and were signed on its behalf on 30 March 2004 by:

Colin Bird
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 since its ultimate parent company includes a cash flow statement in its accounts which are publicly available.

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 (2002: 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 payment patterns for claims outstanding are derived by the Company's actuaries from analysis of historical patterns experienced by the Company and other comparable companies in run-off. 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 yield curve for Treasury bonds in the currencies in which the investments are held. This is consistent with a marked-to-market value for the invested assets of the Company at the balance sheet date.

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 and investment income 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) Allocation of investment return
All investment income is allocated from the Non-Technical Account to the Technical Account.

m) 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.

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

3. Estimation techniques and uncertainties

Introduction

The uncertainty inherent in insurance is inevitably reflected in the financial statements of insurance companies. The uncertainty in the financial statements principally arises in respect of the technical provisions of the Company. There is considerable uncertainty as regards the eventual outcome of the claims that have occurred by the balance sheet date but remain unsettled. This includes claims that may have occurred but have not yet been notified to the Company and those that are not yet apparent to the insured.

As a consequence of this uncertainty, the Company needs to apply sophisticated estimation techniques to determine the appropriate provisions.

Estimation techniques

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 provision is assessed by reference to actuarial projections of the ultimate development of claims in respect of each underwriting 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.

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 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.

Uncertainties

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.

The specific uncertainties affecting the Company's financial statements are as follows:

(i) Asbestos, pollution and other latent claims

Following the commutation during 2002 of the whole account stop loss reinsurance contract with Continental Casualty Company protecting the 1987 & prior underwriting years referred to in note 20 (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.

3. Estimation techniques and uncertainties (continued)

(ii) 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 $103.2 million and undiscounted reinsurance recoveries of $44.3 million. As a result of the uncertainty implicit within these claims, these estimates may be subject to potentially significant adjustments in future years.

(iii) 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.

The Company has established gross 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.

(iv) Reinsurer default

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.

4. Segmental reporting

	Insurance Operations 2003 US$000	Reinsurance Operations 2003 US$000	Total 2003 US$000	Insurance Operations 2002 US$000	Reinsurance Operations 2002 US$000	Total 2002 US$000
Gross premiums written	**(317)**	**(13,184)**	**(13,501)**	(3,822)	7,491	3,669
Outward reinsurance premiums	**345**	**(2,672)**	**(2,327)**	1,778	(87,327)	(85,549)
Net premiums written	**28**	**(15,856)**	**(15,828)**	(2,044)	(79,836)	(81,880)
Gross earned premiums	**(317)**	**(13,184)**	**(13,501)**	(2,102)	45,790	43,688
Outward reinsurance premiums	**345**	**(2,672)**	**(2,327)**	2,409	(95,536)	(93,127)
Net earned premiums	**28**	**(15,856)**	**(15,828)**	307	(49,746)	(49,439)
Allocated investment income from the Non-Technical Account	**4,330**	**22,487**	**26,817**	15,247	83,863	99,110
Gross claims incurred	**(46,235)**	**16,471**	**(29,764)**	(5,310)	(212,735)	(218,045)
Reinsurers' share	**55,938**	**(64,511)**	**(8,573)**	(51,737)	(69,551)	(121,288)
Impact of discounting	**(1,400)**	**(7,272)**	**(8,672)**	40,772	224,246	265,018
Net claims incurred	**8,303**	**(55,312)**	**(47,009)**	(16,275)	(58,040)	(74,315)
Gross operating expenses	**(4,102)**	**(9,170)**	**(13,272)**	(7,114)	(55,525)	(62,639)
Reinsurers' share	**936**	**2,182**	**3,118**	463	615	1,078
Net operating expenses	**(3,166)**	**(6,988)**	**(10,154)**	(6,651)	(54,910)	(61,561)
Balance on the Technical Account – General Business	**9,495**	**(55,669)**	**(46,174)**	(7,372)	(78,833)	(86,205)

Gross written premium by geographical segment (calculated by domicile of ceding company):

	2003 US$000	2002 US$000
Worldwide	**(13,501)**	3,669
	(13,501)	3,669

Items within the Non-Technical Account are not allocated to lines of business since the Directors do not consider such an allocation to be meaningful.

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

	2003 US$000	2002 US$000
Acquisition costs	**(3,053)**	684
Change in gross deferred acquisition costs	-	10,876
Unallocated loss adjustment expenses	-	17,837
Other expenses including increases to provisions for doubtful reinsurance recoveries	**16,325**	33,234
Gross operating expenses	**13,272**	62,631
Reinsurance commissions and profit participation	**(3,118)**	2,033
Change in deferred reinsurance commissions	-	(3,103)
	10,154	61,561

5. Net operating expenses (continued)

Estimated future costs of the run-off have been provided in full and discounted with effect from 31 December 2002. Prior to that date, such expenses were charged to the Technical Account as incurred and disclosed as net operating expenses. The provision for unallocated loss adjustment expenses and subsequent adjustments to the provision are included within net claims incurred in 2002 and 2003 respectively.

6. Exceptional item

	2003	**2002**
	US$000	**US$000**
Settlement of inter-company balance	**(38,808)**	-

During 2003, balances due to and from the Company's former parent company, CX Management Company Limited, as at 31 December 2002 were settled as agreed by the respective boards of directors. This settlement gave rise to the exceptional charge indicated above.

7. Investment return

	2003	**2002**
	US$000	**US$000**
Investment income	**61,733**	55,504
Realised investment gains	**3,053**	24,143
	64,786	79,647
Unrealised investment (losses)/gains	**(36,575)**	19,781
Investment management expenses	**(1,394)**	(318)
Investment return	**26,817**	99,110

8. Employees' remuneration

Members of staff were employed by CX Management Company Limited, the Company's immediate parent company, during the year. From 1 January 2004, all staff were transferred to Tawa Management Limited. The Company's share of the total remuneration and numbers of employees, including the Directors and Directors' emoluments in note 9 below, are as follows:

	2003	**2002**
	US$000	**US$000**
Wages and salaries	**6,442**	6,349
Social security costs	**718**	1,350
Other pension costs	**667**	1,451
	7,827	9,150
Average number of employees	**66**	68

The pension scheme for CX Management Company Limited group, which is a defined contribution scheme, was funded by CX Management Company Limited up to 31 December 2003. Details of the scheme are disclosed in that company's accounts. With effect from 1 January 2004, the responsibility for funding the scheme was transferred to Tawa Management Limited.

9. Directors' emoluments

	2003 US$000	2002 US$000
Highest paid Director		
Emoluments	**67**	146
Contributions to defined contribution pension scheme	**-**	43
	67	189
All Directors		
Emoluments	**206**	146
Contributions to defined contribution pension scheme	**-**	43
	206	189
Number of Directors qualifying for defined contribution pension scheme	**-**	1

10. Auditors' remuneration

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

	2003 US$000	2002 US$000
Audit services		
Current year	**355**	212
Non-audit services	**216**	285
	571	497

11. Taxation

	2003 US$000	2002 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.

12. 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:

	2003	2002
United Kingdom	**£0.56**	£0.63
Euro	**€0.80**	€1.02

13. Investments

	Market Value		Cost	
	2003 US$000	**2002 US$000**	**2003 US$000**	**2002 US$000**
Listed variable yield securities and unit trusts	**25,248**	11,563	**22,092**	10,881
Listed debt securities and other fixed interest securities	**1,152,434**	1,106,600	**1,159,496**	1,074,911
Deposits with credit institutions	**44,730**	304,980	**44,730**	304,980
	1,222,412	1,423,143	**1,226,318**	1,390,772

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 $100.0 million (2002: $120.0 million) against an investment portfolio, and charges to the value of $3.1 million (2002: $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 $631.3 million (2002: $828.4 million) and $63.4 million (2002: $62.8 million).

14. Other debtors

	2003 US$000	**2002 US$000**
Corporation tax recoverable	**-**	1,417
Amounts due from group companies	**398**	32,307
Other debtors	**2,101**	14,530
	2,499	48,254

15. Called up share capital and shareholders' funds

Called up share capital	**2003**	**2002**
Authorised 400,000,000 ordinary shares of £1 each (2002: 400,000,000)	**400,000,000**	400,000,000
Allotted, called up and fully paid 343,924,279 (2002: 331,270,266) ordinary shares of £1 each	**$513,226,000**	$492,419,000

Shareholders' funds attributable to equity interests	**2003 US$000**	**2002 US$000**
Loss for the financial year	**(93,875)**	(85,955)
Issue of share capital	**32,137**	120,000
Net (reduction)/increase in shareholders' funds	**(61,738)**	34,045
Shareholders' funds as at 1 January	**157,412**	123,367
Shareholders' funds as at 31 December	**95,674**	157,412

15. Called up share capital and shareholders' funds (continued)

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 contribution taken into account in 2002 by the Company's former parent company, CNA Financial Corporation, through a hedging arrangement that protected the Company from deterioration of rates of exchange. The contribution, which was accounted for as income in 2002, has been capitalised in 2003 with a corresponding charge to Other charges within the Profit and Loss Account.

16. Profit and loss account

	Profit & loss account 2003 US$000
At 1 January as reported	**(335,007)**
Retained loss for the year	**(93,875)**
At 31 December 2003	**(428,882)**

17. Claims outstanding

	Gross Claims 2003 US$000	Reinsurance 2003 US$000	Net 2003 US$000	Gross Claims 2002 US$000	Reinsurance 2002 US$000	Net 2002 US$000
Provision before discounting	**1,993,526**	**478,341**	**1,515,185**	2,202,137	524,268	1,677,869
Discount	**490,473**	**128,216**	**362,257**	464,432	109,918	354,514
Net of discount	**1,503,053**	**350,125**	**1,152,928**	1,737,705	414,350	1,323,355

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.

The average mean term of the total portfolio of net liabilities is 7.71 years (2002: 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 average, effective rate of investment return used for discounting is 4.28% (2002: 3.68%).

18. 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 $47.9 million (2002: loss of $381.4 million), comprising movements in net earned premiums of (loss) $15.8 million, net incurred commissions of (gain) $6.2 million and net incurred claims (loss) of $38.3 million.

19. Other creditors

	2003 US$000	2002 US$000
Cost of financial investment acquired prior to year end	-	102,406
Sundry creditors	**5,833**	9,854
	5,833	112,260

The cost of financial investment acquired prior to the 2002 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.

20. 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 effected 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 3.

(iii) In December 1999, the Company entered into a whole account stop loss contract with CCC which, in summary, provided $125m 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. The Company is exempt under Financial Reporting Standard No. 8 from the requirement to disclose details of transactions with companies within the same group since its parent company prepares consolidated accounts which are publicly available.

21. Parent company

Following a restructure of the Tawa group, with effect from 16 March 2004, the Company's immediate parent company became Tawa UK Limited, a company registered in England and Wales, and copies of the financial statements are obtainable from The Registrar of Companies, Companies House. The Company's ultimate holding company is Financiere Pinault SCA, a company incorporated in France. The group financial statements of Financiere Pinault SCA may be obtained from the Tribunal de Commerce de Paris, 1Quai de Corse, 75004 Paris, France.