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STRONGHOLD INSURANCE COMPANY LIMITED

REPORT AND FINANCIAL STATEMENTS
2003

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STRONGHOLD INSURANCE COMPANY LIMITED

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STRONGHOLD INSURANCE COMPANY LIMITED

Directors and Management

Directors

J M Massey - Chairman
A M Duffy
H Sopher
K F Watkins

Managing Director

K F Watkins

Secretary

A M Duffy

Auditors

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

Registered Office

P O Box 3068 Rose Lane Business Centre Rose Lane Norwich NR1 1ZG England

STRONGHOLD INSURANCE COMPANY LIMITED

Report of the Directors

The Directors present their report and the financial statements of the Company for the year ended 31 December 2003.

Principal activity and business review

The Company ceased to write new business in 1987 : accordingly the DTI withdrew its authority for the Company to accept contracts of insurance and reinsurance.

The principal activity of the Company continues to be the management of the claims and liabilities which will extend for an indefinite period.

Results and dividends

After allowing for taxation, there was a profit for the year of US\$1,469,000 (2002 - loss US\$4,402,000). The Directors do not recommend the payment of a dividend for the year (2002 - Nil).

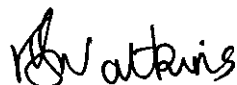
Directors

The names of the Directors at the date of this Report appear on page 2. All of the Directors served throughout the year.

The Directors at 31 December 2003 had the following interests in the share capital of the holding company, Stronghold Holdings Limited :

| | At 31 December 2003 Ordinary shares | At 31 December 2002 Ordinary shares |
|-------------|--|--|
| A M Duffy | 40 | 40 |
| H Sopher | 40 | 40 |
| K F Watkins | 20 | 20 |

By Order of the Board



K F WATKINS
Director

25 March 2004

Statement of Directors' Responsibilities in respect of the Financial Statements

Company law requires the Directors to prepare financial statements for each financial year which give a true and fair view of the state of affairs of the Company 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.

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 safeguarding the assets of the Company and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

Independent Auditors' Report to the Members of Stronghold Insurance Company Limited

We have audited the company's financial statements for the year ended 31 December 2003 which comprise the Statement of Accounting Policies, Profit and Loss Account, Balance Sheet, Cash Flow Statement, Statement of Total Recognised Gains and Losses, Reconciliation of Movements in Shareholders' Funds and the related notes 1 to 22. These financial statements have been prepared on the basis of 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 the Directors and Auditors

As described in the Statement of Directors' Responsibilities the company's directors are responsible for the preparation of the financial statements in accordance with applicable United Kingdom law and accounting standards. Our responsibility is to audit the financial statements in accordance with relevant legal and regulatory requirements and United Kingdom Auditing Standards. We report to you our opinion as to whether the financial statements give a true and fair view and are properly prepared in accordance with the Companies Act 1985. We also report to you if, in our opinion, the Directors' Report is not consistent with the financial statements, if the company has not kept proper accounting records, if we have not received all the information and explanations we require for our audit, or if information specified by law regarding directors' remuneration and transactions with the company is not disclosed. We read the Directors' Report and 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 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.

Fundamental uncertainties

In forming our opinion, we have considered the adequacy of the disclosures made in the financial statements concerning the level of uncertainty in respect of:

- a. the ultimate liability in respect of the technical provisions in the financial statements relating to gross claims outstanding, related reinsurance recoveries and claims handling expenses. The ultimate liability will vary as a result of subsequent information and events and these may result in significant adjustments to the amounts provided. Details of the circumstances relating to this fundamental uncertainty are described in Note 16.
- b. the adequacy of the current resources of the company to meet its likely future requirements. As stated in the Statement of Accounting Policies, Basis of preparation, on page 12, the financial statements have been prepared on a going concern basis. This basis could be invalidated if the resources of the company were exhausted by adverse adjustments arising from the resolution of the above uncertainties. The financial statements do not include any adjustments which would result from the going concern basis becoming inappropriate.

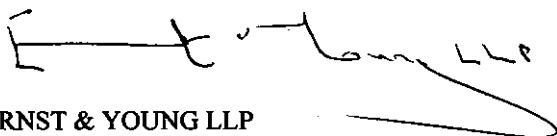
Our opinion is not qualified in this respect.

STRONGHOLD INSURANCE COMPANY LIMITED

Independent Auditors' Report to the Members of Stronghold Insurance Company Limited

Opinion

In our opinion the financial statements give a true and fair view of the state of affairs of the company as at 31 December 2003 and of its profit for the year then ended and have been properly prepared in accordance with the Companies Act 1985.

A handwritten signature in black ink, appearing to read 'Ernst & Young LLP', with a long, sweeping underline.

ERNST & YOUNG LLP
Registered Auditor
London

25 March 2004

STRONGHOLD INSURANCE COMPANY LIMITED

**Profit and Loss Account
for the year ended 31 December 2003**

| | | 2003 | | 2002 restated | |
|---|-------|----------|----------|------------------|----------|
| | Notes | US\$'000 | US\$'000 | US\$'000 | US\$'000 |
| Technical account - General business | | | | | |
| <i>Discontinued operations</i> | | | | | |
| Gross premiums written | 2 | | 94 | | 124 |
| Outwards reinsurance premiums | | | 315 | | (645) |
| Earned premiums, net of reinsurance | | | (221) | | 769 |
| Gross claims and claims handling expenses paid | | 37,852 | | 31,198 | |
| Reinsurers' share of claims paid | | 28,373 | | 18,404 | |
| Net claims and claims handling expenses paid | | 9,479 | | 12,794 | |
| Gross change in the provision for claims | | (2,315) | | 12,336 | |
| Reinsurers' share | | 7,151 | | 11,743 | |
| Net change in the provision for claims | | (9,466) | | 593 | |
| Claims and claims handling expenses incurred net of reinsurance | 4,5 | 13 | | 13,387 | |
| Net operating expenses | 6 | 2 | | - | |
| Total technical charges | | | 15 | | 13,387 |
| Balance on the general business technical account | | | (236) | | (12,618) |
| Non-technical account | | | | | |
| Balance on the general business technical account | | | (236) | | (12,618) |
| Investment income | 9 | 4,618 | | 9,238 | |
| Investment expenses and charges | 10 | (493) | | (470) | |
| Unrealised losses on investments | | (2,420) | | (552) | |
| | | | 1,705 | | 8,216 |
| Profit/(loss) ordinary activities before taxation | | | 1,469 | | (4,402) |
| Tax on ordinary activities | 11 | | - | | - |
| Profit/(loss) on ordinary activities after taxation | | | 1,469 | | (4,402) |

STRONGHOLD INSURANCE COMPANY LIMITED

**Statement of Total Recognised Gains and Losses
for the year ended 31 December 2003**

| | 2003 US\$'000 | 2002 US\$'000 |
|--|------------------|------------------|
| Profit/(loss) on ordinary activities after taxation | 1,469 | (4,402) |
| Currency translation differences on foreign currency net investment | (721) | (246) |
| Total recognised profits/(losses) related to the year | <u>748</u> | <u>(4,648)</u> |

Historical Cost Profits and Losses

The inclusion of unrealised gains and losses in the profit and loss account to reflect the marking to market of investments in the balance sheet is not deemed to be a departure from the unmodified historical cost basis of accounting. Accordingly, a separate note of historical cost profits and losses is not given.

**Reconciliation of Movements in Shareholders' Funds
for the year ended 31 December 2003**

| | 2003 US\$'000 | 2002 US\$'000 |
|---|------------------|------------------|
| Opening shareholders' funds | 6,530 | 11,178 |
| Total recognised profits/(losses) related to the year | 748 | (4,648) |
| Closing shareholders' funds | <u>7,278</u> | <u>6,530</u> |

STRONGHOLD INSURANCE COMPANY LIMITED
**Balance Sheet
as at 31 December 2003**

| | Notes | 2003 US\$'000 | 2002 US\$'000 |
|--|-------|------------------|------------------|
| Assets | | | |
| Investments | | | |
| Other financial investments | 13 | 77,472 | 96,003 |
| Deposits with ceding undertakings | | <u>1,290</u> | <u>1,233</u> |
| | | <u>78,762</u> | <u>97,236</u> |
| Reinsurers' share of technical provisions | | | |
| Claims outstanding | 16 | 219,222 | 211,697 |
| Debtors | | | |
| Debtors arising out of reinsurance operations | | 36,202 | 32,715 |
| Other debtors | | <u>83</u> | <u>28</u> |
| | | <u>36,285</u> | <u>32,743</u> |
| Other assets | | | |
| Cash at bank and in hand | | 16,886 | 7,160 |
| Prepayments and accrued income | | | |
| Accrued interest and rent | | 920 | 1,147 |
| Other prepayments and accrued income | | <u>46</u> | <u>76</u> |
| | | <u>966</u> | <u>1,223</u> |
| Total assets | | <u>352,121</u> | <u>350,059</u> |

STRONGHOLD INSURANCE COMPANY LIMITED**Balance Sheet
as at 31 December 2003**

| | Notes | 2003 US\$'000 | 2002 US\$'000 |
|--|-------|------------------|------------------|
| Liabilities | | | |
| Capital and Reserves | | | |
| Called up share capital | 14 | 48,079 | 48,079 |
| Profit and loss account | | <u>(40,801)</u> | <u>(41,549)</u> |
| Shareholders' funds attributable to equity interests | 15 | <u>7,278</u> | <u>6,530</u> |
| Technical provisions | | | |
| Claims outstanding | 16 | 324,392 | 324,199 |
| Deposits received from reinsurers | | 16,626 | 16,580 |
| Creditors | | | |
| Arising out of reinsurance operations | | 3,028 | 2,158 |
| Other creditors including taxation and social security | | <u>229</u> | <u>88</u> |
| | | <u>3,257</u> | <u>2,246</u> |
| Accruals and deferred income | | 568 | 504 |
| Total liabilities | | <u>352,121</u> | <u>350,059</u> |



K F WATKINS
Managing Director

25 March 2004

STRONGHOLD INSURANCE COMPANY LIMITED

**Statement of Cash Flows
for the year ended 31 December 2003**

| | Notes | 2003 US\$'000 | 2002 US\$'000 |
|---|-------|------------------|------------------|
| Net cash outflow from operating activities | 17 | <u>(7,342)</u> | <u>(7,509)</u> |
| Cash flows were invested as follows: | | | |
| Increase/(decrease) in cash holdings | | 11,306 | (12,438) |
| Net portfolio investment | | | |
| Fixed interest securities | | (18,648) | 4,929 |
| Net investment of cash flows | 18 | <u>(7,342)</u> | <u>(7,509)</u> |
| Movement in opening and closing cash and portfolio investments | | | |
| | | 2003 US\$'000 | 2002 US\$'000 |
| Net cash inflow/(outflow) for the period | | 11,306 | (12,438) |
| Cash (outflow)/inflow : portfolio investments | | (18,648) | 4,929 |
| Movement arising from cash flows | | <u>(7,342)</u> | <u>(7,509)</u> |
| Changes in market values and exchange rates | | (1,463) | 4,337 |
| Total movement in cash and portfolio investments | | <u>(8,805)</u> | <u>(3,172)</u> |
| Cash and portfolio investments net of financing at 1 January | | 103,163 | 106,335 |
| Cash and portfolio investments net of financing at 31 December | | <u>94,358</u> | <u>103,163</u> |

STRONGHOLD INSURANCE COMPANY LIMITED

Notes to the Financial statements

1 Accounting policies

(a) Basis of preparation

These financial statements are prepared in compliance with Section 255 of, and Schedule 9A to, the Companies Act 1985 and in accordance with applicable accounting standards. They also comply with the Statement of Recommended Practice on Accounting for Insurance Business issued by the Association of British Insurers issued in December 1998.

In preparing the financial statements for the year ended 31 December 2003, the Directors, having regard to the uncertainties expressed in Note 16 as to the amounts at which the Company's technical provisions will ultimately be settled, consider that the Company has adequate financial resources to meet its day to day obligations as they fall due. Accordingly the financial statements have been prepared on a going concern basis, without including any adjustments that would be required should the financial resources of the Company prove inadequate. This basis could be invalidated if the resources of the Company were exhausted by adverse adjustments arising from the resolution of the uncertainties referred to in Note 16.

(b) Technical account

- (i) Premiums are accounted for and recorded in the technical account in the year of notification.
- (ii) Provision for claims outstanding comprises provisions for the estimated ultimate cost of claims notified but not settled at the date of the balance sheet and for claims incurred but not notified at that date; the provision reflects anticipated reinsurance and other recoveries, and takes into account future claims handling costs.

The provision for claims outstanding for environmental and asbestos losses, and other losses for Casualty classes, are included after taking into account the future attributable investment earnings.

(c) Investment return

Investment return comprises interest and dividends on an accruals basis, together with realised and unrealised investment gains and losses. Realised investment gains and losses are calculated as the difference between net proceeds on disposal and their purchase price. Unrealised investment gains and losses are calculated as the difference between the valuation at the balance sheet date and their valuation at the last balance sheet date or purchase price, if acquired during the year. Unrealised investment gains and losses include adjustments in respect of unrealised gains and losses recorded in prior years which have been realised during the year and are reported as realised gains and losses in the current profit and loss account.

In previous years an allocation of the investment return from the non-technical account to the general business technical account was made. This allocation is no longer made and prior year figures have been restated.

(d) Investments

Financial investments are stated at market value. Unrealised gains and losses are taken to the profit and loss account.

(e) Foreign currencies

Foreign currency transactions are translated to United States dollars at the rate applicable when recorded in the books, with the exception of transactions in sterling and Canadian dollars, which are translated at rates ruling on 31 December 2003.

Assets and liabilities are shown in the balance sheet at rates ruling on 31 December 2003.

Exchange differences on foreign currency net investment are taken to reserves.

STRONGHOLD INSURANCE COMPANY LIMITED

Notes to the Financial Statements

1 Accounting policies (continued)

(f) Deferred taxation

Deferred taxation is recognised in respect of all timing differences that have originated but not reversed at the balance sheet date where transactions or events that result in an obligation to pay more, or a right to pay less, tax in the future have occurred at the balance sheet. Deferred tax assets are recognised only to the extent that it is more likely than not that there will be suitable taxable profits from which the future reversal of the underlying timing differences can be deducted.

2 Premiums

Premium income substantially relates to reinstatement premiums and is attributable to discontinued operations.

3 Segmental information

| | 2003 US\$'000 | 2002 US\$'000 |
|--|------------------|------------------|
| <i>Technical account</i> | | |
| Gross premiums earned | 94 | 124 |
| Gross claims and claims handling expenses incurred | (35,537) | (43,534) |
| Gross operating expenses | - | - |
| Gross technical result | (35,443) | (43,410) |
| Reinsurance balance | 35,207 | 30,792 |
| Net technical result | (236) | (12,618) |

All premiums relate to general reinsurance business concluded in the United Kingdom.

4 Net claims incurred and claims handling expenses

| | Gross US\$'000 | Reinsurance US\$'000 | Net US\$'000 |
|------------------------------------|-------------------|-------------------------|-----------------|
| 2003 | | | |
| Claims paid | 34,085 | 28,373 | 5,712 |
| Claims handling expenses paid | 3,767 | - | 3,767 |
| | <u>37,852</u> | <u>28,373</u> | <u>9,479</u> |
| Outstanding claims carried forward | 324,392 | 219,222 | 105,170 |
| Outstanding claims brought forward | <u>326,707</u> | <u>212,071</u> | <u>114,636</u> |
| | (2,315) | 7,151 | (9,466) |
| Claims incurred | <u>35,537</u> | <u>35,524</u> | <u>13</u> |
| 2002 | | | |
| Claims paid | 27,592 | 18,404 | 9,188 |
| Claims handling expenses paid | 3,606 | - | 3,606 |
| | <u>31,198</u> | <u>18,404</u> | <u>12,794</u> |
| Outstanding claims carried forward | 324,199 | 211,697 | 112,502 |
| Outstanding claims brought forward | <u>311,863</u> | <u>199,954</u> | <u>111,909</u> |
| | 12,336 | 11,743 | 593 |
| Claims incurred | <u>43,534</u> | <u>30,147</u> | <u>13,387</u> |

STRONGHOLD INSURANCE COMPANY LIMITED

Notes to the Financial Statements

5 Claims handling expenses paid

Claims handling expenses include:

| | 2003 US\$'000 | 2002 US\$'000 |
|---|------------------|------------------|
| Auditors' remuneration - audit services | <u>122</u> | <u>56</u> |

6 Net operating expenses

| | 2003 US\$'000 | 2002 US\$'000 |
|-------------------|------------------|------------------|
| Acquisition costs | | |
| - gross | - | - |
| - reinsurance | <u>(2)</u> | <u>-</u> |
| - net | <u>2</u> | <u>-</u> |

7 Staff costs

| | 2003 US\$'000 | 2002 US\$'000 |
|-----------------------|------------------|------------------|
| Wages and salaries | 259 | - |
| Social security costs | 29 | - |
| Other pension costs | 37 | - |

The average monthly number of employees employed during the year was made up as follows:

| | | |
|------------|---|---|
| Management | 1 | - |
| Claims | 3 | - |

8 Directors' emoluments

The total remuneration received by the Directors for the year is as follows:

| | 2003 US\$ | 2002 US\$ |
|------------------|----------------|----------------|
| Fees | 119,645 | 116,045 |
| Other emoluments | <u>392,528</u> | <u>347,143</u> |
| | <u>512,173</u> | <u>463,188</u> |

The highest paid director received emoluments of US\$368,148 (2002 - US\$338,163).

9 Investment income

| | 2003 US\$'000 | 2002 US\$'000 |
|---|------------------|------------------|
| Income from other investments | 4,168 | 5,434 |
| Gains on the realisation of investments | <u>450</u> | <u>3,804</u> |
| | <u>4,618</u> | <u>9,238</u> |

STRONGHOLD INSURANCE COMPANY LIMITED

Notes to the Financial Statements

10 Investment expenses and charges

| | 2003 US\$'000 | 2002 US\$'000 |
|--|------------------|------------------|
| Investment management expenses | 238 | 183 |
| Interest payable on reinsurance balances | 255 | 287 |
| | <u>493</u> | <u>470</u> |

11 Taxation

(a) No provision has been made in the financial statements for corporation tax on the assessable profits for the year as they have been set off against losses of previous years.

(b) Factors affecting current tax charge

The tax assessed for the period is lower than the standard rate of corporation tax in the UK of 30% (2002 - 30%). The differences are explained below:

| | 2003 US\$'000 | 2002 US\$'000 |
|---|------------------|------------------|
| Profit/(loss) on ordinary activities before tax | <u>1,469</u> | <u>(4,402)</u> |
| Profit/(loss) on ordinary activities multiplied by standard rate of corporation tax in the UK of 30% (2002 - 30%) | 441 | (1,321) |
| Expenses not deductible for tax purposes | 5 | 14 |
| Tax on currency translation differences | (412) | (430) |
| Additional receipt for General Insurance Reserves Regulations | 116 | 5 |
| Utilisation of tax losses | (150) | - |
| Unrelieved losses carried forward | - | 1,732 |
| | <u>-</u> | <u>-</u> |

(c) Factors that may affect future tax charges

The company has tax losses arising in the UK of £12.000m (2002 - £12.094m) that are available indefinitely for offset against future taxable profits of the company.

12 Deferred taxation

No provision has been made in the financial statements for deferred taxation.

Details of the deferred tax asset not included in the financial statements is given below:

| | 2003 US\$'000 | 2002 US\$'000 |
|--|------------------|------------------|
| Short-term timing differences | (178) | (274) |
| Accelerated capital allowances | (14) | (2) |
| Trading losses available for carry forward | <u>(6,343)</u> | <u>(5,812)</u> |
| | <u>(6,535)</u> | <u>(6,088)</u> |

STRONGHOLD INSURANCE COMPANY LIMITED

Notes to the Financial Statements

13 Investments

| | Current value | | Historical cost | |
|--|------------------|------------------|------------------|------------------|
| | 2003 US\$'000 | 2002 US\$'000 | 2003 US\$'000 | 2002 US\$'000 |
| Other financial investments | | | | |
| Shares and other variable-yield securities and shares in unit trusts | 2,741 | - | 2,700 | - |
| Debt securities and other fixed income securities (listed) | 68,219 | 91,255 | 68,704 | 89,279 |
| Deposits with credit institutions | 6,512 | 4,748 | 6,512 | 4,748 |
| | <u>77,472</u> | <u>96,003</u> | <u>77,916</u> | <u>94,027</u> |

The facility provided to the Company in respect of its letter of credit liabilities is secured by a charge over certain of the Company's investments in debt securities and other fixed income investments.

14 Share capital

| | 2003 US\$'000 | 2002 US\$'000 |
|---------------------------------------|------------------|------------------|
| <i>Authorised</i> | | |
| 30,000,000 ordinary shares of £1 each | <u>53,445</u> | <u>53,445</u> |
| <i>Issued and fully paid</i> | | |
| 27,000,000 ordinary shares of £1 each | <u>48,079</u> | <u>48,079</u> |

15 Shareholders' funds

| | Share capital US\$'000 | Profit & loss a/c US\$'000 | Total US\$'000 |
|---|---------------------------|-------------------------------|-------------------|
| 2003 | | | |
| Balance at 1 January | 48,079 | (41,549) | 6,530 |
| Currency translation differences on foreign currency net investment | - | (721) | (721) |
| Retained profit for the financial year | - | 1,469 | 1,469 |
| Balance at 31 December | <u>48,079</u> | <u>(40,801)</u> | <u>7,278</u> |
| 2002 | | | |
| Balance at 1 January | 48,079 | (36,901) | 11,178 |
| Currency translation differences on foreign currency net investment | - | (246) | (246) |
| Retained loss for the financial year | - | (4,402) | (4,402) |
| Balance at 31 December | <u>48,079</u> | <u>(41,549)</u> | <u>6,530</u> |

STRONGHOLD INSURANCE COMPANY LIMITED**Notes to the Financial Statements****16 Claims outstanding**

| | Gross US\$'000 | Reins. US\$'000 | Net US\$'000 |
|------------------------------|-------------------|--------------------|-----------------|
| 2003 | | | |
| Provision before discounting | 408,699 | 320,463 | 88,236 |
| Discounting adjustment | <u>(118,270)</u> | <u>(101,241)</u> | <u>(17,029)</u> |
| | 290,429 | 219,222 | 71,207 |
| Claims handling expenses | 43,944 | - | 43,944 |
| Discounting adjustment | <u>(9,981)</u> | <u>-</u> | <u>(9,981)</u> |
| | 33,963 | - | 33,963 |
| | <u>324,392</u> | <u>219,222</u> | <u>105,170</u> |
| 2002 | | | |
| Provision before discounting | 436,890 | 331,084 | 105,806 |
| Discounting adjustment | <u>(142,518)</u> | <u>(119,387)</u> | <u>(23,131)</u> |
| | 294,372 | 211,697 | 82,675 |
| Claims handling expenses | 40,298 | - | 40,298 |
| Discounting adjustment | <u>(10,471)</u> | <u>-</u> | <u>(10,471)</u> |
| | 29,827 | - | 29,827 |
| | <u>324,199</u> | <u>211,697</u> | <u>112,502</u> |

The company's reserves comprise primarily estimates of asbestos and environmental exposures. In the opinion of the directors estimates of these liabilities are subject to greater variability than other categories. Estimates are usually difficult because of issues such as a general lack of sufficiently detailed data, additional unresolved issues such as whether coverage exists, definition of an occurrence and determination and allocation of damage to financially responsible parties. Where appropriate, individual exposures are assessed using ground up methods and further reserves have been established to cover additional exposures on both known and unknown claims. Other variables which impact the ultimate exposure to asbestos-related claims include the effect of bankruptcies, the extent to which non impaired claimants can be precluded from making claims and strategies to broaden the population of defendant companies.

The level of the related reinsurance recoveries is dependent upon both the accuracy of the estimated gross technical provisions and the ultimate ability to pay of the underlying security. The reinsurance recoveries are stated net of the provision for estimated future irrecoverable amounts. The level of the provision for claims handling expenses is dependent upon the settlement of gross technical provisions, collection of related reinsurance recoveries and changes in the factors influencing these.

Whilst the Directors consider that the gross provision for claims and the related reinsurance recoveries, together with the provision for claims handling expenses, are fairly stated on the basis of the information currently available to them, the ultimate liability will vary as a result of subsequent information and events and may result in significant adjustments to the amounts provided. Adjustments to the technical provisions are reflected in the financial statements for the period in which the adjustments are made.

Technical provisions for environmental and asbestos losses, and other losses for Casualty classes, are included after taking into account the future attributable investment earnings at an assumed compound discount rate of 3.80% (2002 - 4.5%) per annum. The assumed settlement pattern for gross claim payments results in an average term for the liabilities of 10.63 years (2002 - 11.02 years). This settlement pattern has been derived from the historic development of claims payments appropriate for the types of claims within these classes, in particular those relating to environmental and asbestos losses. Separate discount factors are applied to the insurance funds for each underwriting year. The effect of discounting, included within claims incurred net of reinsurance, during the year amounted to a loss of \$7.4m (2002 - gain \$3.2m).

During the year a positive run-off deviation prior to discounting of US\$1.4m (2002 - negative US\$12.0m) was experienced in respect of environmental and asbestos losses.

Notes to the Financial Statements

16 Claims outstanding (continued)

An excess of loss arrangement was entered into with European International Reinsurance Company on 1 October 1996 and a provision for reinsurance recoveries under this arrangement has been included within the provision for claims outstanding as shown above. This arrangement has been partially commuted in accordance with the contract terms.

17 Reconciliation of result before tax to net cash flow from operating activities

| | 2003 US\$'000 | 2002 US\$'000 |
|--|------------------|------------------|
| Profit/(loss) on ordinary activities before tax | 1,469 | (4,402) |
| Realised investment gains | (450) | (3,805) |
| Unrealised investment losses | 2,420 | 552 |
| (Decrease)/increase in provision for claims outstanding | (9,466) | 593 |
| (Increase)/decrease in debtors | (3,251) | 471 |
| Increase/(decrease) in creditors | 1,045 | (3,011) |
| Decrease/(increase) in deposits with ceding undertakings | 147 | (133) |
| (Decrease)/increase in deposits received from reinsurers | (48) | 2,013 |
| Realised exchange gains | 792 | 213 |
| Net cash outflow from operating activities | <u>(7,342)</u> | <u>(7,509)</u> |

18 Movement in cash and portfolio investments

| | At 1 Jan 2003 US\$'000 | Cash flow US\$'000 | Changes to market value and currencies US\$'000 | At 31 Dec 2003 US\$'000 |
|--|---------------------------------|--------------------------|---|----------------------------------|
| Cash at hand and in bank | 11,908 | 11,306 | 184 | 23,398 |
| Shares and other variable-yield securities and shares in unit trusts | - | 2,700 | 41 | 2,741 |
| Debt securities and other fixed income securities | 91,255 | (21,348) | (1,688) | 68,219 |
| | <u>103,163</u> | <u>(7,342)</u> | <u>(1,463)</u> | <u>94,358</u> |

Notes to the Financial Statements

19 Related parties

Companies treated as related parties of the Company for disclosure purposes under Financial Reporting Standard 8, together with the nature of the relationship, are listed below :

Parent undertaking
Stronghold Holdings Limited

Companies related to the Directors
Isis Consulting, Inc.

20 Related party transactions

Details of the emoluments paid to Directors can be found in note 7.

Ms A M Duffy and Mr H Sopher, directors of Stronghold Insurance Company Limited, are also directors of Isis Consulting Inc. During 2003 Isis provided Stronghold with consultancy services for fees totalling US\$658,900, of which US\$120,000 was outstanding at 31 December 2003.

As at 31 December 2003 a balance of US\$5,793 was due to the parent undertaking.

21 Pension scheme

Employees are members of a defined contribution personal pension scheme to which the Company contributes.

22 Holding company

The Company is a subsidiary undertaking of Stronghold Holdings Limited, the ultimate parent undertaking, which is registered in England. Copies of the financial statements of the parent undertaking can be obtained from Clifford Chance, 200 Aldersgate Street, London EC1A 4JJ, England.