

THE CHESTER STREET EMPLOYERS' ASSOCIATION LIMITED

ANNUAL REPORT AND ACCOUNTS

31 DECEMBER 2001



Company number : 57061

THE CHESTER STREET EMPLOYERS' ASSOCIATION LIMITED

Directors

B V Strickland MA, FCA

(Chairman)

P J Grant

(Chief Executive)

R E Beveridge MA

W J Cain BCom, FCA

W Stockdale BSc, PhD

Secretary

R E Beveridge MA

Bankers

The Royal Bank of Scotland Plc

Barclays Bank Plc

Auditors

Ernst & Young LLP

Rolls House

7 Rolls Buildings

Fetter Lane

London EC4A 1NH

Legal advisors

Clifford Chance LLP

200 Aldersgate Street

London EC1A 4JJ

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 2001.

The financial results for the year are shown in the consolidated profit and loss account.

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') 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 Schwarzmunn 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, the Scheme was sanctioned by the Court and became effective on 5 March 2001, with Dan Schwarzmunn 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.

A review of the Scheme payment percentage was made on 17 December 2001, at which time the payment percentage remained unchanged at 5%.

In the opinion of the Board, the attached accounts show the manner in which the affairs of the Group have been conducted during the year ended 31 December 2001 and show the position of the Group at that date. The directors do not recommend payment of a dividend.

THE CHESTER STREET EMPLOYERS' ASSOCIATION LIMITED

DIRECTORS' REPORT

Results

The Profit and Loss Account for the Group appears on pages 4 and 5. These accounts consolidate the results, assets and liabilities of the Group and its subsidiary undertakings as listed in note 15 to the accounts. The 2000 accounts include the results of Iron Trades Insurance Company Limited, up to the date of its disposal on 18 February 2000.

Directors

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

In accordance with the Articles of Association, Messrs P J Grant and R E Beveridge retired, and being eligible, offered themselves for re-election at the Annual General Meeting on 15 August 2001.

All other directors held office throughout the year ended 31 December 2001.

Employees

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

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 and a resolution proposing their reappointment will be put to the Annual General Meeting.

Plumtree Court
London
EC4A 4HT

9 August 2002

By order of the board


R E Beveridge
Secretary

THE CHESTER STREET EMPLOYERS' ASSOCIATION LIMITED

CONSOLIDATED PROFIT AND LOSS ACCOUNT

FOR THE YEAR ENDED 31 DECEMBER 2001

**Technical Account – General Business
Discontinued operations**

| | | 2001 | 2000 |
|--|------|--------|-----------|
| | Note | £m | £m |
| Gross premiums written | | - | 32.2 |
| Outward reinsurance premiums | | - | (3.9) |
| Net premiums written | | - | 28.3 |
| Change in the gross provision for unearned premiums | | - | (2.5) |
| Change in the provision for unearned premiums, reinsurers' share | | - | 1.0 |
| Change in the net provision for unearned premiums | | - | (1.5) |
| Earned premiums, net of reinsurance | | - | 26.8 |
| Total technical income | | - | 26.8 |
| Claims paid | | | |
| - gross amount | 2 | 11.3 | 67.2 |
| - reinsurers' share | | - | (3.0) |
| - net of reinsurance | | 11.3 | 64.2 |
| Change in the provision for claims | | | |
| - gross amount | | (11.3) | 1,187.7 |
| - reinsurers' share | | - | 1.0 |
| - net of reinsurance | | (11.3) | 1,188.7 |
| Claims incurred, net of reinsurance | | - | 1,252.9 |
| Operating expenses | 4 | 3.6 | 13.7 |
| Total technical charges | | 3.6 | 1,266.6 |
| Balance on the technical account for general business | | (3.6) | (1,239.8) |

THE CHESTER STREET EMPLOYERS' ASSOCIATION LIMITED

CONSOLIDATED PROFIT AND LOSS ACCOUNT

FOR THE YEAR ENDED 31 DECEMBER 2001

**Non-technical account
Discontinued operations**

| | | 2001 | 2000 |
|--|-------------|--------------|------------------|
| | | £m | £m |
| Balance on the technical account for general business | Note | (3.6) | (1,239.8) |
| Investment income | | 9.5 | 12.3 |
| Realised gains on investments | | 18.7 | 6.8 |
| | 5 | 28.2 | 19.1 |
| Investment expenses and charges | | (0.3) | (0.4) |
| Unrealised losses on investments | | (20.1) | (8.1) |
| | | (20.4) | (8.5) |
| Profit/(loss) before taxation and exceptional items | | 4.2 | (1,229.2) |
| Exceptional loss on disposal of subsidiary undertaking | 6 | - | (64.4) |
| Profit/(Loss) on ordinary activities before tax | | 4.2 | (1,293.6) |
| Tax on profit/(loss) on ordinary activities | 7 | 0.3 | (1.3) |
| Profit/(Loss) retained for the financial year | 11 | 4.5 | (1,294.9) |

The Group has no recognised gains or losses other than the profit/(loss) for the financial year.

THE CHESTER STREET EMPLOYERS' ASSOCIATION LIMITED

CONSOLIDATED BALANCE SHEET

AS AT 31 DECEMBER 2001

Assets

| | | 2001 | 2000 |
|--|-------------|--------------|--------------|
| | Note | £m | £m |
| Investments | | | |
| Other financial investments | 8 | 163.8 | 169.8 |
| <hr/> | | | |
| Reinsurers' share of technical provisions | | | |
| Claims outstanding | | 0.3 | 0.3 |
| <hr/> | | | |
| Debtors | | | |
| Other debtors | | 0.2 | - |
| <hr/> | | | |
| Other assets | | | |
| Tangible assets | 9 | - | - |
| Cash at bank and in hand | | 4.3 | 3.2 |
| Corporation tax recoverable | | 0.3 | - |
| | | 4.6 | 3.2 |
| <hr/> | | | |
| Prepayments and accrued income | | | |
| Accrued interest | | 2.4 | 1.5 |
| Deferred acquisition costs | 10 | - | - |
| | | 2.4 | 1.5 |
| <hr/> | | | |
| Total Assets | | 171.3 | 174.8 |

THE CHESTER STREET EMPLOYERS' ASSOCIATION LIMITED
CONSOLIDATED BALANCE SHEET
AS AT 31 DECEMBER 2001

Liabilities

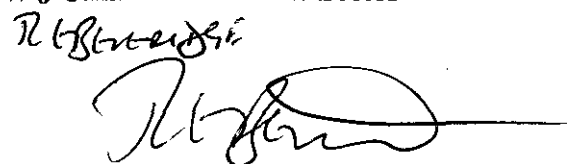
| | Note | 2001 | 2000 |
|--|------|-----------|-----------|
| | | £m | £m |
| Reserves | | | |
| Profit and loss account | 11 | (1,212.5) | (1,217.0) |
| Technical provisions | | | |
| Claims outstanding | 3 | 1,339.1 | 1,350.4 |
| Provisions for other risks and charges | 12 | 37.3 | 38.2 |
| Creditors | | | |
| Other creditors including taxation and social security | | - | 0.1 |
| Corporation tax | | 0.2 | 0.3 |
| Other Scheme Creditors | 2 | 3.9 | - |
| Scheme Creditors | 2 | 2.7 | - |
| | | 6.8 | 0.4 |
| Accruals and deferred income | | 0.6 | 2.8 |
| Total Liabilities | | 171.3 | 174.8 |

Approved by the Board on 9 August 2002

B V Strickland Chairman



W J Cain Director



THE CHESTER STREET EMPLOYERS' ASSOCIATION LIMITED

ASSOCIATION ONLY

BALANCE SHEET

AS AT 31 DECEMBER 2001

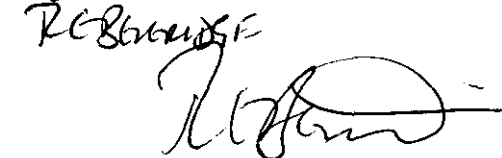
| Assets | Note | 2001 | 2000 |
|-----------------------------|------|------|------|
| | | £m | £m |
| Investments | | | |
| Shares in group undertaking | 15 | - | - |
| Total Assets | | - | - |
| Reserves | 11 | | |
| Profit and loss account | | - | - |
| | | - | - |

Approved by the Board on 9 August 2002

B V Strickland Chairman



~~W J Cairn~~ Director



THE CHESTER STREET EMPLOYERS' ASSOCIATION LIMITED

CONSOLIDATED CASHFLOW STATEMENT

FOR THE YEAR ENDED 31 DECEMBER 2001

| | Note | 2001 £m | 2000 £m |
|---|-----------|--------------|----------------|
| Net cash (outflow) from operating activities | 14 | (4.4) | (28.2) |
| Taxation | | (0.5) | (0.8) |
| Acquisitions and disposals – disposal of subsidiary undertaking | | - | 99.3 |
| Cash available for investment | | (4.9) | 70.3 |
| Net portfolio disinvestment/(investment) | 14 | 6.0 | (117.2) |
| Net cash inflow/(outflow) for the year | 14 | 1.1 | (46.9) |

THE CHESTER STREET EMPLOYERS' ASSOCIATION LIMITED

NOTES TO THE ACCOUNTS

FOR THE YEAR ENDED 31 DECEMBER 2001

1 Accounting policies

Basis of presentation and consolidation.

The Company 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 2001 and the results for the year ended on that date. The 2000 accounts include the results of Iron Trades Insurance Company Limited up to the date of its disposal on 18 February 2000.

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 current guidance on Accounting for Insurance Business issued by the Association of British Insurers.

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 2001

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

Investments are stated in the Group balance sheet on the following bases:

- Redeemable fixed income securities are valued at amortised cost.
- Other listed securities at their middle market values on 31 December, less selling expenses incurred on a forced sale.
- All other investments have been written down to the value anticipated to be realised on a forced sale.

Income from investments

All realised and unrealised gains and losses are taken to the profit and loss account. Realised gains are measured by reference to original cost. 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

Deferred taxation is provided in full on all timing differences at the rate at which it is expected that the tax liability or benefit will arise. Deferred tax assets are recognised to the extent that it is regarded as more likely than not that they will be recovered.

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 95% portion of agreed claims which have been paid to the claimants by other parties, but which still remain a liability to the company. Other scheme creditors reflect an accrual for claims settled but not finalised at the year-end.

THE CHESTER STREET EMPLOYERS' ASSOCIATION LIMITED

NOTES TO THE ACCOUNTS

FOR THE YEAR ENDED 31 DECEMBER 2001

3 Technical provisions

| | 31 December 2001 | 31 December 2000 |
|-----------------------------|------------------|------------------|
| | £m | £m |
| Notified Outstanding Claims | 103.9 | 86.9 |
| Incurred But Not Reported | 1,176.0 | 1,202.2 |
| | 1,279.9 | 1,289.1 |
| Claims Handling Provision | 59.2 | 61.3 |
| | 1,339.1 | 1,350.4 |

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

The company 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.

THE CHESTER STREET EMPLOYERS' ASSOCIATION LIMITED

NOTES TO THE ACCOUNTS

FOR THE YEAR ENDED 31 DECEMBER 2001

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 £59.2m (2000: £61.3m). 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.

4 Operating expenses

| | 2001 £m | 2000 £m |
|---|------------|------------|
| Acquisition costs | - | 3.9 |
| Change in deferred acquisition costs | - | 0.8 |
| | - | 4.7 |
| Administration expenses (including industry levies) | 3.6 | 9.0 |
| | 3.6 | 13.7 |

Included in acquisition costs are commissions for direct insurance amounting to £nil (2000: £3.2m)

Included under administrative expenses are:-

| | 2001 £000 | 2000 £000 |
|----------------------------------|--------------|--------------|
| Directors' emoluments (Note 4.1) | 304 | 380 |
| Auditors' remuneration | | |
| - Audit fees | 90 | 76 |
| - Other services | - | 7 |
| Depreciation | - | 109 |
| Operating lease rentals | | |
| - Land and buildings | - | 188 |

4.1 Directors' emoluments

| | 2001 £000 | 2000 £000 |
|----------------------|--------------|--------------|
| Aggregate emoluments | 304 | 380 |

| | 2001 £000 | 2000 £000 |
|---|--------------|--------------|
| Aggregate emoluments of highest paid director | | |
| Aggregate emoluments | 120 | 151 |

THE CHESTER STREET EMPLOYERS' ASSOCIATION LIMITED

NOTES TO THE ACCOUNTS

FOR THE YEAR ENDED 31 DECEMBER 2001

4.2 Employment costs:

| | 2001 | 2000 |
|-----------------------|------------|------------|
| | £m | £m |
| Wages and salaries | 0.2 | 1.9 |
| Social security costs | - | 0.1 |
| | <u>0.2</u> | <u>2.0</u> |

4.3 Average number of employees during the year

| | 2001 | 2000 |
|----------------------------------|----------|-----------|
| | No | No |
| Administration and other support | 2 | 11 |
| Underwriting | - | 26 |
| Claims | 1 | 27 |
| | <u>3</u> | <u>64</u> |

5 Investment income

| | 2001 | 2000 |
|---|-------------|-------------|
| | £m | £m |
| Gains on the realisation of investments | 18.7 | 6.8 |
| Income from land and buildings | - | 0.3 |
| Income from other investments | 9.5 | 12.0 |
| | <u>28.2</u> | <u>19.1</u> |

6 Exceptional loss on sale of subsidiary

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, resulting in a loss on disposal of £64.4m.

Of the £175m received, funds totalling £27m was retained in a joint escrow account with QBE International Insurance Limited to meet potential warranty claims. The warranty claims relate to certain undertakings in respect of the adequacy of the net claims provisions and the tax liabilities of Iron Trades Insurance Company Limited. The assessment of the quantum of the claim, if any, will occur no later than 28 February 2003. The Directors of the Company believe that there is significant uncertainty over whether a claim will be made against the funds in escrow. Therefore, the £27m in escrow has not yet been recognised as an asset on the grounds of prudence. Whilst a loss on disposal of £64.4m has been recognised in last year's accounts, a profit of up to £27m may arise in future accounting periods.

THE CHESTER STREET EMPLOYERS' ASSOCIATION LIMITED

NOTES TO THE ACCOUNTS

FOR THE YEAR ENDED 31 DECEMBER 2001

7 Tax on profit / (loss) on ordinary activities

| | 2001 | 2000 |
|---|-------|-------|
| | £m | £m |
| The (credit) / charge for taxation comprises: | | |
| United Kingdom Corporation Tax at 30% | 0.1 | 4.1 |
| Deferred tax | (0.4) | (2.8) |
| | (0.3) | 1.3 |

8 Other financial investments

8.1 Other financial investments

| | Current Value | | Cost | |
|---|---------------|-------|-------|-------|
| | 2001 | 2000 | 2001 | 2000 |
| | £m | £m | £m | £m |
| Listed investments | | | | |
| Shares, options and other variable yield | | | | |
| Securities and units in unit trusts | 6.0 | 51.5 | 4.6 | 31.5 |
| Debt securities and other fixed income securities | | | | |
| - at current value | 92.4 | 8.6 | 87.6 | 6.6 |
| - at amortised cost (see note 8.2) | 60.2 | 104.1 | 61.9 | 105.8 |
| | 152.6 | 112.7 | 149.5 | 112.4 |
| Deposits with credit institutions | 5.2 | 5.6 | 5.2 | 5.6 |
| | 163.8 | 169.8 | 159.3 | 149.5 |

8.2 Debt securities and other fixed income securities

The debt securities and other fixed income securities which are shown at amortised cost, are analysed as follows:

| | 2001 | 2000 |
|-------------------------|-------|-------|
| | £m | £m |
| Cost | 61.9 | 105.8 |
| Cumulative amortisation | (1.7) | (1.7) |
| Amortised cost | 60.2 | 104.1 |
| Maturity value | 54.0 | 94.4 |
| Market value | 62.3 | 108.3 |

THE CHESTER STREET EMPLOYERS' ASSOCIATION LIMITED

NOTES TO THE ACCOUNTS

FOR THE YEAR ENDED 31 DECEMBER 2001

9 Tangible assets

| | 2001 | 2000 |
|---|-------------|-------------|
| | £m | £m |
| Cost: | | |
| At 1 January | - | 27.5 |
| Additions | - | - |
| Disposals (including those arising on disposal of subsidiary) | - | (27.5) |
| At 31 December | - | - |
| Depreciation: | | |
| At 1 January | - | 25.3 |
| Charge for the year | - | - |
| Disposals (including those arising on disposal of subsidiary) | - | (25.3) |
| At 31 December | - | - |
| Net book value at 31 December | - | - |

All assets included above relate to computer systems.

10 Deferred acquisition costs

| | Gross | | Reinsurance | |
|--|--------------|-------------|--------------------|-------------|
| | 2001 | 2000 | 2001 | 2000 |
| | £m | £m | £m | £m |
| Balance at beginning of the year | - | 17.1 | - | 0.5 |
| Movement in the year | - | 0.8 | - | - |
| Movement arising on disposal of subsidiary | - | (17.9) | - | (0.5) |
| Balance at end of the year | - | - | - | - |

11 Reconciliation of movement in reserves

Group

| | Profit & Loss | | Profit & Loss | |
|--|--------------------------|--------------|--------------------------|--------------|
| | Account | Total | Account | Total |
| | 2001 | 2001 | 2000 | 2000 |
| | £m | £m | £m | £m |
| 1 January | (1,217.0) | (1,217.0) | 77.9 | 77.9 |
| Profit / (Loss) after tax for the financial year | 4.5 | 4.5 | (1,294.9) | (1,294.9) |
| 31 December | (1,212.5) | (1,212.5) | (1,217.0) | (1,217.0) |

THE CHESTER STREET EMPLOYERS' ASSOCIATION LIMITED

NOTES TO THE ACCOUNTS

FOR THE YEAR ENDED 31 DECEMBER 2001

11 Reconciliation of movement in reserves (continued)

Association only

| | Profit & Loss Account 2001 £m | Revaluation Reserve 2001 £m | Total 2001 £m | Profit & Loss Account 2000 £m | Revaluation Reserve 2000 £m | Total 2000 £m |
|--|--|--|------------------------------|--|--|------------------------------|
| 1 January | - | - | - | 30.8 | - | 30.8 |
| (Loss) after tax for the financial year | - | - | - | (30.8) | - | (30.8) |
| 31 December | - | - | - | - | - | - |

12 Provisions for other risks and charges

2001

| | Deferred Taxation £m | Run-off expense Provision £m | Total £m |
|------------------------------|-------------------------------------|---|---------------------|
| At the beginning of the year | 0.9 | 37.3 | 38.2 |
| Movement in the year | (0.4) | (0.5) | (0.9) |
| At the end of the year | 0.5 | 36.8 | 37.3 |

2000

| | Deferred Taxation £m | Pensions £m | Run-off cost Provision £m | Other Provisions £m | Total £m |
|---|-------------------------------------|------------------------|--|------------------------------------|---------------------|
| At the beginning of the year | 0.7 | 8.3 | - | 0.6 | 9.6 |
| Movement in the year | (2.8) | - | 37.3 | - | 34.5 |
| Movement arising on disposal of subsidiary | 3.0 | (8.3) | - | (0.6) | (5.9) |
| At the end of the year | 0.9 | - | 37.3 | - | 38.2 |

a) Deferred Taxation

The group has unrelieved tax losses carried forward of £1.2bn which have not been recognised as a deferred tax asset.

b) Provision for run-off expenses

The provision for run-off expenses totals £36.8m (2000: £37.3m). 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. This provision has been discounted at 4.9% (2000: 5%), a rate justified by anticipated investment income. No further deduction for anticipated investment income has been made. The undiscounted provision is £107.1m (2000: £95.4m). The average settlement period assumed in discounting this provision is 16.8 years (2000: 19.3 years).

THE CHESTER STREET EMPLOYERS' ASSOCIATION LIMITED

NOTES TO THE ACCOUNTS

FOR THE YEAR ENDED 31 DECEMBER 2001

13 Commitments

The Group had no capital commitments at 31 December 2001 (2000: £nil)

Obligations under operating leases

Annual commitments under non-cancellable operating leases are as follows:

| Group | Land and buildings | |
|--------------------------------|--------------------|--------------|
| | 2001 £000 | 2000 £000 |
| Operating leases which expire: | | |
| Within one year | - | - |
| Between two and five years | - | 188 |
| Over five years | - | - |
| | - | 188 |

Payments under operating leases are charged to the profit and loss account on a straight line basis.

14 Note to the Consolidated cashflow statement

| | 2001 | 2000 |
|--|--------|-----------|
| | £m | £m |
| Reconciliation of profit/(loss) before taxation to net cash outflow from operating activities | | |
| Profit/(loss) before taxation and exceptional items | 4.2 | (1,229.2) |
| (Increase)/decrease in insurance and other debtors | (1.1) | 0.5 |
| (Decrease)/increase in technical provisions | (11.3) | 1,153.7 |
| (Decrease)/increase in provisions for other risks and charges | (0.5) | 37.3 |
| Increase in insurance and other creditors | 4.3 | 2.2 |
| Realised and unrealised gains | - | 5.8 |
| Amortisation of fixed income securities | - | 1.9 |
| Other non-cash movements | - | (0.4) |
| Net cash outflow from operating activities | (4.4) | (28.2) |

| Movements in opening and closing portfolio investments net of financing | 2001 | 2000 |
|--|-------|---------|
| | £m | £m |
| Net cash inflow/(outflow) for the year | 1.1 | (46.9) |
| Cash flow movements from portfolio investments | (6.0) | 117.2 |
| Movements arising from cashflows | (4.9) | 70.3 |
| Disposal of subsidiaries | - | (585.3) |
| Changes in market values and exchange effects | - | (10.0) |
| Total movements in portfolio investments net of financing | (4.9) | (525.0) |
| Portfolio investments net of financing at 1 January | 173.0 | 698.0 |
| Portfolio investments net of financing at 31 December | 168.1 | 173.0 |

THE CHESTER STREET EMPLOYERS' ASSOCIATION LIMITED

NOTES TO THE ACCOUNTS

FOR THE YEAR ENDED 31 DECEMBER 2001

14 Note to the Consolidated cashflow statement (continued)

| | 2001 £m | 2000 £m |
|--|------------|------------|
| Net portfolio investment | | |
| Purchase of equity shares | (31.0) | (226.4) |
| Purchase of fixed interest investments | (190.1) | (220.2) |
| Sale of equity shares | 76.5 | 192.2 |
| Sale of fixed interest investments | 150.2 | 134.6 |
| Sale of other investments | - | 0.4 |
| Changes in deposits with credit institutions | 0.4 | 2.2 |
| Net disinvestment/(investment) | 6.0 | (117.2) |

Movements in cash and portfolio investment

| | At 1 January 2001 £m | Cash Flow £m | At 31 December 2001 £m |
|---|-------------------------------|--------------------|---------------------------------|
| Equity shares | 51.5 | (45.5) | 6.0 |
| Fixed interest investments | 112.7 | 39.9 | 152.6 |
| Deposits with credit institutions | 5.6 | (0.4) | 5.2 |
| | 169.8 | (6.0) | 163.8 |
| Cash at bank and in hand and short term deposits | 3.2 | 1.1 | 4.3 |
| Total | 173.0 | (4.9) | 168.1 |

Movements in technical provisions

| | At 1 January 2001 £m | Change during year £m | At 31 December 2001 £m |
|---|-------------------------------|-----------------------------|------------------------------|
| Claims outstanding | 1,350.4 | (11.3) | 1,339.1 |
| Reinsurers' share of claims outstanding | (0.3) | - | (0.3) |
| | 1,350.1 | (11.3) | 1,338.8 |

THE CHESTER STREET EMPLOYERS' ASSOCIATION LIMITED

NOTES TO THE ACCOUNTS

FOR THE YEAR ENDED 31 DECEMBER 2001

15 Subsidiary Undertakings

| Company | Principal activity | Current Value | | Cost | |
|--|--------------------------|---------------|----------|-------------|-------------|
| | | 2001 | 2000 | 2001 | 2000 |
| | | £m | £m | £m | £m |
| <u>Chester Street Insurance Holdings Limited</u> | <u>General Insurance</u> | <u>-</u> | <u>-</u> | <u>74.1</u> | <u>74.1</u> |

Chester Street Insurance Holdings Limited went into scheme of arrangement, effective from 5 March 2001. Accordingly the current value of this investment was written down to zero in last year's accounts.

Subsidiaries of Chester Street Insurance Holdings Limited

Chester Street Investments Limited Investment holding

Subsidiaries of Chester Street Investments Limited

| | |
|----------------------|---------|
| Cartonleaf Limited | Dormant |
| Islandstream Limited | Dormant |
| Longspiral Limited | Dormant |
| Mossisland Limited | Dormant |
| Retoria Limited | Dormant |

All subsidiaries are wholly owned and registered in England and Wales, at the registered office of the parent undertaking.

From 18 February 2000, Iron Trades Insurance Company Limited and its subsidiaries were no longer part of the group.

THE CHESTER STREET EMPLOYERS' ASSOCIATION LIMITED

NOTES TO THE ACCOUNTS

FOR THE YEAR ENDED 31 DECEMBER 2001

16 Segmental reporting

| | Liability £m | Total £m |
|---|-----------------|-------------|
| 2001 | | |
| Gross premiums written | - | - |
| Gross premiums earned | - | - |
| Gross claims incurred | - | - |
| Gross operating expenses | 3.6 | 3.6 |
| Gross technical result | 3.6 | 3.6 |
| Reinsurance balance | - | - |
| Balance on the technical account | (3.6) | (3.6) |
| Net technical provisions, excluding deferred acquisition costs | 1,339.1 | 1,339.1 |

| | Liability £m | Direct Motor £m | Property £m | Personal Accident & Health £m | Total £m |
|---|-----------------|-----------------------|----------------|--|-------------|
| 2000 | | | | | |
| Gross premiums written | 11.1 | 16.8 | 2.8 | 1.5 | 32.2 |
| Gross premiums earned | 10.0 | 15.0 | 3.1 | 1.6 | 29.7 |
| Gross claims incurred | (1,236.1) | (14.0) | (3.3) | (1.5) | (1,254.9) |
| Gross operating expenses | (7.3) | (5.0) | (1.3) | (0.1) | (13.7) |
| Gross technical result | (1,233.4) | (4.0) | (1.5) | - | (1,238.9) |
| Reinsurance balance | (0.5) | - | (0.4) | - | (0.9) |
| Balance on the technical account | (1,233.9) | (4.0) | (1.9) | - | (1,239.8) |
| Net technical provisions, excluding deferred acquisition costs | 1,350.4 | - | - | - | 1,350.4 |

An analysis of the profit before taxation and net assets by class of business has not been provided because, in the opinion of the directors, the above segmental analysis of the balance on the technical account and net technical provisions, respectively, is the most appropriate to the nature of the business.

17 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.

THE CHESTER STREET EMPLOYERS' ASSOCIATION LIMITED

NOTES TO THE ACCOUNTS

FOR THE YEAR ENDED 31 DECEMBER 2001

18 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)
- b) the management services provider (Iron Trades Management Services Limited)

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

| | 2001 £m | 2000 £m |
|--|------------|------------|
| Scheme Administrator: | | |
| scheme administration fees | 1.2 | 0.1 |
| other services and fees | 0.8 | - |
| Amounts paid to the management services provider | 2.4 | 2.1 |

Amounts due at 31 December:

| | 2001 £m | 2000 £m |
|--|------------|------------|
| Amounts due to PricewaterhouseCoopers | - | - |
| Amounts due from Iron Trades Management Services Limited | 0.3 | - |

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

| | 2001 £m | 2000 £m |
|------------------------|------------|------------|
| PricewaterhouseCoopers | 0.3 | 1.6 |

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

| | 2001 £m | 2000 £m |
|---|------------|------------|
| PricewaterhouseCoopers | 33.2 | 29.6 |
| Iron Trades Management Services Limited | 6.9 | 9.4 |

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.

19 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, whilst it is in the interest of Holdings' scheme creditors. This arrangement does not cover liabilities arising out of the Association's negligence, fraud, willful 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 2001 which comprise the Consolidated Profit and Loss Account, Consolidated Balance Sheet, Company Balance Sheet, Consolidated Cash Flow Statement and the related notes 1 to 19. These accounts have been prepared on the basis of the accounting policies set out therein.

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.

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 £1,279.9m (2000: £1,289.1m). 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. Details of the circumstances relating to this fundamental uncertainty are described in note 3 on page 12.

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

Claims Handling: The accounts include a claims handling provision of £59.2m (2000: £61.3m). 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 is described in the accounting policies section (claims handling expenses) on page 10 and in note 3 (continued) on page 13.

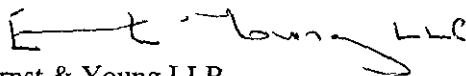
Run-Off Expenses: The accounts include a discounted run-off provision of £36.8m (2000: £37.3m) for estimated operational costs of the run-off. The ultimate cost of the run-off is dependent upon future events and could be materially different from the amount provided. Details of this fundamental uncertainty is described in the accounting policies section (run-off provision) on page 11 and in note 12(b) on page 17.

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

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 2001 and of its profit 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
9 August 2002