

THE CHESTER STREET EMPLOYERS' ASSOCIATION LIMITED

ANNUAL REPORT AND ACCOUNTS

31 DECEMBER 2004

Company number: 57061



THE CHESTER STREET EMPLOYERS' ASSOCIATION LIMITED

Directors

B V Strickland MA, FCA (Chairman)
R E Beveridge MA
W J Cain BCom, FCA

Secretary

R E Beveridge MA

Bankers

Royal Bank of Scotland Plc
Professional Practices
London Corporate Services Centre
PO Box 50294
1 1/2 Devonshire Square
London EC2P 2WL

Management Company

(To 18 May 2005)
Iron Trades Management Services Limited
Corn Exchange
55 Mark Lane
London EC3R 7NE

(From 19 May 2005)
Capita Insurance Services Limited
71 Victoria Street
Westminster
London SW1H 0XA

Auditors

Ernst & Young LLP
1 More London Place
London SE1 2AF

Legal advisors

Clifford Chance LLP
10 Upper Bank Street
Canary Wharf
London E14 5JJ

Actuarial advisors

Watson Wyatt Partners
Watson House
London Road
Reigate RH2 9PQ

Registered Office

Plumtree Court
London EC4A 4HT

THE CHESTER STREET EMPLOYERS' ASSOCIATION LIMITED

DIRECTORS' REPORT

The Directors have pleasure in presenting their Annual Report and the Accounts for the year ended 31 December 2004.

Status, principal activities, review of business developments, subsequent events and future developments

The Chester Street Employers' Association Limited ('The Association') is a mutual company limited by guarantee without any share capital. The Association ceased to write business with effect from 1 January 1990.

In early January 2001, the directors of Chester Street Insurance Holdings Limited ('Holdings'), the company's wholly owned subsidiary, received the preliminary findings of an actuarial review of its reserves, which indicated that a substantial increase would be required in the level of its provision for claims incurred but not yet reported, particularly insofar as that provision was for losses forecast to arise out of claims for asbestos-related diseases. These findings reflected the impact of significant increases in both the number and average cost of asbestos-related disease claims notified during 2000.

The Board of Holdings, having considered those findings and taken appropriate advice, determined that Holdings' liabilities exceeded its assets and that Holdings was insolvent. On 9 January 2001, the High Court granted the petition of the directors for the appointment of Dan Schwarzmenn and Colin Bird of PricewaterhouseCoopers as provisional liquidators.

Following a unanimous vote of the creditors attending and voting at meetings held on 5 February 2001, a Scheme of Arrangement (the 'Scheme') was sanctioned by the Court on 28 February 2001 and became effective on 5 March 2001, with Dan Schwarzmenn and Colin Bird of PricewaterhouseCoopers as Scheme Administrators. On 25 July 2001, Mark Batten, also of PricewaterhouseCoopers, replaced Colin Bird as a provisional liquidator and Scheme Administrator.

At the end of March 2001, the Scheme Administrators set an initial payment percentage of 5% pursuant to the Scheme. In May 2001, the Association of British Insurers (ABI) announced that its members would fund compensation for certain claimants, whose claims would otherwise fail to be met in full because their former employer was no longer able to pay and the claim failed to meet the criteria for compensation by the Financial Services Compensation Scheme (FSCS), formerly the Policyholders Protection Board (PPB).

Payments to creditors under the Scheme began to be made in July 2001. Holdings is cooperating with its policyholders and with the FSCS and the ABI to ensure that claimants receive prompt payment.

The Scheme payment percentage currently remains unchanged at 5%.

THE CHESTER STREET EMPLOYERS' ASSOCIATION LIMITED

DIRECTORS' REPORT

Following the recent legal judgment in the Geologistics case, the company is now able to recover those defence costs incurred in respect of protected post 1972 claims. As such included within other debtors is an amount of £1.4m which was received from the FSCS on 28 April 2005. The Directors and Scheme Administrators are continuing discussions with the FSCS with regard to the recoverability of defence costs incurred on pre 1972 claims made under the Third Parties (Rights Against Insurers) Act 1930.

On 4 December 2002 a wholly owned subsidiary, Chester Street Investments Limited and its subsidiary companies were placed into voluntary liquidation. However, at 31 December 2004, the companies had not been formally struck off.

On 18 February 2000 the company sold its 100% shareholding in Iron Trades Insurance Company Limited for £175m, its book value after accounting for unprovided deferred tax, to QBE International Insurance Limited.

Results

The results for the year ended 31 December 2004 are set out in the profit and loss account on pages 5 and 6.

Following the annual review by Watson Wyatt of the continuing pattern of notified claims for asbestos-related diseases during the financial year, the Directors have felt it appropriate to increase the value of the claims reserves.

During 2004 the actual number of claims settlements has increased, and in addition the claims reserves have been substantially increased to reflect a considerable growth in the number of claims notifications for all asbestos-related diseases. This pattern of increased claims is seen to be driven by a growth in both solicitor activity and a greater awareness of the diseases and potential compensation. In the opinion of the Directors this pattern is not likely to be reversed in the foreseeable future.

The annual review by Watson Wyatt took into account information prepared by the Institute of Actuaries in a paper 'UK Asbestos – The Definitive Guide' which was based on industry data and in particular work undertaken by the Health and Safety Executive. This study is based on similar assumptions regarding exposure and latency periods as that previously used by the company, but it has the advantage of more detailed work, split by age group of asbestos related diseases and a larger underlying database of information. The results of the 'Definitive Guide' paper were compared to the past claims experience of the company and the central projections of the 'Definitive Guide' were compared to the company projections as at 31 December 2003, by considering the ratio of the projected future claim numbers to the number notified to date. Following this assessment the peak for non-shipbuilding mesothelioma claims has been extended so that the ratio of future claims to past claims is more consistent with the 'Definitive Guide' results.

Average claim values have been based on historic settlements by the company.

Directors

The Directors of the company during the year are as shown on page 1.

In accordance with the Articles of Association, Mr. W J Cain retires, and being eligible, offers himself for re-election at the next Annual General Meeting.

All the directors held office throughout the year ended 31 December 2004.

THE CHESTER STREET EMPLOYERS' ASSOCIATION LIMITED

DIRECTORS' REPORT

Employees

The group had 3 employees during the year. Iron Trades Management Services Limited has provided all necessary management and administrative services.

Management Services Provider

On 18 May 2005 the contract with the current management services provider, Iron Trades Management Services Limited (ITMS) will expire. The Scheme Administrators have awarded the new contract to Capita Insurance Services Limited, who will assume responsibility for all the services previously provided by ITMS.

Political and charitable contributions

No contributions were made during the year.

Statement of Directors' responsibilities

Company law requires the directors to prepare accounts for each financial year which give a true and fair view of the state of affairs of the company and the group and the profit or loss of the group for that period. In preparing the accounts, 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 accounts; and
- prepare the accounts on the going concern basis unless it is inappropriate to presume that the group will continue in business.

The directors confirm that they have complied with the above requirements when preparing the accounts, other than preparing the group accounts on a break-up basis since Holdings is no longer a going concern.

The directors are responsible for keeping proper accounting records which disclose with reasonable accuracy at any time the financial position of the group and to enable them to ensure that the accounts comply with the Companies Act 1985. They are also responsible for safeguarding the assets of the group and for taking reasonable steps for the prevention and detection of fraud and other irregularities.

Auditors

The auditors, Ernst & Young LLP, have expressed their willingness to continue in office.

Plumtree Court
London
EC4A 4HT

By order of the board



R E Beveridge
Secretary
23 August 2005

THE CHESTER STREET EMPLOYERS' ASSOCIATION LIMITED
CONSOLIDATED PROFIT AND LOSS ACCOUNT
FOR THE YEAR ENDED 31 DECEMBER 2004

Technical Account – General Business
Discontinued operations

	Note	2004 £m	2003 £m
Claims paid			
- gross amount	2	84.4	51.0
- reinsurers' share		-	-
- net of reinsurance		84.4	51.0
Change in the provision for claims			
- gross amount		966.8	884.9
- reinsurers' share		-	-
- net of reinsurance		966.8	884.9
Claims incurred, net of reinsurance		1,051.2	935.9
Net operating expenses	4	6.1	5.8
Total technical charges		1,057.3	941.7
Balance on the technical account for general business		(1,057.3)	(941.7)

THE CHESTER STREET EMPLOYERS' ASSOCIATION LIMITED
CONSOLIDATED PROFIT AND LOSS ACCOUNT
FOR THE YEAR ENDED 31 DECEMBER 2004

Non-technical account
Discontinued operations

	Note	2004 £m	2003 £m
Balance on the technical account for general business		(1,057.3)	(941.7)
Investment income	5	10.1	8.2
Unrealised gains on investments		7.8	5.8
		17.9	14.0
Investment expenses and charges		(0.2)	(0.2)
Loss on ordinary activities before tax		(1,039.6)	(927.9)
Tax credit on loss on ordinary activities	6	8.2	-
Loss retained for the financial year	9	(1,031.4)	(927.9)

The group has no recognised gains or losses other than the loss for the financial year.

THE CHESTER STREET EMPLOYERS' ASSOCIATION LIMITED

CONSOLIDATED BALANCE SHEET

AS AT 31 DECEMBER 2004

Assets

	Note	2004 £m	2003 £m
Investments			
Other financial investments	7	172.2	172.7
Debtors			
Other debtors	8	3.2	0.2
Other assets			
Cash at bank and in hand		1.4	4.6
Corporation tax recoverable		7.9	1.2
		9.3	5.8
Prepayments and accrued income			
Accrued interest		1.6	1.4
Total Assets		186.3	180.1

THE CHESTER STREET EMPLOYERS' ASSOCIATION LIMITED

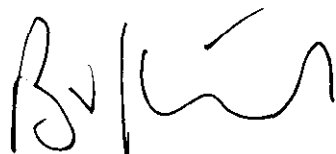
CONSOLIDATED BALANCE SHEET

AS AT 31 DECEMBER 2004

Liabilities

	Note	2004	2003
		£m	£m
Reserves			
Profit and loss account	9	(3,289.5)	(2,258.1)
Technical provisions			
Claims outstanding	3	3,299.6	2,332.8
Provisions for other risks and charges	10	32.2	30.7
Creditors			
Other creditors including taxation and social security		1.7	3.2
Scheme creditors	2	131.5	55.9
Other scheme creditors	2	8.6	13.3
		141.8	72.4
Accruals and deferred income		2.2	2.3
Total Liabilities		186.3	180.1

Approved by the Board on 23 August 2005



B V Strickland
Director



W J Cain
Director

THE CHESTER STREET EMPLOYERS' ASSOCIATION LIMITED

ASSOCIATION ONLY

BALANCE SHEET

AS AT 31 DECEMBER 2004

Assets	Note	2004	2003
		£m	£m
Investments			
Shares in group undertaking	12	-	-
Other Assets			
Cash at Bank and in Hand		-	-
Total Assets		-	-
Reserves			
Profit and loss account		-	-
		-	-

Approved by the Board on 23 August 2005



B V Strickland
Director



W J Cain
Director

THE CHESTER STREET EMPLOYERS' ASSOCIATION LIMITED

CONSOLIDATED CASHFLOW STATEMENT

FOR THE YEAR ENDED 31 DECEMBER 2004

	Note	2004 £m	2003 £m
Net cash outflow from operating activities	11	(13.0)	(1.5)
<i>Taxation</i>		1.5	-
Cash available for investment		(11.5)	(1.5)
Net portfolio disinvestment	11	8.3	1.3
Net cash outflow for the year	11	(3.2)	(0.2)

THE CHESTER STREET EMPLOYERS' ASSOCIATION LIMITED

NOTES TO THE ACCOUNTS

FOR THE YEAR ENDED 31 DECEMBER 2004

1 Accounting policies

Basis of presentation and consolidation.

The group accounts have been prepared in accordance with the provisions of section 255 of and Schedule 9A to the Companies Act 1985, which cover the disclosures applicable to insurance companies.

The Association only balance sheet has been prepared in accordance with the provisions of section 226 of, and Schedule 4 to the Companies Act 1985 and under the historical cost convention modified to include the revaluation of investments in shares in group undertakings. As permitted by section 230 of the Companies Act 1985 a separate profit and loss account for the Association is not presented.

The consolidated accounts incorporate the assets and liabilities of the group and all of its subsidiaries as at 31 December 2004 and the results for the year ended on that date.

The assets and liabilities of Chester Street Insurance Holdings Limited have been prepared on a break-up basis as the company is not a going concern, having entered into a Scheme of Arrangement with its creditors under section 425 of the Companies Act 1985 (the Scheme) on 5 March 2001.

The accounts comply with applicable accounting standards. They also comply with the guidance on Accounting for Insurance Business issued by the Association of British Insurers in November 2003.

Basis of accounting

The annual basis of accounting has been applied to all classes of business.

Claims

General business claims incurred include all losses occurring during the year, whether reported or not, related handling costs and any adjustments to claims outstanding from previous years. Significant delays are experienced in the notification and settlement of certain claims, particularly in respect of liability business, the ultimate cost of which cannot be known with certainty at the balance sheet date. Outstanding claims provisions are based on the estimated ultimate cost of all claims incurred but not settled at the balance sheet date. Any estimate represents a point within a range of possible outcomes. Further details of estimation techniques are given in note 3. Claims provisions are not discounted.

Claims handling expenses

The provision for claims handling expenses (which is included in the balance sheet within technical provisions – claims outstanding) consists of all estimated future costs of negotiating and settling claims until the date that the Directors have anticipated that all claims will have been settled under the Scheme. No deduction has been made for anticipated investment income.

THE CHESTER STREET EMPLOYERS' ASSOCIATION LIMITED

NOTES TO THE ACCOUNTS

FOR THE YEAR ENDED 31 DECEMBER 2004

Run-off provision

The run-off provision consists of all estimated operational costs (other than the cost of negotiating and settling claims) until the date that the Directors have anticipated that all claims will have been settled under the Scheme. This provision has been discounted at a rate justified by anticipated investment income. No further deduction for anticipated investment income has been made.

Investments

Listed investments are stated in the group balance sheet at middle market value based on prices quoted by the relevant exchanges.

Investment income

All realised and unrealised gains and losses are taken to the profit and loss account. Realised gains are measured by reference to original cost. Since the subsidiary is no longer a going concern all the investment return has remained in the non-technical account. In the Association only balance sheet unrealised losses on subsidiaries are taken directly to the profit and loss account.

Dividends received from companies in the United Kingdom are shown at the net amount received.

Taxation

Provision is made for deferred tax liabilities, using the liability method, on all material timing differences, including revaluation gains and losses on investments recognised in the profit and loss account. Deferred tax is calculated at the rates at which it is expected that the tax will arise. Deferred tax balances are not discounted.

Deferred tax assets are recognised to the extent they are regarded as recoverable. Assets are regarded as recoverable when it is more likely than not there will be suitable taxable profits from which the future reversal of the underlying timing differences can be deducted.

2 Claims

Claims paid in the profit and loss account reflect all amounts settled for defence costs and damage claims. The payments include amounts settled by policyholders, the FSCS and the ABI. Scheme creditors represent the portion of agreed claims which have been paid to the claimants by other parties, but which still remain a liability of the company. Other scheme creditors reflect an accrual for claims settled but not processed at the year-end.

THE CHESTER STREET EMPLOYERS' ASSOCIATION LIMITED

NOTES TO THE ACCOUNTS

FOR THE YEAR ENDED 31 DECEMBER 2004

3 Technical provisions

Below is a summary of the gross outstanding claims:

	2004 £m	2003 £m
Notified Outstanding Claims	153.7	136.1
Incurred But Not Reported Claims	3,011.0	2,093.7
	3,164.7	2,229.8
Claims Handling Provision	134.9	103.0
	3,299.6	2,332.8

The ultimate cost of outstanding claims is estimated by using a range of standard actuarial claims projection techniques. The main assumption underlying these techniques is that past claim development experience can be used to project ultimate claims costs and that no changes to past trends, such as public attitudes to claiming or inflation occur. The approach adopted takes into account the nature and materiality of the business and type of data available. Case estimates are generally set by skilled claims technicians applying their experience and knowledge to the circumstances of individual claims. Additional qualitative input, such as allowance for one-off occurrences or changes in legislation, policy conditions or portfolio mix, is also used in arriving at the estimated cost of claims, in order that it represents the most likely outcome taking account of all the uncertainties involved. Claims provisions are not discounted.

Fundamental uncertainty

Chester Street Insurance Holdings Limited ('Holdings') has a substantial exposure to disease claims arising from employers' liability policies written many years ago. The majority of this exposure is in respect of asbestos. There is a significant uncertainty over the ultimate out-turn of asbestos related claims which reflects the limited data available particularly in relation to exposure analysis, the latency period for asbestos related claims and mortality profile of claimants. The claims are extremely long-tail in nature and the latency period for these claims is significant – the usage of asbestos was at its peak over 40 years ago. There is very limited available data in respect of the number of employees of policyholders exposed to asbestos. The future costs arising from these claims cannot, therefore, be predicted with certainty. Accordingly, the provision for claims outstanding in respect of asbestos related claims relies on a considerable degree of judgement as to the number of claims which will emerge, the timing of the claims and the amounts at which they will be settled.

The provision for disease claims is based on information currently available and the ultimate liability may vary as a result of subsequent information and events, and could result in significant adjustments to the amounts provided. Adjustments to the technical provisions are reflected in the accounts for the period in which the adjustments are made.

The Holdings technical provisions represent the directors' best estimate of the likely outcome of the run-off of the company's insurance liabilities and are therefore not comparable with any figure that may be inferred from the level of the initial payment percentage to Holdings' creditors set by the Scheme Administrators pursuant to the Scheme of Arrangement. The technical provisions are still fundamentally uncertain because of the difficulty of forecasting the future development of the claims to which they relate. On 8 March 2004 an agreement was reached between the Scheme Administrators and a significant policyholder to commute the non-FSCS protected Liabilities of Holdings.

THE CHESTER STREET EMPLOYERS' ASSOCIATION LIMITED

NOTES TO THE ACCOUNTS

FOR THE YEAR ENDED 31 DECEMBER 2004

3 Technical provisions (continued)

Provision for claims handling expenses

Included in the balance sheet within technical provisions - claims outstanding is the provision for claims handling expenses of £134.9 (2003: £103.0m). This consists of all estimated future costs of negotiating and settling claims until the date that the Directors have anticipated that all claims will have been settled under the Scheme. No deduction has been made for anticipated investment income. The claims handling expense provision is fundamentally uncertain because of the difficulty of forecasting the future development of the claims to which they relate.

4 Net operating expenses

Included in net operating expenses are:	2004	2003
	£000	£000
Directors' emoluments (see note 4.1)	47	46
Auditors' remuneration	95	75

4.1 Directors' emoluments

	2004	2003
	£000	£000
Aggregate emoluments	47	46

Aggregate emoluments of highest paid director

	2004	2003
	£000	£000
Aggregate emoluments	20	20

4.2 Employment costs

	2004	2003
	£000	£000
Wages and salaries	43	40
Social security costs	4	6
	47	46

4.3 Average number of employees

The average number of employees during the year was 3 (2003: 3).

THE CHESTER STREET EMPLOYERS' ASSOCIATION LIMITED

NOTES TO THE ACCOUNTS

FOR THE YEAR ENDED 31 DECEMBER 2004

5 Investment income

	2004	2003
	£m	£m
Income from investments	5.4	5.8
Realised gains on investments	3.5	2.4
Interest on group relief (see note 8)	1.2	-
	<u>10.1</u>	<u>8.2</u>

6 Tax credit on loss on ordinary activities

	2004	2003
	£m	£m
Current Tax		
Group Relief in respect of prior years	7.9	-
Underprovision of tax recovery from previous year	0.3	-
Current tax credit for the year	<u>8.2</u>	<u>-</u>

Factors affecting tax charge for period

Loss on ordinary activities before tax	<u>(1,039.6)</u>	<u>(927.9)</u>
Loss on ordinary activities multiplied by the standard rate of corporation tax of 30% (2003: 30%)	(311.9)	(278.4)
Effects of:		
Non taxable income	-	-
Prior period adjustments	8.2	-
Losses not utilised	311.9	278.4
Current tax credit for the year	<u>8.2</u>	<u>-</u>

The Inland Revenue have agreed a group relief tax claim in respect of the subsidiary Iron Trades Insurance Company Limited (now known as QBE Insurance Company (UK) Limited) in the amount of £25.9m, relating to the year ended 31 December 1999.

This gives rise to a recoverable amount of £7.9m which has been reflected as a prior year adjustment in the accounts. Under the terms of the purchase and sale agreement between Holdings and QBE Insurance Company (UK) Limited, this amount is wholly due to Holdings

THE CHESTER STREET EMPLOYERS' ASSOCIATION LIMITED

NOTES TO THE ACCOUNTS

FOR THE YEAR ENDED 31 DECEMBER 2004

7 Other financial investments

	Current Value		Cost	
	2004 £m	2003 £m	2004 £m	2003 £m
Listed investments				
Shares, options and other variable yield securities and units in unit trusts	-	3.1	-	2.2
Debt securities and other fixed income securities	172.2	163.8	153.9	153.2
	172.2	166.9	153.9	155.4
Deposits with credit institutions	-	5.8	-	5.8
	172.2	172.7	153.9	161.2

8 Other Debtors

Included within other debtors is an amount of £1.4m in respect of a recent settlement with the Financial Services Compensation Scheme (FSCS), allowing the company to recover defence costs incurred on protected post 1972 claims.

The refund of defence costs is ultimately due to the scheme creditors and therefore this amount is also reflected in scheme creditors.

Also included within other debtors is £1.2m representing interest due from the Inland Revenue on the £7.9m group relief claim in respect of the year ended 1999 – See also note 6

9 Reconciliation of movement in reserves

Group	Profit & Loss		Profit & Loss	
	Account 2004 £m	Total 2004 £m	Account 2003 £m	Total 2003 £m
1 January	(2,258.1)	(2,258.1)	(1,330.2)	(1,330.2)
Retained loss for the financial year	(1,031.4)	(1,031.4)	(927.9)	(927.9)
31 December	(3,289.5)	(3,289.5)	(2,258.1)	(2,258.1)

THE CHESTER STREET EMPLOYERS' ASSOCIATION LIMITED

NOTES TO THE ACCOUNTS

FOR THE YEAR ENDED 31 DECEMBER 2004

10 Provisions for other risks and charges

a) Deferred Taxation

There is an unrecognised deferred tax asset of £998m (2003: £677m). This is made up of trading losses of £990m (2003: £669) and capital losses of £8m (2003: £8m). Deferred tax has not been recognised as it is not anticipated that the group will make profits in future periods.

b) Provision for run-off expenses

	2004	2003
	£m	£m
Balance at 1 January 2004	30.7	29.3
Utilisation of provision	(4.4)	(3.1)
Increase/(release) of provision	5.9	4.5
Balance at 31 December 2004	<u>32.2</u>	<u>30.7</u>

The provision for run-off expenses totals £32.2m (2003: £30.7m). This consists of all estimated operational costs (other than the cost of negotiating and settling claims) until the date that the Directors have anticipated that all claims will have been settled under the Scheme. The provision is fundamentally uncertain because of the difficulty of forecasting the future development of the claims. This provision has been discounted at 4.97% (2003: 5.13%), a rate justified by anticipated investment income. No further deduction for anticipated investment income has been made. The undiscounted provision is £69.4m (2003: £65.9m). The average settlement period assumed in discounting this provision is 12.5 years (2003: 12.2 years).

THE CHESTER STREET EMPLOYERS' ASSOCIATION LIMITED

NOTES TO THE ACCOUNTS

FOR THE YEAR ENDED 31 DECEMBER 2004

11 Note to the Consolidated cashflow statement

	2004	2003
	£m	£m
Reconciliation of loss before taxation to net cash outflow from operating activities		
Loss before taxation and exceptional items	(1,039.6)	(927.9)
Increase in insurance and other debtors	(3.2)	(0.1)
Increase in technical provisions	966.8	884.9
Increase in provisions for other risks and charges	1.5	1.4
Increase in insurance and other creditors	69.3	46.0
Unrealised gains	(7.8)	(5.8)
Net cash outflow from operating activities	<u>(13.0)</u>	<u>(1.5)</u>

	2004	2003
	£m	£m
Movements in opening and closing portfolio investments net of financing		
Net cash outflow for the year	(3.2)	(0.2)
Cash flow movements from portfolio investments	(8.3)	(1.3)
Movements arising from cashflows	(11.5)	(1.5)
Changes in market values	7.8	5.8
Total movements in portfolio investments net of financing	(3.7)	4.3
Portfolio investments net of financing at 1 January	177.3	173.0
Portfolio investments net of financing at 31 December	<u>173.6</u>	<u>177.3</u>

	2004	2003
	£m	£m
Net portfolio investment		
Purchase of equity shares	-	(0.3)
Purchase of fixed interest investments	(37.1)	(48.5)
Purchase of deposits with credit institutions	-	(0.4)
Sale of equity shares	3.1	0.3
Sale of fixed interest investments	36.5	50.2
Sale of deposits with credit institutions	5.8	-
Net disinvestment	<u>8.3</u>	<u>1.3</u>

THE CHESTER STREET EMPLOYERS' ASSOCIATION LIMITED

NOTES TO THE ACCOUNTS

FOR THE YEAR ENDED 31 DECEMBER 2004

11 Note to the Consolidated cashflow statement (continued)

Movements in cash and portfolio investment

	At 1 January 2004 £m	Cashflow £m	Changes to market value £m	At 31 December 2004 £m
Equity shares	3.1	(3.1)	-	-
Fixed interest investments	163.8	0.6	7.8	172.2
Deposits with credit institutions	5.8	(5.8)	-	-
	172.7	(8.3)	7.8	172.2
Cash at bank and in hand and short term deposits	4.6	(3.2)	-	1.4
Total	177.3	(11.5)	7.8	173.6

Movements in technical provisions

	At 1 January 2004 £m	Change during year £m	At 31 December 2004 £m
Claims outstanding	2,332.8	966.8	3,299.6
	2,332.8	966.8	3,299.6

THE CHESTER STREET EMPLOYERS' ASSOCIATION LIMITED

NOTES TO THE ACCOUNTS

FOR THE YEAR ENDED 31 DECEMBER 2004

12 Subsidiary Undertakings

Company	Principal activity	Current Value		Cost	
		2004	2003	2004	2003
		£m	£m	£m	£m
Chester Street Insurance Holdings Limited	General Insurance	-	-	-	-

Chester Street Insurance Holdings Limited went into a scheme of arrangement, effective from 5 March 2001.

13 Segmental reporting

The company wrote business in only one market segment, that of liability insurance.

14 Contingent liability

Note 3 gives details of the estimation techniques used in determining the outstanding claims provision. As stated in this note there is considerable uncertainty as to the quantum of the ultimate settlement of these liabilities. To the extent the ultimate cost is greater than that provided, there is a contingent liability in respect of this uncertainty.

15 Contingent Asset

Under the terms of the Scheme of Arrangement, the company is required to pay all elective defence costs. Where these exceed the payment dividend payable by the company, the excess can be set off against future payment dividends to the same policyholder.

At 31 December 2004, the company had a contingent asset comprising the value of elective defence costs paid in excess of payment dividends paid. The recoverability of this asset is dependent upon future claims arising from the same policyholders and as such cannot be estimated with reliability, and accordingly this asset is not included in the Balance Sheet. The value of the contingent asset will be reduced by the repayment of defence costs by the FSCS following the Geologistics judgment.

THE CHESTER STREET EMPLOYERS' ASSOCIATION LIMITED

NOTES TO THE ACCOUNTS

FOR THE YEAR ENDED 31 DECEMBER 2004

16 Related party transactions

In the opinion of the directors, the following may be considered to be Related Parties in terms of Financial Reporting Standard No. 8 (FRS 8) "Related Party Disclosures", the value of transactions with whom requires to be disclosed:

- a) the Scheme Administrator (PricewaterhouseCoopers LLP)
- b) the management services provider (Iron Trades Management Services Limited)

Amounts paid (excluding Value Added Tax) during the year:

	2004 £m	2003 £m
Scheme Administrator:		
scheme administration fees	2.8	1.8
other services and fees	0.6	0.6
Amounts paid to the management services provider	4.5	3.4

Amounts due at 31 December:

	2004 £m	2003 £m
Amounts due from Iron Trades Management Services Limited	-	0.2
Amounts due to Iron Trades Management Services Limited	0.1	-

Amounts in respect of related parties included in accruals at 31 December:

	2004 £m	2003 £m
PricewaterhouseCoopers LLP	0.1	0.2
Iron Trades Management Services Limited	1.9	1.9

Amounts in respect of related parties included in the run-off provision and claims handling provision at 31 December:

	2004 £m	2003 £m
PricewaterhouseCoopers LLP	17.6	24.1
Iron Trades Management Services Limited	10.1	10.6

The company has taken advantage of the exemption under FRS 8 not to disclose transactions with other group companies where 90% or more of the voting rights are controlled within the group.

Following the expiration of the management services contact, ITMS will, from the 19 May 2005 no longer be a related party. From this date the all services will be provided by Capita Insurance Services Limited.

17 Funding

The Association has entered into an arrangement with its subsidiary, Chester Street Insurance Holdings Limited ('Holdings'), whereby Holdings settles liabilities of the Association for the purpose of discharging its debts as they fall due to creditors in the ordinary course of business, whilst it is in the interest of Holdings' scheme creditors. This arrangement does not cover liabilities arising out of the Association's negligence, fraud, wilful default, breach of duty, breach of trust or other like action.

INDEPENDENT AUDITORS REPORT TO THE MEMBERS OF THE CHESTER STREET EMPLOYERS' ASSOCIATION LIMITED

We have audited the group's accounts for the year ended 31 December 2004 which comprise the Consolidated Profit and Loss Account, Consolidated Balance Sheet, Company Balance Sheet, Consolidated Cash Flow Statement and the related notes 1 to 17. These accounts have been prepared on the basis of the accounting policies set out therein. The accounts have been prepared on a break-up basis.

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 accounts in accordance with applicable United Kingdom law and accounting standards.

Our responsibility is to audit the accounts in accordance with relevant legal and regulatory requirements and United Kingdom Auditing Standards.

We report to you our opinion as to whether the accounts give a true and fair view 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 accounts, 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 group is not disclosed.

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

Basis of audit opinion

We conducted our audit in accordance with 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 accounts. It also includes an assessment of the significant estimates and judgements made by the directors in the preparation of the accounts, and of whether the accounting policies are appropriate to the group'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 accounts 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 accounts.

INDEPENDENT AUDITORS REPORT TO THE MEMBERS OF THE CHESTER STREET EMPLOYERS' ASSOCIATION LIMITED (continued)

Fundamental uncertainties

In forming our opinion, we have considered the adequacy of the disclosure made in the accounts in respect of:

Latent Disease: The accounts include provisions for gross notified and incurred but not reported outstanding claims of £3,164.7m (2003: £2,229.8m). These provisions rely on a considerable degree of judgement due to the uncertainty as to the number of claims which will emerge and the amounts at which they will be settled and could be materially different to the amounts stated. Details of the circumstances relating to this fundamental uncertainty are described in note 3 on page 13.

Claims Handling: The accounts include a claims handling provision of £134.9m (2003: £103.0m). The ultimate cost of claims handling is dependent upon future events and could be materially different to the amount stated. Details of this fundamental uncertainty are described in note 3 (continued) on page 14.

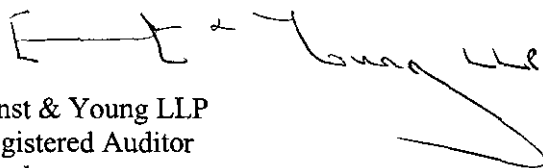
Run-Off Expenses: The accounts include a discounted run-off provision of £32.2m (2003: £30.7m) for estimated operational costs of the run-off. The ultimate cost of the run-off is dependent upon future events and could be materially different from the amount provided. Details of this fundamental uncertainty are described in note 10(b) on page 17.

Given the nature of these issues, it is not possible to quantify the potential effects of the resolution of these uncertainties.

Our opinion is not qualified in respect of the above matters.

Opinion

In our opinion the accounts give a true and fair view of the state of affairs of the company, and of the group as at 31 December 2004 and of the loss of the group for the year then ended and have been properly prepared in accordance with the Companies Act 1985.



Ernst & Young LLP
Registered Auditor
London
23 August 2005