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**PANFINANCIAL INSURANCE COMPANY
LIMITED**

Report and Financial Statements

31 December 1998

**Deloitte & Touche
Stonecutter Court
1 Stonecutter Street
London EC4A 4TR**

**REPORT AND FINANCIAL STATEMENTS**

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REPORT AND FINANCIAL STATEMENTS

OFFICERS AND PROFESSIONAL ADVISERS

DIRECTORS

B Reuterskiold
P J Grant (Chairman)
R J Feather

SECRETARY

R J Feather

REGISTERED OFFICE

Marlon House
71-74 Mark Lane
London
EC3R 7HS

BANKERS

National Westminster Bank PLC

SOLICITORS

Norton Rose

AUDITORS

Deloitte & Touche
Chartered Accountants
Stonecutter Court
1 Stonecutter Street
London EC4A 4TR

**DIRECTORS' REPORT**

The directors present their annual report and the audited financial statements for the year ended 31 December 1998.

PRINCIPAL ACTIVITIES AND BUSINESS

PanFinancial suffered from adverse market conditions during 1992 and, after a review of all products underwritten, the company decided to cease underwriting new business in November 1992. The company continues to run-off its liabilities. The orderly run-off of the company's liabilities will take several years.

RESULTS

The profit and loss accounts for the year are set out on pages 5 and 6. The loss for the year was £309,000 (1997 - profit £531,781).

DIVIDENDS

The directors do not recommend the payment of a dividend (1997- £nil).

DIRECTORS

The present membership of the Board is set out on page 1.

There were no appointments to or resignations from the Board since 1 January 1998.

The interests of P J Grant in the shares of the company at 1 January 1998 and 31 December 1998 were:

Equity shares	14,000,000 £1 ordinary shares
Non-equity shares	20,000,000 £1 'A' preference shares
Non-equity shares	7,500,000 £1 'B' preference shares

None of the other directors held any interests, as defined by the Companies Act 1985, in the share capital of the company.

AUDITORS

Deloitte & Touche have expressed their willingness to continue in office as auditors and a resolution to reappoint them will be proposed at the forthcoming Annual General Meeting.

Approved by the Board of Directors
and signed on behalf of the Board

R J Feather
Secretary

30 June 1999

**STATEMENT OF DIRECTORS' RESPONSIBILITIES**

Company law requires the directors to prepare financial statements for each financial year which show a true and fair view of the state of affairs of the company as at the end of the financial year and of the profit or loss of the company for that period. In preparing those financial statements the directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgements and estimates that are reasonable and prudent;
- state whether applicable accounting standards have been followed;
- prepare the financial statements on a 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.

By order of the Board

R J Feather

Secretary

30 June 1999



AUDITORS' REPORT TO THE MEMBERS OF PANFINANCIAL INSURANCE COMPANY LIMITED

We have audited the financial statements on pages 5 to 17 which have been prepared under the accounting policies set out on pages 10 and 11.

Respective responsibilities of directors and auditors

As described on page 3 the company's directors are responsible for the preparation of financial statements. It is our responsibility to form an independent opinion, based on our audit, on those statements and to report our opinion to you.

Basis of opinion

We conducted our audit in accordance with 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 uncertainty relating to insurance liabilities

In forming our opinion, we have considered the adequacy of the disclosure made in note 15 to the accounts concerning the material uncertainty with respect to the technical provisions required to cover the insurance liabilities. In view of the significance of this uncertainty we consider that it should be drawn to your attention but our opinion is not qualified in this respect.

Opinion

In our opinion, the financial statements give a true and fair view of the state of the company's affairs as at 31 December 1998 and of its loss for the year then ended and have been properly prepared in accordance with the Companies Act 1985.

Deloitte & Touche
Deloitte & Touche

Chartered Accountants and Registered Auditors

30 June 1999



PROFIT AND LOSS ACCOUNT

Year ended 31 December 1998

TECHNICAL ACCOUNT - GENERAL BUSINESS

	Note	£'000	1998 £'000	£'000	1997 £'000
Gross premiums written	3	-		-	
Outwards reinsurance premiums		-		-	
Earned premiums net of reinsurance			-		-
Total technical income			-		-
Claims paid - gross amount		876		3,596	
- reinsurers' share		(3,490)		(5,214)	
- net of reinsurance			(2,614)		(1,618)
Change in the provision for claims					
- gross amount		2,523		1,418	
- reinsurers' share		(491)		(254)	
- net of reinsurance			2,032		1,164
Claims incurred net of reinsurance			(582)		(454)
Net operating expenses	4		(343)		(241)
Exchange differences			81		(164)
Total charges			(844)		(859)
BALANCE ON THE TECHNICAL ACCOUNT FOR GENERAL BUSINESS			(844)		(859)


PROFIT AND LOSS ACCOUNT
Year ended 31 December 1998
NON-TECHNICAL ACCOUNT

	Note	1998 £'000	1997 £'000
Balance on the general business technical account		(844)	(859)
Investment income	7	518	316
Unrealised gains	7	17	11
		<hr/>	<hr/>
Loss on ordinary activities before taxation	8	(309)	(532)
Taxation	9	-	-
		<hr/>	<hr/>
Loss on ordinary activities after taxation	13	<u>(309)</u>	<u>(532)</u>

The company ceased underwriting new business in November 1992 and, accordingly, all items in the profit and loss account derive from discontinued activities.

A statement of total recognised gains and losses has not been prepared as there are no gains or losses for the current year and the preceding financial year other than those shown in the profit and loss account.

A statement of historical cost profit and losses has not been prepared as there are no differences between the reported profit and loss and the historical cost profit and loss for the current year and the preceding year.



BALANCE SHEET
31 December 1998

	Note	1998 £'000	1997 £'000
ASSETS			
INVESTMENTS			
Other financial investments	10	<u>2,821</u>	<u>2,619</u>
REINSURERS' SHARE OF TECHNICAL PROVISIONS			
Claims outstanding	15	<u>1,395</u>	<u>1,830</u>
DEBTORS			
Debtors arising out of reinsurance operations		346	2,812
Other debtors		-	13
		<u>346</u>	<u>2,825</u>
OTHER ASSETS			
Cash at bank and in hand		<u>3,705</u>	<u>4,162</u>
TOTAL ASSETS		<u><u>8,267</u></u>	<u><u>11,436</u></u>


BALANCE SHEET
31 December 1998

	Note	1998 £'000	1997 £'000
LIABILITIES			
CAPITAL AND RESERVES			
Called up equity share capital	11	14,000	14,000
Profit and loss account	13	(39,860)	(39,551)
Shareholders' funds attributable to equity interests		(25,860)	(25,551)
Called up non-equity share capital	11	27,500	27,500
Total shareholders' funds		1,640	1,949
TECHNICAL PROVISIONS			
Claims outstanding	15	4,130	6,523
PROVISIONS FOR OTHER RISKS AND CHARGES			
	16	171	315
CREDITORS			
Arising out of direct insurance operations		50	69
Arising out of reinsurance operations		2,266	2,568
Other creditors including taxation and social security		10	12
		2,326	2,649
TOTAL LIABILITIES		8,267	11,436

These financial statements were approved by the Board of Directors on 30 June 1999.

Signed on behalf of the Board of Directors

P J Grant

Director


CASH FLOW STATEMENT
Year ended 31 December 1998

	Note	1998 £'000	1997 £'000
Net cash (outflow) / inflow from operating activities	17	<u>(255)</u>	<u>543</u>
Cash flows were invested as follows			
(Decrease)/Increase in cash holdings		(457)	824
Net portfolio investment/ (reduction)			
Variable yield securities		<u>202</u>	<u>(281)</u>
Net investment of cash flows		<u>(255)</u>	<u>543</u>
Movement in opening and closing portfolio investments			
Net cash inflow			
Cash	18	(709)	695
Variable interest securities		<u>373</u>	<u>12</u>
Movement arising from cash flows	18	(336)	707
Changes in market values and exchange rate effects	18	<u>81</u>	<u>(164)</u>
Total movement in portfolio		(255)	543
Portfolio investments at 1 January	18	<u>6,781</u>	<u>6,238</u>
Portfolio investments at 31 December	18	<u>6,526</u>	<u>6,781</u>

**NOTES TO THE ACCOUNTS****For the year ended 31 December 1998****1. BASIS OF FINANCIAL STATEMENTS**

The financial statements are prepared under the historical cost convention.

The financial statements have been prepared on a basis consistent with the provisions of Section 255 of, and Schedule 9A to, the Companies Act 1985 as amended by the Companies Act 1985 (Insurance Companies Accounts) Regulations 1993. They have also been prepared in accordance with applicable accounting standards and the Statement of Recommended Practice issued by the Association of British Insurers in December 1998.

The particular accounting policies adopted are described in Note 2 below.

2. ACCOUNTING POLICIES**(a) Technical account***Credit risk and asset risk*

The underwriting results are determined at the end of each year. Following the decision to cease underwriting new business in November 1992, the provisions for claims outstanding and claims incurred but not reported were increased and combined so as to establish an overall provision equal to the estimated future liabilities in respect of one year business. Any further provision required is made when the need is recognised, and should any adjustment be necessary in future years such an adjustment will be made as soon as the need becomes apparent.

Political risk

The majority of policies gave cover for periods in excess of one year. The directors have adopted a three year basis of accounting whereby underwriting results in respect of each underwriting year are determined not less than three years after its commencement, at which stage the underwriting result is transferred to the profit and loss account. Any further provision required is made when the need is recognised, and should any adjustment be necessary in future years such an adjustment will be made as soon as the need becomes apparent.

Financial facilities

Until the end of 1991 the company wrote financial facility insurance which is reported with the one year credit risk business. Certain financial guarantee business under this heading was written prior to 1991 for periods up to seven years. This specific class of business is included under the three year business above.

(b) Premiums written

Premiums are credited to the technical account at the later of inception date and the date the premium is recorded.

Outward reinsurance premiums are accounted for in the same accounting period as the reinsured business.

(c) Claims incurred

Claims incurred comprise all claim payments in the financial year and the movement in the provision for claims incurred but not reported.

Credit is only taken for salvage and subrogation recoveries on receipt due to the uncertainty associated with such recoveries.

Outward reinsurance recoveries are accounted for in the same accounting period as the claim for the reinsured business.

**NOTES TO THE ACCOUNTS****For the year ended 31 December 1998****2. ACCOUNTING POLICIES (continued)****(d) Technical provisions**

The technical provisions comprise provisions for claims outstanding and claims incurred but not reported so as to establish an overall provision equal to the estimated future liabilities.

(e) Provision for run-off costs

The company ceased underwriting new business in November 1992. Its liabilities will take several years to run-off and a provision has been included within administration expenses for all run-off costs expected to be incurred in running off its liabilities until 31 December 2001 (1997 - 31 December 2000).

(f) Investment income

Investment income comprises interest and realised gains and losses on investments. It is recorded on the accruals basis, and reported in the non-technical account.

(g) Foreign exchange

Underwriting and trading transactions in foreign currencies are recorded at the rates of exchange prevailing at the end of the month of the transaction. Monetary assets and liabilities denominated in foreign currencies are recorded at the rates of exchange prevailing at the year end. Gains or losses are dealt with in the technical account.

(h) Investments

Investments are valued at market value.

(i) Leases

Rental costs under operating leases are charged within the provision for run-off costs in equal annual amounts over the periods of the leases.

(j) Commissions

Commissions payable and receivable on one and three year business are taken to the net operating expenses account in the year in which they arise.

(k) Pension costs

The costs of individual money purchase arrangements are written off as incurred.

(l) Unrealised gains and losses

The movement in unrealised gains and losses in the non technical account comprise the increase/decrease in the year in the value of investments held at the balance sheet date together with the reversal of unrealised investment gains/losses recognised in earlier accounting periods in respect of investment disposals of the current period.


NOTES TO THE ACCOUNTS
For the year ended 31 December 1998
3. SEGMENTAL ANALYSIS

All the company's business falls within the credit and suretyship class of business and has been analysed between credit and political business.

1998	Credit £'000	Political £'000	Total £'000
Gross premiums written			
- risks located in UK	-	-	-
- risks located in Europe	-	-	-
- risks located in other countries	-	-	-
Gross claims incurred	3,344	55	3,399
Gross operating expenses	(212)	(131)	(343)
Reinsurance balance	<u>(3,823)</u>	<u>(159)</u>	<u>(3,982)</u>
1997	Credit £'000	Political £'000	Total £'000
Gross premiums written			
- risks located in UK	-	-	-
- risks located in Europe	-	-	-
- risks located in other countries	-	-	-
Gross claims incurred	1,460	3,554	5,014
Gross operating expenses	(162)	(79)	(241)
Reinsurance balance	<u>(3,011)</u>	<u>(2,457)</u>	<u>(5,468)</u>

The company is in run-off and underwrites no new business. The technical results in 1997 and 1998 arise from the reassessment of technical provisions at each year end.

4. NET OPERATING EXPENSES

1998	Gross £'000	Reinsurance £'000	Net £'000
Administrative expenses	<u>343</u>	<u>-</u>	<u>343</u>
1997	Gross £'000	Reinsurance £'000	Net £'000
Administrative expenses	<u>241</u>	<u>-</u>	<u>241</u>


NOTES TO THE ACCOUNTS
For the year ended 31 December 1998
5. DIRECTORS' EMOLUMENTS

	1998 £'000	1997 £'000
Emoluments	291	125
Aggregate of money purchase pension contributions	1	19
	1998 No.	1997 No.
Number of directors who are members of a money purchase scheme	1	1
	1998 £'000	1997 £'000
Highest paid director's remuneration	291	125
Aggregate of money purchase pension contributions	1	19

6. EMPLOYEES

The average number of persons (including directors) employed by the company during the year was 1 (1997 - 1).

	1998 £'000	1997 £'000
The total employee costs were:		
Wages and salaries	291	125
Social security	29	13
Other pension costs	1	19
	321	157


NOTES TO THE ACCOUNTS
For the year ended 31 December 1998
7. INVESTMENT RETURN

	1998 £'000	1997 £'000
Income from other investments	518	316
Unrealised gains	17	11
	<u>535</u>	<u>327</u>

8. LOSS ON ORDINARY ACTIVITIES BEFORE TAXATION

The loss for the year before taxation is arrived at after charging the following:

	1998 £'000	1997 £'000
Operating leases - land and buildings	-	-
Auditors' remuneration audit fee	20	34
	<u>20</u>	<u>34</u>

9. TAXATION

Current year taxable profits are offset by prior year losses. As at 31 December 1998 there were tax losses of approximately £30 million available for carry forward against future profits of the same trade.

10. INVESTMENTS

	1998 £'000	1997 £'000
Other financial investments: Variable yield securities	2,821	2,619
	<u>2,821</u>	<u>2,619</u>

11. CALLED UP SHARE CAPITAL

	1998 £'000	1997 £'000
Authorised:		
Equity shares: 14,000,000 £1 ordinary shares	14,000	14,000
Non-equity shares: 20,000,000 £1 'A' preference shares	20,000	20,000
Non-equity shares: 7,500,000 £1 'B' preference shares	7,500	7,500
	<u>41,500</u>	<u>41,500</u>
Called up, allotted and fully paid:		
Equity shares: 14,000,000 £1 ordinary shares	14,000	14,000
Non-equity shares: 20,000,000 £1 'A' preference shares	20,000	20,000
Non equity shares: 7,500,000 £1 'B' preference shares	7,500	7,500
	<u>41,500</u>	<u>41,500</u>

The preference shares do not carry voting rights and are not entitled to dividends. They rank in priority to the ordinary shares on a winding-up of the company but are not entitled to any surplus over and above the par value of the shares on a winding-up. The 'B' preference shares rank in priority to the 'A' preference shares on a winding-up of the company.


NOTES TO THE ACCOUNTS
For the year ended 31 December 1998
12. RELATED PARTIES

Mr P J Grant, the chairman of the company, owns all of the allotted share capital of the company and is the only controller of the company as defined by Financial Reporting Standard 8 Related Party Disclosures.

13. PROFIT AND LOSS ACCOUNT

	1998 £'000	1997 £'000
Loss brought forward at 1 January	(39,551)	(39,019)
Loss for the year after taxation	<u>(309)</u>	<u>(532)</u>
Loss carried forward at 31 December	<u><u>(39,860)</u></u>	<u><u>(39,551)</u></u>

14. RECONCILIATION OF MOVEMENTS IN SHAREHOLDERS' FUNDS

	1998 £'000	1997 £'000
(Loss)/profit for the year	<u>(309)</u>	<u>(532)</u>
Net change in shareholders' funds	(309)	(532)
Opening shareholders' funds	<u>1,949</u>	<u>2,481</u>
Closing shareholders' funds	<u><u>1,640</u></u>	<u><u>1,949</u></u>


NOTES TO THE ACCOUNTS
For the year ended 31 December 1998
15. TECHNICAL PROVISIONS

Claims Outstanding	Credit £'000	Political £'000	Total £'000
Gross			
Balance as at 1 January 1998	5,178	1,345	6,523
Exchange differences and other adjustments	145	(15)	130
Movements	(2,604)	81	(2,523)
Balance as at 31 December 1998	<u>2,719</u>	<u>1,411</u>	<u>4,130</u>
Reinsurance			
Balance as at 1 January 1998	944	886	1,830
Exchange differences and other adjustments	66	(10)	56
Movements	(423)	(68)	(491)
Balance as at 31 December 1998	<u>587</u>	<u>808</u>	<u>1,395</u>
Net			
Balance as at 1 January 1998	4,234	459	4,693
Exchange differences and other adjustments	79	(5)	74
Movements	(2,181)	149	(2,032)
Balance as at 31 December 1998	<u>2,132</u>	<u>603</u>	<u>2,735</u>

The orderly run-off of the company's liabilities will take several years and there is material uncertainty with respect to the reserves required to cover the insurance liabilities. However, the directors are satisfied that the current level of funds is prudent given the information currently available to them.

16. PROVISIONS FOR OTHER RISKS AND CHARGES

	1998 £'000	1997 £'000
Provision for run-off costs at 1 January 1998	315	436
Release to profit and loss account	(144)	(121)
Provision for run-off costs at 31 December 1998	<u>171</u>	<u>315</u>


NOTES TO THE ACCOUNTS
For the year ended 31 December 1998
**17. RECONCILIATION OF (LOSS)/PROFIT BEFORE TAXATION TO NET CASH
INFLOW/(OUTFLOW) FROM OPERATING ACTIVITIES**

	1998 £'000	1997 £'000
Loss for the year before taxation	(309)	(532)
Decrease in insurance funds	(2,319)	(1,463)
Decrease in reinsurers' share of funds	435	1,302
Decrease in debtors	2,479	505
(Decrease)/Increase in creditors	(321)	946
Decrease in other creditors and accruals	(146)	(127)
Revaluation of opening technical provisions	(74)	(88)
	<hr/>	<hr/>
Net cash inflow/(outflow) from operating activities	(255)	543
	<hr/>	<hr/>

18. MOVEMENT IN CASH, PORTFOLIO INVESTMENTS AND FINANCING

	At 1 January 1997 £'000	Cash Flows £'000	Market value and foreign currency £'000	At 31 December 1997 £'000
Cash and deposits at call	3,338	695	129	4,162
Variable interest securities	2,900	12	(293)	2,619
	<hr/>	<hr/>	<hr/>	<hr/>
Total cash and cash equivalents	6,238	707	(164)	6,781
	<hr/>	<hr/>	<hr/>	<hr/>

	At 1 January 1998 £'000	Cash Flows £'000	Market value and foreign currency £'000	At 31 December 1998 £'000
Cash and deposits at call	4,162	(709)	252	3,705
Variable interest securities	2,619	373	(171)	2,821
	<hr/>	<hr/>	<hr/>	<hr/>
Total cash and cash equivalents	6,781	(336)	81	6,526
	<hr/>	<hr/>	<hr/>	<hr/>