# CX Reinsurance Company Limited

## Report & Accounts

## 1 January to 20 March 2006

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## CHIEF EXECUTIVE OFFICER'S REVIEW

### Introduction

On 21 March 2006, the Company's share capital was restructured and sold to a consortium in which the former parent company, Tawa UK Limited, participates. As part of this process, an additional accounting period from 1 January 2006 to 20 March 2006 was required. The change in shareholders and related change to the Board of Directors have had no impact on the strategy of the Company, which is as set out below. The run-off manager continues to be Tawa Management Limited.

Unfortunately, this short accounting period has witnessed a high level of development of incurred claims. As a consequence, the reassessment of the Company's reserves has led to a reduction in the surplus of $11 million to $54 million.

### Claims portfolio

As explained in each of my previous reports, the claims deterioration has been particularly marked in the reinsurance of professional indemnity risks. In the first few months of 2006, claims relating to errors and omissions, both US and worldwide, have been the principal concern. Notification of new claims was significantly higher than expected, especially from large US carriers. The run-off of these liabilities, relating to business written on a claims made basis prior to 2002, continues to exceed forecasts based on analysis of historic patterns.

The setting of reserves continues to be hampered by the late reporting of claims from a number of cedants and brokers. Successful management of a portfolio of volatile liabilities is wholly dependent on accurate, complete and timely information. The Company and its run-off manager have therefore invested heavily in developing systems and processes to ensure that reliable information, which is required to deliver the strategy, is available when needed. The delays in providing notification, which are frequently in breach of policy terms and acceptable market standards, have been a persistent blight on the management of the Company's liabilities. It remains my hope that, as the sophistication of run-off management across the reinsurance market develops, this will be matched by improvements in the provision of claims information.

The level of incurred development, almost five years after the last risk was written, emphasises the degree of volatility which remains within the Company's balance sheet, despite the notable success achieved in reducing the size of the portfolio, and confirms that the strategy of accelerating the run-off by commutation of liabilities is the only feasible approach to the protection of the interests of policyholders and other stakeholders.

### Reinsurance recoveries

The reinsurance asset on the balance sheet continues to be significant in the context of the Company's surplus. Discounted reinsurers' share of outstanding claims was $119.6 million (2005: $149.9 million). The change was mainly due to reductions in reserves and related reinsurance for the IGI personal accident exposures. As indicated in note 3(iii), the Company remains dependent on Continental Casualty Company for protection relating to these liabilities.

### Discounting, investment return and cash flow

The Company continues to discount its claims reserves and related reinsurance recoveries for the time value of money. The investment return for the period covered the unwind of the discount, which continues to be the principal objective of the Company's investment strategy. The impact of discounting on the balance sheet was a benefit of $192.0 million (2005: $190.9 million).

The management of the Company's liquidity to ensure that payment of claims and commutations can be achieved when due will continue to be a challenge until the closure of the run-off. An increasing proportion of the Company's US dollar funds are held as surplus collateral within the trust funds and collateral accounts providing benefit for US policyholders. We continue to work with regulators in the US to maximise the availability of funds to make US dollar payments.

## CHIEF EXECUTIVE OFFICER'S REVIEW (CONTINUED)

### Objectives

Since the acquisition of the Company by Tawa UK Limited, the essential elements of the run-off strategy have been and will remain 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
- continue to develop the systems, procedures and human resources available to the Company to provide the infrastructure and support required to achieve the Company's objectives.

The run-off manager, Tawa Management Limited, continues to commit all efforts and expertise to the implementation of this strategy.

**Colin Bird**
**Chief Executive Officer**

## FINANCIAL REVIEW

### Overview

The Company recorded a loss of $11.2 million in the period to 20 March 2006 (2005: profit of $1.7 million) as a result of the increases in outstanding claims notified to the Company during the period. The Company's surplus (shareholders' funds) decreased as a consequence to $54.0 million at 20 March 2006 (2005: $65.2 million).

### Technical account

Net earned premium for the period was $0.2 million (2005: $11.4 million). The movement in 2005 was driven by a reinsurance premium refund of $6.8 million following the settlement of a dispute.

Gross claims and run-off expenses paid during the period were $92.4 million (2005: $436.5 million) and reinsurers' share of claims paid was $34.5 million (2005: $71.6 million). Settlement of gross claims on an annualised basis was lower in 2006 due to the finalisation of fewer commutations. Commutation activity is unpredictable and in the experience of the company it is usually higher in the second half of the year. The reinsurers' share of claims paid was higher on an annualised basis in 2006 due to the increase in activity within the IGI portfolio, which is 100% reinsured. Gross undiscounted claims outstanding decreased by 7.7% to $889.8 million at 20 March 2006 and undiscounted claims net of reinsurance decreased by 5.3% to $710.3 million.

The claims deterioration which has dominated the result for the period is explained in the Chief Executive's Report. The claims mitigation efforts continue to be directed towards the classes of business where deterioration has been experienced.

The impact of discounting for the time value of money in the balance sheet at 20 March 2006 was $192.0 million (2005: $190.9 million). The change in the discount reflected in the profit and loss account was $(0.1) million (2005: $(70.8) million) after accounting for the effect of foreign exchange movements. The small movement in 2006 was due to the increases in interest rates since the end of 2005 which have increased the relative impact of discounting in the balance sheet. The Company continues to use risk free yield curves in discounting its reserves and provides for unallocated loss adjustment expenses required to complete the run-off.

Net operating income in the period was $0.9 million (2005: charge of $(7.8) million). The charge in 2005 was attributable to management fees and increase in provisions for doubtful reinsurance recoveries.

### Investment return

The key principle within the investment strategy remains the mitigation of risks relating to changes in interest rates and foreign exchange rates and to credit and liquidity risks. This mitigation is achieved by broadly matching the duration and currency of the liabilities and maintaining a high quality and readily realisable portfolio of fixed income securities (average rating AA). Within the confines of this strategy, the Company continues to look for opportunities to enhance the return from the portfolio.

Investment yield for the period was -1.2% (2005: 4.1%). Although negative, the investment performance was sufficient to cover the aggregate of the unwind of the discount and the impact of changes in interest rates on net discounted reserves, which is the fundamental requirement of the investment return. The investment return was driven by increases in interest rates, particularly US interest rates, in the first three months of 2006. For example, the 10-year rate used in discounting the US dollar cash flows was 4.86% at 20 March 2006, compared to 4.56% at 31 December 2005. Investment performance was better than the unwind of the discount, which is based on the performance of risk free Government securities, due to the contribution from US corporate and asset backed securities within the Company's investment portfolio.

### Balance sheet

The changes in the balance sheet are a function of the transactions and developments explained above with reference to the profit and loss account.

**Stephen Baxter**
**Treasurer**

## REPORT OF THE DIRECTORS

The Directors present their thirty-fourth report together with the financial statements for the period from 1 January to 20 March 2006.

### 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. The Company is regulated by the FSA.

### 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 4, and the results for the year are set out on pages 9 and 10.

Following the period end, on 20 March 2006 the Company brought its 2006 accounting reference period to a close. It is proposed that the accounting reference period that began on 21 March 2006 will be shortened so as to end on 31 December 2006 and thereafter the Company will re-adopt calendar year reporting.

In connection with the sale of the Company to a consortium, including its former parent, Tawa UK Limited, following the period end on 21 March 2006, the Company restructured its share capital by subdividing its issued ordinary shares into A non-voting and B voting shares and reclassifying its authorised but unissued shares as A non-voting shares.

The Directors do not recommend that a final dividend be paid (2005: $ nil). The balance from the profit and loss account is to be transferred from reserves.

### Directors and Directors' interests

The Directors of the Company are listed on page 7 and unless otherwise indicated, all served throughout the period.

None of the Directors held an interest in the shares of the Company at the end of the financial period. In connection with the restructuring of the share capital, since the period end, on 21 March 2006 P A Jardine and P M Marcell each acquired 216 B voting shares. 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 maintains insurance cover for its Directors and Officers against liabilities which may be incurred by them while acting as Directors and Officers. As at the date of this report, indemnities are in force under which the Company has agreed to indemnify its Directors and Officers, to the extent permitted by law and the Company's Articles of Association, against all costs, charges, losses, liabilities and expenses that they may incur in the execution of their duties, powers and offices as Directors and Officers of the Company. Copies of these indemnities are kept at the Company's registered office and are open for inspection by any member of the Company without charge.

The Company made no political or charitable donations during the period (2005: $ nil).

### Statement of Directors' responsibilities

The Directors are responsible for preparing the financial statements. The Directors have chosen to prepare the accounts in accordance with United Kingdom Generally Accepted Accounting Principles. United Kingdom company law requires the Directors to prepare financial statements for each financial period which give a true and fair view of the state of affairs of the Company as at the end of the financial period 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 subject to any material departures disclosed and explained in the financial statements; and
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the Company will continue in business.

## REPORT OF THE DIRECTORS (CONTINUED)

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.

**Risk management**

In the ordinary course of business, the Company is exposed to, and manages, a variety of risks, with insurance, credit and liquidity risk being of particular significance. The management of risk is fundamental to the Company, with the Board having responsibility for the overall system of internal control and for reviewing its effectiveness. Such systems are designed to manage, rather than eliminate, the risk of failure to achieve business objectives; any system can provide only reasonable and not absolute assurance against material misstatement or loss.

The Company has processes for identifying, evaluating and managing the significant risks faced by the Company. These processes have been in place for the whole of the period and have continued up to the date this document was approved.

The Company has a detailed risk management process, culminating in a Board review, which identifies the key risks facing the Company. Each operational area within the Company is responsible for the identification and assessment of their particular risk exposures, and implementing risk management policies, limits and procedures, as approved by the Board.

The Board has delegated specific risk monitoring and control responsibilities to the Audit Committee and the Asset and Liability Management and Financial Reporting Committee as follows:

- the Audit Committee, on behalf of the Board, considers the effectiveness of the operation of internal control processes and procedures in the Company during the financial period, including the review of reports from the external auditors, and reports its conclusions to the Board;
- the Asset and Liability Management and Financial Reporting Committee considers the management of assets and liabilities, including the level of risk to be accepted in relation to both assets backing the Company's liabilities and assets backing the surplus and the monitoring and controlling CX RE's financial and regulatory reporting.

**Auditors**

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

**Disclosure of information to Auditors**

Each Director confirms that so far as he is aware there is no relevant audit information of which the Company's auditors are unaware. Each Director also confirms that he has taken all the steps that he ought to have taken as a Director in order to make himself aware of any such information and to establish whether the auditors are aware of that information.

**By order of the Board**

**Christopher Jones**
**Company Secretary**
11 July 2006

## CORPORATE INFORMATION

**Directors**

G M J Erulin (France) - Chairman
C G Bird - Chief Executive Officer
J J Hendrickson (USA) – Non-Executive (appointed 26 May 2006)
P A Jardine - Non-Executive
P M Marcell - Non-Executive
G Pagniez (France) - Non-Executive
E M Rosenstiehl (France) - Non-Executive
P J Singer (resigned 21 March 2006)
C R Thresh (resigned 21 March 2006)

**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 period from 1 January to 20 March 2006 which comprise the profit and loss account, the balance sheet, and the related notes 1 to 22. 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 law and United Kingdom Accounting Standards (United Kingdom Generally Accepted Accounting Practice).

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

We report to you our opinion as to whether the financial statements give a true and fair view in accordance with the relevant financial reporting framework and are 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 other transactions is not disclosed.

We read the Directors' report and the other information contained in the annual report for the above period 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 International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the financial statements. It also includes an assessment of the significant estimates and judgements made by the Directors in the preparation of the financial statements and of whether the accounting policies are appropriate to the Company's circumstances, consistently applied and adequately disclosed.

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

**Opinion**
In our opinion:

- the financial statements give a true and fair view, in accordance with United Kingdom Generally Accepted Accounting Practice, of the state of the Company's affairs as at 20 March 2006 and of its loss for the period then ended; and
- the financial statements have been properly prepared in accordance with the Companies Act 1985; and
- the information given in the Directors' report is consistent with the financial statements.

**Emphasis of matter – estimation techniques and uncertainties**
Without qualifying our opinion, we draw attention to 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 they may result in material, but presently unquantifiable, adjustments to the amounts provided in respect of the ultimate liabilities, which will vary as a result of subsequent information and events. Adjustments to the amount of the provisions are reflected in the financial statements for the period in which the adjustments are made.

Deloitte & Touche LLP

Deloitte & Touche LLP
Chartered Accountants and Registered Auditors
London
11 July 2006

## PROFIT AND LOSS ACCOUNT

*For the period from 1 January to 20 March 2006*

### Technical Account – General Business

| | Notes | 20 March 2006 | | 2005 | |
|---|---|---|---|---|---|
| | | US$000 | US$000 | US$000 | US$000 |
| **Gross premiums written** | 4 | | **144** | | 4,574 |
| Outward reinsurance premiums | | | **12** | | 6,796 |
| **Net premiums written and earned** | | | **156** | | 11,370 |
| Allocated investment (losses) / income from the Non-Technical Account | | | **(1,687)** | | 32,826 |
| Claims paid | | | | | |
| Gross amount | | **(92,381)** | | (436,531) | |
| Reinsurers' share | | **34,526** | | 71,589 | |
| | | **(57,855)** | | (364,942) | |
| Change in the provision for claims | | | | | |
| Gross amount | | **79,988** | | 501,244 | |
| Reinsurers' share | | **(35,149)** | | (102,993) | |
| Impact of discounting | | **(107)** | | (70,761) | |
| | | **44,732** | | 327,490 | |
| **Net claims incurred** | 4 | | **(13,123)** | | (37,452) |
| Net operating income / (expenses) | 4,5 | | **874** | | (7,820) |
| **Balance on the Technical Account - General Business** | 4 | | **(13,780)** | | (1,076) |

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 12 to 22 form part of these financial statements.

## PROFIT AND LOSS ACCOUNT (CONTINUED)

*For the period from 1 January to 20 March 2006*

**Non-Technical Account**

| | Notes | 20 March 2006 | | 2005 | |
|---|---|---|---|---|---|
| | | US$000 | US$000 | US$000 | US$000 |
| **Balance on the Technical Account - General Business** | | | **(13,780)** | | (1,076) |
| **Investment return** | | | | | |
| Investment income and realised gains | 6 | **6,204** | | 36,335 | |
| Unrealised investment losses | 6 | **(7,530)** | | (2,323) | |
| Investment expenses and charges | 6 | **(361)** | | (1,186) | |
| Allocated to the Technical Account | | **1,687** | | (32,826) | |
| Other income | 7 | | **364** | | 2,765 |
| **(Loss) / profit on ordinary activities before tax** | | | **(13,416)** | | 1,689 |
| Tax on (loss) / profit on ordinary activities | 11 | | **-** | | - |
| Group relief received | 11 | | **2,251** | | - |
| **(Loss) / profit for the financial period** | 16 | | **(11,165)** | | 1,689 |

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

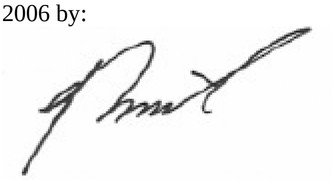
The notes on pages 12 to 22 form part of these financial statements.

## BALANCE SHEET
*As at 20 March 2006*

| | Notes | 20 March 2006 US$000 | 2005 US$000 |
|---|---|---|---|
| **Assets** | | | |
| **Investments** | | | |
| Other financial investments | 13 | **597,799** | 636,711 |
| **Reinsurers' share of technical provisions** | | | |
| Claims outstanding | 17 | **119,631** | 149,921 |
| **Debtors** | | | |
| Debtors arising out of direct insurance operations | | **274** | 296 |
| Debtors arising out of reinsurance operations | | **40,550** | 38,770 |
| Other debtors | 14 | **1,417** | 3,280 |
| | | **42,241** | 42,346 |
| **Other assets** | | | |
| Cash at bank and in hand | | **5,558** | 14,320 |
| **Prepayments and accrued income** | | | |
| Other prepayments and accrued income | | **7,666** | 10,616 |
| **Total assets** | | **772,895** | 853,914 |
| **Liabilities** | | | |
| **Capital and reserves** | | | |
| Called up share capital | 15 | **513,226** | 513,226 |
| Share premium account | | **11,330** | 11,330 |
| Profit and loss account | 16 | **(470,519)** | (459,354) |
| **Shareholders' funds attributable to equity interests** | | **54,037** | 65,202 |
| **Technical provisions** | | | |
| Claims outstanding | 17 | **637,912** | 709,205 |
| **Creditors** | | | |
| Creditors arising out of direct insurance operations | | **2,913** | 1,587 |
| Creditors arising out of reinsurance operations | | **68,530** | 69,221 |
| Other creditors including tax and social security | 19 | **9,503** | 8,699 |
| | | **80,946** | 79,507 |
| **Total liabilities** | | **772,895** | 853,914 |

The notes on pages 12 to 22 form part of these financial statements.

These financial statements were approved by the Board of Directors on 6 July 2006 and were signed on its behalf on 11 July 2006 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 2005 by the Association of British Insurers.

The Company is exempt under Financial Reporting Standard No. 1 (Revised 1996) 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 principal 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 period.

#### 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 period, regardless of whether such amounts may relate in whole or in part to a later financial period, 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 due which are estimated to be earned in the following or subsequent financial periods, 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 period. Deferred acquisition costs represent the proportion of acquisition costs incurred, which correspond 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 period, 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.

## 2. Accounting policies (continued)

### g) 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 an 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 mark-to-market value for the invested assets of the Company at the balance sheet date.

### h) 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.

### i) Investment income, expenses and charges

Investment income is accounted for on a receivable basis, gross of any 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.

### j) 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 period 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.

### k) Allocation of investment return

All investment (losses) / income were allocated from the Non-Technical Account to the Technical Account.

### 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 when the value is received and it is reasonable to assume that the benefit will inure to the Company.

### m) Investments

Investments are shown in the financial statements at mid-market value at the balance sheet date. Investment transactions are recognised on a settlement date basis.

### n) Pensions

The pension scheme for employees of Tawa Management Limited, which is a defined contribution scheme, is funded by Tawa Management Limited. Details of the pension scheme are disclosed in that company's accounts.

## 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 2f, 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. In addition, in certain areas of the portfolio, exposure analysis has been performed. 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 methodology used to project ultimate development for liability classes is reviewed annually by the Company's external actuary.

The provision for claims outstanding and the provision for all future expenses related to the run-off of the net liabilities are discounted to take account of future investment income which will be generated prior to settlement of the claims, as outlined in Note 2g 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, due to the nature of the insurance industry there is inherent uncertainty in these estimates. 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 and prior underwriting years, 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 incorporated the result of an exposure analysis which was performed with the assistance of an external consultant. 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. 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 period reflect gross undiscounted reserves of $42.0 million (2005: $42.2 million) and undiscounted reinsurance recoveries of $nil (2005: $nil). As a result of the uncertainty implicit within these claims, these estimates may be subject to potentially significant adjustments in future fiscal periods.

***(iii) IGI Contingency***

In 1997, the Company entered into an arrangement with IOA Global Limited ("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 Limited ("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, including other CNA insurance subsidiaries, and ultimately to a group of reinsurers participating in a reinsurance pool known as the Associated Accident and Health Reinsurance Underwriters ("AAHRU") Facility. With effect from 1 January 2002, the Company acquired additional reinsurance protection from Continental Casualty Company, a member of the CNA Group, so that, from that date, the Company has no remaining net exposure to risks written through IGI.

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 Mutual Life Insurance Company ("John Hancock") under four excess of loss reinsurance treaties ("the Treaties") issued by the Company. While John Hancock has indicated that it is not able to quantify accurately its potential exposure to its cedants on business which is retroceded to the Company, John Hancock has reported $219 million (2005: $219 million) of paid and unpaid losses, under these Treaties. John Hancock is disputing portions of its assumed obligations resulting in these reported losses. The Company has been advised that John Hancock is, or has been, involved in multiple arbitrations with its own cedants, in which proceedings John Hancock is seeking to avoid and/or reduce risks that would otherwise arguably be ceded to the Company through the Treaties. The Company has also been informed that John Hancock has settled several of these disputes, but the Company is not aware of the details of the settlements. To the extent that John Hancock is successful in reducing its liabilities in these disputes, that development may have an impact on the recoveries it is seeking under the Treaties from the Company.

In addition, the Company has instituted arbitration proceedings against John Hancock, in which the Company is seeking rescission of the Treaties as well as access to and the right to inspect the books and records relating to the Treaties. Discovery is ongoing in that an arbitration hearing is currently scheduled for April 2007. Based on information known at this time, the Company believes it has strong grounds to challenge successfully its alleged exposure derived from John Hancock through the ongoing arbitration proceedings. The Company has also undertaken legal action seeking to avoid portions of the remaining exposure arising out of the IGI Program.

The Company has established reserves for its estimated exposure under the IGI Program, other than that derived from John Hancock, and an equal amount due from reinsurers. The Company has not established any reserve for any exposure derived from John Hancock because, as indicated, the Company believes the contract should be rescinded. Although the results of the Company's various loss mitigation strategies with respect to the entire IGI Program to date support the recorded reserves, the estimate of ultimate losses is subject to considerable uncertainty due to the complexities described above. As a result of these uncertainties, the Company's results gross of the impact of reinsurance in future periods may be adversely affected by potentially significant additions to gross reserves, although the Company is not able to determine the extent of loss beyond the reserves established. Any such additions to reserves would be fully recoverable from the Company's reinsurers.

***(iv) Reinsurer default***

The level of uncertainty inherent in the recoverability of reinsurance recoveries is enhanced at this point in time due to the impact on the reinsurance industry of a number of severe catastrophes in recent years, including the 2004 and 2005 hurricanes. 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 20 March 2006 US$000 | Reinsurance Operations 20 March 2006 US$000 | Total 20 March 2006 US$000 | Insurance Operations 2005 US$000 | Reinsurance Operations 2005 US$000 | Total 2005 US$000 |
|---|---|---|---|---|---|---|
| **Gross premiums written** | **68** | **76** | **144** | (45) | 4,619 | 4,574 |
| Outward reinsurance premiums | **3** | **9** | **12** | 6,841 | (45) | 6,796 |
| **Net premiums written** | **71** | **85** | **156** | 6,796 | 4,574 | 11,370 |
| **Gross earned premiums** | **68** | **76** | **144** | (45) | 4,619 | 4,574 |
| Outwards reinsurance premiums | **3** | **9** | **12** | 6,841 | (45) | 6,796 |
| **Net earned premiums** | **71** | **85** | **156** | 6,796 | 4,574 | 11,370 |
| **Allocated investment income from Non-Technical Account** | **(275)** | **(1,412)** | **(1,687)** | 5,358 | 27,468 | 32,826 |
| **Gross claims incurred** | **(7,191)** | **(5,202)** | **(12,393)** | 452 | 64,261 | 64,713 |
| Reinsurer's share | **844** | **(1,467)** | **(623)** | (7,030) | (24,374) | (31,404) |
| Impact on discounting | **(18)** | **(89)** | **(107)** | (11,549) | (59,212) | (70,761) |
| **Net claims incurred** | **(6,365)** | **(6,758)** | **(13,123)** | (18,127) | (19,325) | (37,452) |
| Gross operating income / (expenses) | **102** | **772** | **874** | (1,242) | (6,578) | (7,820) |
| Reinsurers' share | **-** | **-** | **-** | - | - | - |
| **Net operating income / (expenses)** | **102** | **772** | **874** | (1,242) | (6,578) | (7,820) |
| **Balance on the Technical Account - General Business** | **(6,467)** | **(7,313)** | **(13,780)** | (7,215) | 6,139 | (1,076) |

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

| | 20 March 2006 US$000 | 2005 US$000 |
|---|---|---|
| Worldwide | **144** | 4,574 |
| | **144** | 4,574 |

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 income / (expenses)

| | 20 March 2006 US$000 | 2005 US$000 |
|---|---|---|
| Acquisition costs | **(542)** | (1,595) |
| Other expenses including decreases / (increases) to provisions for doubtful reinsurance recoveries | **1,416** | (6,225) |
| | **874** | (7,820) |

The provision for unallocated loss adjustment expenses and subsequent adjustments to the provision are included within net claims incurred in 2006 and 2005 respectively.

## 6. Investment return

| | 20 March 2006 US$000 | 2005 US$000 |
|---|---|---|
| Investment income | **6,228** | 34,639 |
| Realised investment (losses) / gains | **(24)** | 1,696 |
| | **6,204** | 36,335 |
| Unrealised investment losses | **(7,530)** | (2,323) |
| Investment management expenses | **(361)** | (1,186) |
| Investment return | **(1,687)** | 32,826 |

## 7. Other income

| | 20 March 2006 US$000 | 2005 US$000 |
|---|---|---|
| Gains in relation to movements in foreign currency exchange rates | **364** | 2,765 |
| Other income | **364** | 2,765 |

## 8. Employees' remuneration

| | 20 March 2006 US$000 | 2005 US$000 |
|---|---|---|
| Wages and salaries | **68** | 163 |
| Social security costs | **2** | 31 |
| | **70** | 194 |
| Average number of employees | **1** | 1 |

## 9. Directors' emoluments

| | 20 March 2006 US$000 | 2005 US$000 |
|---|---|---|
| **Highest paid Director** | | |
| Emoluments | **68** | 163 |
| | **68** | 163 |
| **All Directors** | | |
| Emoluments | **184** | 688 |
| | **184** | 688 |

## 10. Auditors' remuneration

Amounts payable to Deloitte & Touche LLP, and their associates, by the Company in respect of non audit services were $0 (2005: $216,000). A more detailed analysis of auditors' remuneration basis is provided below:

| | 20 March 2006 | | 2005 | |
|---|---|---|---|---|
| | US$000 | % | US$000 | % |
| **Audit services** | | | | |
| Services as auditors | **300** | **100** | 351 | 62 |
| **Other Services** | | | | |
| Valuation and actuarial | **-** | **-** | 216 | 38 |
| | **300** | **100** | 567 | 100 |

Significant non-audit services require pre-approval by the audit committee.

## 11. Taxation

| | 20 March 2006 US$000 | 2005 US$000 |
|---|---|---|
| **Current tax** | | |
| UK Corporation Tax on (loss) / profit of the period | **-** | - |
| Group relief received | **2,251** | - |
| Total current tax | **2,251** | - |
| **Deferred tax** | | |
| Origination and reversal of timing difference | **-** | - |
| Total tax on (loss) / profit on ordinary activities | **-** | - |

### 11. Taxation (continued)

The difference between the total current tax shown above and the amount calculated by applying the standard rate of UK Corporation tax to the profit on ordinary activities before tax is as follows:

| | 20 March 2006 US$000 | 2005 US$000 |
|---|---|---|
| (Loss) / profit on ordinary activities before tax | **(13,416)** | 1,689 |
| Tax on (loss) / profit on ordinary activities at standard UK corporation tax rate of 30% (2005: 30%) | **(4,025)** | 507 |
| Effects of: | | |
| Expenses not deductible for tax purposes | **53** | 266 |
| Capital allowances less than depreciation | **(1)** | (7) |
| Section 107 interest | **(1,352)** | (3,684) |
| Change in technical reserves disclaimed under FA2000 s107(4) | **(2,760)** | (27,560) |
| Group relief received | **675** | - |
| | **(7,410)** | (30,478) |
| Group relief surrendered | **7,410** | 30,478 |
| Taxable profit chargeable to tax | **-** | - |

The Company has agreed to surrender the benefit of tax losses relating to the period to other group companies for a consideration of up to $3.3 million (2005: $13.7 million). The receipt of this consideration is contingent upon Her Majesty's Revenue and Customs' agreement of the recipient company's tax returns.

There is a deferred, unrecognised tax asset of $119.5 million (2005: $122.9 million) in respect of the accumulated losses that have not been recognised, as it is not certain that the Company will be able to realise this asset by generating sufficient, future taxable profits and no amount has been received for the sale of transferable losses during the period.

### 12. Rates of exchange

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

| | 20 March 2006 | 2005 |
|---|---|---|
| United Kingdom | **£0.57** | £0.58 |
| Euro | **€ 0.69** | € 0.69 |

### 13. Investments

| | Market value | | Cost | |
|---|---|---|---|---|
| | 20 March 2006 US$000 | 2005 US$000 | 20 March 2006 US$000 | 2005 US$000 |
| Listed variable yield securities and unit trusts | **63,828** | 63,732 | **62,688** | 62,398 |
| Listed debt securities and other fixed interest securities | **491,053** | 540,711 | **500,312** | 542,616 |
| Deposits with credit institutions | **42,918** | 32,268 | **42,918** | 32,268 |
| | **597,799** | 636,711 | **605,918** | 637,282 |

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 $56.9 million (2005: $74.0 million) against an investment portfolio, and charges to the value of $0.4 million (2005: $1.2 million) against certain bank deposits.

## 13. Investments (continued)

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 $257.0 million (2005: $284.9 million) and $62.4 million (2005: $62.1 million).

## 14. Other debtors

| | 20 March 2006 US$000 | 2005 US$000 |
|---|---|---|
| Amounts due from group companies | **35** | 1,898 |
| Other debtors | **1,382** | 1,382 |
| | **1,417** | 3,280 |

## 15. Called up share capital and shareholders' funds

| | 20 March 2006 | 2005 |
|---|---|---|
| Called up share capital | | |
| Authorised 400,000,000 ordinary shares of £1 each (2005: 400,000,000) | **400,000,000** | 400,000,000 |
| Allotted, called up and fully paid 343,924,280 (2005: 343,924,280) ordinary shares of £1 each | **$513,226,000** | $513,226,000 |

**Shareholders' funds attributable to equity interests**

| | 20 March 2006 US$000 | 2005 US$000 |
|---|---|---|
| (Loss) / profit for the financial period | **(11,165)** | 1,689 |
| Shareholders' funds as at 1 January | **65,202** | 63,513 |
| Shareholders' funds as at 20 March / 31 December | **54,037** | 65,202 |

**Issued share capital:**

Since the period end, on 21 March 2006, the Company restructured its share capital by sub dividing the 343,924,280 issued voting shares of £1 each into 343,920,000 "A" non-voting shares and 4,280 B voting shares.

In connection with the sale of the Company to a consortium, including its former parent, Tawa UK Limited, following the period end on 21 March 2006, the Company restructured its share capital and reclassified its authorised but unissued shares as A non-voting shares.

## 16. Profit and loss account

| | 20 March 2006 US$000 | 2005 US$000 |
|---|---|---|
| At 1 January | **(459,354)** | (461,043) |
| Retained (loss) / profit for the period | **(11,165)** | 1,689 |
| **At 20 March / 31 December** | **(470,519)** | (459,354) |

## 17. Claims outstanding

| | Gross Claims 20 March 2006 US$000 | Reinsurance 20 March 2006 US$000 | Net 20 March 2006 US$000 | Gross Claims 2005 US$000 | Reinsurance 2005 US$000 | Net 2005 US$000 |
|---|---|---|---|---|---|---|
| Provision before discounting | **889,754** | **179,502** | **710,252** | 964,008 | 213,826 | 750,182 |
| Discount | **(251,842)** | **(59,871)** | **(191,971)** | (254,803) | (63,905) | (190,898) |
| **Net of discount** | **637,912** | **119,631** | **518,281** | 709,205 | 149,921 | 559,284 |

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 8.13 years (2005: 8.27 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 4.83% (2005: 4.55%).

## 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 period on prior year estimates, reflected in the Technical Account - General Business, prior to the impact of discounting, was a net loss of $13.3million (2005: gain of $43.1 million), comprising movements in net earned premiums of (gain) $0.2 million, net incurred commissions of (loss) $0.5 million and net incurred claims (loss) of $13.0 million.

## 19. Other creditors including tax and social security

| | 20 March 2006 US$000 | 2005 US$000 |
|---|---|---|
| Sundry creditors | **9,503** | 8,699 |
| | **9,503** | 8,699 |

## 20. Related party transactions

Following its sale to Tawa UK Limited, 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. Management charges and fees payable to Tawa Management Limited in the period to 20 March 2006 were $3.8 million (2005: $23.7 million). There are no other related party transactions requiring disclosure.

## 21. Parent company

At the balance sheet date, the Company's immediate parent company was Tawa UK Limited, a company registered in England and Wales. Copies of the financial statements are obtainable from The Registrar of Companies, Companies House, Crown Way, Maindy, Cardiff CF14 3UZ. The Company's ultimate holding company and controlling party was Financiere Pinault SCA, a company incorporated in France.

### 22. Post balance sheet events

On 21 March 2006, Tawa UK Limited, the immediate parent company and 100% shareholder of the Company sold a significant proportion of its shareholding in the Company to a consortium in which Tawa UK Limited participates. On the same day, the Company agreed to surrender, by way of consortium relief, tax losses to the extent they are available at 31 December 2006.