



Chesnara plc

Interim Report and Accounts

For the Six Months Ended

30 June 2004

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Financial Highlights

	6 months ended 30 June		Year ended 31 December
	2004	2003	2003
Modified statutory solvency basis (MSSB)			
Operating loss before tax	(6.9)	(9.1)	(15.4)
Profit on sale of discontinued operation	2.0	—	—
Loss on ordinary activities before tax	£(4.9)m	£(9.1)m	£(15.4)m
Shareholders' funds	£71.0m	£82.5m	£78.7m
Achieved Profits basis			
Operating loss before tax	£(13.5)m	£(28.7)m	£(44.7)m
Value in-force	87.9	120.7	98.5
Net worth	52.8	53.8	54.2
Shareholders' funds (embedded value)	£140.7m	£174.5m	£152.7m
Life annual premium income	£64.7m	£74.7m	£146.0m
Life single premium income	£22.9m	£14.6m	£27.7m
Life annualised premium income	£67.0m	£76.2m	£149.0m
Basic loss per share (MSSB)	(4.4)p	(8.3)p	(12.7)p
Dividend per share	4.75p	—	—

Chairman's Statement

I am pleased to present the first interim statements of Chesnara plc, the new vehicle formed to hold the life assurance operations of Countrywide Assured Group plc ("CAG"). These operations were demerged from CAG on 24 May 2004 and Chesnara plc was then listed on the London Stock Exchange on 25 May 2004.

Background

Chesnara's primary subsidiary — Countrywide Assured plc ("CA") — administers a portfolio of some 228,000 life assurance and personal pension policies. It continues to service its existing clients and to sell and market Guaranteed Income Bonds. As a substantially closed book, it is expected that the embedded value of the Group will decline over time as the number of policies in force reduces and surplus emerging in the life business is distributed by way of dividends. As the portfolio runs off, the regulatory capital supporting the life business may also be reduced and returned to shareholders.

Business Review

The first six months of 2004 have seen a strong and steady emergence of underlying surplus from the policy-based cashflows. However the results for the six months have been affected, to a significantly adverse extent, by two key issues.

First, the level of provision required for mortgage endowment complaints redress has required strengthening over and above that set out in the Supplementary Listing Particulars issued on the 10 May 2004, which related to adverse experience in the early months of the year. The Financial Services Authority and the Association of British Insurers issued new rules and guidance regarding endowment complaints on 25 May 2004. After a period during which Chesnara sought clarification and guidance on the new regime, the Board now believe that a further significant strengthening of the provision is required.

The second issue is that of persistency of our Protection policy base where the expected convergence of actual experience to assumed underlying rates has yet to materialise fully. The Board have therefore reflected this in their assessment of the Value In-Force at the half-year.

These adverse effects have been partially offset by the profit realised on the sale of Key Retirement Solutions Limited ("KRS"), the Group's IFA, which specialises in the sale of equity release products.

On the operational side, the business is running within its budgeted operating costs and significant progress has been made on the selection of an outsourcing partner which will mitigate future fixed and semi fixed expense issues.

On a Modified Statutory Solvency Basis ("MSSB"), Chesnara has posted a pre-tax loss of £4.9m for the six months ended 30 June 2004. This is after taking a total charge of £16.6m for mortgage endowment complaints redress, an acceleration of £0.9m in the amortisation of Deferred Acquisition Costs and a credit of £2m in respect of the sale of Key Retirement Solutions.

On the alternative Achieved Profits basis of reporting the pre-tax loss for the six months ended 30 June 2004 is £11.7m. A major factor affecting this result over and above the charge for mortgage endowment complaint redress is a revision to persistency assumptions for Protection business, which gives rise to a reduction of £6m (£4.5m net of tax) in the value of policies in force.

Whilst the Embedded Value has reduced from £152.7m at 31 December 2003 to £140.7m at 30 June 2004, the Net Asset Value has experienced a relatively small decrease. After the dividend appropriation of £4.02m, it has reduced by £1.4m to £52.8m at 30 June 2004. Whereas it represented 35% of Embedded Value at 31 December 2003 it has risen to 37.5% at the half year.

CA's solvency cover (the ratio of admissible assets held to cover the required minimum margin) remains at a premium to the target level of 150% set by the Board and in excess of the actual level of 160% at 1 January 2004. At 30 June 2004 it was, after allowing for the interim dividend, a healthy 183%.

Despite the impact on earnings of adverse factors in the first half year, the strong emergence of surplus from the underlying product base, together with a healthy solvency position, enables the Board to continue to target a total dividend of £10m for the full year and to recommend an interim dividend of 4.75p per share which equates to a total interim dividend of £4.02m.

Christopher Sporborg
Chairman

11 August 2004

Chief Executive Officer's Statement

Background

Chesnara plc, which was listed on the London Stock Exchange on 25 May 2004, was formed to become the new holding company of the life assurance activities formerly owned by Countrywide Assured Group plc ("CAG"). Details relating to the demerger are set out in Note 1 to these financial statements.

The demerger followed a year-long review by CAG which had, inter alia, been considering ways in which to rationalise its corporate structure around its estate agency, professional property services and life businesses. In the context of the different business profiles and investment propositions offered by these businesses and, as the activities of the life business are fundamentally different in nature from the rest of the members of the CAG group, it was considered that a separate listing for the life business would enable shareholders to better assess the risk and rewards associated with the life business and its cash flows and would allow management to create additional value for shareholders through greater focus as an independent business.

Chesnara's primary subsidiary — Countrywide Assured plc ("CA") — was established in 1988 as the life assurance division of CAG, selling mortgage-related life assurance products through CAG's financial services division. In 1995, CA acquired Premium Life, a life assurance company, and integrated it into its existing operations. In August 2002, CAG entered into a distribution agreement with Friends Provident ("FP") which resulted in new business being switched to FP from August 2003. At this point CA was substantially closed to new business. CA continues to administer an existing portfolio of some 228,000 life assurance and pension policies, and it continues to service its existing clients and to sell and market Guaranteed Income Bonds. Most of its policies in force comprise either non-linked term assurance, unit-linked endowment policies or guaranteed bonds.

Business Review

The Chairman has provided headline information in the Business Review section of his report. In this report I provide background on the headlines and other relevant information.

Mortgage Endowment Complaints Redress Provision

CA is required to write to its endowment policyholders at least every two years to appraise them of any potential shortfall in the expected maturity value of their policy. During the first half of the year the company completed a mailing programme, which began in May 2003, whereby virtually all endowment policyholders received the required mailing.

During the early months of 2004 it became apparent that, with a background of heightened media coverage, an underlying increase in the level of complaints was occurring. This media coverage was concentrated when the House of Commons Treasury Select Committee issued a report, "Restoring confidence in long-term savings: Endowment mortgages," on 9 March 2004. This experience led the Board to decide that it needed to strengthen the provision for redress on future mortgage endowment complaints by £4.8m (£3.4m net of tax). Supplementary Listing Particulars relating to this were issued on 10 May 2004.

On the day that Chesnara plc was listed — 25 May 2004 — the FSA and the ABI issued new rules and guidance in respect of endowment re-projection mailings. These new rules also included an immediate change in the time bar rules. There is now a requirement to give clear notification to policyholders of an individual "cut-off" date by which they must complain (if they are minded to do so). If a policyholder does not submit a complaint by the "cut off" date, then the company has the right to refuse to consider it. The "cut off" date is to be stated in new-style, focussed review letters, which must also highlight potential shortfalls, and also in any other "key communications" with policyholders. A more immediate effect is that a number of CA policyholders who would have become time-barred in the second half of the year will now have the time period in which they have the right to complain extended.

After a period during which Chesnara sought clarification and guidance on the new regime, the Board expect these new rules to have a material effect on its results due to the temporary deferral of expected time-barring and the likelihood of an increased propensity to complain due to the detailing of the "cut-off" date. Therefore it is further strengthening the provision for future mortgage endowment complaints redress at 30 June 2004 by £11.75m (£8.2m net of tax) leading to total charges to pre-tax profit in respect of increases in the provision for the six month period of £16.6m (£11.6m net of tax). After strengthening, the provision amounted to £22.4m at 30 June 2004. Chesnara believes that the further charge is a sensible and prudent response to the changed environment. The Board will continue to monitor the adequacy of the provision, particularly in the light of customer response to the next mailing programme which is scheduled to begin in the last quarter of 2004.

Persistency

Persistency experience over the first six months of 2004 has differed between our two major product lines. On Endowment business there has been convergence of actual experience towards our underlying persistency assumptions and we do not see the need to make any significant alterations to these. However, on Protection business the expected convergence has yet to fully materialise. In recognition of this we are increasing the longer-term lapse assumptions and also extending the temporary lapse assumption, at a lower rate, for a further year. The effect of this is to reduce the Value In-Force, and hence the Achieved Profits result, by £6m (£4.5m net of tax).

Disposal of KRS

KRS, an Independent Financial Adviser, was a wholly owned subsidiary of Chesnara. It is one of the market leaders in the marketing of property related equity release products and sells associated financial services. Originally an appointed representative of CA, it adopted IFA status in May 2001.

Prior to the demerger the future of KRS within Chesnara had been the subject of discussion with KRS management. In the absence of any significant strategic fit or synergy Chesnara agreed to sell the business, with limited warranties, to its management for cash in the sum of £2.8m (£2.6m net of the settlement of outstanding debt and costs of disposal). The sale by CA was completed on 30 June 2004 and as KRS was held at nil value in that company, the net proceeds of £2.6m represent a one-off addition to its pre-tax profit measured on both the Modified Statutory Solvency and Achieved Profits bases (£2.6m net of tax). At the date of disposal the net assets of KRS were £0.6m so that a pre-tax and net of tax profit of £2.0m is recognised in the consolidated profit and loss account. Continuing service contracts and underlease arrangements with KRS will allow CA to recover some of its fixed overhead expense base.

MSSB Result

The Group has posted a pre-tax loss of £4.9m for the six months ended 30 June 2004 under the Modified Statutory Solvency Basis ("MSSB") of reporting, which is used to present the Group's primary financial statements. This is stated (1) after charging, to the consolidated profit and loss account, £16.6m for adverse mortgage endowment complaint redress effects and £6m in respect of the amortisation of Deferred Acquisition Costs ("DAC") and (2) after crediting to the consolidated profit and loss account £2m in respect of the profit on the disposal of KRS. As the return on shareholder funds is relatively minor in the context of the overall MSSB result and, as the Group's life assurance operations are now substantially closed to new business, these figures give a broad indication of the current rate at which surplus is emerging from the run off of the in-force book. The rate of DAC amortisation has been increased by £0.9m pre-tax to take account of the adjustment to Protection business persistency assumptions. It is now expected that DAC (£10.1m at 30 June 2004) will be fully amortised prior to the end of 2005.

Achieved Profits Result

Summary supplementary information on the Achieved Profits basis as reflected in Notes 14 and 15 of these interim statements is presented to provide alternative information to that presented under MSSB. The Achieved Profits method recognises profits as they are earned over the life of an insurance policy and assists in identifying the value being generated by the life business. The result determined under this method represents the movement in the life business embedded value. As the Group's life assurance operations are now substantially closed to new business the principal underlying components of the achieved result are the expected return from the business in force (being the yield at the risk discount rate on the related policy cashflows as they fall into surplus) together with (1) variances of actual experience from that assumed for each component of the policy in force cashflows and (2) the impact of resetting assumptions for each component of the prospective cashflows.

The Group has, under this basis, posted a pre-tax loss of £11.7m for the six months ended 30 June 2004, which comprises principally an expected return of £5.4m offset by charges of £16.6m for adverse mortgage endowment complaints redress effects, and of £4m in respect of the resetting of assumptions in respect of prospective cashflows. As under MSSB this basis also recognises a profit of £2m in respect of the sale of KRS.

Within the charge for the resetting of assumptions, the main component is a reduction of the value of policies in force of £6m (£4.5m net of tax) in respect of revised persistency assumptions for Protection business, while changes to economic assumptions are not significant overall: in particular the risk discount rate used to discount prospective cashflows on policies in-force remains unchanged at 9.25%. The overall net of tax achieved loss is £8m, which represents the movement on embedded value before dividend distributions.

Embedded Value

The embedded value set out in Note 15 has the following components:

	30 June		31 December
	2004	2003	2003
	£000	£000	£000
Share Capital	4,228	4,228	4,228
Demerger Reserve	36,272	36,272	36,272
Retained Earnings	6,935	3,332	8,395
Undistributed Surplus	5,362	10,030	5,329
Value In-Force (after cost of capital)	87,901	120,661	98,521
Embedded Value	140,698	174,523	152,745

The embedded value as at 30 June 2004 is stated after providing for a dividend of £4m in respect of the six months then ended. No dividend was declared or payable in respect of the six months ended 30 June 2003 or the year ended 31 December 2003.

The tables below set out the components of the in-force value by major product lines at each period end.

	30 June		31 December
	2004	2003	2003
	000	000	000
Number of policies			
Endowments	84	104	94
Protection	113	131	129
Other	31	33	32
Total	228	268	255

	30 June		31 December
	2004	2003	2003
	£m	£m	£m
Value In-Force			
Endowments	50.1	51.4	52.4
Protection	57.3	79.8	70.3
Other	4.7	3.7	4.7
	112.1	134.9	127.4
Valuation adjustments	(7.3)	4.8	(7.4)
Cost of capital	(4.0)	(5.5)	(4.4)
Total in-force value (pre-tax)	100.8	134.2	115.6
Tax	(12.9)	(13.6)	(17.1)
Total in-force value (post-tax)	87.9	120.6	98.5

The reduction in value in force of Protection policies for the six months ended 30 June 2004 reflects actual persistency experience together with the effect of an increase of underlying lapse assumptions.

Solvency and Regulatory Capital

In spite of the significant charges in respect of increases in the mortgage endowment complaints redress provision, CA, which is subject to prudential regulation by the Financial Services Authority ("FSA"), remains in a healthy solvency position, as illustrated by the following solvency cover information:

	30 June 2004	1 January 2004
	£m	£m
Admissible assets held to cover solvency margin	49.9	47.3
Required minimum margin	27.2	29.5
Solvency cover	183%	160%
Excess of available assets over 150% solvency cover	£9.1m	£3.1m

The position at 30 June 2004 is stated after recognising the interim dividend payable of £4m. Admissible assets have benefited, in the period, from the settlement for cash by CAG of outstanding intercompany debt of £2.2m, which had previously been treated as inadmissible. The Board, as a matter of policy, continue to target solvency cover of at least 150%. It can be seen, therefore, that based on current assumptions Chesnara plc, is in a favourable position to pursue a progressive dividend policy.

In July 2004, the FSA published PS04/16 "Integrated Prudential Sourcebook for Insurers", which includes final policy statements on life capital requirements. This requires firms to undertake individual self-assessment of their capital needs and provides for individual capital guidance by the FSA. It is expected to become final in November 2004 in order to be applicable for 31 December 2004 year ends. CA has completed an initial assessment of the risks to which it is subject and of the concomitant capital requirements. On the basis of this preliminary assessment, the Board of CA do not believe that the overall capital requirements will be such as to impose significant additional constraints on distributions other than those determined by the solvency cover target as set out above. The initial assessment is, however, subject to guidance from the FSA.

Investment Funds

The Board continue to have a conservative approach to the investment of Shareholder funds, which underpins our strong solvency position. This approach targets the investment of 90% of funds in cash or fixed interest securities. The equity content, which, on the back of investment gains had increased to nearly 15% of funds at the 2003 year-end, was gradually reduced to 11% by the half year. Rising interest rates negatively affected fixed interest capital values in the half-year and, whilst there is the prospect of interest rate rises, further fixed interest investment is unlikely.

On Policyholder investment funds, and in particular the Managed Fund, which represents a highly significant proportion of these funds, our fund managers produced mixed performance during the half-year. The fund which grew at 1.94% during the half year is broadly in line with the ABI Life Balanced Managed Fund average of 1.98%. The underlying performance was compromised due to the necessity to move the pricing basis from that of an expanding fund to one of a contracting fund, as one would expect in a substantially closed book scenario. The effect of this was to depress the unit price of this fund by approximately 4.5%, which contributed to a fall in the price of 2.5% over the half year. Apart from the impact on policyholders' policy values, this reduction has also led to an increase in the overall cost of mortgage endowment complaints redress and has led to a reduction of Value In-Force, as the future charges based on fund value have been reduced.

Developments

In the second half of the year Chesnara intends to progress outsourcing, the implementation of International Financial Reporting Standards and development of the business with particular focus on opportunities for consolidation within the industry.

As detailed in the Listing Particulars, a significant proportion of the life assurance business operating costs are fixed or semi-fixed in nature and Management are taking action to address this issue. In our in-force value assumptions we have assumed that we will reduce our operating expenses to be in-line with indicative costs provided to us by potential outsourcing partners. Currently we have entered into a period of due diligence with Marlborough Stirling Group ("MSG"), an established life and pensions outsourcing organisation. We are targeting the signing of contracts by the year-end, with MSG providing the requisite services at a cost that is likely to be in line with our assumptions.

On Financial Reporting Standards we are currently assessing the impact and planning for the implementation of two key areas of development. First, as to International Financial Reporting Standards we will implement these for our next Interim reporting in respect of the six months ending 30 June 2005 when we will disclose prior year comparatives on a consistent basis. Of particular significance are IFRS4 "Insurance Contracts" and IAS39 "Financial Instruments: Recognition and Measurement". Although these will involve substantive work to identify and to account appropriately for the investment-type arrangements within our existing product portfolio, it is not expected that such changes will have a significant effect on reported earnings.

Second, a new exposure draft on accounting for life insurance business, FRED34, was issued in July 2004. This will require implementation in our 31 December 2004 accounts. New requirements in respect of with-profits business will not apply to the Group, but it is clear that, along with other life assurance companies, more open disclosure of our capital position will be required.

During the latter part of the half-year strong signs of the long-heralded consolidation of the life assurance industry have started to emerge. The Board believe that many opportunities for consolidation remain, particularly in the small to medium sector, and will continue to investigate the possibility of value-enhancing merger and acquisition activity.

Outlook

The results in the first six months have been impacted by adverse Protection persistency experience and the need to make further provisions for redress for endowment misselling, initially because of adverse experience and latterly due to the introduction of new rules and guidance. Accordingly we have strengthened our assumptions to reflect these changed circumstances.

Prospects for equity markets, which have traded in a relatively narrow range in the first half-year, remain mixed. Any sustained recovery will, to some extent, ameliorate the cost of these adverse variances.

The underlying emergence of surplus from the realisation of the value in-force in the second half of the year should continue strongly, albeit at a slightly lower level than in the first half due to the reduction in policy numbers, as would be expected in a substantially closed book.

Dividend

In our Listing Particulars we stated that we are "targeting a dividend in respect of the year ending 31 December 2004, subject to unforeseen circumstances, of approximately £10m". Despite the negative influences on the half year results, the healthy emergence of surplus from the underlying product base, together with a strong solvency position, enables the Board to reaffirm this target.

Graham Kettleborough
Chief Executive Officer

11 August 2004

**Consolidated profit and loss account — modified statutory solvency basis
(unaudited)**

Long term business technical account

		6 months ended 30 June	Year ended 31 December
		(restated)	(restated)
	Note	2004 £000	2003 £000
Earned premiums, net of reinsurance	6		
Gross premiums written		87,631	89,380
Outward reinsurance premiums		(15,761)	(14,083)
		71,870	75,297
Investment income		15,339	16,149
Unrealised gains on investments		—	23,351
Other technical income, net of reinsurance		727	3,494
		87,936	118,291
Claims incurred, net of reinsurance			
Claims paid			
Gross amount		(101,017)	(92,787)
Reinsurers' share		14,421	8,774
Change in the provision for claims			
Gross amount	7	(2,405)	(2,191)
Reinsurers' share	7	(429)	2,497
		(89,430)	(83,707)
Change in other technical provisions, net of reinsurance, not shown under other headings	7		
Long term business provision, net of reinsurance			
Gross amount		5,204	19,371
Reinsurers' amount		1,427	(5,845)
Other technical provisions, net of reinsurance		1,146	(36,643)
		(81,653)	(106,824)
Net operating expenses	8	(10,936)	(16,752)
Investment expenses and charges	9	(703)	(3,048)
Unrealised losses on investments		(1,098)	—
Allocated investment return transferred to the non-technical account		530	343
Other technical charges, net of reinsurance		(208)	(247)
		(94,068)	(126,528)
		(6,132)	(8,237)
Tax attributable to the long term business			
— Current		(532)	26
— Deferred		1,729	2,038
Balance on the technical account for long term business		(4,935)	(6,173)

Consolidated profit and loss account — modified statutory solvency basis (unaudited)

Non-technical account

		6 months ended 30 June		Year ended 31 December
		Discontinued Operations	(restated)	(restated)
	Note	2004 £000	2004 £000	2003 £000
Balance on the long term business technical account		—	(4,935)	(6,173)
Tax credit attributable to the balance on the long term business technical account		—	(1,197)	(2,064)
Pre-tax loss arising on long term business		—	(6,132)	(8,237)
Allocated investment return transferred from the long- term business technical account		—	(530)	(343)
Other income		2,382	9	72
Other charges		(2,273)	(266)	(449)
Operating profit/(loss)	6	109	(6,919)	(8,957)
Profit on sale of a discontinued operation	12	1,948	—	—
Other profits/(losses)		—	—	—
Profit/(loss) on ordinary activities before tax		2,057	(6,919)	(8,957)
Continuing operations			(6,919)	(8,957)
Discontinued operations			2,057	(107)
			(4,862)	(9,064)
Tax on loss on ordinary activities				
— current			(565)	5
— deferred			1,729	2,047
Loss on ordinary activities after tax			(3,698)	(7,012)
Dividends paid and proposed	4		(4,027)	—
Retained loss for the period transferred to reserves			(7,725)	(7,012)
Basic loss per share (pence)	5		(4.4)p	(8.3)p
Dividend per share	4		4.75p	—

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 deemed not 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 — modified statutory solvency basis (unaudited)

		6 months ended 30 June		Year ended 31 December
	Note	2004 £000	2003 £000	2003 £000
Shareholder funds at 1 January		78,739	89,508	89,508
Loss for the financial period		(3,698)	(7,012)	(10,769)
Dividends paid and proposed	4	(4,027)	—	—
Transfer from profit and loss account to redeem preference share	13	(50)	—	—
Transfer to capital redemption reserve following redemption of redeemable preference share	13	50	—	—
Shareholder funds at 30 June/31 December		71,014	82,496	78,739

Consolidated balance sheet — modified statutory solvency basis (unaudited)

		30 June		31 December
	Note	2004 £000	2003 £000	2003 £000
ASSETS				
Investments				
Land and buildings		450	450	450
Other financial investments		239,955	281,790	269,974
		240,405	282,240	270,424
Assets held to cover linked liabilities		474,422	433,399	474,280
		714,827	715,639	744,704
Reinsurers' share of technical provisions	7			
Long term business provisions		50,702	51,898	49,275
Technical provisions for linked liabilities		118,951	112,098	120,515
Claims outstanding		5,216	4,973	5,645
		174,869	168,969	175,435
Debtors				
Debtors arising out of direct insurance operations		4,751	4,713	4,691
Other debtors		3,328	15,660	13,479
		8,079	20,373	18,170
Other assets				
Tangible assets		492	1,338	904
Cash at bank and in hand		55,305	15,530	23,880
Other — present value of acquired inforce business		1,758	2,127	1,963
		57,555	18,995	26,747
Prepayments and accrued income				
Deferred acquisition costs		10,134	23,311	16,135
Other prepayments and accrued income		5,986	6,993	6,466
		16,120	30,304	22,601
Total assets		<u>971,450</u>	<u>954,280</u>	<u>987,657</u>
LIABILITIES				
Capital and reserves				
Called up share capital	13	4,228	4,228	4,228
Capital redemption reserve		50	—	—
Demerger reserve		36,272	36,272	36,272
Profit and loss account		30,464	41,996	38,239
Shareholders' funds attributable to equity interests		71,014	82,496	78,739
Technical provisions	7			
Long term business provision		279,213	303,041	284,417
Claims outstanding		12,903	8,292	10,498
		292,116	311,333	294,915
Technical provisions for linked liabilities	7	588,415	541,428	591,125
Provision for other risks and charges		3,750	9,014	6,232
Creditors				
Creditors arising out of direct insurance operations		5,454	5,115	5,681
Dividend proposed		4,017	—	—
Other creditors		6,684	4,894	10,965
		16,155	10,009	16,646
Total liabilities		<u>971,450</u>	<u>954,280</u>	<u>987,657</u>

**Consolidated cash flow statement — modified statutory solvency basis
(unaudited)**

		6 months ended 30 June		Year ended 31 December
	Note	2004 £000	2003 £000	2003 £000
Net cash inflow from operating activities	10	12,268	(8,314)	(7,470)
Taxation recovered		(384)	(99)	349
Capital expenditure		(107)	(126)	(46)
Disposal of subsidiary	12	2,750	—	—
Cash balances transferred with disposal		(408)	—	—
Equity dividends paid		(10)	—	—
Preference shares issued		50	—	—
Preference shares redeemed		(50)	—	—
Net cash inflow/(outflow) of the Group excluding long-term business		14,109	(8,539)	(7,167)
The cash flows were invested as follows:				
Portfolio investments				
Purchases:				
Equities		36	1,012	10,234
Fixed income securities		1,228	10,735	11,058
Deposits		37,500	94,551	129,551
		38,764	106,298	150,843
Sales:				
Equities		(1,169)	(6,469)	(11,369)
Fixed income securities		(541)	(10,155)	(12,932)
Deposits		(35,458)	(97,305)	(131,693)
		(37,168)	(113,929)	(155,994)
Net purchase/(sales) of portfolio investments	11	1,596	(7,631)	(5,151)
Increase/(decrease) in cash and short-term deposits, net of overdrafts		12,513	(908)	(2,016)
Net investment of cash flows		14,109	(8,539)	(7,167)

In accordance with FRS1, this statement excludes the cashflows of the long-term business fund.

Notes (unaudited)

(forming part of the financial statements)

1 Life business demerger and acquisition by Chesnara plc

On 24 May 2004, Chesnara plc acquired the whole of the issued ordinary share capital of Countrywide Assured Life Holdings Limited ("CALH") from Countrywide plc, which had, itself, acquired the whole of the ordinary issued share capital of CALH on 22 May 2004 from Countrywide Assured Group plc ("CAG"). These arrangements were effected to secure the demerger from CAG of CALH, which, together with its subsidiary companies, comprised the Life Business of CAG.

On the acquisition of CALH, Chesnara plc issued, as fully paid, 2.5p ordinary shares to the shareholders of CAG ("the CAG shareholders") as recorded on the shareholders register on 21 May 2004, *pro rata* to their holding in CAG, such that they received one ordinary share in Chesnara plc for every two ordinary shares held in CAG. On 25 May 2004, the existing ordinary shares of 2.5p in Chesnara plc were consolidated into ordinary shares of 5p each on the basis of one new share for every two old shares, so that, in effect, the CAG shareholders received one ordinary 5p share in Chesnara plc for every four ordinary shares previously held in CAG.

Information relating to this scheme, including, inter alia, detailed financial information on CALH and pro forma financial information on the Chesnara plc Group, was included in a document entitled "Chesnara plc — Introduction to the Official List" (the "Listing Particulars"), dated 18 March 2004, and in a document entitled "Supplementary listing particulars relating to the introduction to the Official List" (the "Supplementary Listing Particulars"), dated 10 May 2004. Copies of both the Listing Particulars and the Supplementary Listing Particulars may be obtained from the Chesnara plc Registered Office at Harbour House, Portway, Preston, PR2 2PR, UK or at www.chesnara.co.uk.

CALH, together with its subsidiary companies, comprises the whole of the operations and trading activities of Chesnara plc, except for certain costs which are incurred centrally by Chesnara plc in connection with its Corporate Governance activities, and which are fully recharged by way of a Group management charge to its principal operating subsidiary companies.

2 Basis of preparation

The unaudited interim accounts for the six months ended 30 June 2004 have been prepared in accordance with the accounting policies of Countrywide Assured Life Holdings Limited ("CALH") as set out in the Listing Particulars referred to in Note 1, which have been adopted as the accounting policies of Chesnara plc.

These interim accounts and the comparative financial information have been prepared in accordance with applicable accounting and reporting standards and under the historical cost convention modified to include revaluation of investments and comply with the Statement of Recommended Practice ("SORP") on Accounting for Insurance Business issued by the Association of British Insurers, as revised in November 2003.

In order to comply with the revised SORP, the Directors have decided to report using smoothed investment assumptions. This represents a change in the accounting policies referred to above and the results arising on the long-term business technical account and the non-technical account have, accordingly, been restated. As a result of the change, allocations of investment return are made from the long-term business technical account to the non-technical account, being the difference between the longer-term investment return and the actual return on investments of the long-term business, which are directly attributable to shareholders. The longer-term investment return is an estimate of the long-term trend investment return for the relevant category of investment having regard to past performance, current trends and future requirements. There is no impact on reported losses or net assets as a result of these changes.

The unaudited interim accounts and comparative figures for the financial year ended 31 December 2003 and the six months ended 30 June 2003 are the results and financial position of the Chesnara plc Group applying the merger accounting convention. In accordance with that convention, the consolidated results and financial position of Chesnara plc are based on the consolidated results and financial position of CALH. The consolidated results of CALH for the year ended 31 December 2003 and its consolidated financial position as at that date were included in the Listing Particulars referred to in Note 1 and were reported on by the Reporting Accountants in accordance with the Statements of Investment Circular Reporting Standards issued by the Auditing Practices Board in the United Kingdom. The report of the Reporting Accountants was unqualified.

Notes (unaudited) — continued

2 Basis of preparation — continued

The unaudited comparative figures for the six months ended 30 June 2003 have been presented to provide consistent treatment and disclosure between periods.

The interim accounts and comparative financial information include the results of the Company and its subsidiary undertakings made up to the stated period ends. Other than in respect of the acquisition of CALH by Chesnara plc when merger accounting has been applied, the acquisition method of accounting has been adopted for all other acquisitions and disposals. Under this acquisition accounting method, the results of subsidiary undertakings acquired or disposed of in the period are included in the consolidated profit and loss account from the date of acquisition or up to the date of disposal.

3 Interim Report

A copy of the interim report is being sent out to all shareholders on 19 August 2004 and will be available to the public at the Company's registered office, Harbour House, Portway, Preston, PR2 2PR, UK and at www.chesnara.co.uk.

4 Dividends paid and proposed

	6 months ended 30 June		Year ended 31 December
	2004 £000	2003 £000	2003 £000
First interim dividend	10	—	—
Second interim dividend	4,017	—	—
	<u>4,027</u>	<u>—</u>	<u>—</u>

The first interim dividend was proposed and paid by Countrywide Assured Life Holdings Limited ("CALH") to Countrywide plc prior to the demerger referred to in Note 1. This was done to establish the status of CALH as a subsidiary company of Countrywide plc.

The second interim dividend of 4.75p per share will be paid on 24 September 2004 to shareholders registered at the close of business on 27 August 2004, the dividend record date. The ex-dividend date is 25 August 2004.

5 Loss per share

The basic loss per share is calculated as follows:

	6 months ended 30 June		Year ended 31 December
	2004	2003	2003
Loss for the period after tax (£000)	(3,698)	(7,012)	(10,769)
Weighted average number of shares	84,564,168	84,564,168	84,564,168
Basic loss per share	<u>(4.4)p</u>	<u>(8.3)p</u>	<u>(12.7)p</u>

The basic loss per share for the six months ended 30 June 2004 is stated after taking account of profit on sale of a discontinued operation.

The weighted average number of shares is the number of ordinary shares, entitled to dividend, in issue at 30 June 2004. Except for the cancellation of 2 ordinary shares on 22 June 2004, the effect of which is not considered to be material, this corresponds with the number of ordinary shares issued by Chesnara plc on 25 May 2004 in accordance with the scheme of demerger described in Note 1 above. The fully diluted number of shares is 86,255,452, the difference being the number of shares that would be issued if the share options described in Note 13 were to be exercised. These shares have not been treated as dilutive in accordance with FRS14 "Earnings per Share" as their conversion to ordinary shares would reduce the net loss per share.

Notwithstanding the fact that the ordinary shares in Chesnara plc were issued on 25 May 2004 the number of shares so determined has been applied uniformly to the results after tax for all periods

Notes (unaudited) — continued

5 Loss per share — continued

reported in this statement, as this is considered to be the most meaningful way to present loss per share, having regard to the basis on which such results have been presented as set out in Note 2 above.

The earnings per share information presented in the Listing Particulars referred to in Note 1 above followed the same method of presentation except that the weighted average number of shares of 82,273,819 was based on the number of Countrywide Assured Group plc ordinary shares in issue at 31 December 2003, adjusted for the prospective Chesnara plc Share Consolidation of one Chesnara plc share for every four Countrywide Assured Group plc shares.

6 Segmental information

	6 months ended 30 June		Year ended 31 December
	2004 £000	2003 £000	2003 £000
(a) Turnover			
Earned Premiums, net of reinsurance			
Periodic premiums (gross)	64,686	74,740	146,004
Single premiums (gross)	22,945	14,640	27,720
	87,631	89,380	173,724
Outward reinsurance premiums	(15,761)	(14,083)	(31,399)
	71,870	75,297	142,325
Turnover arising in IFA business (discontinued activity)	2,382	2,100	4,291
Total turnover	74,252	77,397	146,616
(b) Operating (loss)/profit			
Continuing operations	(6,919)	(8,957)	(15,510)
Discontinued operations	109	(107)	151
	(6,810)	(9,064)	(15,359)

7 Technical Provisions

	6 months ended 30 June		Year ended 31 December
	2004 £000	2003 £000	2003 £000
Long term business provision			
Gross amount			
At beginning of period	284,417	322,412	322,412
Movement in the long term business technical account excluding bonuses	(5,204)	(19,371)	(37,995)
At end of period	279,213	303,041	284,417
Reinsurers' share			
At beginning of period	49,275	57,743	57,743
Movement in the long term business technical account	1,427	(5,845)	(8,468)
At end of period	50,702	51,898	49,275
Net technical provisions			
At beginning of period	235,142	264,669	264,669
Net movement in the long term business technical account excluding bonuses	(6,631)	(13,526)	(29,527)
At end of period	228,512	251,143	235,142

Notes (unaudited) — continued

7 Technical Provisions — continued

	6 months ended 30 June		Year ended 31 December
	2004 £000	2003 £000	2003 £000
Technical Provision for linked liabilities			
Gross amount			
At beginning of period	591,125	498,678	498,678
Movement in the long term business technical account excluding bonuses	(2,710)	42,750	92,447
At end of period	588,415	541,428	591,125
Reinsurers' share			
At beginning of period	120,515	105,991	105,991
Movement in the long term business technical account	(1,564)	6,107	14,524
At end of period	118,951	112,098	120,515
Net technical provisions			
At beginning of period	470,610	392,687	392,687
Net movement in the long term business technical account excluding bonuses	(1,146)	36,643	77,923
At end of period	469,464	429,330	470,610
Claims outstanding			
Gross amount			
At beginning of period	10,498	6,101	6,101
Movement in the long term business technical account excluding bonuses	2,405	2,191	4,397
At end of period	12,903	8,292	10,498
Reinsurers' share			
At beginning of period	5,645	2,476	2,476
Movement in the long term business technical account	(429)	2,497	3,169
At end of period	5,216	4,973	5,645
Net technical provisions			
At beginning of period	4,853	3,625	3,625
Net movement in the long term business technical account excluding bonuses	2,834	(306)	1,228
At end of period	7,687	3,319	4,853

8 Net operating expenses

	6 months ended 30 June		Year ended 31 December
	2004 £000	2003 £000	2003 £000
Acquisition costs:			
Commission for direct insurance business	(45)	(879)	(1,154)
Other	1,225	2,653	3,467
Change in gross deferred acquisition costs	6,001	10,616	17,793
	7,181	12,390	20,106
Administration expenses	3,755	4,362	9,759
	10,936	16,752	29,865

Notes (unaudited) — continued

9 Investment expenses and charges

	6 months ended 30 June		Year ended 31 December
	2004	2003	2003
	£000	£000	£000
Investment management expenses, including interest	703	685	1,469
Loss on realisation of investments	—	2,363	2,428
	<u>703</u>	<u>3,048</u>	<u>3,897</u>

10 Reconciliation of operating loss to net cash outflow/inflow from operating activities

	6 months ended 30 June		Year ended 31 December
	2004	2003	2003
	£000	£000	£000
Operating loss before tax	(6,810)	(9,064)	(15,359)
Adjustment for non-cash items:			
Depreciation on tangible fixed assets	179	304	659
Loss relating to long term business	7,467	9,751	11,787
Cash transferred to/(from) long term business fund	5,500	(9,000)	(9,000)
Other items	5,932	(305)	4,443
Net cash inflow/(outflow) from operating activities	<u>12,268</u>	<u>(8,314)</u>	<u>(7,470)</u>

11 Movement in opening and closing portfolio investments, net of financing

	6 months ended 30 June		Year ended 31 December
	2004	2003	2003
	£000	£000	£000
Increase/(decrease) in cash and short term deposits, net of overdrafts	12,513	(908)	(2,016)
Net purchases/(sales) of portfolio investments	1,596	(7,631)	(5,151)
Preference share capital issued	50	—	—
Preference share capital redeemed	(50)	—	—
Investment depreciation	(239)	(429)	(28)
Portfolio investments, net of financing at start of year/period	<u>37,851</u>	<u>45,046</u>	<u>45,046</u>
Portfolio investments, net of financing at end of period	<u>51,721</u>	<u>36,078</u>	<u>37,851</u>
Represented by:			
Shares in unit trusts	4,060	—	5,167
Fixed income securities	8,064	10,292	7,561
Deposits with credit institutions	24,128	21,724	22,167
Investment properties	450	450	450
Cash at bank and in hand	15,019	3,612	2,506
	<u>51,721</u>	<u>36,078</u>	<u>37,851</u>

Notes (unaudited) — continued

12 Profit on sale of a discontinued operation

On 30 June 2004 the Group disposed of its interest in Key Retirement Solutions Limited ("KRS"), its wholly-owned IFA subsidiary, by way of the sale for cash of its entire issued share capital, to a company controlled by the KRS executive management. The proceeds on sale of £2.8m were attributed £0.2m as to the repayment of a subordinated loan payable to another subsidiary company with the balance of £2.6m attributed to the sale of shares. Under the disposal method of accounting the cumulative net of tax profits and losses of KRS have been recognised in the consolidated group profit and loss account up to the date of disposal such that, after the deduction of expenses incurred in connection with the disposal, a profit of £2.0m has been realised on the sale. As the previous write-downs of the investment in KRS in the accounts of its parent company had not been allowed as a charge against taxable profits for corporation tax purposes and as the profit on sale does not exceed those write downs, accordingly no taxable profit arises on the disposal.

13 Called up Share Capital

	30 June 2004 £	On incorporation 29 October 2003 £
Authorised		
Ordinary shares of £1 each	—	50,000
Ordinary shares of 5p each	10,050,000	—
	<u>10,050,000</u>	<u>50,000</u>
Issued		
Ordinary shares of £1 each	—	2
Ordinary shares of 5p each	4,228,208	—
	<u>4,228,208</u>	<u>2</u>

Under the merger accounting convention referred to in Note 2, the issued and called up share capital of the Group at 30 June 2003 and 31 December 2003 is stated at £4,228,208, being the allotment of ordinary shares on 25 May 2004 pursuant to demerger.

The following note sets out changes in the authorised and issued share capital of Chesnara plc from 29 October 2003, the date of incorporation, to 30 June 2004.

(a) Ordinary shares of £1 each

	Authorised		Issued	
	Number	£	Number	£
On incorporation on 29 October 2003	50,000	50,000	2	2
Reorganisation on 9 March 2004	(50,000)	(50,000)	(2)	(2)
Balance at 30 June 2004	<u>—</u>	<u>—</u>	<u>—</u>	<u>—</u>

Notes (unaudited) — continued

13 Called up Share Capital — continued

(b) Ordinary shares of 2.5p each

	Authorised		Issued	
	Number	£	Number	£
Reorganisation on 9 March 2004				
(i) Sub-division of existing £1 shares	2,000,000	50,000	80	2.00
(ii) Creation of further shares	398,000,000	9,950,000	—	—
Cancellation of shares on 17 May 2004	—	—	(78)	(1.95)
Allotment on 25 May 2004				
pursuant to demerger	—	—	169,128,338	4,228,208.45
Consolidation on 25 May 2004 of existing shares of 2.5p each into ordinary shares of 5p each	(400,000,000)	(10,000,000)	(169,128,340)	(4,228,208.50)
Balance at 30 June 2004	—	—	—	—

(c) Ordinary shares of 5p each

	Authorised		Issued	
	Number	£	Number	£
Consolidation on 25 May 2004 of existing ordinary shares of 2.5p each into ordinary shares of 5p each	200,000,000	10,000,000	84,564,170	4,228,208.50
Cancellation of shares on 22 June 2004	—	—	(2)	(.10)
Sub-division and conversion on 22 June 2004 of £50,000 authorised share capital represented by a Redeemable Preference Share	1,000,000	50,000	—	—
Balance at 30 June 2004	201,000,000	10,050,000	84,564,168	4,228,208.40

(d) Redeemable Preference Share of £50,000

	Authorised		Issued	
	Number	£	Number	£
Reorganisation on 9 March 2004	1	50,000	1	50,000
Redemption on 22 June 2004	—	—	(1)	(50,000)
Sub-division and conversion on 22 June 2004 into ordinary shares of 5p each	(1)	(50,000)	—	—
Balance at 30 June 2004	—	—	—	—

Notes (unaudited) — continued

13 Called up Share Capital — continued

On 29 October 2003, on incorporation, the Company had an authorised share capital of £50,000, divided into 50,000 ordinary shares of £1 each, of which two ordinary shares were allotted, called up and fully paid on incorporation.

On 1 March 2004, the two issued ordinary shares of £1 each were transferred to two partners of Pinsents, solicitors to Chesnara plc (the “subscriber shareholders”).

On 9 March 2004, the share capital of the Company was reorganised as follows:

- (i) the 49,998 authorised but unissued ordinary shares were sub-divided into 1,999,920 ordinary shares of 2.5p each;
- (ii) the authorised share capital was increased to £10,050,000 by the creation of a further 398,000,000 ordinary shares of 2.5p each and a new redeemable preference share of £50,000;
- (iii) each of the two issued ordinary shares of £1 each was sub-divided into 40 ordinary shares of 2.5p each; and
- (iv) in order to satisfy the requirements of section 117 of the Companies Act 1985 as to the minimum paid up share capital for a public company, the redeemable preference share was issued (paid up as to one quarter) to one of the subscriber shareholders.

On 17 May 2004, 78 ordinary shares of 2.5p each held by the subscriber shareholders were gifted back to the Company and cancelled. On cancellation an amount representing the nominal value of those shares was transferred to a capital redemption reserve.

On 25 May 2004, in accordance with the demerger referred to in Note 1, three additional shares were allotted to the subscriber shareholders and 169,128,335 shares were allotted to the shareholders of Countrywide plc (“Countrywide”) as recorded on the shareholder register on 25 May 2004 such that they received one ordinary share in Chesnara plc for every one ordinary share in Countrywide. Following this allotment, the existing ordinary shares of 2.5p were consolidated into ordinary shares of 5p each on the basis of one new share for every two old shares. Fractions arising on this consolidation were transferred to a nominee and sold in the market for the benefit of the Company.

On 22 June 2004:

- (i) the remaining two ordinary shares of 5p each held by the subscriber shareholders were gifted back to the Company and cancelled. On cancellation an amount representing the nominal value of these shares was transferred to a capital redemption reserve; and
- (ii) the redeemable preference share of £50,000 was paid up in full and then redeemed. The nominal amount of the redeemable preference share, being £50,000, was sub-divided and converted into ordinary shares of 5p each and an amount of £50,000, being equal to the par value of the redeemable preference share, was transferred to a capital redemption reserve.

Pursuant to an agreement dated 18 March 2004 between Chesnara plc and Numis Securities Limited (“Numis”), Numis received, on the admission of Chesnara plc to the Official List of the UK Listing Authority, an option to subscribe for Chesnara plc shares equivalent in number to 2% of the issued share capital of Chesnara plc at the date of admission. The period in which Numis is entitled to exercise the option to acquire shares begins 6 months after the admission date and ends 36 months after the admission date. The exercise price for the option will be calculated on the basis of a theoretical market capitalisation for Chesnara plc of £76,666,667. The option arrangement was entered into as part of the arrangements for the engagement of Numis as brokers to Chesnara plc further to a letter of engagement dated 18 March 2004 between the two parties.

The issued share capital of Chesnara plc at the date of admission was 84,564,170 ordinary shares of 5p each. Accordingly, Numis has an option to subscribe for 1,691,284 ordinary shares at an option price of 90.66 pence per share.

Notes (unaudited) — continued

14 Life Assurance profit analysis on the Achieved Profits basis

(a) Basis of presentation

Supplementary information is presented in Notes 14 to 16 which presents summary data relating to the results and financial position of the Group on the Achieved Profits Basis, the objective of which is to provide alternative information to that presented under the Modified Statutory Solvency Basis. The information includes the result of the Group's Life Assurance long-term business on a basis determined in accordance with the ABI Guidance "Supplementary reporting for long-term assurance business" (the "Achieved Profits method") issued in December 2001.

The unaudited interim supplementary information prepared on the Achieved Profits basis and unaudited comparative figures for the year ended 31 December 2003 are the results and financial position of the Chesnara plc Group as deemed appropriate under the merger accounting convention. In accordance with that convention, the consolidated results and financial position of Chesnara plc are based on the consolidated results and financial position of Countrywide Assured Life Holdings Limited.

The unaudited comparative figures for the six months ended 30 June 2003 have been presented to provide consistent treatment and disclosure between periods.

(b) Achieved profits result

	6 months ended 30 June		Year ended 31 December
	2004 £000	2003 £000	2003 £000
New business contribution	331	(1,062)	(703)
Existing business contribution			
Expected return	5,364	5,961	13,925
Experience variances			
— persistency	1,759	(5,265)	(12,185)
— complaints and pensions review redress	(16,796)	(8,155)	(14,110)
— mortality/morbidity	(871)	3,612	3,969
— other	2,486	(2,316)	3,212
Operating assumption charges			
— persistency	(6,005)	(21,238)	(26,797)
— expenses and deductions	(190)	—	(12,227)
— other	—	(821)	(801)
Expected return on unencumbered capital	430	589	972
Operating loss before tax	(13,492)	(28,695)	(44,745)
Investment variances	2,243	2,023	(1,061)
Economic assumption changes			
Investment return	(445)	(4,367)	3,855
Risk discount rate	—	4,105	(2,533)
Achieved loss before tax	(11,694)	(26,934)	(44,484)
Tax	3,674	2,329	(1,899)
Achieved loss after tax	(8,020)	(24,605)	(46,383)
Dividend paid and proposed	(4,027)	—	—
Retained loss for the period	(12,047)	(24,605)	(46,383)

(c) Methodology

The Achieved Profits methodology recognises as an element of "Shareholder Funds" the discounted value of the expected future statutory surpluses arising from the contracts in force at the period end. These future surpluses are calculated by projecting future cash flows using realistic assumptions for each component of cash flow. Demographic actuarial assumptions adopted for the determination of discounted value are generally reviewed annually, although more frequent reviews are carried out if there is evidence of material changes. Future economic and investment assumptions are based on period end conditions.

Notes (unaudited) — continued

14 Life Assurance profit analysis on the Achieved Profits basis — continued

Operating profit has been determined upon the principles embodied in paragraph 58 of “Components of Achieved Profits” of the Achieved Profits supplementary reporting guidance issued by the ABI in December 2001. Experience variances shown above have been determined using closing assumptions.

(d) Key assumptions

The table below shows the key economic and investment assumptions used in the calculation of the value of the in-force business.

	6 months ended 30 June		Year ended 31 December
	2004	2003	2003
	%	%	%
Risk discount rate	9.25	8.35	9.25
Future expenses inflation	3.85	4.00	3.50
Future expense charge inflation rate	3.85	3.35	3.50
Future RPI	2.85	2.35	2.50
Unit-linked funds			
— Income (pre-tax)	3.43	3.00	3.39
— Capital Growth (pre-tax)	3.79	3.35	3.73
— Unit-linked funds (total)	7.22	6.35	7.12
Investment returns (pre-tax)			
Government fixed interest	5.10	4.20	5.00
Other fixed interest	5.50	4.60	5.50
Equity	7.70	6.80	7.60
Property	7.70	6.80	7.60

The risk discount rate is used to discount projected future cash flows from the business in-force to present value and is set within the context of assumptions for future investment returns.

The principal economic assumptions have been determined by reference to underlying medium term government fixed interest yields at the respective valuation dates. Other interest yield assumptions reflect the yield curve for different asset outstanding terms and credit and liquidity adjustments. The equity return assumes, over the longer term, a risk premium over medium term government fixed interest yields.

The following gives details of other significant business and operating assumptions.

Future persistency experience assumptions are determined, in the main, by reference to the life business' own emerging experience of individual products. Explicit allowance for anticipated short term adverse persistency risk has been reflected by the establishment of additional provisions at 31 December 2003, 30 June 2003 and 30 June 2004. The provision held at 30 June 2004 anticipates additional adverse persistency continuing during 2004 and 2005 for both protection and endowment policies after which time longer-term persistency experience is assumed to apply.

Mortality and morbidity decrement assumptions are determined by reference to emerging underlying experience, published industry data and reassurer rates.

Future policy servicing expense assumptions are based on an analysis of recent experience. Per policy and per claim expenses are assumed to inflate at a rate consistent with assumptions regarding future economic conditions and investment earnings rates.

During 2003, the life business substantially closed to new business and the allowance for future expenses in the calculation of the embedded value at 31 December 2003 and 30 June 2004 has been based on management's view of total company expenses chargeable to the long-term business. In addition, the Board has decided, on the grounds of prudence, that, in view of the uncertain outlook for expenses over the longer term, cash flows arising beyond a 14.5-year time horizon should be excluded from the value of policies in-force.

The provision established to cover redress on endowment complaints is based on recent experience of complaints cases, assuming the life business continues to deal with complaints in accordance with the regulator's procedural requirements, including the application of time-barring.

Notes (unaudited) — continued

14 Life Assurance profit analysis on the Achieved Profits basis — continued

The portion of a reinsurer default reserve that relates to unit-linked business is assumed to be released within 18 months. However, the portion of this reserve that relates to with-profits business is assumed to be released over the expected lifetime of that business.

Expenses inflation and indexation of capital gains assumptions are set within the context of rates of price inflation implicit within the yields of 15 year index linked gilt edged securities.

Future fund management expenses are based on current fees charged to the life business.

Tax has been provided at the rates applicable to investment income and expenses relief provided under relevant life company tax legislation, which is assumed to continue unaltered. A projection of future tax charges, based on an assumption of continuation of current tax rules, is made and is discounted at the risk discount rate to produce a deferred tax charge at the period end. The net result is grossed up by the deferred tax charge movement and current tax to derive the gross results.

15 Value of policies in-force and embedded value of the life assurance business

	6 months ended 30 June		Year ended 31 December
	2004 £000	2003 £000	2003 £000
At beginning of period (net of tax)	98,521	135,956	135,956
Gross decrease in value of policies in-force	(14,859)	(17,680)	(36,205)
Taxation	4,239	2,385	(1,230)
At end of period (net of tax)	87,901	120,661	98,521
Net worth at end of period	52,797	53,862	54,224
Embedded value at end of period	140,698	174,523	152,745

16 Reconciliation of MSSB shareholder equity to embedded value

	6 months ended 30 June		Year ended 31 December
	2004 £000	2003 £000	2003 £000
MSSB shareholders' equity	71,014	82,496	78,739
MSSB adjustments			
— deferred acquisition costs	(10,134)	(23,311)	(16,135)
— purchased in-force value	(1,758)	(2,127)	(1,963)
— actuarial reserves	(348)	(11)	(169)
— deferred taxation	3,023	7,815	4,752
Sub-total	61,797	64,862	65,224
Reinsurer default reserve	(9,000)	(11,000)	(11,000)
	52,797	53,862	54,224
Value of in-force book	87,901	120,661	98,521
Embedded value	140,698	174,523	152,745

Independent review report by KPMG Audit Plc to Chesnara plc

Introduction

We have been engaged by the company to review the financial information set out on page 3 and pages 10 to 22 prepared on a modified statutory basis and the financial information set out on page 3 and pages 23 to 25 prepared on an achieved profits basis, and we have read the other information contained in the interim report and considered whether it contains any apparent misstatements or material inconsistencies with the financial information.

This report is made solely to the company in accordance with the terms of our engagement to assist the company in meeting the requirements of the Listing Rules of the Financial Services Authority. Our review has been undertaken so that we might state to the company those matters we are required to state to it in this 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 for our review work, for this report, or for the conclusions we have reached.

Directors' responsibilities

The interim report, including the financial information contained therein, is the responsibility of, and has been approved by, the directors. The directors are responsible for preparing the interim report in accordance with the Listing Rules which require that the accounting policies and presentation applied to the interim figures should be consistent with those applied in preparing the preceding annual accounts except where they are to be changed in the next annual accounts in which case any changes, and the reasons for them, are to be disclosed.

Review work performed

We conducted our review in accordance with guidance contained in Bulletin 1999/4: Review of interim financial information issued by the Auditing Practices Board for use in the United Kingdom. A review consists principally of making enquiries of group management and applying analytical procedures to the financial information and underlying financial data and, based thereon, assessing whether the accounting policies and presentation have been consistently applied unless otherwise disclosed. A review is substantially less in scope than an audit performed in accordance with Auditing Standards and therefore provides a lower level of assurance than an audit. Accordingly we do not express an audit opinion on the financial information.

Review conclusion

On the basis of our review we are not aware of any material modifications that should be made to the financial information as presented for the six months ended 30 June 2004.

KPMG Audit Plc

Chartered Accountants
Manchester

11 August 2004

