Chesnara plc

Financial Statements
for the Year Ended
31 December 2005

Financial Calendar

31 March 2006 .... Results announced for the year ended 31 December 2005

12 April 2006 .... Ex dividend date

13 April 2006 .... Published Financial Statements issued to shareholders

18 April 2006 .... Dividend record date

11 May 2006 .... Annual General Meeting

16 May 2006 .... Dividend payment date

September 2006 .... Interim results announced for the six months ending 30 June 2006

Key Contacts

Registered and Head Office	Harbour House Portway Preston Lancashire PR2 2PR Tel: 01772 840000 Fax: 01772 840010 www.chesnara.co.uk
Legal Advisers	Pinsent Masons Solicitors 1 Park Row Leeds LS1 5AB
Auditor	KPMG Audit Plc St James' Square Manchester M2 6DS
Registrars	Capita The Registry 34 Beckenham Road Beckenham Kent BR3 4TU
Stockbrokers	Numis Securities Cheapside House 138 Cheapside London EC2V 6LH Panmure Gordon Moorgate Hall Moorgate London EC2M 6XB
Bankers	National Westminster Bank plc 135 Bishopsgate London EC2M 3UR The Royal Bank of Scotland 8th Floor, 135 Bishopsgate London EC2M 3UR Lloyds TSB plc 3rd Floor, Black Horse House Medway Wharf Road Tonbridge Kent TN9 1QS
Public Relations Consultants	Cubitt Consulting 30 Coleman Street London EC2R 5AL
Corporate Advisers	Hawkpoint Partners Limited 4 Great St. Helen's London EC3A 6HA

Contents

	Page
Financial Highlights	4
Chairman's Statement	5
Directors Information	7
Operating and Financial Review	8
Corporate Governance	25
Directors' Remuneration Report	31
Directors' Report	38
Statement of Directors' Responsibilities in respect of the Financial Statements	41
Report of the Independent Auditor	42
Consolidated Income Statement	44
Consolidated Balance Sheet	45
Company Balance Sheet	46
Consolidated Statement of Cash Flows	47
Company Statement of Cash Flows	48
Consolidated Statement of Changes in Equity	49
Company Statement of Changes in Equity	50
Notes to the Consolidated Financial Statements	51
Statement of Directors' Responsibilities in relation to the Achieved Profit Basis Supplementary Information	111
Independent Auditor's Report to Chesnara plc on the Achieved Profit Basis Supplementary Information	112
Supplementary Information on an Achieved Profit Basis	113
Notes to the Achieved Profit Result	115
Notice of Annual General Meeting	122

Financial Highlights

	Year ended 31 December	
	2005	2004
IFRS basis		
Operating profit	21.3	2.8
Financing costs	(0.8)	(0.3)
Profit on sale of subsidiary company	–	1.9
Profit before income taxes	**£20.5m**	**£4.4m**
Basic earnings per share	19.26p	6.10p
Dividend per share	12.45p	11.85p
Shareholders' net equity	**£108.3m**	**£79.4m**
Achieved profit basis		
Operating profit/(loss) before tax and exceptional items	12.5	(5.8)
Exceptional items		
Profit on acquisition and sale of subsidiary companies	18.3	1.9
Operating profit/(loss) before tax	30.8	(3.9)
Investment variances and economic assumption changes	5.8	0.9
Achieved profit/(loss) before tax	**£36.6m**	**£(3.0)m**
Value in-force	119.5	84.6
Other net assets	66.2	64.6
Embedded value	**£185.7m**	**£149.2m**
Life annual premium income (AP)	£118.0m	£123.3m
Life single premium income (SP)	£60.1m	£78.9m
Life annualised premium income (AP + 1⁄10 SP)	£124.0m	£131.2m

In contrast with the IFRS basis of reporting, the Achieved Profit (AP) basis recognises the discounted value of the expected future statutory surpluses, arising from the long-term business contracts in force at the year end, as a component of shareholders' equity. Accordingly, the annual AP result recognises within profit the movement in this component.

Under the AP basis of reporting, the exceptional profit arising during the year ended 31 December 2005 relates to the acquisition of CWA Life Holdings plc and represents the excess of the embedded value of that company, at acquisition date, over the total purchase price. The exceptional profit arising during the year ended 31 December 2004 relates to the sale of Key Retirement Solutions Limited, being the excess of the net proceeds received over its carrying value.

I am pleased to present the second annual financial statements of Chesnara plc ("Chesnara"), the company originally formed to hold the demerged life assurance operations of Countrywide plc. The company was listed on the London Stock Exchange on 25 May 2004.

Background

Chesnara's original and primary subsidiary, Countrywide Assured plc ("CA"), manages a portfolio of some 175,000 life assurance and personal pension policies whilst its recent acquisition, City of Westminster Assurance Company Limited ("CWA"), a subsidiary of CWA Life Holdings plc ("CWALH"), manages a further 81,000 policies. The primary focus of the Group is to manage the realisation of surplus from the run off of these businesses to provide the basis for a reliable and progressive dividend flow to shareholders. Whilst CA continues to sell and market Guaranteed Income and Growth Bonds, CWA is closed to new business other than by way of top-ups to existing contracts. As substantially closed books, it is expected that the embedded value of these businesses will decline over the longer term as the number of policies in force reduces and as the surplus emerging in the businesses is distributed by way of dividends. As the portfolio runs off, the regulatory capital supporting them may also be reduced and returned to shareholders.

Business Review

Since its listing Chesnara has pursued a policy of delivering enhanced value to shareholders. I am pleased to report two significant transactions that deliver on that policy during 2005. Firstly, in February, we entered into a contract with Liberata Financial Services Limited, which outsourced CA's back office operations. This arrangement removes some potential future fixed cost issues associated with a reducing book of business and, as it is based on a per policy charge, it will mean a greater alignment of administration expenses with policy generated income. Later, in June, we delivered on our stated strategy of value-enhancing acquisitions, when we acquired CWALH for £47.8m, including £0.3m transaction costs, from Irish Life and Permanent plc. This acquisition offers the prospect of significant financial synergies once the businesses are merged by way of a transfer of CWA's long-term business funds into those of CA under FSMA 2000. This process, which was initiated in the latter half of 2005, is anticipated to complete by mid-2006. We believe that CWA will, as it is a more mature run-off business, provide a reasonably predictable dividend flow and improve the quality and longevity of shareholder returns.

Chesnara has adopted International Financial Reporting Standards ("IFRS") as the basis for presenting the primary statement of earnings, financial position and cash flows. It continues to publish supplementary financial information, based on the Achieved Profit (AP) method of reporting and, with effect from interim 2006 reporting, intends to report on the European Embedded Value basis in lieu of the AP basis. We have set out information relating to the impact of the transition to IFRS on the results and financial position of the Group in Note 48 to these financial statements (on page 108).

On the IFRS basis, I am pleased to report Chesnara has posted a pre-tax profit of £20.5m for the year ended 31 December 2005 which represents a significant improvement over the previous year's pre-tax profit of £4.4m. This result has been driven by the continuing strong emergence of surplus from both CA and, in particular, CWA where profits have exceeded our initial expectations. The strong emergence of surplus has enabled us to withstand the impact of further amounts set aside for mortgage endowment misselling redress.

In our Interim financial statements we reported the need to increase the provision for mortgage endowment misselling redress by £3.9m (£2.7m net of tax), together with an adverse experience effect of £0.3m. However, since then, and contrary to our expectations, complaint levels have remained constant despite a significant reduction in our mailing activity. We have seen further growth in the number of, and advertising by, complaint handling firms and this has underpinned the numbers of complaints received. The increasing incidence of time-barring and the welcome recovery in the equity markets has mitigated the effect of the higher than expected number of complaints. Taking into account experience to date, and our view of likely future experience, we feel it necessary to adjust the provision such that a further net charge of £3.5m (£2.5m net of tax) is incurred at the year end.

The significant reduction in the level of additional provisioning (some £9m less than 2004) together with the strong earnings generated allows the Board to recommend a final dividend of 7.55p per share (2004: 7.1p). This represents an increase of 6.3% over the final dividend for 2004, while the resulting total dividend for the year of 12.45p (2004: 11.85p) represents a 5.1% increase.

On the alternative Achieved Profit basis of reporting, the achieved profit before tax of £36.6m (2004: loss of £(3.0)m), includes an exceptional profit of £18.3m arising on the acquisition of CWALH, which effectively

represents the excess of the embedded value acquired over the total purchase consideration. Key contributors to the turnround in the underlying result are the year-on-year reduction in the level of additional provisioning for mortgage endowment misselling redress, the positive overall impact of investment returns and the net effect of changes in persistency experience and assumptions. Investment returns have been positive as the strong growth in investment values has outweighed the effects of recognising the impact of reduction in fixed interest yields. During the year lapses within CA were less than allowed for by our temporary assumptions which results in a positive contribution to profit. However, the rate of lapse has not fully converged with our longer-term assumptions and, although it has proved necessary to strengthen these, the persistency result is positive overall.

The Group embedded value has, before making provision for the proposed final dividend of £7.9m, increased from £149.2m at 31 December 2004 to £185.7m at 31 December 2005. This net increase is largely due to the equity of £22m raised in connection with the acquisition of CWALH in June 2005 and recognition of the net earnings in the period of £26.3m reduced by dividends paid of £11.2m. The recognition of net earnings includes the net of tax exceptional credit of £13.1m, being the discount of the purchase price of CWALH to its embedded value.

Both CA's and CWA's regulatory capital positions (the ratio of available capital resource to total capital resource requirements) remain, after their proposed final dividend distributions, at a premium to the target level of 150% set by the Board. CA's combined post-dividend ratio of 185% is broadly comparable with the 2004 year-end figure of 190% whilst CWA' s post-dividend ratio of 158% also demonstrates a margin over the target level. At the Group level, Chesnara had, after its final dividend distribution, excess regulatory capital, as measured under the EU Insurance Groups Directive, of £21.3m at 31 December 2005 (31 December 2004: £27.6m). This is equivalent to cover at 158% (31 December 2004: 190%) of the Group regulatory capital requirement.

CA has invested significant effort in preparing its Individual Capital Assessment ("ICA"), under which its capital requirements are assessed with guidance from the FSA. Guidance received from the FSA has confirmed that CA's regulatory capital resource requirements do not exceed the Board's target level as set out above. CWA has also prepared an ICA which demonstrates that further capital support is unlikely to be required.

Outlook

As these results evidence, both CA and CWA generate healthy surplus flows from their underlying books of business and, although a degree of uncertainty remains regarding endowment misselling redress and persistency, these effects are likely to reduce as the book matures and as an increasing number of policyholders become time-barred from securing redress for endowment misselling complaints.

With outsourcing mitigating potential future expense issues, rising investment markets providing a positive underpin and the acquisition of CWA providing positive financial synergies, we believe that we are well placed to fulfil our stated objective of delivering a reliable and progressive dividend flow.

To further this objective we will continue to research the market for closed life books and seek out further consolidation opportunities.

The Board wishes to extend its thanks to all employees for their contribution to the notable achievements during the year and also to welcome our colleagues from CWA.

Christopher Sporborg
Chairman

30 March 2006

Christopher H Sporborg CBE

Aged 66, is the Non-executive Chairman of Chesnara plc. He is also Chairman of the Nomination Committee. He was formerly Deputy Chairman of Hambros PLC, Deputy Chairman of Hambros Bank Limited and Chairman of Hambro Insurance Services Group PLC. At Hambros he was responsible for the acquisition of Bairstow Eves PLC in 1985 and the formation of Hambro Countrywide plc, now Balanus Limited, a subsidiary of Countrywide plc, and, in 1988, the creation of the life company then called Hambro Guardian Assurance plc and now part of the Chesnara plc group of companies. He is Chairman of Countrywide plc and a director of Getty Images Inc. and Lindsey Morden Group Inc.

Graham Kettleborough

Aged 49, is the Chief Executive of Chesnara plc. He joined Countrywide Assured plc in July 2000 with responsibility for marketing and business development and was appointed as Managing Director and to the Board in July 2002. Prior to joining Countrywide Assured plc, he was Head of Servicing and a Director of the Pension Trustee Company at Scottish Provident. He has lifetime experience of the Life Assurance industry, primarily in customer service, marketing, product and business development, gained with Scottish Provident, Prolific Life, City of Westminster Assurance and Target Life.

Ken Romney

Aged 55, is the Finance Director and Company Secretary of Chesnara plc. He joined Countrywide Assured plc in 1989 and became a member of the Board in 1997. He has worked in the Life Assurance industry for the last 22 years. He was Chief Accountant at Laurentian Life (formerly Imperial Trident) up to 1987 and was Financial Controller at Sentinel Life between 1987 and 1989. He worked for Price Waterhouse in their audit division until 1983 in both the UK and South Africa. He is a Fellow of the Institute of Chartered Accountants in England and Wales.

Frank Hughes

Aged 48, is the Business Services Director of Chesnara plc. He joined Countrywide Assured plc in November 1992 as an IT Project Manager and was appointed to the Board as IT Director in May 2002. He has 21 years' experience in the Life Assurance industry, primarily in IT, gained with Royal Life, Norwich Union and CMG.

Peter Mason

Aged 55, is the Senior Independent Non-executive Director of Chesnara plc and is Chairman of the Audit Committee. He also serves on the Remuneration and Nomination Committees. He joined the Board of Countrywide Assured Group plc as Non-executive Director in May 1992 and is currently a Non-executive Director of Countrywide plc, Homeowners Friendly Society, City of Westminster Assurance Company Limited and Countrywide Assured plc. He is the Investment Director and Actuary of Neville James Group, an investment management company. He was admitted as a Fellow of the Institute of Actuaries in 1979.

Mike Gordon

Aged 58, is an Independent Non-executive Director of Chesnara plc and is Chairman of the Remuneration Committee. He also serves on the Audit Committee and the Nomination Committee. He spent 12 years as Group Sales Director of Skandia Life Assurance Holdings. He is the Senior Independent Non-executive Director of Countrywide plc and Chairman of Bankhall Investment Management Limited, a Skandia-owned subsidiary.

Terry Marris

Aged 56, is an Independent Non-executive Director of Chesnara plc and serves on the Audit Committee, the Remuneration Committee and the Nomination Committee. He joined Countrywide Assured Group plc in 1992 and was Managing Director of Countrywide Assured plc until July 2002 and is currently Chairman of Countrywide plc's Conveyancing Division. He was formerly a Director of Countrywide Assured Group plc. Previous roles included senior management positions at Lloyds Bank and General Accident.

Operating and Financial Review

The Business, its Objectives and Strategy

Background

Chesnara plc ("Chesnara"), 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 plc ("Countrywide"). It was considered that as the activities of the life business were fundamentally different in nature from the rest of the members of the Countrywide group, a separate listing would be appropriate for the life business. The listing enabled shareholders to better assess the risk and rewards associated with the life business and its cash flows and allows management to create additional value for shareholders through greater focus as an independent business.

Chesnara's principal subsidiary at the time of the demerger – Countrywide Assured plc ("CA") – had been established in 1988 as the life assurance division of Countrywide, selling mortgage-related life assurance products through Countrywide's financial services division. Following its substantial closure to new business in August 2003, CA continues to administer an existing portfolio of some 175,000 policies, including those acquired as a result of the purchase of Premium Life in 1995. This portfolio, which primarily consists of endowment and protection policies, reflects CA's history of providing mortgage-related policies to an estate agency-based financial services sales force.

A significant proportion of CA's life and pensions business is unit-linked and although there is a small amount of with profits business (less than 3% by policy count) this is wholly reinsured to Guardian Assurance plc ("Guardian"). Guardian is now a subsidiary of Aegon N.V., one of the world's largest insurance groups. The investment management of the related unit-linked funds is predominantly outsourced to Schroder Investment Management Limited.

Since the demerger, Chesnara has pursued a policy of delivering enhanced value to shareholders through focusing its activities on the efficient run off of its life businesses which are substantially closed to new business. Significant steps which have been taken to achieve this include: (1) the sale of Key Retirement Solutions Limited, an Independent Financial Adviser, which was a wholly-owned subsidiary of Chesnara and which was engaged in the marketing of property-related equity release products and the sale of associated financial services; and (2) the completion by CA of an Insurance Administration Services Agreement with Liberata Financial Services Limited ("Liberata"). This agreement, which is described below, allows us more properly to align the cost base of the CA life business with the size of its policy portfolio as it runs off. In turn this supports and makes more certain the emergence of surplus within the long-term insurance funds which can be transferred for onward distribution to shareholders by way of dividend.

Having established its operating model, Chesnara has been able to focus on managing its life business in run off and on the pursuit of its strategy of acquiring other life businesses. We believe that this strategy affords opportunities for further operational and administrative efficiencies, together with other financial benefits. These include, significantly, the potential for the effective merging of life and pensions funds, under Part VII of the Financial Services and Markets Act 2000 ("FSMA 2000"), which we believe, besides reducing the reporting and regulatory burden, raises the prospect of financial synergies, including the more efficient use of regulatory capital.

The Board believes that the acquisition of suitable propositions will enhance both the longevity and certainty of the dividend stream to shareholders and the prospect of a return of capital, provided there is no clearly superior investment alternative.

On 2 June 2005, Chesnara completed the acquisition of CWA Life Holdings plc ("CWALH"), formerly Irish Life (UK) Holdings plc, from Irish Life and Permanent plc for a total purchase consideration of £47.8m of which some £0.3m related to costs associated with the transaction. CWALH's life business subsidiary is City of Westminster Assurance Company Limited ("CWA"). This was Chesnara's first acquisition since its listing in May 2004 and delivers on its stated strategy of the consolidation of value enhancing closed life businesses. The funding for the purchase, which was settled in cash, was made by the raising of further equity of £22m from shareholders by way of a placing and an open offer, and by the provision of a bank loan of £21m, with the balance being sourced from internal retained funds.

The Board believes the bank loan, which is repayable in five equal annual amounts on the anniversary of the draw down date, introduces an element of gearing to the balance sheet which is proportionate to both the size of the acquisition and to the existing capital base of the company.

CWALH is a suitable and attractive acquisition for shareholders, policyholders and management. Being approximately 40% of the size of the existing Chesnara operations in terms of embedded value it represents

both a sizeable and a manageable acquisition. It has a strong capital position, no significant regulatory issues and has no with profits exposure. CWA has outsourced its investment management services to Irish Life Investment Managers Limited under an agreement which continues until 2008 and has outsourced the majority of its back office functions to Computer Services Corporation under an Insurance and Pension Services Agreement which expires in 2009. It currently administers a portfolio of some 81,000 policies. In common with CA these include a mix of endowment, protection and pension policies. However, unlike CA, there is a relatively high proportion of pension policies and this helps to improve the overall mix of Chesnara's business by spreading the risk subsisting within the different policy types. As its business has been in run off since 1995 and has outsourced its administration since 1999, its future surplus flows can be predicted with a reasonable degree of certainty. This, together with the planned transfer of the CWA business into CA, which will enable financial synergies to be realised, will, the Board believes, enhance the short, medium and long-term cash flow of the enlarged group. The contribution from CWALH, will, in future, provide the capacity to support the repayment of the bank loan and to enhance reported earnings and dividend flow to shareholders. We have initiated the process of transferring the life and pension funds of CWA to CA under Part VII of FSMA 2000, as referred to above: it is anticipated that this transfer will be effective from 30 June 2006.

CA continues to market and sell Guaranteed Income and Guaranteed Growth Bonds through Independent Financial Advisers and directly to investors, resulting in £48.6m of single premium income in 2005 (2004: £73.5m). CA also sells a small amount of protection business to existing customers while both CA and CWA benefit from additional inward flows on their existing life and pension contracts by way of inflation-linked increases and rebates received from the government in respect of contracted-out policies.

Objectives of the Business

Chesnara's priority is to maximise shareholder returns through the efficient and compliant management of the existing business. It will seek to add value through the sale of Guaranteed Income and Growth Bonds and may also choose to sell other low risk products in order to enhance future cash flows. In addition, Chesnara believes that there are opportunities for consolidation in the small to medium sector of closed books and run-off situations in the Life Assurance industry. It will, therefore, continue to investigate these where there is potential to enhance shareholder value.

As CA and CWA have both successfully concluded the outsourcing of the majority of their back office functions to third party service providers, a significant element of their expense base is now directly linked to the reducing policy base. This reduces the fixed and semi-fixed cost issues that would have had a potentially damaging effect on shareholder returns. Both CA and CWA focus on customer retention and this is captured in the service and performance levels agreed with the service providers and therefore, barring external factors, a reasonably predictable level of income can be expected to flow from the policy base.

CA and CWA management retain regulatory responsibility for the business and will build on these requirements to ensure that key risks are identified and managed to maximise the flow of emerging surplus. As both are regulated, as described below, management will operate with a level of prudence but will seek to ensure that shareholders receive distributions consistent with the constraints on the business. In the absence of any value-enhancing consolidation opportunities or other developments that require capital then there is, in the medium term, the possibility of the release of surplus capital to shareholders.

The following is a summary of the key strengths and resources which underpin the Group's ability to meet its objectives:

Financial strength – Chesnara has a strong balance sheet and is well capitalised. CA and CWA together maintain capital resource cover well in excess of regulatory capital requirements.

Knowledge and experience – Chesnara has a strong Board and management team with an average of over 16 years' experience in managing life assurance business. The senior management team also has experience in the integration and management of closed books within a highly regulated environment.

Regulatory record – Chesnara has a strong focus on compliance and risk management and it maintains a close relationship with the Financial Services Authority ("FSA"), CA's and CWA's primary regulator. During 2005 the FSA performed an "Arrow" assessment on CA and provided Individual Capital Guidance to it, based on the Individual Capital Assessment, which CA had prepared in accordance with regulatory requirements. As a result, CA is implementing changes which will serve to enhance its risk identification and risk management environment, while it has confirmed that its regulatory capital resources requirements will continue to be established under the current "Pillar 1" regime. CWA currently has no issues outstanding as a result of any FSA assessment or review.

Future development costs – As a consequence of outsourcing the majority of its back office functions to a third party service provider, future development costs for CA are likely to be lower than if it was a stand-alone entity as they will be incurred on a shared platform, subject to a systems migration, which is due for completion in 2007. Until such time as the migration completes CA is entitled, under its contract with Liberata, to an agreed level of development resource without charge. The platform sharing will also offer the benefit of consultation with other users in the definition of development requirements. Such developments are expected to be funded out of emerging surplus and these, to a degree, are allowed for in calculating the value of the business. Some development costs may, under the terms of the policies, be passed to policyholders and this will limit the effect on shareholder returns. CWA's future development is limited to regulatory-driven changes as its systems are operationally mature. There will be some savings in the specification of changes due to the removal of duplication of effort across the two Life companies.

Structure of the Business

Chesnara Group activities are based on two sites: Chesnara Head Office and CA functions operate from a single base in Preston, Lancashire, while CWA is currently a stand-alone entity operating from a single base in Luton, Bedfordshire.

Throughout 2004 CA maintained a workforce of some 200 engaged in the maintenance and servicing of CA customer contracts and associated support functions. Prior to the sale of KRS in June 2004, the Group employed a further workforce of some 41 in Preston and a home-based sales force of around 35 in that operation. Following the demerger, CA re-established its plan to outsource its back office functions in order to reduce the significant cost inefficiencies that would arise with fixed and semi-fixed costs on a diminishing policy base. This resulted in the completion of an Insurance Administration Services Agreement with Liberata, which took effect from 1 February 2005. As a result of this, some 184 people transferred to Liberata on that date under a TUPE arrangement.

The agreement with Liberata, which runs for 10 years, provides CA with a defined level of cost per policy, during the term, and mitigates a number of risks including:

- the impact of increasing per policy costs which would affect both policy competitiveness and returns to shareholders
- the failure to retain resource with key skills, knowledge and experience against a backdrop of reducing policy numbers and consequent headcount reductions
- the inevitable disparity between maintaining key resource levels and funding necessary systems developments to meet ongoing business requirements (e.g. of a legal and regulatory nature) and the reducing income with which to support them

The Chesnara Head Office and CA functions share resources and now have just 15 employees who concentrate on the identification of development and consolidation opportunities with a view to maximising the total return to shareholders, management of the Liberata contract and on corporate governance and the fulfilment of regulatory responsibilities.

The CWA operation, which has 9 employees is based in premises on the same site as Computer Services Corporation (CSC), its third party services provider. CSC provides services similar to these provided by Liberata as described above, with similar advantages, under an agreement which is due to expire in 2009, except that, unlike CA, CWA has retained direct responsibility for its Actuarial and Accounting functions.

Chesnara is now a small professional knowledge-based team which is resourced to deliver known requirements. As such it will, from time to time, require external resource to facilitate new and/or unexpected developments. In the main, it aims to build on its existing relationships but will closely monitor the availability, quality and cost of suitable alternatives.

Legal and Regulatory

CA and CWA are regulated by the Financial Services Authority ("FSA"). As a result they are subject to both the general operation of the FSMA 2000 and the regulatory processes of the FSA. Whilst the weight of Conduct of Business rules has reduced slightly following substantial closure to new business they are still subject to the full weight of prudential regulation. This falls largely on the areas of solvency, capital adequacy and policyholder protection and is the subject of progressive development to bring it in line with the development of EU Directives and will, therefore, continue to bring challenges to Chesnara Group companies.

Of particular note are the following:

- the change to the Appointed Actuary regime where, as from 31 December 2004, the Boards of CA and CWA are required, *inter alia*, to take direct responsibility for the proper provision for long-term insurance liabilities and for the adequacy of capital resources in relation to capital requirements.
- the introduction of the Individual Capital Assessment ("ICA") regime, in accordance with Policy Statement 04/16 Integrated Prudential Sourcebook issued in July 2004, which provides management and the FSA a means of assessing the financial strength of life companies.

Both CA and CWA completed an ICA during 2005 and, in the instance of CA, this was subject to guidance by the FSA. Both assessments indicate that each Company's regulatory capital requirements are determined by the "Pillar 1" calculation, as set out on page 83 of these financial statements. In 2006, following the transfer of the long-term insurance funds of CWA to CA under Part VII of FSMA 2000, an ICA will be produced on a combined basis.

As part of the regulatory process both CA and CWA continue to be subject to a regime of periodic and themed reviews by the FSA and of the development and maintenance of an ongoing risk mitigation programme.

Both subsidiaries are in a good state of preparedness for the implementation of pensions simplification and have established projects to progress the FSA's Treating Customers Fairly initiative.

In addition, in accordance with EU requirements, work has been completed on the introduction of International Financial Reporting Standards (IFRS) and we reported on this basis for the first time for our results for the six months ended 30 June 2005. These financial statements are the first annual financial statements, which report the results, financial position and cash flows of the Group under IFRS and further details may be found on page 108 of these financial statements.

Key Dependencies

The Chesnara Group continues to rely on a number of key relationships for the successful and efficient conduct of its business:

Reinsurance – CA and CWA have transferred part of their exposure to certain risks to other insurance companies through reinsurance arrangements. Under such arrangements, other insurers have assumed a portion of the losses and expenses associated with reported and unreported losses in exchange for a portion of the policy premiums.

Outsourcing – CA and CWA have transferred most of their operational functions to third party service providers under agreements described above. Both CA and CWA maintain a close relationship with the providers to monitor their financial and operational performance, to ensure that their performance is in accordance with agreed service standards.

Systems – While under the direct management of CA, the business maintained adequate operational systems and maintained, and regularly tested, a business continuity plan. With the transfer of operations to Liberata the systems and the continuity plan have been transferred to them. As part of the agreement Chesnara will support Liberata's intention to migrate CA's mainframe systems to their modern and flexible Amarta system: this migration is scheduled for completion in 2007. The related agreement also provides for Liberata to manage the systems, including provision for business continuity, required by the Preston-based governance team. CWA's life policy administration and accounting systems are managed by CSC, who are also responsible for the formulation and testing of a business continuity plan.

Investment management – CA and CWA have both outsourced the management of their own and policyholder investments to third party investment managers. Ongoing monitoring of their performance is maintained and is formally reviewed each month by internal management and every quarter with the Investment Managers. During 2005 CA decided that its investment management arrangements should be predominantly with a single provider, Schroder Investment Management Limited, and to that end discontinued its arrangements with Hendersons Global Investors Limited. In the instance of CWA investment management services are provided by Irish Life Investment Managers Limited under an agreement which continues until 2008.

Actuarial function – The Appointed Actuary regime ended on 31 December 2004 and in its place CA and CWA were both required to appoint a Head of Actuarial Function. CA was also required to appoint a With-Profits Actuary. In order to maintain continuity, CA appointed their former Appointed Actuary, Peter Wright of Tillinghast-Towers Perrin, to these roles, while in order to maintain consistency he was also appointed Head

of Actuarial Function to CWA following its acquisition by the Chesnara Group. Hitherto the role had been performed internally within CWA.

Operating Review

Basis of Accounting

The Group reports primarily in accordance with International Financial Reporting Standards ("IFRS") which it has adopted for the first time and this is considered more fully in the Financial Review below and in Note 48 (on page 108) to the financial statements. As IFRS essentially permits the "grandfathering" of the principles and bases used to measure profit arising on long-term insurance contracts under previously-adopted UK GAAP and, as the business of the Group predominantly relates to Life contracts in run off, so the earnings profile of the Group will continue to be dominated by the underlying emergence of surplus in these businesses as measured for UK regulatory reporting purposes. We have concluded that the impact of the restatement of previously reported earnings to IFRS, taking the restatements under IFRS as a whole, is not significant.

The Group continues to provide supplementary information on the Achieved Profit ("AP") basis. In contrast to IFRS, the AP basis of reporting is value based and recognises profits as they are earned over the lives of the underlying insurance and investment contracts. As also considered in the Financial Review below it is the Group's intention to report in accordance with European Embedded Value principles with effect from interim 2006 reporting, in substitution for reporting under the AP basis.

IFRS Result

(a) Analysis of results

The following both summarises earnings information reflected in the IFRS Income Statement, showing, for the year ended 31 December 2005, the contribution from the constituent members of the Group and provides other headline statistics. The principal Life subsidiaries are Countrywide Assured plc ("CA") and City of Westminster Assurance Company Limited ("CWA").

	Year ended 31 December 2005					Year ended 31 December 2004
	CA £000	CWA £000	Parent company £000	Amortisation of AVIF £000	Total £000	Total £000
Operating profit	8,591	14,607	105	(2,042)	21,261	2,785
Finance costs	–	–	(805)	–	(805)	(336)
Profit on sale of a subsidiary company	–	–	–	–	–	1,948
Profit before income taxes	8,591	14,607	(700)	(2,042)	20,456	4,397
Life annual premium income (AP)					£118.0m	£123.3m
Life single premium income (SP)					£60.1m	£78.9m
Life annualised premium income (AP +1⁄10 SP)					£124.0m	£131.2m
Policies in force at period end					256,000	208,000
Headcount (average FTE)					44	222

Notes

(1) The CWA result reflects the post-acquisition profit arising from 2 June 2005, the acquisition date.

(2) Financing costs during the year ended 31 December 2005 arise in respect of a bank loan of £21m raised to part finance the acquisition of CWA.

(3) Amortisation of Acquired Value In-Force (AVIF) represents a post acquisition charge to profits of the write down of the acquired value of CWA in-force business, as measured at the acquisition date. The pattern of amortisation, which is in respect of a seven-month post acquisition period, is broadly intended to match the pattern of surplus arising from the run off of the underlying CWA insurance and investment contract portfolios.

(b) Commentary on overall result

Overall the IFRS result for the year ended 31 December 2005 reflects the continuing strong emergence of surplus in CA and CWA as the underlying insurance and investment contracts run off. The results for both

2005 and 2004 have been materially adversely affected by increases in provisions for redress and administration costs in connection with mortgage endowment misselling claims. While these provisions, which are more fully discussed below, were increased by £16.6m in 2004, they have been increased by a further £10.4m in 2005 (£7.3m net of tax), of which £3.9m (£2.7m net of tax) had been reflected at the 2005 interim reporting position.

While the provisions have been increased for the reasons set out in (c) below, it is worthy of note that this action reflects the Board's view of exposure to claims arising after 31 December 2005. The actual redress experience in 2005, including CWA in the post-acquisition period, was some £3m (pre-tax) favourable to the provisions actually held for 2005 settlements. Therefore, the overall net charge to pre-tax profits in 2005 due to mortgage endowment misselling redress effects was £7.7m (£5.4 net of tax).

The reduction in the level of increase in these provisions is one of the main factors in the underlying significant improvement in reported 2005 earnings compared with 2004. Other significant factors include:

(1) A reduced charge of £4.0m in 2005 (2004: £11.0m) in respect of the amortisation of deferred acquisition costs arising on the CA insurance portfolio.

(2) The marginal contribution from CWA is reflected in the results for the first time. The net pre-tax contribution from CWA, after financing costs and amortisation of AVIF, as set out above is £11.8m and this, in turn reflects the purchase of CWA at a discount of some 22% to its underlying embedded value as measured at the acquisition date, together with evidence of some inherent conservatism in the assumptions adopted to measure that embedded value. The Achieved Profit Supplementary Information included in pages 113 to 121 reflects an exceptional profit arising on the acquisition of CWA: these exceptional profits are essentially recognised, under IFRS reporting, over the lives of the underlying contracts.

The CWA results have benefited in particular from favourable investment market performance and from a change in statutory assumptions, resulting, in part, from favourable mortality experience: these conditions may not replicate in the future.

(c) Mortgage endowment misselling redress provisions

CA and CWA are required to write to endowment policyholders at least every two years to appraise them of the expected maturity value of their policies. These mailings are governed by the rules and guidance issued by the FSA and ABI in May 2004, which include 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 the policyholder does not complain by the 'cut-off' date then the company has the right to refuse to consider the complaint. After a short delay, in which the relevant systems changes were made, CA began mailing the new style letters in September 2004. Early indications were that the new letters were having little effect on customer complaint rates and therefore no adjustment to the mortgage endowment complaints redress provision was considered necessary at the time that we issued the 2004 Report and Accounts on 21 March 2005, based on experience to that date. However, since then the industry has witnessed increased media coverage and ever-present advertising driven by the proliferation of endowment complaint handling firms. Whilst the value of the service provided by these largely unregulated firms can be debated, it is clear that their activities have given rise to greater than expected levels of complaints.

In our Interim reporting we indicated that an increase of £3.9m (£2.7m net of tax) in the provision was necessary. This, together with adverse experience of £0.3m in the first six months of 2005, led to a total charge to profit of £4.2m at that time. It was expected that, as CA mailing activity would substantially reduce in the latter part of 2005, the number of complaints would reduce concomitantly. In the event this has not been the case and the activities of an expanding number of complaint handling firms has underpinned the numbers of complaints received with an increasing percentage of complaints being received via these firms. We have therefore revised our expectations for both the current period of low mailing levels and for the latter part of 2006 and beyond when increased mailing levels recommence.

As a result the Board now consider that it is necessary to adjust the provision such that a further net charge of £3.5m (£2.5m net of tax) is incurred at the year end. This takes into account the level of complaints received, the positive contribution from the increase in the equity markets during the year, the increasing number of cases that are expected to become time-barred under the existing rules and revised expectations of the number of complaints received in the future. The provision is calculated on a best estimate basis taking into account recent experience. This will however be alleviated as more of the population becomes time-barred. As a result CWA's exposure is significantly reduced from the middle of 2006, whilst CA's exposure

significantly reduces in mid-2007. Therefore the expectation is that the majority of cases which will be the subject of complaint and settled in the future will be settled in the next 18 months.

Whereas CA has a rolling programme of mailing, CWA adopted a bulk mailing procedure where mailings are spread over a few months every two years. CWA last mailed their endowment policyholder base in the first half of 2005 and, to date, it appears that the provision, which was strengthened to reflect our view of the fair value of assets and liabilities on acquisition, is proving to be substantially adequate. It is significant that the number of endowment policies in-force in CWA is proportionately much lower than that in CA and that, due to the nature of the mailing profile, the population becomes time-barred, where appropriate, comparatively earlier.

(d) Management of insurance and investment contract portfolios expense base

The expenses incurred in 2005 in connection with the administration and performance of corporate governance functions for the insurance and investment contracts were broadly in line with expectations for both Life businesses. This is underpinned, significantly, by the existence of the third-party administration contracts for both operations.

As reported in the 2004 Financial Statements we successfully completed an agreement with Liberata to outsource CA's back office functions with effect from February 2005. The agreement, which runs for 10 years, provides CA with a defined level of cost per policy during the term and mitigates the risks and significant cost inefficiencies that arise from a diminishing policy base. The operational handover has gone well and the transition project, which will migrate the business to Liberata's systems, is progressing under the joint control of CA and Liberata.

CWA's back office is also outsourced on a defined per policy cost, albeit to a different supplier – Computer Sciences Corporation. This agreement is currently due to expire in January 2009.

Following a decision delivered in the European Court of Justice (ECJ) in early 2005 in the case of Staatssecretaris von Financien v Arthur Andersen and Co, Accountants, there was uncertainty whether charges made under the various outsourcing arrangements, which subsist within the Group, would continue to be exempt from VAT. This has significance for the Group's Life businesses as their supplies are almost wholly VAT exempt, which means that any VAT levied on supplies of services to the Life businesses represents a permanent additional cost burden. In July 2005 HM Revenue and Customs issued a Consultation Document entitled "Changes to the VAT Exemption for Insurance-related Services" and, notwithstanding the strong industry lobbying against the proposed changes, the Directors were of the opinion, at the time of reporting our interim 2005 results, that it is was prudent to make allowance for future additional VAT costs in valuing insurance contract liabilities.

Subsequently it was announced by the UK Government that, in view of the fact that the VAT treatment of financial services and insurance would be subject to review by the European Commission in the near future, it had decided to delay implementation of the ECJ judgement. This development has increased the uncertainty surrounding the eventual outcome and therefore the basis on which the Group had made allowance at the interim 2005 position for future additional VAT costs. Taking all of these circumstances into account the Directors believe that it is appropriate to continue to maintain such provisions on the basis on which they had already been established, as set out below.

The terms of CA's agreement with Liberata referred to above are such that the effect of any additional cost burden arising from the proposed VAT change will be shared, while under the terms of policyholder contracts CA is able to recover additional costs from policyholders in the majority of cases. CWA is likely to be able to recover some of the additional costs arising from these changes under its policy terms. The impact of the changes is that CA's reported IFRS earnings for the year ended 31 December 2005 are reduced by £1.3m (£1.0m net of tax) while the value of policies in force included within the overall embedded value reduces by £0.2m (pre and post tax). CA had already anticipated these costs for Prudential Reporting to the FSA at 31 December 2004, but had reversed the related provision for UK GAAP reporting at that time. CWA had, during the six months ended 30 June 2005, for both FSA Prudential Reporting and reported IFRS earnings, established a liability of £0.8m (£0.6m net of tax), together with a concomitant reduction in the value of policies in force within its embedded value of £2.5m (£1.7m net of tax) by way of changes to the underlying expense assumptions. These changes were, however, fully anticipated in connection with the acquisition of CWA and were recognised in establishing the fair value of assets and liabilities in the acquisition balance sheet as at 2 June 2005.

Achieved Profit Result

Supplementary information on the Achieved Profit basis as produced in the financial statement on pages 113 to 121 is presented to provide alternative information to that presented under IFRS. The Achieved Profit method recognises profits as they are earned over the life of insurance and investment contracts and assists in identifying the value being generated by the Life businesses. The result determined under this method represents the movement in the life businesses' embedded value. As the Group's life assurance operations are now substantially closed to new business, the principal underlying components of the Achieved Profit result are the expected return from the business in force (being the yield at the risk discount rate on the related policy cash flows as they fall into surplus) together with (1) variances of actual experience from that assumed for each component of the policy in force cash flows and (2) the impact of resetting assumptions for each component of the prospective cash flows.

The following is a summarised statement of our AP pre-tax result:

	Year ended 31 December 2005				Year ended 31 December 2004
	CA £000	CWA £000	Parent company £000	Total £000	Total £000
Operating profit/(loss) before tax and exceptional items	3,956	8,582	–	12,538	(5,882)
Exceptional items					
Profit on sale and acquisition of subsidiary companies	–	18,262	–	18,262	1,948
Operating profit/(loss) before tax	3,956	26,844	–	30,800	(3,934)
Investment return variances	6,436	3,031	(758)	8,709	1,774
Economic assumption changes					
Investment return	(5,352)	(335)	–	(5,687)	(2,146)
Risk discount rate	2,489	263	–	2,752	1,320
Achieved profit/(loss) before tax	**7,529**	**29,803**	**(758)**	**36,574**	**(2,986)**

The significant £39.6m variance in the achieved result over 2004 indicates a strong base for ongoing debt and equity servicing through continuing emergence of surplus from the in-force portfolios.

The following sets out the more significant influences underlying this result:

(a) Operating profit before tax and exceptional items

The principal factors underlying the significant improvement in the operating result before tax and exceptional items, comparing 2005 with 2004, are:

(1) Lower year on year charges for provisions for mortgage endowment complaints redress, being £10.4m pre tax (£7.3m net of tax) in 2005 and £16.6m pre tax (£11.6m net of tax) in 2004. Furthermore, the 2005 result benefited from some £3m pre-tax in respect of redress experience settlements in 2005 being favourable to the provisions held. These effects are more fully described in "IFRS Result" above.

(2) Maintenance of the expected overall return on the existing business portfolio, (representing the unwind of the risk discount rate on the discounted cash flows within the embedded value calculation) at some £10.5m in both years. This was effected by the acquisition of the CWA portfolio, which from a Group perspective compensates for the diminishing CA in-force book.

(3) A relatively strong post acquisition new business contribution from CWA at £1.3m pre tax (£0.9 net of tax), arising largely from enhancements to existing contracts.

(4) Net favourable operational experience variances, other than those arising from complaints redress provisions, being £3.0m pre tax (£2.6m net of tax) higher than experienced in 2004. This improvement has arisen largely as a result of favourable persistency experience in 2005 against amounts specifically set aside for 2005, including particularly the impact of temporary lapse provisions.

(5) Lower net reductions in achieved profit year on year arising from operating assumption changes, being a £1.0m pre-tax (£0.8m net of tax) reduction in 2005 compared with a £6.2m pre-tax reduction (£4.3m net

of tax) in 2004. The principal factors underlying this decrease are significantly lower charges in respect of revised persistency assumptions relating to the CA portfolio, being a £3.8m pre-tax (£3.2 net of tax) reduction in 2005 compared with a £9.1m pre tax (£7.7m net of tax) reduction in 2004. Whereas, taking 2005 as a whole, on CA protection business there has been general convergence of actual experience with the longer-term persistency assumptions, such convergence has not emerged at a sufficient rate with respect to endowment business: this has arisen partly as a result of higher than expected numbers of endowment misselling complaints and the subsequent encashment of related policies. In the event we have considered it necessary to strengthen the underlying longer-term assumptions for endowment business persistency.

Group-wide unfavourable persistency assumption change effects of £4.1m pre-tax in 2005 have been offset by favourable persistency experience variances of £6.2m pre-tax, so that overall, there has been a net credit of £2.1m to pre-tax achieved profit for 2005, on account of persistency effects.

(b) Exceptional item: profits arising on acquisition of CWALH

In addition to the foregoing the achieved operating profit before tax for 2005 has been significantly impacted by an exceptional credit of £18.3m pre-tax (£13.1m net of tax), representing the difference between the total purchase consideration for the acquisition of CWALH and its embedded value at the acquisition date. This effectively reflects the fact that the purchase price for the acquisition of CWALH was broadly at a discount of 22% to its embedded value, and the amount represents the enhancement to shareholder value in Achieved Profit terms as a result of the acquisition. The amount which has been reflected as an exceptional credit has been measured after restating CWALH's embedded value at the acquisition date for:

(i) revised economic assumptions, which, except for the risk discount rate established at 7.7%, were fully aligned with those of CA (whose risk discount rate was reduced from 9% to 8% during 2005) at the acquisition date;

(ii) amended expense assumptions to reflect anticipated higher outsourcer costs, due to an increased VAT burden, as described above;

(iii) an increase in the mortgage endowment misselling redress provision, as described above.

The CWA risk discount rate of 7.7% at the acquisition date was lower than that of CA, reflecting lower perceived risk in its policy portfolio, arising in part from its greater maturity as a business in run off.

There are a number of potential synergies which may arise from the acquisition of CWALH and from the proposed transfer of CWA long-term business funds to CA, which have not been reflected in the overall Group embedded value assumptions.

(c) Investment return variances and economic assumption changes

The Achieved Profit for the year is struck after adjusting operating profit after exceptional items for both variances in the expected return on the investment portfolio and economic assumption changes. Both of these items have been significantly impacted during the year by investment market factors. On the one hand the continuing recovery in investment markets through 2005 has boosted favourable variances arising from the investment portfolio from some £1.8m pre-tax in 2004 to some £8.7m across both the CA and the post-acquisition CWA portfolios in 2005: this is reflected through higher current and projected deductions for Capital Gains Tax from insurance and investment contracts and through higher current and projected investment management charges which are related to the absolute size of the investment portfolios backing insurance and investment contracts. On the other hand economic assumptions have been significantly influenced by a reduction in underlying longer-term risk free rates of return, which has now given rise to a lower assumption as to real future rates of investment growth, and, hence, a reduction in the in-force value of insurance and investment contracts. It has also given rise to a concomitant reduction in the risk discount rates used to discount the future cash flows arising on the insurance and investment contracts to measure the value in force, which has accordingly increased. In the instance of CA this reduction has been, as stated above, from 9% to 8% over 2005, while in the instance of CWA the reduction was predominantly recognised in the pre-acquisition period.

The table on page 15 sets out the year on year impact of changes in investment return and risk discount rate assumptions. A lower projected investment return leads to a reduction in the value of in-force policies as there is a consequential reduction in the projection of the level of investment fee income earned by the Group as this depends on the absolute size of funds under management. Overall there has been a net pre-tax £2.9m

charge to Achieved Profit, and, therefore, reduction in Embedded Value due to these economic assumption changes in 2005 compared with a £0.8m net pre-tax reduction in 2004.

Embedded Value

The movement on embedded value comprises:

	Year ended 31 December	
	2005 £000	**2004 £000**
Embedded value at beginning of period	149,187	152,745
Net achieved profit for the period	26,291	469
Issue of new equity		
Share capital	1,001	–
Share premium	20,458	–
Dividends paid in period	(11,249)	(4,027)
Embedded value at end of period	**185,688**	**149,187**

The balance sheet prepared on an achieved profit basis is summarised as follows:

	31 December	
	2005 £000	**2004 £000**
Value in-force	119,476	84,594
Other net assets	66,212	64,593
	185,688	**149,187**
Represented by:		
Share capital	41,501	40,500
Share premium	20,458	–
Capital redemption reserve	50	50
Retained earnings	123,679	108,637
Embedded value	**185,688**	**149,187**

The embedded value represents the value of the Group's net assets attributable to shareholders, together with an estimate of the net present value of profits attributable to shareholders from the policies in force. The capital structure set out above has been restated from that reported in previous periods to reflect the adoption of the reverse acquisition method of accounting as described more fully in Note 2 (on page 51) to the financial statements prepared on the IFRS basis. This gave rise to an amount previously reported as a demerger reserve of £36,272,000 at 31 December 2004 being included in share capital and involved no net change in stated embedded value at that date.

The amounts presented above in respect of the year ended 31 December 2004 have also been restated from amounts previously reported, for the addback, at that period end of dividends proposed but not yet paid at the period end. These adjustments have been made to align the treatment of dividends proposed but not paid at the balance sheet date, under Achieved Profit reporting, with IFRS and for the purposes of reporting embedded value. Similarly, the final dividend of £7.9m proposed as at 31 December 2005 has not been reflected as a movement on embedded value for the year ended 31 December 2005 or as a reduction in embedded value as at that date.

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

	31 December	
Number of policies	**2005 000**	**2004 000**
CA		
Endowment	67	78
Protection	78	99
Other	30	31
Total	175	208
CWA		
Endowment	18	–
Protection	24	–
Annuities	4	–
Pensions	35	–
Total	81	–*
CA and CWA combined	**256**	**208**

* Not applicable as not part of the Group at this date.

	31 December	
Value in-force	**2005 £m**	**2004 £m**
CA		
Endowment	41.1	49.3
Protection	44.9	45.0
Other	4.1	3.3
Total	90.1	97.6
CWA		
Endowment	13.9	–
Protection	20.7	–
Annuities	2.4	–
Pensions	29.4	–
Total	66.4	–*
CA and CWA combined	**156.5**	**97.6**
Valuation adjustments	0.7	3.0
Cost of capital	(6.3)	(4.4)
Total in-force value (pre-tax)	150.9	96.2
Taxation	(31.4)	(11.6)
Total in-force value (post-tax)	**119.5**	**84.6**

* Not applicable as not part of the Group at this date.

The value in force represents the discounted value of the future surpluses arising from the insurance and investment contracts in force at each respective period end. The future surpluses are calculated by using realistic assumptions for each component of the cash flow.

Policyholder Funds Investment Return

The CA Managed Fund, which represents a significant proportion of CA policyholder funds under management, returned 16.0% over the year ended 31 December 2005. This compares to the average of 17.01% achieved by the ABI Life Balanced Managed Funds sector. The absolute level of growth has had a positive impact on policyholder values, reduced the level of mortgage endowment misselling redress and led to an increase in the value in-force, as future charges, based on fund values, have increased. However, performance

has fallen short of the relevant ABI average and, following a review of its fund management arrangements and associated costs, CA has discontinued its arrangements with Henderson Global Investors Limited and transferred the management of the assets to Schroder Investment Management Limited, its other existing investment fund manager.

The CWA Global Managed Fund, which represents a significant proportion of CWA policyholder funds under management, returned 17.00% over the year ended 31 December 2005 which is in line with the ABI Life Balanced Management Funds sector average. Positive effects arise from the absolute level of growth similar to those recorded above. Management of the CWA funds continues with Irish Life Investment Managers Limited.

Returns to Shareholders

Returns to shareholders are underpinned by the emergence of surplus in and transfer of surplus from the Life businesses' long-term insurance funds to shareholder funds and by the return on shareholder net assets representing shareholder net equity. These realisations are utilised in the first instance for the repayment and servicing of the bank loan on the basis set out in Note 30 to the IFRS Financial Statements (on page 93). The surplus arises from the realisation of value in-force, which effectively unwinds at the risk discount rate used to discount the underlying cash flows: at 31 December 2005 this rate was reset at 8.0% (31 December 2004: 9.0%) for the value in-force subsisting within CA and at 7.7% for the value-in force subsisting within CWA. This implies a composite rate of 7.9% for total value in force. The return on shareholder net assets is determined by the Group's investment policy. Shareholder funds bear central corporate governance costs which cannot be fairly attributed to the long-term insurance funds and which arise largely in connection with the status of Chesnara plc as a listed company.

The dividend target and distribution are set within the context of the Board's policy of maintaining capital resources available at a minimum level of 150% of regulatory capital resource requirements in respect of CA and at an amount of £5m greater than regulatory capital resource requirements in respect of CWA. The capital resources cover in respect of these constituents as at 31 December 2005 is set out in the Financial Review below.

The Board's continuing primary aim is to provide a reliable and progressive dividend flow to shareholders within the context of the emergence of surplus in the life businesses. During 2004 the shares traded at an implied yield of between 11.5% and 12% based on the dividend intention stated at the time of listing in May 2004. The Company's share price strengthened progressively through the second and third quarters of 2005 and has recently stabilised at a range between 155p and 170p per share. This growth appears to have been driven in part by the well publicised consolidation of that part of the life industry which focuses on the run off of closed life and pensions policy portfolios and by a positive reaction to Chesnara's participation in this marketplace through the acquisition of CWA. With total proposed dividends in respect of the year ended 31 December 2005 at 12.45p per share, this implies a yield of between 7.3% and 8% and represents growth of 5.1% over total dividends paid in 2004. The shares may also be characterised as trading at a discount to embedded value, as now reported as at 31 December 2005, and as adjusted for the prospective final dividend of 7.55p per share, of between nil and 9%, based on recent share price performance.

Financial Review

Solvency and Regulatory Capital

Regulatory capital resources and requirements

The regulatory capital of life insurance companies in the UK is calculated by reference to FSA prudential regulations. The rules are designed to ensure that companies have sufficient assets to meet their liabilities in specified adverse circumstances. As such, there is a restriction on the full transfer of surplus from the long-term business funds to shareholders funds of the Life companies and on the full distribution of reserves from the Life companies to Chesnara.

The following summarises the capital resources and requirements of the life businesses for regulatory purposes: The position is shown before and after making provision for dividends which were approved subsequent to the respective period ends.

	Pre dividend 31 December		Post dividend 31 December	
	2005 £m	2004 £m	2005 £m	2004 £m
CA				
Available capital resources (CR)	59.2	64.0	51.2	57.9
Long-term insurance capital requirement (LTICR)	25.7	27.9	25.7	27.9
Resilience capital requirement (RCR)	2.0	2.6	2.0	2.6
Total capital resources requirement (CRR)	27.7	30.5	27.7	30.5
Target capital requirement cover	40.5	44.4	40.5	44.4
Excess of CR over target requirement	18.7	19.6	10.7	13.5
Ratio of available CR to CRR	214%	210%	185%	190%
CWA				
Available capital resources (CR)	25.3	–*	14.5	–*
Long-term insurance capital requirement (LTICR)	8.4	–*	8.4	–*
Resilience capital requirement (RCR)	0.8	–*	0.8	–*
Total capital resources requirement (CRR)	9.2	–*	9.2	–*
Target capital requirement cover	14.2	–*	14.2	–*
Excess of CR over target requirement	11.1	-*	0.3	–*
Ratio of available CR to CRR	275%	–*	158%	–*

* Not applicable as not part of the Group at these dates.

CA's Board, as a matter of policy, will continue to target CR cover for total CRR at a minimum level of 150% of the LTICR plus 100% of the RCR. The CA solvency position has benefited from the reduction of £3m, to £6m, in the Reassurer Default Reserve (held for regulatory solvency purposes only) against the possible default of Guardian Assurance plc ("GA") (see below). This followed a review of publicly available information regarding the financial position of GA.

The CWA target capital requirement cover is expressed as a £5m excess over the regulatory CRR, as a consequence of a long-standing agreement with the FSA. If our internal target cover for CR to total CRR at 150% of the LTICR plus 100% of the RCR had been applied, the excess of capital resources post dividend would have been £1.1m.

It can be seen from this information that Chesnara plc, which relies on dividend distributions from its Life businesses, CA and CWA, is currently in a favourable position to service its loan commitments and to continue to pursue a progressive dividend policy.

Insurance Groups Directive

Chesnara had excess regulatory capital, as measured under the EU Insurance Groups Directive of £29.2m at 31 December 2005 (31 December 2004: £33.7m). Both of these amounts are stated before recognition of final

dividends for each year which had not been approved at each respective year end. They represent the excess of the aggregate value of regulatory capital employed in the Group over the aggregate minimum solvency requirements imposed by local regulators.

The following sets out the calculation of cover of regulatory capital employed over the aggregate minimum requirement, stated pre and post recognition of the final dividend for each year:

	31 December	
	2005 £m	2004 £m
Pre-dividend		
Available group capital resources	66.1	64.2
Group regulatory capital requirement	(36.9)	(30.5)
Excess	29.2	33.7
Cover	179%	210%
Post-dividend		
Available group capital resources	58.2	58.1
Group regulatory capital requirement	(36.9)	(30.5)
Excess	21.3	27.6
Cover	158%	190%

Individual Capital Assessments

In July 2004 the FSA published Policy Statement 04/16 "Integrated Prudential Sourcebook for Insurers", which included final policy statements on capital requirements for life companies. The provisions, which took effect from 31 December 2004, include a framework for life companies to undertake individual self assessments of their capital needs and provide for individual capital guidance by the FSA. This typically involves placing a realistic value on the assets and liabilities of the Life businesses and making explicit allowance in the valuation for the actual business risks.

CA and CWA completed Individual Capital Assessments during 2005 and, in the instance of CA, received guidance from the FSA. As a result of this process the Life businesses have concluded that their effective current and medium-term capital requirements constraints on distributions to Chesnara will continue to be determined on the basis set out under "Capital Resources and Requirements" above.

Following the proposed transfer of CWA long-term insurance funds to CA under Part VII of FSMA 2000, which it is anticipated will be effected at 30 June 2006, it is intended to establish an Individual Capital Assessment for the Life businesses on a combined basis.

Guardian Default Reserve

Following the implementation of the Insurers (Reorganisation and Winding Up) Regulations 2004, CA maintains a reserve of £6m at 31 December 2005 relating to possible default by Guardian, with whom it had aggregate reinsured liabilities at 31 December 2005 of £221.3m (2004: £184.0m). This reserve was reduced from £9m at 31 December 2004, following a review of the financial condition of Guardian.

This reserve is maintained to establish the regulatory capital requirements position and, therefore, serves to restrict the amount which may be transferred from CA's long-term business fund to shareholder funds. It is not, however, recognised for IFRS reporting purposes, as the likelihood of default under the reinsurance arrangements is considered by the Board of CA to be remote. For AP reporting purposes the reserve, which has written down the shareholders' net asset value component of embedded value, is released back in establishing the value of the policies in-force component (see "Embedded Value" section in the Operating Review above). There is, however, a cost to shareholders in maintaining the reserve and this was recognised at less than £1m within the cost of capital adjustments to the Embedded Value at 31 December 2005 (31 December 2004: £1.2m).

FRS 27

FRS 27 Life Assurance was published in December 2004 with a view to full compliance for accounting periods commencing on or after 23 December 2005. The standard has relevance to the Group in respect of disclosure of capital available to its Life Assurance business and in respect of guarantees. The level of long-term liabilities in respect of with-profits business is less than £500m. Accordingly, no disclosure of realistic liabilities for that class of business is required under FRS 27, nor is any available capital resource allocated to it.

Whereas the Accounting Standards Board had, in view of the tight timescales for full implementation of the requirements of the standard, agreed to modifications to the disclosure requirements for 2004, full compliance is required in respect of the year ended 31 December 2005. Accordingly disclosures in accordance with FRS 27 are made in Note 27 to these financial statements (on page 83).

IFRS Reporting

As explained in Note 2 to these financial statements (on page 51), the Group has adopted International Financial Reporting Standards ("IFRS") for the first time, as the basis for presenting the primary statements of earnings, financial position and cash flows. It continues to publish supplementary financial information, based on the Achieved Profit method of reporting. The impact of the introduction of IFRS on previously reported financial information in reporting for the year ended 31 December 2004 or as at 31 December 2004 is summarised as follows:

	Year ended or as at 31 December 2004	
	UK GAAP £000	IFRS £000
Shareholder net equity	73,952	79,442
Profit before taxation	4,551	4,397
Taxation	813	759
Profit after taxation	5,364	5,156
Basic earnings per share	6.34p	6.10p

The main enduring influence of IFRS on reported earnings and on the financial position of the Group arises from the requirement to classify the Group's long-term business into insurance or investment contracts (as defined under IFRS). The primary consequence of this is that insurance contracts continue to be valued using identical methods as under UK GAAP, subject to liability adequacy testing, while acquisition costs and fees received for services provided on investment contracts, previously charged or credited to income up front under UK GAAP, are now deferred over the life of the contract, together with a concomitant release of actuarially based provisions which it is no longer necessary to carry. The net impact of this treatment, compared with UK GAAP, is to reduce shareholder equity while future period reported earnings will be higher than would otherwise be reported under UK GAAP, as the deferred costs and income are released as charges or credits to earnings.

Shareholder net equity has also been impacted by the effect of the addback of the final dividend of £6,124,000 in respect of the year ended 31 December 2004, which is not recognised as a liability at that date under IFRS. This dividend has also been added back for the purposes of reporting embedded value as at 31 December 2004 and the statements of Achieved Profit and Embedded Value in respect of the year ended 31 December 2004 or as at 31 December 2004 respectively, presented in these financial statements, have been restated accordingly.

The impact of these restatements under IFRS are not considered significant in the overall context of the earnings and financial position of the Group. As the main activities of the Group are centred on long-term businesses in run off, the earnings profile of the Group will continue to be dominated by the underlying emergence of surplus from those businesses. While the application of IFRS compared with UK GAAP leads to a relatively minor reallocation of profit recognition between periods, the prospects for the disposition of the surplus emerging by way of transfer to shareholder funds and onward distribution by way of dividend and the capacity to repay and service borrowings are determined principally by the underlying regulatory solvency position of the Life businesses within the Group (see Solvency and Regulatory Capital section above). The adoption of IFRS changes neither the nature nor the measurement of those regulatory constraints, nor does it have a significant influence on the future capacity to return capital to shareholders.

European Embedded Value Principles (EEV)

We note the significant industry-wide development, in accordance with principles introduced by the Chief Financial Officers Forum in May 2004, to account for and present the results and financial position of life businesses on the EEV basis. It is our intention to adopt the EEV basis, in lieu of the Achieved Profit basis, commencing with the interim results for 2006. This will allow the changes to reporting to be made in conjunction with the effects of the expected transfer of CWA's long-term insurance funds to CA, referred to above.

The change to EEV reporting will impact our method of reporting in a number of areas. Among the more significant are:

(i) reformulation of the risk discount rate, where the risk margin will be more transparently and objectively established and

(ii) recognition of the future stream of expenses allocable to shareholder funds.

We do not currently expect these changes, taken together with a number of other lesser adjustments, to have a significant impact on our reported embedded value.

Capital Structure, Treasury Policy and Liquidity

The Group's operations are financed through retained earnings and through the current emergence of surplus. It normally does not make use of financial reinsurance or similar arrangements. There is no trading in any currencies other than sterling. Cash available for more than twelve months is normally transferred to fund managers for longer-term investment.

During the year the Group finalised the acquisition of CWA, which was settled for cash, by raising further equity of £22m from shareholders by way of a placing and open offer and by the provision of a bank loan of £21m, with the balance of £4.5m of the total purchase consideration being sourced from internal retained funds. The Board believes that the bank loan, which is repayable in five equal amounts on the anniversary of the draw down date, introduces an element of gearing to the balance sheet, which is proportionate to both the size of the acquisition and to the existing capital base of the Company.

The Board continues to have a conservative approach to the investment of shareholder funds in the Life businesses, which underpins our strong solvency position. This approach targets the investment of 100% of available funds in cash and fixed interest securities.

The profile and mix of investment asset holdings between fixed interest stocks and cash on deposit is such that realisations to support dividend distributions can be made in an orderly and efficient way.

Other factors which may place a demand on capital resources in the future include the costs of unavoidable large scale systems development such as those which may be involved with Euro conversion and the requirement to finance further possible acquisitions of other closed life books and businesses in run-off. To the extent that ongoing administration of the Company's Life businesses is performed within the terms of its third party administration agreement, the Group is sheltered, to a degree, from these development costs as they are likely to be on a shared basis, as common platforms are developed. In particular, the CA agreement with Liberata caps the potential costs of Euro conversion, whilst CWA's agreement contains an obligation for CSC to provide necessary support at no cost.

To the extent that the Group proposes to acquire closed life businesses in the future, it is intended that this could be done through a suitable combination of equity and debt financing and, to a lesser degree, from internal resources. This would be done, however, within the constraints of not diluting returns to shareholders and of the operation of regulatory rules regarding the level of debt finance which may be borne by Insurance Groups.

Cash flows

The Group's longer-term cash flow cycle is currently characterised by the inflow to shareholders funds of transfers from the long-term insurance funds, which are supported by the emergence of surplus within those funds. These flows are used to support dividend distributions to shareholders.

Going concern

The Group's cash flow position described above supports its ability to trade in the short-term. Projections of surplus arising in the insurance funds indicate that these are at levels which should be able to continue to withstand normal business risks. In addition, CA prepares an annual "Financial Condition Report" ("FCR"), as

recommended by the Institute of Actuaries. This report is based on a review of that company's ability to withstand a number of adverse scenarios. The last report published in 2005 indicated that CA is able to withstand, over the medium to longer term, the impact of these adverse scenarios, including a number of them in combination. During 2006, following the transfer of the long-term insurance funds of CWA to CA under Part VII of FSMA 2000 we intend to prepare an FCR on a combined basis.

The base expectation is that, notwithstanding the existence of risks addressed in these adverse scenarios, the Group will generate surplus in its long-term business sufficient to meet its debt obligations and to pursue a reliable and progressive dividend policy.

The Directors are committed to achieving a high standard of corporate governance including compliance with the principles and practices of the Combined Code on Corporate Governance (the "Code"), as published by the Financial Reporting Council in July 2003 and as appended to the Listing Rules.

The following statement, together with the Directors Remuneration Report on pages 31 to 37, describes how the principles set out in the Code have been applied by the Company and details the Company's compliance with the Code's provisions for the year ended 31 December 2005.

Exceptions to Compliance with the Combined Code

The Company has, except where explained below, complied throughout the year with all of the provisions of the Combined Code.

Prior to 6 May 2005, Christopher Sporborg was Chairman of the Remuneration Committee and therefore that committee was not composed entirely of independent non-executive directors. However, on 6 May 2005 Mike Gordon, an independent non-executive director, was appointed Chairman of the Remuneration Committee in place of Christopher Sporborg, thereby ensuring compliance with this provision of the Combined Code from that date onwards.

The Company now complies with those provisions of the Combined Code which were reported as not having been complied with in the last Corporate Governance Report because the Company had not, at that time, completed a full annual operating cycle.

The Board

The Board comprises a non-executive chairman, three other non-executive directors and three executive directors, each of whom served throughout the period under review.

Biographical details of all directors are given on page 7. The Board, which is planned to meet eight times during the year, has a schedule of matters reserved for its consideration and approval. These matters include:

- setting corporate strategy
- approving the annual budget and medium-term projections
- reviewing operational and financial performance
- approving major acquisitions, investments and capital expenditure
- reviewing the Group's system of financial and business controls and risk management
- approving appointments to the Board
- appointment of the Company Secretary
- approval of policies relating to directors' remuneration

This schedule is reviewed annually. In addition, the directors of the Company are also directors of the two Life subsidiary companies. Under FSA Prudential Regulation the directors of these boards have responsibility for maintenance and projections of solvency and for assessment of capital requirements, based on risk assessments, and for establishing the level of long-term business provisions, including the adoption of appropriate assumptions.

The responsibilities that the Board has delegated to the Executive Management of the business include: the implementation of the strategies and policies of the Group as determined by the Board; monitoring of operational and financial results against plans and budget; prioritising the allocation of capital, technical and human resources; and developing and managing risk management systems.

The Roles of the Chairman and Chief Executive

The division of responsibilities between the Chairman of the Board, Christopher Sporborg, and the Chief Executive, Graham Kettleborough, is clearly defined and has been approved by the Board. The Chairman leads the Board in the determination of its strategy and in the achievement of its objectives and is responsible for organising the business of the Board, ensuring its effectiveness and setting its agenda. The Chairman has no day-to-day involvement in the management of the Group. The Chief Executive has direct charge of the Group on a day-to-day basis and is accountable to the Board for the financial and operational performance of the Group.

Senior Independent Director

The Board has appointed Peter Mason as Senior Independent Director. He is always available to meet shareholders on request and to ensure that the Board is aware of shareholder concerns not resolved through the existing mechanisms for shareholder communication.

Directors and Directors' Independence

The Board considers that Peter Mason, Mike Gordon and Terry Marris are independent non-executive directors.

In making this determination, the Board has carefully considered the following matters:

Terry Marris has within the last five years been an employee of a subsidiary company within the Countrywide Assured Life Holdings Limited Group ("CALH"), which was acquired by the Company on 24 May 2004. He also held the position of Managing Director of Countrywide Assured plc, the principal operating life assurance subsidiary of CALH prior to the acquisition of CALH by the Company. He resigned these positions in July 2002.

Peter Mason and Mike Gordon are also directors of Countrywide plc, the ultimate holding company of Countrywide Assured Group plc ("CAG"), which was, until 22 May 2004, the ultimate holding company of CALH, whose subsidiary companies had material business relationships with fellow subsidiary companies within the CAG group.

Peter Mason is also a non-executive director of Countrywide Assured plc, a position which he has held since 1 October 1990 and a non-executive director of CALH, the parent company of Countrywide Assured plc, a position which he has held since 18 November 1991.

The Board considers that the characteristics, aims and mode of operation of the relevant activities are sufficiently different from those prevailing when these directors held the relevant positions, that the judgement and independence of mind they exercise on behalf of the Company are not adversely affected or circumscribed. The Board is of the view that the considerable specific experience and knowledge of these three directors in the business of the Group outweighs any residual risk in the historic relationships described above, while the overall balance of the Board provides significant independence of mind and judgement. The Board further considers that, taking the Board as a whole, the Independent Directors are of sufficient calibre and number that their views carry sufficient weight in the Company's decision making.

The Directors are given access to independent professional advice, at the Company's expense, when the Directors deem it necessary in order for them to carry out their responsibilities.

Details of the Chairman's professional commitments are included in his biography on page 7. He does perform a number of pro-bono roles, but the Board is satisfied that these are not such as to interfere with his performance, which is based around a commitment of between fifty and sixty hours in any three-month period.

Professional Development

The Directors were advised, on their appointment, of their legal and other duties and obligations as Directors of a listed Company. This has been supplemented by the adoption and circulation to each Director of a written Code of Conduct, covering all aspects of the specific operation of Corporate Governance standards and of policies and procedures within the Group. Throughout their period in office, the Directors have, through the conduct of business at scheduled Board meetings, been continually updated on the Group's business and on the competitive and regulatory environment in which it operates. Through their continuing membership of the Boards of the two principal operating life subsidiaries of the Group all of the Directors who served during the period under review continue to have considerable knowledge and experience of the business of the Chesnara plc group, including, significantly, the wider FSA regulatory environment as to Conduct of Business and Prudential Regulation.

There have been no appointments to the Board during the period covered by this report. A detailed induction programme will be undertaken for all such future appointments embracing the Code of Conduct referred to above and up to date information on the strategy and financial and operating performance of the Group.

Information

Regular reports and information are circulated to the Directors in a timely manner in preparation for Board and Committee meetings.

As stated above all of the Company's directors are also members of the Boards of the Company's two principal operating life assurance subsidiaries, which hold scheduled quarterly meetings. These meetings are serviced by detailed regular reports and information, which cover all of the key areas relevant to the direction and operation of those subsidiaries, including:

- Earnings report
- Report from and recommendations by the Head of Actuarial Function
- Compliance report
- Risk management report
- Investment report
- Outsourcing report

In addition annual reports are produced which cover an assessment of the capital requirements of the life assurance subsidiaries, their financial condition and a review of their internal financial and business controls.

The quarterly meetings of the two life assurance subsidiaries are timed to be held immediately prior to Chesnara plc Board meetings.

On a monthly basis, the Directors receive summary high level information which enables them to maintain continuing oversight of the Group's and management's performance against objectives.

In addition to these structured processes, the papers are supplemented by information which the Directors require from time to time in connection with major events and developments, where critical views and judgements are required of Board members outside the normal reporting cycle.

Performance Evaluation

During the period under review the Chairman undertook a formal performance evaluation of the Board, individual directors and of the Audit, Remuneration and Nomination Committees. To that end he devised a series of questionnaires to provide a framework for the evaluation process and to provide a means of making year-on-year comparisons. Individual director assessments were supplemented by discussions between the Chairman and each director on a one-to-one basis.

In addition and using similar methods to those described above the non-Executive Directors, led by the Senior Independent Director, met to conduct a performance evaluation of the Chairman.

The Company Secretariat facilitated the process to ensure that they were conducted in a timely and objective manner while the Head of Internal Audit, reporting to the Senior Independent Director, monitors the assessment and follow through of the issues arising in the evaluation process.

Company Secretary

The Company Secretary, Ken Romney, is responsible for advising the Board, through the Chairman, on all governance matters. The Directors have access to the advice and services of the Company Secretary.

Board Committees

The Board has established the committees set out below to assist in the execution of its duties. Each of these committees operates according to written terms of reference and the Chairman of each committee reports to the Board. The constitution and terms of reference of each committee are reviewed annually to ensure that the committees are operating effectively and that any changes considered necessary are recommended to the Board for approval. The terms of reference of each committee are available on the Company's website at www.chesnara.co.uk or, upon request, from the Company Secretary. There have been no changes to any of the Committees' terms of reference during the period covered by this review.

The attendance record of each of the Directors at scheduled Board and Committee meetings for the period under review is:

	Scheduled Board	Nomination Committee	Remuneration Committee	Audit Committee
Non-executive Chairman – Christopher Sporborg	7(8)	2(2)	n/a	n/a
Non-executive Director – Peter Mason	8(8)	2(2)	3(3)	5(5)
Non-executive Director – Terry Marris	7(8)	1(2)	2(3)	3(5)
Non-executive Director – Mike Gordon	6(8)	2(2)	3(3)	4(5)
Executive Director – Graham Kettleborough	8(8)	n/a	n/a	n/a
Executive Director – Ken Romney	8(8)	n/a	n/a	n/a
Executive Director – Frank Hughes	7(8)	n/a	n/a	n/a

The figures in brackets indicate the maximum number of meetings in the period during which the individual was a Board member. The information above relates to the period from 1 February 2005 to 31 January 2006.

Nominations Committee

During the period under review, the Nominations Committee comprised Christopher Sporborg (who also served as Chairman of the Committee), Peter Mason, Terry Marris and Mike Gordon. The Committee considers the mix of skills and experience that the Board requires and seeks the appointment of directors to meet its assessment of what is required to ensure that the Board is effective in discharging its responsibilities.

During the period, the Committee met twice and considered the continuing mix of skills and experience of the Directors. There were no new appointments during the period.

The terms of reference of the Committee are available on the Company's website at www.chesnara.co.uk or, upon request, from the Company Secretary.

Remuneration Committee

Full details of the composition and work of the Remuneration Committee are provided in the Directors' Remuneration Report on pages 31 to 37.

Audit Committee

During the period under review, the Audit Committee comprised Peter Mason (who also acted as Chairman), Mike Gordon and Terry Marris the other independent non-executive Directors. The Board is satisfied that Peter Mason has recent and relevant financial experience. On invitation, the Chief Executive, the Finance Director, the Head of Internal Audit and the external Auditor attend meetings to assist the Committee in fulfilment of its duties. The Committee met five times during the period under review.

The role of the Audit Committee is to assist the Board in discharging its duties and responsibilities for financial reporting, corporate governance and internal control. The Committee is also responsible for making recommendations to the Board in relation to the appointment, re-appointment, and removal of the external Auditor. The Committee's duties include keeping under review the scope and results of the audit work, its cost effectiveness and the independence and objectivity of the Auditor.

During the period under review, the Audit Committee discharged its responsibilities by:

- reviewing the Group's draft Financial Statements prior to Board approval and reviewing the external Auditor detailed reports thereon, in respect of the half year ended 30 June 2005 and the full year ended 31 December 2005
- reviewing the appropriateness of the Group's accounting policies, particularly their amendment in light of the first-time adoption of International Financial Reporting Standards
- reviewing and approving the audit fee estimates

- reviewing the external Auditor plan for the audit of the Group's financial statements which included an assessment of key risks and confirmation of Auditor independence
- reviewing and approving the Internal Audit plan for the internal audit of the Group's internal controls, embracing operating, financial and business controls
- reviewing an annual report on the Group's systems of internal control and its effectiveness and reporting to the Board on the results of the review
- reviewing regular reports from the Head of Internal Audit
- reviewing the report on key risks by executive management
- reviewing the appointment of the external Auditor
- meeting the external Auditor without an executive director or a member of the Company's senior management being present
- reviewing the nature and volume of non-audit services provided by the external Auditor to ensure that a balance is maintained between objectivity and value added
- reviewing and approving the audit fee and non-audit fees
- reviewing the Group's whistle-blowing procedures

Auditor's Independence and Objectivity

The external Auditor, KPMG Audit Plc and its associates, provide some non-audit services primarily in the provision of taxation and regulatory advice and in relation to Corporate transactions that may arise from time to time. In order to ensure that auditor objectivity and independence are safeguarded, the following procedures have been put in place:

Audit-related services

These relate to formalities such as shareholder and other circulars, regulatory reports and work on acquisitions and disposals. This is work that the external Auditor performs in its capacity as Auditor, where the nature of the work is closely allied to that on the audit of the annual financial statements. Accordingly, this work will be undertaken by the external Auditor unless unusual circumstances apply.

Tax advice

The external Auditor will be used when particularly relevant and all other significant tax advice will be put out to tender.

General advice

All sizeable projects are put out to tender. The external Auditor will be invited to tender, provided that both parties are satisfied that the nature of the contract will not present a threat to the independence of the Auditor.

These safeguards have been approved by the Audit Committee and it is intended that they will be reviewed when required in the light of internal developments or in the external circumstances of the Company. The Auditor reports to both the Directors and the Audit Committee with regard to compliance with professional and regulatory requirements and best practice.

Details of the fees paid to the Auditor, and its associates, for non-audit services during the year are provided in Note 13 to the financial statements (on page 73).

Relations with Shareholders

The Chief Executive, Graham Kettleborough, and the Finance Director, Ken Romney, meet with institutional shareholders on a regular basis and are available for additional meetings when required. Should they consider it appropriate, institutional shareholders are able to meet with the Chairman, Christopher Sporborg, the Senior Independent Director, Peter Mason and any other Director. The Chairman is responsible for ensuring that appropriate channels of communication are established between the Chief Executive and the Finance Director on the one part and the shareholders on the other and is responsible for ensuring that the views of shareholders are known to the Board. This includes twice yearly feedback prepared by the Group's brokers on meetings the Executive Directors have held with institutional shareholders.

Annual and interim reports are distributed to other parties who may have an interest in the Group's performance and those reports, together with a wide range of information of interest to existing and potential shareholders, are made available on the Company's website, www.chesnara.co.uk .

Regular meetings are also held with industry analysts and commentators so that they are better informed in formulating opinions and making judgements on the Group's performance. Private investors are encouraged to attend the Annual General Meeting ("AGM") at which the opportunity is provided to ask questions on each proposed resolution. The Chairmen of the Board Committees will be available to answer such questions as appropriate. Details of the resolutions to be proposed at the AGM on 11 May 2006 can be found in the notice of the meeting on pages 122 to 124.

Internal Control

The Board is ultimately responsible for the Group's system of internal control and for reviewing its effectiveness. In establishing the system of internal control, the Directors have regard to the materiality of relevant risks, the likelihood of risks occurring and the costs of mitigating risks. It is, therefore, designed to manage rather than eliminate the risks which prevent the Company meeting its objectives and, accordingly, only provides reasonable and not absolute assurance against the risk of material misstatement or loss.

In accordance with "Internal Control: Guidance for Directors on the Combined Code" (The "Turnbull Guidance") the Board confirms that there is an ongoing process for identifying, evaluating and managing the significant risks faced by the Group, that this process has been in place for the year under review and up to the date of approval of the Annual Financial Statements and that the process is regularly reviewed by the Board and accords with the guidance.

In accordance with the regulatory requirements of the FSA, the Group's two principal life assurance subsidiaries have established and maintained severally a risk and responsibility regime. This ensures that the identification, assessment and control of risk is firmly embedded within the organisations and that there are procedures for monitoring and update of the same. The Compliance function of each life assurance subsidiary reviews and reports quarterly on this regime to the respective subsidiary Board. This process is supplemented by the establishment and maintenance of key risk registers for both the life assurance subsidiaries and for the Company, which ensure that, against various appropriate classes of risk, there is identification, assessment and control of the material risks subsisting within these organisations. The maintenance of the key risk registers is the responsibility of the executive management, who report on them quarterly to the Boards of the life assurance subsidiaries and to each Chesnara Audit Committee meeting.

As stated above, all of the Company's directors are also members of the two principal life assurance subsidiaries' Boards and the scheduled quarterly Board Meetings of these life assurance subsidiaries are immediately followed by corresponding Board meetings of the Company, which thereby has effective oversight of the maintenance and effectiveness of controls subsisting within the life assurance subsidiaries. In addition the Chesnara Board confirms that it has undertaken a formal annual review of the effectiveness of the system of internal control for the year ended 31 December 2005 and that it has taken account of material developments between that date and the date of approval of the Annual Financial Statements. The Board confirms that these reviews took account of reports by the Internal Audit Department on the operation of controls, internal financial controls, management assurance on the maintenance of controls and reports from the external Auditor on matters identified in the course of statutory audit work.

The Board also confirms the continuing appropriateness of the maintenance of an Internal Audit Function, which reports to the Senior Independent Director.

Going Concern

The Directors Statement on Going Concern is included in the Directors' Report on page 40.

The Remuneration Committee

The Remuneration Committee (the "Committee") determines the overall pay policy, the remuneration packages and service contracts of the Executive Directors of the Company including the operation of bonus schemes. It also monitors the remuneration of other senior employees of Chesnara plc.

Following the review of the requirements of the Combined Code, Christopher Sporborg, who is Chairman of the Company and who was Chairman of the Committee resigned his membership of the Committee. Mike Gordon who was appointed Chairman of the Committee in his stead, has chaired all of the meetings of the Committee covered by this report. The other Committee members are Peter Mason and Terry Marris. The Company Secretary, Ken Romney, acts as Secretary to the Committee, and provides advice on legal and regulatory issues relating to remuneration policy. At the request of the Committee, Graham Kettleborough, the Chief Executive, also attends and makes recommendations to the Committee regarding changes to the remuneration packages of individual directors (excluding himself) or policy generally. Such recommendations are discussed by the Committee and adopted or amended as it sees fit. No director is present at any part of the Committee meeting at which his own remuneration or contractual terms are being discussed. The membership and terms of reference of the Committee are reviewed annually and the terms of reference are available on the Company's website at www.chesnara.co.uk, upon request, from the Company Secretary. Details of the number of meetings held and the attendance can be found in the Corporate Governance Report on page 25.

Remuneration Policy

The Committee aims to set remuneration at an appropriate level to attract, retain and motivate executives of the necessary calibre. An annual review of remuneration is undertaken to ensure reward levels are appropriate to the duties and responsibilities of the roles with a suitable balance between the fixed and variable elements of overall reward. In determining salary levels due regard is given to external market data relating to both financial services sector companies and listed companies of similar size. Market median reward levels are used when formulating and reviewing policy.

The annual bonus scheme and the long-term incentive plan are designed to incentivise and retain the Executive Directors. The plans, which are cash based, reward the achievement of corporate targets set for the year and are therefore aligned with the delivery of value to shareholders. The annual bonus plan is pensionable whilst the long-term plan is not. The Committee may award other discretionary bonuses to the Executive Directors where they consider extraordinary value has been created or significant achievement has occurred.

The Company has, established frameworks for approved and unapproved discretionary share option plans and a sharesave plan, none of which was utilised.

Basic Salary

The Committee reviews salaries annually taking into consideration individual and Company performance, the responsibilities and accountabilities of each role, the experience of each individual and his or her marketability and future potential, and market data relating to both financial services sector companies and listed companies of similar size.

Executive Directors' remuneration also includes non-pensionable benefits in kind by way of a company car, life assurance and private medical insurance.

Bonus Schemes

The 2005 Annual Bonus Scheme was designed to incentivise the Executive Directors in order to align performance with shareholder interests, Directors are incentivised on achievement of the budgeted UK GAAP pre-tax profit. Originally the scheme was designed to generate an award of 25% of basic salary on achievement of 90% of the target, and a maximum award of 50% of basic salary for achievement of, or exceeding, the target. A *pro rata* sliding scale applied between these points and no award was generated for achievement below 90% of the target. The Committee retained the right to consider allowances for exceptional factors that were deemed to be outside of management's control.

During 2005 the Committee reviewed the scheme and amended it so that the target for the year was adjusted to be the CA UK GAAP pre-tax result for the first half of the year and the combined UK GAAP pre-tax result for the second half of CA and CWA, the newly-acquired subsidiary; 50% of the on-target bonus would be guaranteed as a retention measure and the Committee's right to consider allowances for exceptional factors was withdrawn in order that the Executive Directors' interests were fully aligned to shareholders' interests in respect of the non-guaranteed element of the scheme. The table below sets out the details of the awards made to the Executive Directors under the scheme in 2005.

Annual Bonus Scheme – awards made in respect of year ended 31 December 2005

Graham Kettleborough	£65,000
Ken Romney	£50,000
Frank Hughes	£45,000

Awards made under the Annual Bonus Scheme are pensionable as this is considered to be a significant retention feature of such an arrangement.

The Long-term Incentive Plan was designed as a long-term cash based incentive for Executive Directors. In order to align performance with shareholder interests, Directors were incentivised on achievement of budgeted FSA profits before tax (but excluding any movements on the Guardian Default Reserve: see page 21) and net shareholder income. The scheme was based on four performance periods – H2 2004, 2005, 2006 and H1 2007. The bonus threshold started at 75% of the performance target and was scaled up *pro rata* such that full entitlement was earned on achievement of the targeted figure. If the performance target was exceeded in any one period then the excess earned could be locked in to the bonus pool subject to an overall cap of 200% of salary. The bonus pool was to be released by way of two equal payments, subject to continued service. The first instalment would have been payable at the end of H2 2007 and the second at the end of H2 2008, thereby encouraging loyalty. However, during 2005 the Committee reviewed this scheme and decided that the measure should be brought in line with the Annual Bonus Scheme, that is that (1) it should be based on UK GAAP pre-tax profit; (2) 50% of the target bonus should be guaranteed to reward loyalty; and that (3) the scheme should apply on a rolling half year basis with rewards becoming payable three years after they had been earned. Whilst only the guaranteed element of the scheme was earned in respect of the first half of 2005, outperformance against target generated performance-related rewards, in addition to the guaranteed element, in the second half of the year.

The table below summarises the awards made to the Executive Directors under the above scheme for each of the relevant periods covered by this report.

Management Performance Incentive Plan – awards made in 2004 and 2005

	Amount awarded in respect of the half-year ended		
	31 December 2005	**30 June 2005**	**31 December 2004**
Graham Kettleborough	£50,029	£21,667	£52,286
Ken Romney	£38,483	£16,667	£40,403
Frank Hughes	£34,635	£15,000	£40,403

Awards made under the Long-term Incentive Plan are non-pensionable.

Share Options

The Board has established frameworks for a sharesave plan and approved and unapproved discretionary share option plans which may, at the discretion of the Remuneration Committee, be utilised for granting options to Executive Directors and other employees. During 2005 no such options were granted.

Service Contracts

The Executive Directors, who were all appointed on 1 March 2004, have service contracts with a rolling twelve-month notice period. Compensation on termination of service contracts will be decided on a case-by-case basis having regard to the particular circumstances.

Pension Policy

Until the end of May 2005 the Executive Directors, with the permission of Countrywide Assured Group plc ("CAG") (from which Chesnara was demerged in May 2004) and the Trustees of their pension scheme, continued membership of the defined contribution section of the CAG pension scheme. Both they, and the Company contributed to this scheme. From 1 June 2005 they became eligible to enter, and entered, the Chesnara plc stakeholder scheme where employer contributions are made at the same rate as would have been payable had their membership of the CAG scheme continued.

Non-Executive Directors

The remuneration of the Non-executive Directors is determined by the Board as a whole in accordance with the Articles of Association. Non-executive Directors do not have service contracts with the Company, neither are they eligible for bonuses, pensions or participation in Company share option schemes. The date of expiry of their terms of appointment are:

	Date of expiry of term of appointment
Christopher Sporborg (Chairman)	31 December 2008
Peter Mason	31 October 2008
Mike Gordon	30 April 2008
Terry Marris	1 March 2007

On 4 July 2005, the Board agreed to reappoint Christopher Sporborg, Peter Mason and Michael Gordon for a further three years, which is in line with the normal practice of the Board. Their respective terms had previously ended on 31 December 2005, 31 October 2005 and 30 April 2005. Peter Mason retires by rotation at the end of the forthcoming AGM, at which a resolution proposing his re-election will be tabled.

Directorate

The following served as directors of Chesnara plc from its incorporation on 29 October 2003 to 1 March 2004:

Pinsents Director Limited
Pinsents Company Services Limited

These corporate directors, owned by Pinsent Masons, solicitors, Legal Advisers to Chesnara plc, held office merely for the purposes of incorporating the Company and resigned on 1 March 2004 in favour of the directors set out below, who were all appointed on 1 March 2004.

Chairman

Christopher Sporborg

Non-Executive Directors

Peter Mason
Terry Marris
Mike Gordon

Executive Directors

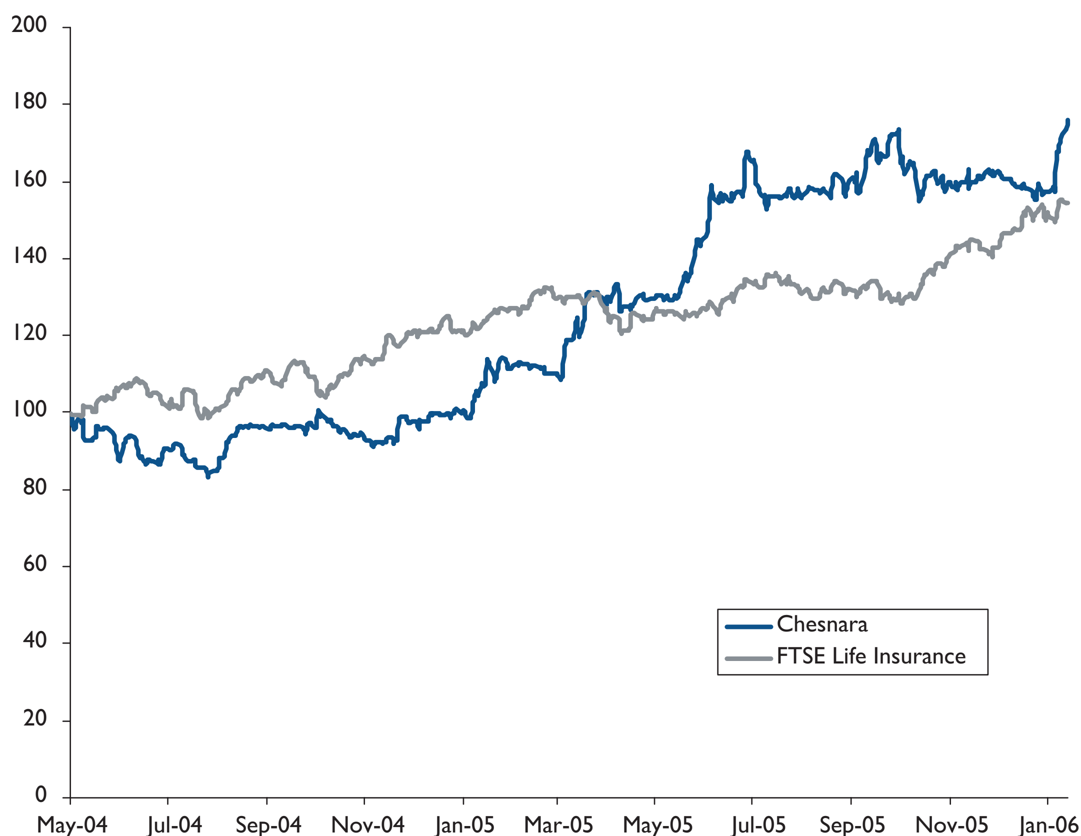
Graham Kettleborough
Ken Romney
Frank Hughes

As explained in Note 2 to the financial statements (on page 51), 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, on 22 May 2004, acquired the whole of the issued ordinary share capital of CALH 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.

Accordingly, the relevant directors for whom disclosure is made in this report, besides those who served as directors of Chesnara plc from 1 March 2004 to 31 December 2005 as set out above, are those who served as directors of CALH from 1 January 2004 to 24 May 2004. With the exception of Mike Nower, who resigned as a director of CALH on 25 May 2004, all of the other directors of CALH over that relevant period, being Christopher Sporborg, Peter Mason and Terry Marris, were appointed as non-executive directors of Chesnara plc on 1 March 2004. On 1 March 2004, Mike Gordon was also appointed as a non-executive director of Chesnara plc and Graham Kettleborough, Ken Romney and Frank Hughes were appointed as executive directors of Chesnara plc. Christopher Sporborg, Mike Nower, Peter Mason, Terry Marris and Mike Gordon were also serving directors of CAG between 1 January 2004 and 22 May 2004, and Christopher Sporborg, Mike Nower, Peter Mason, and Mike Gordon were serving directors of Countrywide plc between 22 May 2004 and 24 May 2004, when CALH was under the ownership of those respective companies.

The relevant emoluments in the disclosures which follow are those made by CALH or its subsidiary companies between 1 January 2004 and 24 May 2004 and those made by Chesnara plc or its subsidiary companies between 1 March 2004 and 31 December 2005. The disclosure of all other relevant interests and arrangements are made by virtue of the ownership of CALH as set out above.

Performance Graph



The above graph shows a comparison of the Company's total shareholder return ("TSR") performance against the FTSE Life Assurance sector index. The Company considers this to be the most appropriate index, given that its activities are centred on life assurance. The graph has been prepared in accordance with section 234B of the Companies Act 1985, except that it shows the TSR for the Company and the relevant index from 25 May 2004 to 31 December 2005 only. The Company was first listed on the London Stock Exchange on 25 May 2004.

Directors' Interests in Shares

Directors interests in the ordinary shares of Chesnara plc were as set out below (number of shares):

	31 December 2005		31 December 2004	
	Beneficial	**Non-beneficial**	**Beneficial**	**Non-beneficial**
Christopher Sporborg	75,000	–	75,000	–
Peter Mason	2,500	–	2,500	–
Terry Marris	52,708	–	52,708	–
Mike Gordon	–	–	–	–
Graham Kettleborough	19,659	–	14,677	–
Ken Romney	15,476	–	14,072	–
Frank Hughes	5,163	–	4,694	–

There were no changes in the Directors' shareholdings in Chesnara plc between 31 December 2005 and 30 March 2006.

None of the Directors had either a beneficial or a non-beneficial holding in the ordinary share capital of CALH between 1 January 2004 and 24 May 2004, the date of the acquisition of CALH by Chesnara plc.

Directors' interests in the ordinary shares of Countrywide Assured Group plc ("CAG") at 22 May 2004, the date of the disposal of CALH by CAG to Countrywide plc, were as set out below (numbers of shares):

	22 May 2004	
	Beneficial	Non-beneficial
Christopher Sporborg	300,000	–
Peter Mason	10,000	–
Terry Marris	210,832	–
Mike Gordon	–	–
Graham Kettleborough	17,724	–
Ken Romney	56,288	–
Frank Hughes	18,776	–
Mike Nower	273,180	–

None of the Directors had either a beneficial or a non-beneficial holding in the ordinary share capital of Countrywide plc between 22 May 2004, the date of the acquisition of CALH by Countrywide plc from CAG, and 24 May 2004, the date of the acquisition of CALH from Countrywide plc by Chesnara plc.

Directors' Remuneration

The auditors are required to report on this and the remaining sections of the Remuneration Report.

Total Directors' remuneration for the year ended 31 December 2005 is shown below with comparative figures for the year ended 31 December 2004.

	Year ended 31 December	
Aggregate emoluments:	2005 £000	2004 £000
Fees to non-executive directors	130	111
Emoluments to executive directors	680	519
Company contributions to pension schemes	51	38
Total	861	668

The following table, which has been prepared in accordance with regulatory requirements, sets out the constituents of Directors emoluments for the year-ended 31 December 2005:

	Salaries and fees £000	Bonuses £000	Deferred bonuses £000	Benefits £000	Total 2005 £000	Total 2004 £000
Executive Directors						
Graham Kettleborough	124	65	72	12	273	204
Ken Romney	96	50	55	12	213	160
Frank Hughes	90	45	50	9	194	155
	310	160	177	33	680	519
Non-Executive Director						
Christopher Sporborg	50	–	–	–	50	42
Peter Mason	30	–	–	–	30	27
Terry Marris	25	–	–	–	25	21
Mike Gordon	25	–	–	–	25	21
	130	–	–	–	130	111
Other						
Mike Nower	–	–	–	–	–	–
Total	440	160	177	33	810	630

The fees payable to Terry Marris were paid, with the addition of VAT, to his employing company, Countrywide Property Lawyers Limited, a subsidiary of Countrywide plc.

The following table sets out each Director's pension benefits for the years ended 31 December 2005 and 31 December 2004:

	Company contributions to money purchase scheme	
	2005 £000	2004 £000
Graham Kettleborough	15	11
Ken Romney	26	19
Frank Hughes	10	8
	51	38

Graham Kettleborough, Ken Romney and Frank Hughes were members of the Defined Contribution Section of the Countrywide Assured Group plc (CAG) pension scheme until the end of May 2005. Under a deed of settlement dated 18 March 2004 CAG and the Scheme Trustees had given permission for continued membership until that date. Consequently they are now deferred members of that scheme. From 1 June 2005 they became eligible to enter, and entered, the Chesnara plc Stakeholder Scheme where employer contributions are made at the same rate as would have been payable had their membership of the CAG scheme continued.

Terry Marris and Mike Nower have personal pension plans to which the Countrywide plc group and the Countrywide Assured Group plc group contributed. None of these contributions was made by companies within the Countrywide Assured Life Holdings Limited group between 1 January 2004 and 24 May 2004 or by companies within the Chesnara plc group from 24 May 2004 to 31 December 2005.

No pension contributions were made by companies within the CALH group between 1 January 2004 and 24 May 2004 or by companies within the Chesnara plc group from 24 May 2004 to 31 December 2005 in respect of Christopher Sporborg, Peter Mason or Mike Gordon.

Directors' Share Options

Details of the entitlements of the Directors to share options in Countrywide Assured Group plc between 1 January 2004 and 22 May 2004, the date of the disposal of Countrywide Assured Life Holdings Limited to Countrywide plc are as follows:

Director	At 1 January 2004	Granted	Exercised	Waived/ lapsed	At 22 May 2004	Exercise price £	Market price at exercise £	From	To	Scheme
Terry Marris	133,333		(133,333)		–	1.40	1.86	April 2001	April 2005	Executive (1996)
	250,000		(250,000)		–	1.31	1.86	Mar 2002	Mar 2006	Executive (1996)
	2,500		(2,500)		–	0.00	1.96	May 2004	Mar 2006	Deferred Incentive (1996)
	–	71,425	(71,425)		–	1.40	1.96	May 2004	Mar 2006	Deferred Incentive (1996)
	44,740		(44,740)		–	1.40	1.815	April 2000	April 2005	Executive Share Bonus
	5,171		(3,467)	(1,704)	–	0.744	1.96	Nov 2005	May 2006	SAYE (1996)
	80,000		(80,000)		–	1.065	1.90	April 2004	April 2011	Executive (1996)
	100,000		(100,000)		–	1.51	1.96	April 2007	April 2009	Deferred Incentive (1996)
	100,000		(100,000)		–	1.51	1.96	April 2005	April 2012	Executive (1996)
	6,172		(4,361)	(1,811)	–	1.224	1.96	Nov 2007	May 2008	SAYE (1996)
	721,916	71,425	(789,826)	(3,515)	–					
Mike Nower	5,230		(5,230)		–	0.752	1.588	Nov 2001	May 2004	SAYE (1996)
	133,333				133,333	1.40		April 2001	April 2005	Executive (1996)
	245,000				245,000	1.31		May 2002	May 2006	Executive (1996)
	5,050				5,050	0.00		May 2004	May 2006	Deferred Incentive(1996)
	32,680				32,680	1.535		Mar 2002	Mar 2007	Executive Share Bonus
	6,622		(4,440)	(2,182)	–	0.744	1.76	Nov 2004	April 2005	SAYE (1996)
	80,000				80,000	1.065		April 2004	April 2011	Executive (1996)
	175,000				175,000	1.51		April 2007	April 2009	Deferred Incentive(1996)
	175,000				175,000	1.51		April 2005	April 2012	Executive (1996)
	5,099				5,099	1.224		Nov 2007	May 2008	SAYE (1996)
	863,014	–	(9,670)	(2,182)	851,162					
Graham Kettleborough	40,000		(40,000)		–	1.065	1.96	April 2004	April 2011	Executive (1996)
	10,735		(3,150)	(7,585)	–	1.224	1.96	Nov 2007	May 2008	SAYE (1996)
	50,735	–	(43,150)	(7,585)	–					
Ken Romney	4,627		(3,102)	(1,525)	–	0.744	1.96	Nov 2004	April 2005	SAYE (1996)
	40,000		(40,000)		–	1.065	1.96	April 2004	April 2011	Executive(1996)
	6,441		(1,890)	(4,551)	–	1.224	1.96	Nov 2007	May 2008	SAYE (1996)
	51,068	–	(44,992)	(6,076)	–					
Frank Hughes	20,000		(20,000)		–	1.125	1.96	Sept 2000	Sept 2007	Executive (1995)
	40,000		(40,000)		–	1.065	1.96	April 2004	April 2011	Executive (1996)
	4,445		(2,980)	(1,465)	–	0.744	1.96	Nov 2004	April 2005	SAYE (1996)
	7,246		(2,126)	(5,120)	–	1.224	1.96	Nov 2007	May 2008	SAYE (1996)
	71,691	–	(65,106)	(6,585)	–					

Subsequent to 22 May 2004, Mike Nower's options, as set out above, were converted into equivalent options in Countrywide plc.

No options have been granted in respect of any Chesnara plc Share Option Scheme between 24 May 2004 and 30 March 2006.

The aggregate of gains made on the exercise of options in the shares of Countrywide Assured Group plc for the year ended 31 December 2004 was £672,169.

Approved by the Board of Directors on 30 March 2006 and signed on its behalf by:

Christopher Sporborg **Graham Kettleborough**

Directors' Report

The Directors present their report and the audited consolidated accounts of Chesnara plc for the year ended 31 December 2005.

Results and Dividends

The Group Consolidated Income Statement for the year ended 31 December 2005, prepared in accordance with International Financial Reporting Standards and set out on page 44, shows:

	2005 £000	2004 £000
Profit for the year	18,615	5,156

An interim dividend of 4.90p per ordinary share was paid by Chesnara plc on 14 November 2005. The Board recommends payment of a final dividend of 7.55p per ordinary share on 16 May 2006 to shareholders on the register at the close of business on 18 April 2006.

Activities

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.

Information relating to the scheme of demerger and the subsequent introduction of Chesnara plc to the Official List of the London Stock Exchange, 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. Further Information may also be found in Note 2 to the financial statements on page 51.

On 2 June 2005, the Company completed the acquisition of CWA Life Holdings plc ("CWALH"), formerly Irish Life (UK) Holdings plc, from Irish Life and Permanent plc for a total purchase consideration of £47.8m, of which some £0.3m related to costs associated with the transaction. CWALH's life business subsidiary is City of Westminster Assurance Company Limited ("CWA"). The funding for the purchase which was settled in cash, was made by the raising of further equity of £22m from the shareholders by way of a placing and open offer, and by the provision of a bank loan of £21m, with the balance being sourced from internal retained funds. Further information relating to these transactions may be found in the following notes to the financial statements: Note 5 Acquisition and Disposal of Subsidiaries (on page 69); Note 38 Share Capital and Share Premium (on page 98) and Note 30 Borrowings (on page 93).

CALH and CWALH, together with their subsidiary companies, comprise 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.

The principal activities and a review of the Group's business and operations during the year, significant events and future prospects are contained in the Chairman's Statement and in the Operating and Financial Review on pages 5 to 24.

Financial Risk

Disclosure with respect to financial risk is included in Note 4 (on page 60) to the financial statements.

Directors

Pinsents Director Limited and Pinsents Company Services Limited served as corporate Directors of the Company from its incorporation on 29 October 2003 to 1 March 2004.

The present directors are listed on page 7. All of the present directors served from 1 March 2004 to 31 December 2005 and there have been no changes between that date and 30 March 2006.

With the exception of Mike Nower, who resigned as a director of CALH on 25 May 2004, all of the other directors of CALH between 1 January 2004 and 24 May 2004, being Christopher Sporborg, Peter Mason and Terry Marris were appointed, on 1 March 2004, as non-executive directors of the Company. On 1 March 2004, Mike Gordon was also appointed as a non-executive director of the Company and Graham Kettleborough, Ken Romney and Frank Hughes were appointed as executive directors of the Company.

The non-executive directors who served as Chairmen and members of the Nominations and Audit Committees of the Board are set out in the Corporate Governance Report on pages 25 to 30. Information in respect of the Chairman and members of the Remuneration Committee and in respect of directors' service contracts is included in the Directors Remuneration Report on pages 31 to 37, which also includes details of directors' interests in shares and share options.

On 4 July 2005 Christopher Sporborg, Peter Mason and Mike Gordon, whose existing terms of appointment expired during 2005, were re-appointed for a further three years so that their terms of appointment now end on 31 December 2008, 31 October 2008 and 30 April 2008 respectively.

Pursuant to the Articles of Association, Peter Mason and Graham Kettleborough will retire by rotation at the Annual General Meeting and, being eligible, offer themselves for re-election. No director seeking re-election has a service contract with the Company of more than one year's duration.

No director had any material interest in any significant contract in the Company or in any of the subsidiary companies during the year.

Substantial Shareholdings

The following substantial interests in the Company's ordinary share capital at 31 December 2005 have been notified to the Company:

Name of substantial shareholder	Total number of ordinary shares held	Percentage of the issued share capital as at 31 December 2005
Allianz AG (including 16,679,641 (15.95%) held by Veer Palthe Voute NV, a subsidiary company)	16,706,667	15.98%
Lloyds TSB Group plc	5,151,609	4.93%
Witmer Asset Management LLC	3,896,173	3.73%
Standard Life Group	3,287,883	3.14%
Morgan Stanley Securities Limited	3,220,216	3.08%

- These substantial shareholder interests remained unchanged at 23 March 2006 and no other person holds 3% or more of the issued share capital of the Company.
- There were no significant contracts with substantial shareholders during the year.

Charitable Donations and Political Contributions

Charitable donations made by Group companies during the year ended 31 December 2005 were £nil (2004: £nil). No political contributions were made during the year ended 31 December 2005 (2004: £nil).

Employees

The average number of employees during the year was 44 (2004: 222).

Chesnara plc has a policy of keeping employees informed of its affairs through regular internal communication and meetings with the Directors. Employees are encouraged to involve themselves in the performance of the Company and to suggest initiatives that will lead to improvement or the mitigation of risk. Chesnara plc strives to provide its employees with clear and fair terms of employment and clean, healthy and safe working conditions. The Company has a fair remuneration policy and offers equal opportunities to all present and potential employees. It believes that its best interests are served by encouraging its employees to develop

skills and progress in their careers and recognises the value and significant contribution its employees are able to make to the success of the business.

Equal Opportunities

Chesnara is committed to a policy of equal opportunity in employment and believes that this is essential to ensuring its success. Chesnara plc will continue to select, recruit, train and promote the best candidates based on suitability for the role and treat all employees and applicants fairly regardless of race, gender, marital status, ethnic origin, religious beliefs or disability. Chesnara plc will ensure that no employee suffers harassment or intimidation.

Disabled Employees

Chesnara plc will provide employment for disabled persons wherever the requirements of the Group allow and if applications for employment are received from suitable applicants. If existing employees become disabled, every reasonable effort will be made to achieve continuity of employment.

Health, Safety and Welfare at Work

Chesnara plc places great importance on the health, safety and welfare of its employees. Relevant policies, standards and procedures are reviewed on a regular basis to ensure that any hazards or material risks are removed or reduced to minimise or, where possible, exclude the possibility of accident or injury to employees or visitors.

The policies, standards and procedures are communicated to employees through contracts of employment, the staff handbook and employee briefings and all employees have a duty to exercise responsibility and do everything possible to prevent injury to themselves and others.

Social, Environmental and Ethical Issues

Chesnara plc takes seriously its responsibilities for social, ethical and environmental issues and recognises the importance of developing and maintaining high standards.

We aim to be sensitive to the cultural, social and economic needs of our local community and endeavour to protect and preserve the environment where we operate.

We seek to be honest and fair in our relationships with our customers and provide the standards of products and services that have been agreed.

Being an office-based financial services company, Chesnara plc believes that its activities do not materially contribute to pollution or cause material damage to the environment. However, the Company takes all practicable steps to minimise its effects on the environment and encourages its employees to conserve energy, minimise waste and recycle work materials.

Creditors Payment Policy

It is Chesnara plc's policy to pay creditors in accordance with the CBI Better Practice Payment Code (available at www.payontime.co.uk) on supplier payments. The number of creditor days outstanding at 31 December 2005, based on the consolidated Financial Statements, was 3 for the Group (2004: 4) and 3 for the Company (2004: 6).

Going Concern Statement

After making appropriate enquiries, the Directors confirm that they are satisfied that the Company and the Group have adequate resources to continue in business for the foreseeable future. Accordingly, they continue to adopt the going concern basis in the preparation of the Financial Statements.

Auditors

In accordance with section 384 of the Companies Act 1985, a resolution for the re-appointment of KPMG Audit Plc as auditors of the Company is to be proposed at the forthcoming Annual General Meeting.

Approved by the Board on 30 March 2006 and signed on its behalf by:

Ken Romney
Company Secretary

Statement of Directors' Responsibilities in respect of the Financial Statements

The directors are responsible for preparing the Financial Statements and the Group and Parent Company financial statements in accordance with applicable law and regulations.

Company law requires the directors to prepare Group and Parent Company financial statements for each financial year. Under that law they are required to prepare the Group financial statements in accordance with IFRSs as adopted by the EU and have elected to prepare the Parent Company financial statements on the same basis.

The Group and Parent Company financial statements are required by law and IFRSs as adopted by the EU to present fairly the financial position of the Group and the Parent Company and the performance for that period; the Companies Act 1985 provides in relation to such financial statements that references in the relevant part of that Act to financial statements giving a true and fair view are references to their achieving a fair presentation.

In preparing each of the Group and Parent Company 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 they have been prepared in accordance with IFRSs as adopted by the EU; and
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the Group and Parent Company will continue in business.

The directors are responsible for keeping proper accounting records that disclose with reasonable accuracy at any time the financial position of the Parent Company and enable them to ensure that the financial statements comply with the Companies Act 1985. They have general responsibility for taking such steps as are reasonably open to them to safeguard the assets of the Group and detect fraud and other irregularities.

Under applicable law and regulations, the directors are also responsible for preparing a Directors' Report, Directors' Remuneration Report and the Corporate Governance Statement that comply with that law and those regulations.

The directors are responsible for the maintenance and integrity of the corporate and financial information included on the Company's website. Legislation in the UK governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

Report of the Independent Auditor to the Members of Chesnara plc

We have audited the Group and Parent Company financial statements (the "financial statements") of Chesnara plc for the year ended 31 December 2005 which comprise the Group Income Statement, the Group and Parent Company Balance Sheets, the Group and Parent Company Cash Flow Statements, the Group and Parent Company Statements of Changes in Shareholders' Equity, and the related notes. These financial statements have been prepared under the accounting policies set out therein. We have also audited the information in the Directors' Remuneration Report that is described as having been audited.

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 auditor's report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Company and the Company's members as a body, for our audit work, for this report, or for the opinions we have formed.

Respective responsibilities of directors and auditors

The directors' responsibilities for preparing the Corporate Governance Report, the Directors' Remuneration Report and financial statements in accordance with applicable law and International Financial Reporting Standards (IFRSs) as adopted by the EU are set out in the Statement of Directors' Responsibilities on page 41.

Our responsibility is to audit the financial statements and the part of the Directors' Remuneration Report to be audited in accordance with relevant legal and regulatory requirements and International Standards on Auditing (UK and Ireland).

We report to you our opinion as to whether the financial statements give a true and fair view and whether the financial statements and the Directors' Remuneration Report to be audited have been properly prepared in accordance with the Companies Act 1985 and, as regards the Group financial statements, Article 4 of the IAS Regulation. 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 other transactions is not disclosed.

We review whether the Corporate Governance Statement reflects the company's compliance with the nine provisions of the 2003 FRC Combined Code specified for our review by the Listing Rules of the Financial Services Authority, and we report if it does not. We are not required to consider whether the Board's statements on internal control cover all risks and controls, or form an opinion on the effectiveness of the Group's corporate governance procedures or its risk and control procedures.

We read the other information contained in the Financial Statements and consider whether it is consistent with the audited financial statements. We consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the financial statements. Our responsibilities do not extend to any other information.

Basis of audit opinion

We conducted our audit in accordance with International Standards on Auditing (UK and Ireland) 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 and the part of the Directors' Remuneration Report to be audited. 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 Group's and 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 and the part of the Directors' Remuneration Report to be audited 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 and the part of the Directors' Remuneration Report to be audited.

Opinion

In our opinion:

- the Group financial statements give a true and fair view, in accordance with IFRSs as adopted by the EU, of the state of the Group's affairs as at 31 December 2005 and of its profit for the year then ended;

- the Parent Company financial statements give a true and fair view, in accordance with IFRSs as adopted by the EU as applied in accordance with the provisions of the Companies Act 1985, of the state of the Parent Company's affairs as at 31 December; and
- the financial statements and the part of the Directors' Remuneration Report to be audited have been properly prepared in accordance with the Companies Act 1985 and, as regards the Group financial statements, Article 4 of the IAS Regulation.

KPMG Audit Plc 30 March 2006
Chartered Accountants and Registered Auditor
St James' Square
Manchester M2 6DS

Consolidated Income Statement for the year ended 31 December 2005

	Note	Year ended 31 December	
		2005 £000	2004 £000
Insurance premium revenue		115,673	122,835
Insurance premium ceded to reinsurers		(26,691)	(30,055)
Net insurance premium revenue	6	**88,982**	**92,780**
Fee and commission income			
Insurance contracts	7	49,405	54,359
Investment contracts	7	5,971	1,471
Other	7	–	2,373
Investment income	8	214,691	57,009
Total revenue (net of reinsurance payable)		**359,049**	**207,992**
Other operating income	9	1,226	1,659
Net income		**360,275**	**209,651**
Policyholder claims and benefits incurred	10	(291,921)	(195,474)
Reinsurers' share of claims and benefits incurred	10	61,300	31,152
Net policyholder claims and benefits incurred		(230,621)	(164,322)
Change in investment contract liabilities	11	(85,130)	(17,200)
Reinsurers' share of investment contract liabilities	11	3,742	1,951
Net change in investment contract liabilities		(81,388)	(15,249)
Fees, commission and other acquisition costs	12	(5,699)	(12,135)
Administrative expenses	13	(18,675)	(14,448)
Other operating expenses			
Charge for amortisation of intangible assets	14	(2,364)	(383)
Other	14	(267)	(329)
Total expenses		**(339,014)**	**(206,866)**
Operating profit		**21,261**	**2,785**
Financing costs	15	(805)	(336)
Profit on sale of subsidiary company		–	1,948
Profit before income taxes		**20,456**	**4,397**
Income tax (expense)/credit	16	(1,841)	759
Profit for the year		**18,615**	**5,156**
Basic earnings per share	41	19.26p	6.10p
Diluted earnings per share	41	19.26p	6.09p

The notes and information on pages 51 to 110 form part of these financial statements.

The Group considers that it has no product or distribution based segmentation and, as it only has significant business activity within the UK, it has no geographic segmentation. Accordingly, no segmented reporting is presented.

Consolidated Balance Sheet at 31 December 2005

	Note	31 December 2005 £000	31 December 2004 £000
Assets			
Intangible assets			
Deferred acquisition costs	17	13,000	8,137
Acquired value of in-force business			
Insurance contracts	18	24,900	1,818
Investment contracts	18	14,661	–
Property and equipment	19	–	403
Reinsurers' share of insurance contract provisions	28	199,563	154,597
Amounts deposited with reinsurers	29	62,697	22,888
Investment properties	20	25,422	3,092
Financial assets			
Equity securities at fair value through income	21	688,478	187,026
Holdings in collective investment schemes at fair value through income	21	340,379	301,054
Debt securities at fair value through income	21	383,817	280,148
Loans and receivables including insurance receivables	21/ 22	19,810	15,013
Derivative financial instruments	21/ 23	16,108	–
Total financial assets		1,448,592	783,241
Reinsurers share of accrued policyholder claims	34	4,810	4,165
Income taxes	24	199	103
Cash and cash equivalents	25	282,452	43,933
Total assets		**2,076,296**	**1,022,377**
Liabilities			
Insurance contract provisions	28	1,072,064	601,805
Financial liabilities			
Investment contracts at fair value through income	29	803,146	306,786
Borrowings	30	20,638	–
Derivative financial instruments	23	416	–
Total financial liabilities		824,200	306,786
Provisions	31	1,433	926
Deferred tax liabilities	32	13,327	1,748
Reinsurance payables	33	2,049	3,333
Payables related to direct insurance and investment contracts	34	23,866	14,351
Deferred income	35	20,195	8,038
Income taxes	36	3,345	1,198
Other payables	37	7,550	4,750
Total liabilities		**1,968,029**	**942,935**
Net assets		**108,267**	**79,442**
Shareholders' equity			
Share capital	38	41,501	40,500
Share premium	38	20,458	–
Other reserves		50	50
Retained earnings	39	46,258	38,892
Total shareholders' equity		**108,267**	**79,442**

The notes and information on pages 51 to 110 form part of these financial statements.

Approved by the Board of Directors on 30 March 2006 and signed on its behalf by:

Christopher Sporborg **Graham Kettleborough**

Company Balance Sheet at 31 December 2005

	Note	31 December 2005 £000	31 December 2004 £000
Assets			
Non-current assets			
Financial assets			
Investment in subsidiaries		52,006	4,228
Current assets			
Loans and receivables	**22**	1,472	433
Income taxes	**24**	150	–
Cash and cash equivalents	**25**	1,211	154
Total current assets		2,833	587
Total assets		**54,839**	**4,815**
Current liabilities			
Borrowings	**30**	4,063	–
Income taxes	**36**	–	1
Other payables	**37**	940	536
Total current liabilities		5,003	537
Non-current liabilities			
Borrowings	**30**	16,575	–
Total liabilities		**21,578**	**537**
Net assets		**33,261**	**4,278**
Shareholders' equity			
Share capital	**38**	5,229	4,228
Share premium	**38**	20,458	–
Other reserves		50	50
Retained earnings	**39**	7,524	–
Total shareholders' equity		**33,261**	**4,278**

The notes and information on pages 51 to 110 form part of these financial statements.

Approved by the Board of Directors on 30 March 2006 and signed on its behalf by:

Christopher Sporborg **Graham Kettleborough**

Consolidated Statement of Cash Flows for the year ended 31 December 2005

	Year ended 31 December	
	2005 £000	2004 £000
Profit for the year	**18,615**	**5,156**
Adjustments for:		
Depreciation	105	302
Amortisation of deferred acquisition costs	4,998	11,235
Amortisation of acquired in-force value	2,363	383
Tax expense/(recovery)	1,841	(759)
Interest receivable	(7,929)	(1,046)
Dividends receivable	(17,901)	(7,787)
Change in fair value of investment properties	(1,344)	(89)
Fair value gains on financial assets	(75,786)	(31,086)
Loss on sale of property and equipment	300	4
Profit on sale of subsidiary company	–	(1,948)
Interest received	9,545	1,199
Dividends received	18,473	7,735
Interest expense	805	–
Equity settled share based payment expense	–	336
Changes in operating assets and liabilities (excluding the effect of acquisitions)		
Increase in intangible assets related to investment and insurance contracts	(8,936)	–
(Increase)/decrease in financial assets	(3,537)	1,641
Increase in reinsurers share of insurance contract provisions	(37,818)	(5,100)
Increase in amounts deposited with reinsurers	(4,021)	(2,738)
Decrease in other loans and receivables	9,706	9,262
Increase in insurance contract provisions	122,572	21,395
Increase in investment contract liabilities	52,510	20,810
Increase/(decrease) in provisions	507	(540)
Increase/(decrease) in reinsurance payables	(1,284)	2,248
Increase/(decrease) in payables related to direct insurance and investment contracts	9,515	(743)
Decrease in other payables	(5,199)	(6,417)
Cash generated from operations	**88,100**	**23,453**
Income tax paid	(4,217)	(1,392)
Net cash from operating activities	**83,883**	**22,061**
Cash flows from investing activities		
Acquisition of subsidiary, net of cash acquired	124,497	–
Disposal of subsidiary, net of cash disposed of	–	2,344
Purchases of property and equipment	(2)	(145)
Net cash from investing activities	**124,495**	**2,199**
Cash flows from financing activities		
Proceeds from the issue of share capital	23,533	50
Redemption of redeemable preference share	–	(50)
Proceeds from borrowings	20,638	–
Payment of transaction costs	(2,074)	–
Dividends paid	(11,249)	(4,027)
Interest paid	(707)	–
Net cash generated from/(utilised by) financing activities	**30,141**	**(4,027)**
Net increase in cash and cash equivalents	**238,519**	**20,233**
Cash and cash equivalents at beginning of period	**43,933**	**23,700**
Cash and cash equivalents at end of period	**282,452**	**43,933**
In the cash flow statement proceeds from the sale of property and equipment comprise:		
Net book amount	300	4
Loss on sale	(300)	(4)
Proceeds from sale	–	–

The notes and information on pages 51 to 110 form part of these financial statements.

Company Statement of Cash Flows for the year ended 31 December 2005

	Year ended 31 December	
	2005 £000	2004 £000
Profit for the year	**18,773**	**3,731**
Adjustment for		
Tax recovery	(148)	–
Interest expense	805	–
Equity settled share based payment	–	336
Dividends received from subsidiary company	(19,325)	(4,067)
Changes in operating assets and liabilities		
Increase in loans and receivables	(1,039)	(433)
Increase in payables	303	537
Cash (utilised by)/generated from operations	**(631)**	**104**
Cash flows from investing activities		
Acquisition of subsidiary company	(47,778)	–
Dividends received from subsidiary company	19,325	4,067
Net cash (utilised by)/generated from investing activities	**(28,453)**	**4,067**
Cash flows from financing activities		
Net proceeds from the issue of share capital	23,533	50
Redemption of redeemable preference share	–	(50)
Payment of transaction costs	(2,074)	–
Net proceeds from borrowings	20,535	–
Dividends paid	(11,249)	(4,017)
Interest paid	(604)	–
Net cash generated from/(utilised by) financing activities	**30,141**	**(4,017)**
Net increase in cash and cash equivalents	**1,057**	**154**
Cash and cash equivalents at beginning of period	**154**	**–**
Cash and cash equivalents at end of period	**1,211**	**154**

The notes and information on pages 51 to 110 form part of these financial statements.

Consolidated Statement of Changes in Equity for the year ended 31 December 2005

	Year ended 31 December 2005				
	Share capital £000	Share premium £000	Capital redemption reserve £000	Retained earnings £000	Total £000
Equity shareholders' funds at 1 January 2005	**40,500**	**–**	**50**	**38,892**	**79,442**
Profit for the period representing total recognised income and expenses	–	–	–	18,615	18,615
Dividends paid	–	–	–	(11,249)	(11,249)
Issue of ordinary shares pursuant to exercise of option	84	1,449	–	–	1,533
Issue of ordinary shares pursuant to placing and open offer	917	21,083	–	–	22,000
Expenses incurred in connection with issue of ordinary shares pursuant to placing and open offer	–	(2,074)	–	–	(2,074)
Equity shareholders' funds at 31 December 2005	**41,501**	**20,458**	**50**	**46,258**	**108,267**

	Year ended 31 December 2004			
	Share capital £000	Capital redemption reserve £000	Retained earnings £000	Total £000
Equity shareholders' funds at 1 January 2004	**40,500**	**–**	**37,477**	**77,977**
Profit for the period representing total recognised income and expenses	–	–	5,156	5,156
Dividends paid	–	–	(4,027)	(4,027)
Issue of redeemable preference share on reorganisation	50	–	–	50
Redemption of preference share	(50)	–	–	(50)
Transfer from retained earnings to redeem preference share	–	50	(50)	–
Grant of share option	–	–	336	336
Equity shareholders' funds at 31 December 2004	**40,500**	**50**	**38,892**	**79,442**

On 9 March 2004, in order to satisfy the requirements of section 117 of the Companies Act 1985 as to the minimum paid up share capital of a public company, a redeemable preference share of £50,000 was issued to one of the subscriber shareholders of the Company. On 22 June 2004 the redeemable preference share was paid up in full and then redeemed. An amount of £50,000, being equal to the par value of the redeemable preference share was transferred from retained earnings to a capital redemption reserve. Accordingly, the transactions in connection with the redeemable preference share were effectively undertaken to meet a short-term legal requirement and did not comprise part of Company borrowings.

The notes and information on pages 51 to 110 form part of these financial statements.

Company Statement of Changes in Equity for the year ended 31 December 2005

	Year ended 31 December 2005				
	Share capital £000	Share premium £000	Capital redemption reserve £000	Retained earnings £000	Total £000
Equity shareholders' funds at 1 January 2005	**4,228**	**–**	**50**	**–**	**4,278**
Profit for the period representing total recognised income and expenses	–	–	–	18,773	18,773
Dividends paid	–	–	–	(11,249)	(11,249)
Issue of ordinary shares pursuant to exercise of option	84	1,449	–	–	1,533
Issue of ordinary shares pursuant to placing and open offer	917	21,083	–	–	22,000
Expenses incurred in connection with issue of ordinary shares pursuant to placing and open offer	–	(2,074)	–	–	(2,074)
Equity shareholders' funds at 31 December 2005	**5,229**	**20,458**	**50**	**7,524**	**33,261**

	Year ended 31 December 2004			
	Share capital £000	Capital redemption reserve £000	Retained earnings £000	Total £000
Equity shareholders' funds at 1 January 2004	**–**	**–**	**–**	**–**
Issue of ordinary shares as consideration for acquisition of subsidiary company	4,228	–	–	4,228
Issue of redeemable preference share on reorganisation	50	–	–	50
Redemption of preference share	(50)	–	–	(50)
Transfer from retained earnings to redeem preference share	–	50	(50)	–
Profit for the period representing total recognised income and expenses	–	–	3,731	3,731
Dividends paid	–	–	(4,017)	(4,017)
Grant of share option	–	–	336	336
Equity shareholders' funds at 31 December 2004	**4,228**	**50**	**–**	**4,278**

On 9 March 2004, in order to satisfy the requirements of section 117 of the Companies Act 1985 as to the minimum paid up share capital of a public company, a redeemable preference share of £50,000 was issued to one of the subscriber shareholders of the Company. On 22 June 2004 the redeemable preference share was paid up in full and then redeemed. An amount of £50,000, being equal to the par value of the redeemable preference share was transferred from retained earnings to a capital redemption reserve. Accordingly, the transactions in connection with the redeemable preference share were effectively undertaken to meet a short-term legal requirement and did not comprise part of Company borrowings.

The notes and information on pages 51 to 110 form part of these financial statements.

1 General information

Chesnara plc (the Company) is a limited liability company incorporated and domiciled in England and Wales and has primary listings on the London Stock Exchange. The address of the registered office is Harbour House, Portway, Preston PR2 2PR, UK.

The Company and its subsidiaries, together forming the Group, underwrite life risks such as those associated with death, disability and health. The Group also provides a portfolio of investment contracts for the savings and retirement needs of customers through asset management. These activities are performed almost entirely in the UK. The Group is substantially closed to new business, such that new insurance contracts are only issued to existing customers, dependent on their changing needs. New investment contracts relate to the sale of Guaranteed Growth and Guaranteed Income Bonds.

These financial statements were authorised for issue by the Directors on 30 March 2006.

2 Accounting policies

(a) Statement of compliance

EU law (IAS Regulation EC1606/2002) requires that the annual consolidated financial statements of the Company for the year ended 31 December 2005 be prepared in accordance with International Financial Reporting Standards (IFRSs) as adopted by the EU (“Adopted IFRSs”).

Both the Parent Company financial statements and the Group financial statements have been prepared and approved by the Directors in accordance with Adopted IFRSs. In publishing the Parent Company financial statements together with the Group financial statements the Company has taken advantage of the exemption in s230 of the Companies Act 1985 not to present its individual income statement and related notes that form a part of these approved financial statements.

These are both the Parent Company’s and the Group’s first financial statements prepared in accordance with Adopted IFRSs and IFRS 1 First-time Adoption of International Financial Reporting Standards has been applied. IFRS 1 grants certain exemptions from the full requirements of IFRSs in the transition period; none of these exemptions have been utilised by the Company or Group. The Group has taken the exemption granted by IFRS 4 from providing comparatives to the movements in insurance contract provisions set out in Note 28 (on page 87). All IFRSs and interpretations that had been adopted by the EU as at the date the financial statements were authorised for issue by the Directors have been applied with the exception of IFRS 7 Financial Instruments: Disclosure and the amendments to IAS 1 Presentation of Financial Statements: Capital Disclosures which are effective for annual periods beginning on or after 1 January 2007 and have not been adopted early.

When IFRS 7 and the amendments to IAS 1 are eventually applied, the balance sheets, income statements and cash flows of the parent Company and the Group will be unaffected. Changes will be required to the information disclosed in the notes to the financial statements about financial instruments, insurance contracts and the capital position of the Group.

An explanation of how the transition to IFRSs has affected the reported financial position, financial performance and cash flows of the parent Company and the Group is included in Note 48 (on page 108).

(b) Basis of preparation

General

The Group financial statements consolidate those of the Company and its subsidiaries (together referred to as the “Group”). The Parent Company financial statements present information about the Company as a separate entity and not about its group.

The financial statements are presented in pounds sterling, rounded to the nearest thousand and are prepared on the historical cost basis except that the following assets and liabilities are stated at their fair value: derivative financial instruments, financial instruments at fair value through income, investment property and investment contract liabilities at fair value through income.

Assets and liabilities are presented on a current and non-current basis in the notes to the financial statements. If assets are expected to be recovered and liabilities expected to be settled within a year, they are classified as current. If they are expected to be recovered or settled in more than one year, they are classified as non-current.

2 Accounting policies (continued)

The preparation of financial statements in conformity with IFRSs requires management to make judgements, estimates and assumptions that affect the application of policies and reported amounts of assets and liabilities, income and expenses. The estimates and associated assumptions are based on historical experience and various other factors that are believed to be reasonable under the circumstances, the result of which form the basis of making the judgements about carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates.

The estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised in the year in which the estimate is revised if the revision affects only that year, or in the year of the revision and future years if the revision affects both current and future years. Judgements made by management in the process of applying the Group's accounting policies that have a significant effect on the financial statements and estimates with a significant risk of material adjustment in the next year are set out in Note 3 (on page 59).

The accounting policies set out below have been applied consistently to all years presented in these consolidated financial statements and in preparing an opening IFRS balance sheet at 1 January 2004 for the purpose of the transition to Adopted IFRSs.

The financial statements have been prepared in accordance with the disclosure provisions of Financial Reporting Standard 27 Life Insurance, issued by the Accounting Standards Board.

Life business demerger and acquisition by Chesnara plc: reverse acquisition accounting

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 ("Countrywide"), which had, itself, acquired the whole of the issued ordinary 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 Countrywide ("the Countrywide shareholders") as recorded on the shareholders register on 21 May 2004, *pro rata* to their holding in Countrywide, such that they received one ordinary share in Chesnara plc for every two ordinary shares held in Countrywide. 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 Countrywide shareholders received one ordinary 5p share in Chesnara plc for every four ordinary shares held in Countrywide.

In substance the transactions described above represent a continuation of the business of CALH. Chesnara plc, a company with net assets of £2 prior to its acquisition of CALH, was used as a vehicle effectively to secure a listing for the business of CALH on the London Stock Exchange, and, prior to its acquisition of CALH, such net assets did not comprise an integrated set of activities and assets which were capable of generating revenue or of providing a return to investors. Chesnara plc, at the date of its acquisition of CALH, did not, therefore, comprise a business as defined in IFRS 3 Business Combinations. However the consolidated financial statements of Chesnara plc have been prepared based on the reverse acquisition method as set out in IFRS 3, as the Directors consider that this is the fairest way of presenting the financial position, results of operations and cash flows of the combined entities. Accordingly CALH is deemed to be the effective acquirer of Chesnara plc and the consolidated financial statements have been prepared as a continuation of the consolidated financial statements of CALH and its subsidiaries. The consolidated income statement and cash flows for the year ended 31 December 2004 represent the consolidated financial statements of CALH and the results of Chesnara plc are included in the consolidated financial statements from the demerger date as set out above.

The fair value of the identifiable net assets and of the equity instruments of Chesnara plc before its deemed acquisition by CALH are negligible and the deemed consideration, based on the fair value of the equity instruments deemed to have been issued by CALH to the shareholders of Chesnara plc, is also negligible and is taken as £nil. Accordingly, the application of the purchase method of accounting for the deemed acquisition of Chesnara plc by CALH does not give rise to any goodwill or negative goodwill in the consolidated financial statements.

(c) Basis of consolidation

Subsidiaries

The consolidated financial statements incorporate the assets, liabilities and the results of the Company and of its subsidiary undertakings. Subsidiary undertakings are those entities in which the Group directly or indirectly has the power to govern the financial and operating policies in order to gain benefits from their activities. The financial statements of subsidiaries are included in the consolidated financial statements from the date that control commences until the date that control ceases.

Intragroup balances, and any income and expenses or unrealised gains or losses arising from intragroup transaction, are eliminated in preparing the consolidated financial statements.

(d) Business combinations

The Group uses the purchase method of accounting to account for the acquisition of subsidiaries. The cost of an acquisition is measured as the fair value of the assets given, equity instruments issued and liabilities incurred or assumed at the date of exchange, plus costs directly attributable to the acquisition. Identifiable assets acquired and liabilities and contingent liabilities assumed in a business combination are measured initially at their fair values at the acquisition date.

(e) Product classification

The Group's products are classified as either insurance or investment contracts for accounting purposes. Insurance contracts are contracts, which transfer significant insurance risk. Contracts under which the transfer of insurance risk to the company from the policyholder is not significant are classified as investment contracts. Where contracts contain both insurance and investment components and the investment components can be measured reliably, the contracts are unbundled and the components are separately accounted for as insurance contracts and investment contracts respectively.

(f) Insurance contracts

(i) Premiums

Premiums are accounted for when due, or in the case of unit-linked insurance contracts when the liability is recognised, and exclude any taxes or duties based on premiums. Outward reinsurance premiums are accounted for when due.

(ii) Claims and benefits

Claims are accounted for in the accounting period in which they are due or notified. Surrenders are accounted for in the accounting period in which they are paid. Claims include policyholder bonuses allocated in anticipation of a bonus declaration. Reinsurance recoveries are accounted for in the same period as the related claim.

(iii) Acquisition costs

Acquisition costs comprise all direct and indirect costs arising from the conclusion of insurance contracts. An explicit deferred acquisition cost asset is established in the balance sheet to the extent that acquisition costs exceed initial fees deducted. Deferred acquisition costs are amortised at a rate based on the pattern of anticipated margins in respect of the related policies. Deferral of costs is limited to the extent that there are available future margins.

Renewal commission and other direct and indirect acquisition costs arising on enhancements to existing contracts are expensed as incurred.

(iv) Measurement of insurance contract provisions

Under current IFRS requirements, insurance contract provisions are measured using accounting policies having regard to the principles laid down in Council Directive 2002/83/EC.

Unit-linked provisions are measured by reference to the value of the underlying net asset value of the Group's unitised investment funds, determined on a bid value, at the balance sheet date. Deferred tax on unrealised capital gains is also reflected in the measurement of unit-linked provisions.

Insurance contract provisions are determined following an annual actuarial investigation of the long-term funds in accordance with regulatory requirements. The provisions are calculated on the basis of current information and using the appropriate valuation method.

2 Accounting policies (continued)

For immediate annuities in payment the provision is calculated as the discounted value of the expected future annuity payments under the policies, allowing for mortality, interest rates and expenses.

For the other classes of non-linked business the provision is calculated on a net premium basis, being the level of premium consistent with a premium stream, the discounted value of which, at the outset of the policy, would be sufficient to cover exactly the discounted value of the original guaranteed benefits at maturity, or at death if earlier, on the valuation basis. The provision is then calculated by subtracting the present value of future net premiums from the present value of the benefits guaranteed at maturity, or death if earlier, as a result of events up to the balance sheet date. Negative provisions do not arise under the net premium method, which makes no allowances for voluntary discontinuances by policyholders, and which only implicitly allows for future policy maintenance costs.

For those classes of non-linked and unit-linked business where policyholders participate in profits the liability is wholly reassured to Guardian Assurance plc. The liability is calculated on a net premium basis, but is then increased to net asset share as a result of the liability adequacy test.

Insurance contract provisions can never be definitive as to their timing nor the amount of claims and are therefore subject to subsequent reassessment on a regular basis.

Insurance contract provisions are tested for adequacy by discounting current estimates of all contractual cash flows and comparing this amount to the carrying value of the provision and any related assets. Where a shortfall is identified, an additional provision is made and the Group recognises the deficiency in income for the year.

(g) Investment contracts

(i) Amounts collected

Amounts collected on investment contracts, which primarily involve the transfer of financial risk such as long-term savings contracts, are accounted for using deposit accounting, under which the amounts collected, less any initial fees deducted, are credited directly to the balance sheet as an adjustment to the liability to the investor.

(ii) Amounts deposited with reinsurers

Amounts deposited with reinsurers under reinsurance arrangements, which primarily involve the transfer of financial risk, are entered directly to the balance sheet as amounts deposited with reinsurers. These assets are designated on initial recognition as at fair value through income.

(iii) Benefits

For investment contracts, benefits paid are not included in the income statement but are instead deducted from investment contract liabilities in the accounting period in which they are paid.

(iv) Acquisition costs

Acquisition costs relating to investment contracts comprise directly attributable incremental acquisition costs, which vary with and are related to securing new contracts, and are recognised as an asset to the extent that they represent the contractual right to benefit from the provision of investment management services. The asset is presented as a deferred acquisition cost asset and is amortised over the expected term of the contract, as the fees relating to the provision of the services are recognised. All other costs are recognised as expenses when incurred.

(v) Liabilities

All investment contract liabilities are designated on initial recognition as held at fair value through income. The financial liability in respect of unit-linked contracts is measured by reference to the value of the underlying net asset value of the Group's unitised investment funds, determined on a bid value, at the balance sheet date. Deferred tax on unrealised capital gains is also reflected in the measurement of unit-linked provisions.

The Group has designated investment contract liabilities at fair value through Income as this more closely reflects the basis on which the business is managed. Guaranteed Income and Guaranteed Growth Bond liabilities and other investment contract liabilities are managed together with related investment assets on a fair value basis as part of the documented risk management strategy.

The fair value of other investment contracts is measured by discounting current estimates of all contractual cash flows that are expected to arise under contracts.

(h) Contracts with discretionary participation features (DPF)

A discretionary participation feature is a contractual right held by a policyholder to receive, as a supplement to guaranteed minimum payments, additional payments that are likely to be a significant portion of the total contractual payments. All such contracts are wholly reinsured with Guardian Assurance plc, a subsidiary of Aegon NV and the amount or timing of the additional payments are contractually at the discretion of the reinsurer and are contractually based on:

(i) the performance of a specified pool of contracts or a specified type of contract,

(ii) realised and/or unrealised investment returns on a specified pool of assets held by the reinsurer, or

(iii) the profit or loss of the reinsurer.

All contracts with discretionary participation features, whether classified as investment or insurance contracts, are accounted for as insurance contracts.

(i) Reinsurance

The Group cedes reinsurance in the normal course of business for the purpose of avoiding the retention of undue concentration of risk on any one life. Assets, liabilities and income and expense arising from ceded reinsurance contracts are presented separately from the related assets, liabilities, income and expenses from the related insurance contracts because the reinsurance arrangements do not relieve the Group from its direct obligations to its policyholders.

Only rights under contracts that give rise to a significant transfer of insurance risk are accounted for as reinsurance assets. Rights under contracts that do not transfer significant insurance risk are accounted for as financial instruments.

The net premiums payable to a reinsurer may be more or less than the reinsurance assets recognised by the Group in respect of the reinsurance cover purchased. Any gain or loss is recognised in the income statement in the period in which the reinsurance premiums are payable.

Rights under reinsurance contracts comprising the reinsurers' share of insurance contract provisions and accrued policyholder claims are estimated in a manner that is consistent with the measurement of the provisions held in respect of the related insurance contracts. Such assets are deemed impaired if there is objective evidence, as a result of an event that occurred after its initial recognition, that the Group may not recover all amounts due and the event has a reliably measurable impact on the amounts that the Group will receive from the reinsurer.

(j) Fee and commission income

Fees charged for investment management services provided in connection with investment contracts are recognised as revenue as the services are provided. Initial fees which exceed the level of recurring fees and relate to the future provision of services are deferred and amortised over the anticipated period in which services will be provided.

Initial fees charged for investment management services provided in connection with insurance contracts are recognised as revenue when received.

For both insurance and investment contracts, initial fees on regular premiums, annual management charges and contract administration charges are recognised as revenue on an accruals basis. Surrender charges are recognised as a reduction to policyholder claims and benefits incurred when the surrender benefits are paid.

Benefit based fees comprising charges made to unit-linked insurance and investment funds for mortality and morbidity benefits are recognised as revenue on an accruals basis.

Commissions received or receivable which do not require the Group to render further services are recognised as revenue by the Group on the effective commencement or renewal dates of the related contract. However, when it is probable that the Group will be required to render further services during the life of the contract, the commission, or part thereof, is deferred and recognised as revenue over the period in which services are rendered.

(k) Investment income

Investment income comprises income from financial assets and rental income from investment properties.

Income from financial assets comprises dividend and interest income, net fair value gains and losses (both unrealised and realised) in respect of financial assets classified as fair value through income, and realised gains on financial assets classified as loans and receivables.

2 Accounting policies (continued)

Dividends are accrued on an ex-dividend basis. Interest received and receivable in respect of interest-bearing financial assets classified as fair value through income is included in net fair value gains and losses. For loans and receivables and cash and cash equivalents interest income is calculated using the effective interest method.

Rental income from investment properties under operating leases is recognised in the income statement on a straight-line basis over the term of each lease. Lease incentives are recognised in the income statement as an integral part of the total lease income.

(l) Expenses

(i) Operating lease payments

Leases where a significant proportion of the risks and rewards of ownership is retained by the lessor are classified as operating leases. Payments made under operating leases are recognised in the income statement on a straight-line basis over the term of the lease. Lease incentives received are recognised in the income statement as an integral part of the total lease expense.

(ii) Financing costs

Financing costs comprise interest payable on borrowings calculated using the effective interest rate method.

(m) Income taxes

Income tax on the profit or loss for the year comprises current and deferred tax and is recognised in the income statement.

(i) Current tax

Current tax is the expected tax payable on the taxable income for the year, using tax rates enacted or substantively enacted at the balance sheet date, and any adjustment to tax payable in respect of previous years.

(ii) Deferred tax

Deferred tax is provided using the balance sheet liability method, providing for temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes. The amount of deferred tax provided is based on the expected manner of realisation or settlement of the carrying amount of assets and liabilities, using tax rates enacted or substantively enacted at the balance sheet date.

A deferred tax asset is recognised only to the extent that it is probable that future taxable profits will be available against which the asset can be utilised. Deferred tax assets are reduced to the extent that it is no longer probable that the related tax benefit will be realised.

(n) Acquired value of in-force business

Acquired in-force insurance and investment contracts are measured at fair value at the time of acquisition.

The difference between the fair value of insurance contracts and the liability measured in accordance with the Group's accounting policies for the contracts is recorded as acquired present value of in-force business ("Acquired PVIF"). Acquired PVIF is carried gross of tax and is amortised against income on a time profile which, it is intended, will broadly match the profile of the underlying emergence of surplus as anticipated at the time of acquisition. It is tested for impairment if there are indications that recoverability of the full carrying value is in doubt.

Acquired PVIF in respect of in-force investment contracts is stated at cost less accumulated amortisation and impairment losses. The initial cost is deemed to be the fair value of the contractual customer relationships acquired. The acquired present value of the in-force investment contracts is carried gross of tax and is amortised against income on a time profile which, it is intended, will broadly match the profile of the underlying emergence of profit from the contracts. It is tested for impairment annually.

(o) Property and equipment

Items of property and equipment are stated at cost less accumulated depreciation and impairment losses.

Depreciation is charged to the income statement on a straight-line basis over the estimated useful lives of the property and equipment as follows:

Computers	5 years
Fixtures and fittings	5 years
Office equipment	5 years
Motor vehicles	4 years

(p) Investment property

Investment properties are properties which are held either to earn rental income or for capital appreciation or for both. On initial recognition investment properties are measured at cost including attributable transaction costs, and are subsequently measured at fair value. Independent external valuers, having an appropriate recognised professional qualification and recent experience in the location and category of property being valued, value the portfolio every twelve months.

The fair values reflect market values at the balance sheet date, being the estimated amount for which a property could be exchanged on the date of valuation between a willing buyer and a willing seller in an arm's length transaction after proper marketing wherein the parties had each acted knowledgeably, prudently and without compulsion.

Any gain or loss arising from a change in fair value is recognised in the income statement. Rental income from investment property is accounted for as described in accounting policy (k).

(q) Financial assets

Financial assets are classified into different categories depending on the type of asset and the purpose for which it is acquired. Currently two different categories of financial assets are used: 'financial assets at fair value through income' and 'loans and receivables'. Financial assets classified as fair value through income comprise financial assets designated as such on initial recognition and derivative financial instruments.

All financial assets held for investment purposes other than derivative financial instruments are designated as fair value through income on initial recognition since they are managed, and their performance is evaluated, on a fair value basis in accordance with documented investment and risk management strategies. This designation is also applied to the Group's investment contracts, since the investment contract liabilities are managed together with the investment assets on a fair value basis as part of the documented risk management strategy.

Purchases and sales of 'regular way' financial assets are recognised on the trade date, which is when the Group commits to purchase, or sell the assets.

All financial assets are initially measured at fair value plus, in the case of financial assets not classified as at fair value through income, transaction costs that are directly attributable to their acquisition.

Subsequent to initial recognition, financial assets classified as fair value through income are measured at their fair value without any deduction for transaction costs that may be incurred on their disposal.

The fair value of financial assets quoted in an active market is their bid prices at the balance sheet date. If the market for a financial asset is not active, the Group establishes fair values by using a valuation technique. Valuation techniques include the use of recent arm's length market transactions, references to the current fair value of another instrument that is substantially the same, discounted cash flow analysis and option pricing models. If the value of equity instruments cannot be reliably measured, they are measured at cost.

Financial assets classified as loans and receivables are stated at amortised cost less impairment losses.

(r) Derivative financial instruments

Derivative financial instruments are recognised at fair value. The gain or loss on remeasurement to fair value is recognised immediately in profit or loss. Hedge accounting has not been applied.

The fair value of interest rate swaps is the estimated amount that the Group would receive or pay to terminate the swap at the balance sheet date, taking into account current interest rates and the current creditworthiness of the swap counterparties. The fair value of forward exchange contracts is their quoted market price at the balance sheet date, being the present value of the quoted forward price.

(s) Cash and cash equivalents

Cash and cash equivalents include cash in hand, deposits held at call with banks and other short-term highly liquid investments. Highly liquid is defined as realisable into cash within 90 days.

(t) Impairment

The carrying amounts of the Group's assets which are not carried at fair value are reviewed at each balance sheet date to determine whether there is any indication of impairment. If any such indication exists, the assets' recoverable amount is estimated. An impairment loss is recognised whenever the carrying amount of an asset exceeds its recoverable amount. Impairment losses are recognised in the income statement.

Impairment losses are reversed through the income statement if there is a change in the estimates used to determine the recoverable amount. Such losses are reversed only to the extent that the assets' carrying amount does not exceed the carrying amount that would have been determined, net of depreciation or amortisation where applicable, if no impairment loss had been recognised.

2 Accounting policies (continued)

(u) Provisions

Provisions are recognised when the Group has a present, legal or constructive obligation as a result of past events such that it is probable that an outflow of economic benefits will be required to settle the obligation and a reliable estimate of the amount of the obligation can be made. Where the effect of the time value of money is material, the amount of the provision is the present value of the expenditures expected to be required to settle the obligation. The Group recognises provisions for onerous contracts when the expected benefits to be derived from a contract are less than the unavoidable costs of meeting the obligations under the contract.

(v) Borrowings

Borrowings are recognised initially at fair value, less transaction costs and are subsequently stated at amortised cost. The difference between the carrying value on initial recognition and the redemption value is recognised in the income statement over the borrowing period on an effective interest rate basis.

(w) Employee benefits

(i) Pension obligations

Group companies operate defined contribution pension schemes, which are funded through payments to insurance companies, to which Group companies pay fixed contributions. There are no legal or constructive obligations on Group companies to pay further contributions if the fund does not hold sufficient assets to pay employee benefits relating to service in current and prior periods. Accordingly, Group companies have no further payment obligations once the contributions have been paid.

Contributions to defined contribution pension schemes are recognised as employee benefit expense when they are due.

(ii) Bonus plans

The Group recognises a liability and an expense for bonuses based on a formula that takes into consideration the profit attributable to the Company's shareholders after certain adjustments. The expense is recognised in income on an accruals basis.

(x) Share capital

Shares are classified as equity when there is no obligation to transfer cash or other assets. Incremental costs directly attributable to the issue of equity instruments are shown in equity as a deduction from the proceeds, net of tax. Incremental costs directly attributable to the issue of equity instruments, as consideration for the acquisition of a business, are included in the cost of acquisition.

(y) Dividends

Dividend distributions to the Company's shareholders are recognised as liabilities in the period in which the dividends are paid, and, for the final dividend, when approved by the Company's shareholders at the annual general meeting.

(z) Foreign currency transactions

Foreign currency transactions are translated into pounds sterling at the foreign exchange rate ruling at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies are translated into pounds sterling at the foreign exchange ruling at the balance sheet date. Foreign exchange differences arising on translation are recognised in the income statement.

3 Accounting estimates and judgements

The Group makes estimates and assumptions that affect the reported amounts of assets and liabilities and also makes critical accounting judgements in applying the Group's accounting policies. Such estimates and judgements are continually evaluated and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable. The more critical areas where accounting estimates and judgements are made are described below.

(a) Classification of long-term contracts

The Group has exercised judgement in its classification of long-term business as between insurance and investment contracts, which fall to be accounted for differently in accordance with the policies set out in Note 2 Accounting Policies (on page 51). Insurance contracts are those where significant risk is transferred to the Group under the contract and judgement is applied in assessing whether the risk so transferred is significant, especially with regard to pensions contracts, which are predominantly, but not exclusively, created for investment purposes.

(b) Estimates of future benefits payments arising from long-term insurance contracts

The Group makes estimates of the expected number of deaths for each of the years that it is exposed to risk. These estimates are based on standard mortality tables adjusted to reflect the Group's own experience. For contracts without fixed terms the Group has assumed that it will be able to increase charges to policyholders in future years, in line with emerging mortality experience.

The Group has offered guaranteed annuity options within certain contracts. Estimates have been made of the number of contract holders who will exercise these options, in order to measure their value. Changes in investment conditions could result in significantly more contract holders exercising their options than the Group has assumed in determining the liabilities arising from these contracts.

The Group makes estimates of future deaths, voluntary contract terminations, investment returns and administration expenses at the inception of long-term insurance contracts with fixed and guaranteed terms. These estimates, which are reconsidered annually, form the assumptions used to calculate the liabilities arising from these contracts.

The assumptions used to establish insurance contract liabilities and appropriate sensitivities relating to variations in critical assumptions are disclosed in Note 28 (on page 87).

(c) Fair value of investment contracts

Guaranteed Income and Guaranteed Growth Bonds

The fair value of investment contract liabilities, in respect of Guaranteed Income and Guaranteed Growth Bonds, (which are fully described in Note 4(b) (on page 64)) is established using a valuation technique, which broadly approximates the following methodology:

(i) the fair value of the contract, measured at inception, is the purchase price paid for it. This price implies a retail market rate of interest prevailing at the inception of the contract, which is used to equate the contractual cash flows payable under the bond to the purchase price, including an allowance for expenses incurred in managing the contract;

(ii) subsequent measurement of the liability at fair value reflects the impact of changes in retail market interest rates for these products: this is accomplished in practice by tracking movements in the less-than-5-year gilt index as the bonds are predominantly less than 5 years in term.

This methodology has been adopted to reduce volatility in reported earnings in the income statement as the liabilities so determined are measured in a way which is consistent with the fair value of the underlying invested financial assets.

(d) Liability for future redress in respect of mortgage endowment misselling complaints

Included within insurance contract liabilities is a liability in respect of amounts anticipated to be payable as redress for upheld mortgage endowment misselling complaints. In establishing this liability the Group makes estimates about the number of future upheld complaints (taking into account the number of complaints received, the number of complaints time-barred and the number of complaints which are admitted) and about the average cost of redress per upheld complaint. These estimates are determined, taking into account historical experience and investment return projections. Variations in these estimates could result in higher or lower than expected numbers of upheld complaints and higher or lower than expected amounts of redress per upheld complaint. The impact of variations in these assumptions is disclosed in Note 28 (on page 87) to these financial statements.

3 Accounting estimates and judgements (continued)

(e) Deferred acquisition costs and deferred income

The Group applies judgement in deciding the amount of direct costs that are incurred in acquiring the rights to provide investment management services in connection with the issue of investment contracts. Judgement is also applied in establishing the amortisation of the assets representing these contractual rights and the recognition of initial fees received in respect of these contracts. The assets are amortised on a straight-line basis over the lifetime of the investment management service contracts and deferred income is amortised on a straight-line basis over the period in which it is earned. Estimates are applied in determining the lifetime of the investment management service contracts and in determining the recoverability of the contractual rights assets by reference to expected future income and expense levels. This test for recoverability is performed using best estimates of future cash flows, using a market consistent estimate of future investment returns.

(f) Amortisation of acquired value of in-force business

The Group applies accounting estimates and judgement in determining the fair value, amortisation and recoverability of acquired in-force business relating to insurance and investment contracts. The acquired value of in-force business has been amortised on a basis that reflects the expected profit stream arising from the business acquired at the date of acquisition. This profit stream is estimated from the experienced termination rates, expenses of management and age of the individual contract holders as well as global estimates of investment growth, based on recent experience at the date of acquisition. Acquired value of in-force business is tested for recoverability by reference to expected future income levels, if there are indications that recoverability of the full carrying value is in doubt.

4 Management of insurance and financial risk

The Group's management of insurance and financial risk is a critical aspect of the business. For a significant proportion of the Group's life insurance contracts, the cash flows are linked, directly or indirectly, to the performance of the financial assets which support those contracts. This gives rise to financial risk, which also arises on the Group's investment contracts in relation to financial assets which support these contracts. The Group has procedures for setting and monitoring the Group's assets and liability position with the objective of ensuring that the Group can always meet its obligations without undue cost and in accordance with the Group's internal and regulatory capital requirements.

(a) Insurance risk management

Introduction

The primary insurance activity carried out by the Group comprises the assumption of the risk of loss from persons that are directly subject to the risk. Such risks in general relate to life, accident, health and financial perils that may arise from an insurable event with the majority of the Group's exposure relating to mortality risk on individual lives, predominantly in the UK. As such the Group is exposed to the uncertainty surrounding the timing and severity of claims under the related contracts. The Group also has exposure to market risk through its insurance and investment activities.

The Group manages its insurance risk through underwriting limits, approval procedures for new products or for policies that exceed set limits, pricing guidelines, reinsurance and monitoring of emerging issues. The Group is substantially closed to new insurance business and, in practice, only sells a limited amount of new insurance business to existing policyholders: the assumption of new insurance risks is, accordingly, limited.

The principal risk is that the frequency and severity of claims is greater than expected. The theory of probability is applied to the pricing and provisioning for a portfolio of insurance contracts. Insured events are, by their nature, random, and the actual number and size of events during any one year may vary from those estimated using established statistical techniques. The risk under assurance policies is partly naturally hedged by risks under annuity policies where the exposure is to the risk of longevity.

Underwriting strategy

The aim of the underwriting strategy is to avoid the assumption of undue concentration of risk on any one life and there are defined underwriting procedures embracing the limits on cover for individual policies.

Reinsurance strategy

The aim of the reinsurance strategy is to reinforce the underwriting strategy by avoiding the retention of undue concentration of risk on any one life. Accordingly, there is a policy on reinsurance, which limits the total exposure on any one policy. However there are a small number of policies which breach these limits due to historical reasons.

The Group holds a wide range of reinsurance treaties, including wholly reinsured business and risk premium reinsurance which includes original terms reinsurance and facultative reinsurance.

Ceded reinsurance contains credit risk, and such reinsurance recoverables are reported after deductions for known insolvencies and uncollectable items. The Group monitors the financial condition of reinsurers on an ongoing basis and reviews its reinsurance arrangements periodically.

The Group has a policy in place of only entering into new reinsurance contracts with reinsurers rated A and above.

Terms and conditions of insurance contracts

The terms and conditions of insurance contracts that have a material effect on the amount, timing and uncertainty of future cash flows arising from insurance contracts are set out in the product analyses below, which gives an assessment of the Group's main products and the ways in which it manages the associated risks.

	Sums assured – gross and net of reassurance 31 December 2005	
	Gross £000	Net £000
Annuities-immediate (per annum)	3,553	3,449
Long-term with DPF	85,759	–
Long-term without DPF	7,093,121	4,695,350
Total	**7,182,433**	**4,698,799**

Long-term insurance contracts – immediate annuities

Product features

This type of annuity is purchased with a single premium at outset, and is paid to the policyholder for the remainder of his/her lifetime. Annuities may be level or escalate at a fixed rate.

There are two types of immediate annuities: retirement and voluntary. Voluntary annuities are made at the discretion of the policyholder. Policyholders of personal pensions may have to purchase an immediate annuity on retirement. Other variations (joint life annuities) are to continue the annuity (at the same level or lower) to the surviving spouse or partner.

Payments are often guaranteed to be paid for a minimum term regardless of survival (e.g. 5 or 10 years).

Profit on existing contracts arises when mortality and investment experience are better than expected. All risks and rewards associated with this type of product accrue to shareholders.

Management of risks

The main risks associated with this product are longevity and investment risks. Longevity risks arise as the annuities are paid for the lifetime of the policyholder, and this risk is managed through the initial pricing of the annuity. Investment risk depends on the extent to which the annuity payments under the contracts have been matched by suitable assets. The Group regularly monitors the asset matching for these contracts as discussed in "Market risk" below.

The key risks are managed through appropriate pricing and product design. Reinsurance is not generally used for this product, although there is a small number of reinsured policies. Underwriting is not used for this product.

In respect of mortality risk (longevity), the pricing assumption is based on both historic in-house and industry available information on mortality experience for the population of policyholders, including allowances for future mortality improvements.

4 Management of insurance and financial risk (continued)

In respect of investment risk, with this type of product the lump sum premium is available for the Group to invest at the start of the contract. The asset mix will consist of fixed interest securities, including gilts, with varying redemption dates. The income earned on the investment will not usually be sufficient to cover the annuity and the expense outgo, so each year part of the lump sum will be disinvested, which is taken account of in the asset mix, in order to balance the fund. If annuitants die as expected the assets referred to above would be appropriate. However, in most cases annuitants will not die as expected and, therefore, the Group will need to buy and sell assets as necessary throughout the term of the policies to minimise the risk of mismatch. This position is monitored on a regular basis. Details of default risk on the fixed interest securities are covered under the "Credit risk" section below.

Concentration of insurance risks

The tables for immediate annuity contracts set out below illustrate the concentration of risk based on two bands of contracts grouped by the annuity payable each year for each annuity policy insured.

Annuity payable each year for each life insured	Total annuities payable each year			
	Before reassurance		After reassurance	
	£000	%	£000	%
As at 31 December 2005				
£0 – £25,000	3,508	98.7	3,440	99.7
More than £25,000	45	1.3	9	0.3
	3,553	100	3,449	100
As at 31 December 2004				
£0 – £25,000	776	94.5	705	98.7
More than £25,000	45	5.5	9	1.3
	821	100	714	100

Long-term insurance contracts – with discretionary participation features

Product features

The Group historically wrote with-profits business in the UK, where the policyholder benefits comprise a discretionary annual bonus and a discretionary terminal bonus.

Management of risks

This business is wholly reassured to Guardian plc and hence the only risk retained by the Group for this business is the risk of default by the reinsurer. This risk is detailed under "Credit risk" below.

Long-term insurance contracts – without discretionary participation features

Product features

The Group has written both non-linked and unit-linked contracts, with benefits including death and morbidity benefits on a whole life, endowment and term assurance basis.

For contracts where death is the insured risk, the most significant factors that could increase risk are epidemics (such as AIDS, SARS or a flu pandemic) or widespread changes in lifestyle, such as eating, smoking and exercise habits, resulting in earlier or more claims than expected.

Management of risks

Unit-linked insurance contracts are contracts where monthly reviewable charges are made for insurance risk and administration charges and consist mainly of regular unit-linked endowments where the primary purpose is to provide an investment return. In addition, the policyholder is insured against death and serious injury. Unit-linked contracts operate by investing the policyholders' premiums into pooled investment funds of the Group, the policyholders' share of the fund being represented by units. The benefit is payable on death, or maturity if earlier, the amount payable on death being subject to a guaranteed minimum amount. The maturity or surrender value depends on the investment performance of the underlying fund and on the level of charges levied by the Group for policy administration fees, mortality and other charges.

For contracts with fixed and guaranteed benefits and fixed future premiums, there are no mitigating terms and conditions that reduce the insurance risk accepted. This is the case for a small proportion (approximately 5.1% of total sums assured) of the Life Assurance business sold by the Group.

For the remainder of the business, operated on a quasi-linked basis, the Group charges for mortality risk on a monthly basis and has the right to alter these charges based on its mortality experience and hence minimise its exposure to mortality risk. The Group also reserves the right at regular intervals to change the premium payable in the light of charges made for insurance risk and administration services and the investment performance of the assets notionally backing these contracts. Delays in implementing increases in charges and market or regulatory restraints over the extent of the increases may reduce this mitigating effect.

A number of these contracts also include Permanent Health Insurance (PHI) benefits which have reviewable charges and the Group reserves the right to alter these charges based on its morbidity experience and hence to minimise its exposure to morbidity risk. Delays in implementing increases in charges and market or regulatory restraints over the extent of the increases may reduce this mitigating effect.

Reinsurance is used extensively on the business described above to mitigate concentrations of insurance risk.

For units held under unit-linked contracts all of the investment risk is borne by the policyholder, with the exception of a small number of contracts which provide for a minimum guaranteed rate of return, as investment performance directly affects the value of the unit fund and hence the benefits payable. Therefore, the Group is exposed only to insurance risk insofar as the value of the unit fund is lower than the guaranteed minimum death benefit. This insurance risk is managed primarily through pricing, product design and appropriate investment strategy.

Concentration of insurance risk

The tables for long term insurance contracts set out below illustrate the concentration of risk based on five bands of contracts grouped by benefits assured for each policy assured.

Benefits assured for each life assured	**Total benefits assured**			
	Before reassurance		**After reassurance**	
In £000 bands	**£m**	**%**	**£m**	**%**
As at 31 December 2005				
0 – 250	6,986	97.3	4,680	99.7
250 – 500	133	1.9	13	0.3
500 – 750	32	0.4	2	–
750 – 1,000	16	0.2	–	–
More than 1,000	12	0.2	–	–
	7,179	100	4,695	100
As at 31 December 2004				
0 – 250	7,559	97.5	4,725	100
250 – 500	122	1.6	1	–
500 – 750	34	0.4	1	–
750 – 1,000	18	0.2	–	–
More than 1,000	21	0.3	–	–
	7,754	100	4,727	100

In addition to the above the Group has, at 31 December 2005, a total of approximately £18m per annum of retained PHI sums assured. The Group does not retain PHI sums assured on any one life greater than £25,000 per annum.

4 Management of insurance and financial risk (continued)

Long-term insurance contracts – guaranteed annuity options

Product features

There are a small number of unit-linked deferred annuity policies (which are investment contracts) with guarantees regarding the rate at which the policyholder is able to convert the unit fund into an annuity at retirement, which creates an insurance liability. At retirement the fund available can either be transferred to another provider, used to purchase an annuity with a Group company at the current annuity rates then applying, or used to purchase an annuity from a Group company at guaranteed annuity rates written into the policy document. The guaranteed annuity rates are only available in certain circumstances. Policyholders gain the benefit of whichever of the then-current annuity rates or guaranteed annuity rates gives them the higher benefits.

Management of risks

The main risks associated with this product are longevity and market risks. These were controlled through product design and pricing. However, the guaranteed annuity rates were set during the 1960s and 1970s, when these products were sold. As these rates are no longer suitable in current conditions, appropriate technical provisions are held to reflect the risk arising from the guarantees.

The longevity assumptions underlying the technical provisions are based on both historic in-house and industry available information on mortality experience for the population of policyholders, including allowances for future mortality improvements.

Concentration of insurance risks

There are 417 such policies in force at 31 December 2005. The underlying contracts have total unit funds of £4.7m, with the largest fund being less than £0.2m.

Other risks on insurance contracts

Apart from financial risks relating to the financial assets, which support life assurance contracts, (described below), there are other significant types of risk pertaining to life insurance contracts, as follows:

Expense risk

The Group strategy is to outsource policy administration to third party administrators in order to reduce the significant expense inefficiencies that would arise with fixed and semi-fixed costs on a diminishing policy base. There are, however, risks associated with the use of outsourcing. In particular, there will be a need in future to renegotiate the terms of the outsourcing arrangements as the existing agreement expires. There is also a risk that at some point in the future third party administrators could default on their obligations. The Group monitors the financial soundness of third party administrators and it has retained step-in rights on the more significant of these agreements. There are also contractual arrangements in place which provide for financial penalties in the event of default by the administration service providers.

Mortgage endowment misselling complaints

The Life businesses have experienced a significant level of complaints from mortgage endowment policyholders since their first regulatory mailing programme in 2000. In response to this, the Life businesses hold mortgage endowment complaints redress provisions. The Group continues to monitor closely, among other factors, the volume of complaints and the value of compensation paid to policyholders in order to assess the continuing adequacy of the provisions.

There remains however a residual risk that at some point in future the levels of complaints received may prove to be significantly higher than those anticipated within the provision.

(b) Investment contracts

Description of investment contracts

The Group provides three types of investment contract which are predominantly written in the UK.

(i) Unit-linked savings

These are typically single premium contracts, with the premiums invested in a pooled investment fund (usually an internal fund of the life assurance company), where the policyholder's investment in the fund is represented by units. The benefits payable at maturity or surrender of the contract are the bid value of these units.

The key variables affecting the timing and uncertainty of future cash flows are investment performance, persistency and expense inflation.

(ii) Unit-linked pensions

The contractual features are similar to unit-linked savings, except they may be single or regular premium contracts. The benefits payable on retirement purchase an open market pension annuity.

The key variables affecting the timing and uncertainty of future cash flows are investment performance, interest risks, persistency and expense inflation.

(iii) Guaranteed Income and Growth Bonds

These are mainly single premium contracts for a fixed term offering either monthly or annually fixed payments together with a return of premium at the maturity date. A guaranteed growth bond variant has also been issued which offers no income but a higher guaranteed payment at the maturity date.

The key variables affecting the timing and uncertainty of cash flows are expense inflation, interest rates, persistency and mortality.

Risks associated with investment contracts

The risks associated with investment contracts are expense risk, persistency risk and market risk. Market risk is the risk of loss of fair value resulting from adverse fluctuations in interest and foreign currency exchange rates and in equity prices and the consequent effect that this has on the value of charges earned by the Group and on any guarantees in the contracts. Expense risk is of the same nature as described under other risks on insurance contracts above. Persistency risk is the risk that the investor cancels the contract or discontinues paying new premiums into the contract, thereby exposing the Group to a loss resulting from an adverse movement in the actual experience compared to that expected in the product pricing. Although changes in the levels of persistency would not adversely affect the result in the short term they would reduce future profits available from the contract.

(c) Financial risk management

The Group is exposed to financial risk through its life assurance contracts, financial assets, the financial liabilities which it issues, including investment contracts, and its reinsurance assets. These financial risks include market risk, credit risk (including risk of reinsurer default), and liquidity risk. Each of these financial risks is described below, together with a summary of the ways in which the Group manages them.

Market risk

Market risk is the risk that arises from exposure to adverse variations in the fair value of financial instruments due to changes in interest rates, asset prices (including equities) and foreign currency exchange rates.

(1) Interest rate risk in insurance contracts and financial instruments

The Group's exposure to market risk for changes in interest rate is concentrated in its investment portfolio, and to a lesser extent, its debt obligations. However, changes in investment values attributable to interest rate changes are mitigated by corresponding and partially offsetting changes in the economic value of insurance contract provisions, investment contract liabilities and debt obligations. The Group monitors this exposure through periodic reviews of its asset and liability positions. Estimates of cash flows, as well as the impact of interest rate fluctuations relating to the Group's investment portfolio and insurance contract provisions, are monitored periodically. The Group's objective is to match the timing of cash flows from insurance and investment contract liabilities with the timing of cash flows from assets subject to identical or similar risks. This policy ensures that the Group is able to meet its obligations under its contractual liabilities as they fall due. The overall objective of these strategies is to limit the net changes in the value of assets and liabilities arising from interest rate movements. The Group believes that interest rate movements will generate asset value changes that substantially offset changes in the value of the liabilities relating to the underlying products.

The Group specifically writes a number of contracts which expose it to interest rate risk. Primarily, these are annuities and non-linked investment contracts.

4 Management of insurance and financial risk (continued)

Annuities

The Group's immediate annuities expose it to interest rate risk. Deviations from expected mortality expose the Group to interest rate risk as the interest-bearing asset which back the annuities may not match the duration of the cash out-flows, with a consequential risk that the Group will not be able to invest in assets with suitable returns to support the annuity payments. There is also an exposure to interest rates arising as a result of the guaranteed annuity option described above, in respect of a small number of deferred annuities.

Non-linked investment contracts

The Group writes Guaranteed Income and Guaranteed Growth Bonds which contain guaranteed payments. The Group is exposed to interest rate risk in these contracts as it holds interest-bearing securities which are expected to meet the cash flows from the bonds. This risk is managed through investing in fixed interest securities which mature at the guaranteed value, although there is some residual risk which arises from the effect of the uncertainty in timing of cash flows due to the variability inherent in deaths and surrenders before maturity.

The Group is also exposed to the risk of changes in future cash flows from fixed income securities arising from changes in market interest rates.

The table below summarises the effective interest rates at the balance sheet date for interest-bearing assets and liabilities, together with the contractual maturity dates of those assets and liabilities.

Interest bearing assets and liabilities

		Non-linked						
As at 31 December 2005	**Effective interest rate %**	**Less than one year £000**	**One to five years £000**	**Five to ten years £000**	**Over ten years £000**	**Total non-linked £000**	**Linked £000**	**Total £000**
Debt securities-fixed	4.36	66,971	119,954	23,443	66,759	277,127	105,187	382,314
Debt securities-floating	4.84	1,503	–	–	–	1,503	–	1,503
Cash and cash equivalents-cash	4.75	35,457	–	–	–	35,457	6,338	41,795
Cash and cash equivalents-deposits	4.75	82,483	–	–	–	82,483	158,174	240,657
Borrowings	6.88	(4,200)	(16,800)	–	–	(21,000)	–	(21,000)
Interest-bearing investment contract liabilities	4.20	(47,803)	(113,953)	–	–	(161,756)	–	(161,756)
Net assets and liabilities		**134,411**	**(10,799)**	**23,443**	**66,759**	**213,814**	**269,699**	**483,513**

		Non-linked						
As at 31 December 2004	**Effective interest rate %**	**Less than one year £000**	**One to five years £000**	**Five to ten years £000**	**Over ten years £000**	**Total non-linked £000**	**Linked £000**	**Total £000**
Debt securities-fixed	4.63	106,709	116,002	4,355	29,519	256,585	23,563	280,148
Debt securities-floating	–	–	–	–	–	–	–	–
Cash and cash equivalents-cash	4.40	22,804	–	–	–	22,804	5,933	28,737
Cash and cash equivalents-deposits	4.40	15,196	–	–	–	15,196	–	15,196
Borrowings	–	–	–	–	–	–	–	–
Interest-bearing investment contract liabilities	4.50	(66,441)	(114,902)	(20)	–	(181,363)	–	(181,363)
Net assets and liabilities		**78,268**	**1,100**	**4,335**	**29,519**	**113,222**	**29,496**	**142,718**

These tables disclose assets and liabilities which are held in linked funds separately from other assets and liabilities as the interest rate exposure in these liabilities is matched with a corresponding exposure in the assets held to match the liabilities.

Included within the less than one year category are instruments which do not have a maturity date.

The Group also has an indirect exposure to the average mortgage rate as follows:

Mortgage rate risk

Products which are invested in the Guaranteed Growth Fund provide a return to policyholders which is linked to the average mortgage rate. The risk arises due to a mismatch of assets and liabilities as there are no suitable assets available to back this guarantee and hence the assets are held in cash. This means that the return on assets held is lower than the return given to policyholders. Provisions are held to meet this shortfall, on appropriate assumptions as to future levels of return on assets and return given to policyholders. There is a risk that the return given to policyholders will increase by more than the return on assets due to inability to match the guarantee – that is, that the spread between mortgage rates and cash deposit rates will increase.

(2) Equity price risk

The Group's portfolio of marketable equity securities, which is carried on the balance sheet at fair value, has exposure to price risk. This risk is defined as the potential loss in market value resulting from an adverse change in prices. The Group has a policy of not having significant investments in equities within the shareholder funds. However shareholders are still exposed to movements within policyholder funds. In general the assets are matched by corresponding insurance contract provisions and investment contract liabilities.

The areas where there is a residual risk to shareholders are as follows:

(i) Surplus units

Market risk arises from the existence of surplus units (over and above requirements to match policyholder unit liabilities) in the insurance company funds. Such surplus units (which effectively back surplus carried forward in the long-term insurance funds) arise because the number of units in the funds are in decline. Although the asset and liability units are regularly realigned there is usually a small residual number of surplus units in order to minimise the possibility of being mismatched in respect of policyholder unit liabilities.

(ii) Mortgage endowment misselling redress provision

Market risk arises in two ways in respect of the redress provisions for mortgage endowment misselling.

The first is that a fall in equity prices directly increases the cost of future redress payments. In addition it is also likely that a large fall in equity prices would increase the propensity for policyholders to make a complaint about their mortgage endowment policies.

(iii) Guarantees in Timed Investment Funds

Investment guarantees have been made in respect of policies invested in the Group's Timed Investment Funds whereby the price paid to policyholders for their units on death or maturity will always be the highest price that the units have reached during their period of investment in the funds. This risk is managed within the investment strategy of the fund (see Note 27(d) (on page 86) for more details).

(iv) Change in insurance contract provisions

When calculating insurance contract provisions for the non unit component of liabilities under linked contracts allowance is made for both future investment management charges and investment expenses as a proportion of unit funds. As investment charges are generally in excess of investment expenses this surplus is used to offset future administration expenses on the contracts. In a falling market the absolute amount of the surplus of investment charges over investment expenses would reduce and hence this might lead to an increase in insurance contract provisions.

(3) Foreign currency exchange risk

The Group is not materially exposed to foreign exchange risk as the only assets denominated in foreign currencies are matched by corresponding insurance contract provisions and financial liabilities.

Credit risk

Credit risk is the risk that a counterparty will be unable to pay amounts in full when due.

4 Management of insurance and financial risk (continued)

The Group is exposed to credit risk in the following areas:

(i) reinsurers' share of insurance liabilities

(ii) amounts deposited with reinsurer in relation to investment contracts

(iii) amounts due from reinsurers in respect of claims already paid

(iv) counterparty risk with respect to corporate bond, deposits and debt securities

The Group structures the levels of credit risk it accepts by placing limits on its exposure to a single counterparty, or group of counterparties. Such risks are subject to at least an annual review.

By far the largest credit risk to the Group is in relation to its reinsurance assets. Although the Group holds a significant proportion of its financial assets in securities, the risk of default on these is largely passed on to policyholders and investors through the unit-linked funds backing the insurance and investment contracts the Group issues.

The Group retains some residual risks on assets which support annuities, guaranteed investment bonds and shareholder's equity. These risks are monitored: a key aspect of this is the Group's policy of investing only in high-quality corporate bonds and government-issued debts. The Group does not currently purchase assets rated below AA by Standard and Poors.

The Group's objective is to earn competitive relative returns by investing in a diversified portfolio of securities. Watch lists are maintained for exposures requiring additional review and all credit exposures are reviewed at least annually.

The Group's exposure to credit risk is summarised below:

	Credit rating-debt securities					
As at 31 December 2005	**AAA £000**	**AA £000**	**A £000**	**Unrated £000**	**Cash balances £000**	**Total £000**
Debt securities, deposits and cash balances with credit institutions						
Linked	2,514	217	12,368	–	152,322	167,421
Non-linked	82,128	80,603	12,841	327	130,130	306,029
Government or pseudo Government deposits						
Linked	–	–	–	102,278	–	102,278
Non-linked	–	–	–	90,541	–	90,541
Total debt, deposits and cash balances	**84,642**	**80,820**	**25,209**	**193,146**	**282,452**	**666,269**

	Credit rating-debt securities					
As at 31 December 2004	**AAA £000**	**AA £000**	**A £000**	**Unrated £000**	**Cash balances £000**	**Total £000**
Debt securities, deposits and cash balances with credit institutions						
Linked	2,091	705	16,144	–	5,933	24,873
Non-linked	86,591	82,556	65,100	431	38,000	272,678
Government or pseudo Government deposits						
Linked	–	–	–	4,623	–	4,623
Non-linked	–	–	–	21,907	–	21,907
Total debt, deposits and cash balances	**88,682**	**83,261**	**81,244**	**26,961**	**43,933**	**324,081**

Reinsurance credit risk

Reinsurance is used to manage insurance risk. This does not however discharge the Group's liability as primary insurer. If a reinsurer fails to pay a claim for any reason, the Group remains liable for the payment to the policyholder. The creditworthiness of major reinsurers is considered on an annual basis by reviewing their financial strength.

It should be noted that for historical reasons the Group has a significant exposure of £221.3m (of which £201.1m is in respect of currently guaranteed benefits) at 31 December 2005 (31 December 2004: £184.0m) to Guardian plc, which does not have a published credit rating. The exposure is in relation to insurance contract liabilities, which have been reinsured, and in relation to amounts deposited with Guardian plc in respect of investment contract liabilities.

The Group also has significant exposure to the following reinsurers, neither of which has a published credit rating.

	Exposure in relation to reinsured insurance liabilities and in relation to amounts deposited in respect of investment contracts 31 December	
	2005 £000	**2004 £000**
GE Frankona Reassurance Limited	7,655	–
Irish Life Assurance plc	37,715	–
	45,370	**–**

In addition the Group also has an exposure on a number of its risk premium reinsurance contracts, although in general the premiums payable under these contracts in any period will be higher than the claims payments received.

Liquidity risk

The Group has to meet daily calls on its cash resources. There is therefore a risk that cash will not be available to settle liabilities when due at a reasonable cost. The Group manages this risk by regular monitoring of its cash flow position.

5 Acquisition and disposal of subsidiaries

Acquisition

On 2 June 2005, Chesnara plc acquired the whole of the issued ordinary share capital of CWA Life Holdings plc ("CWALH"), formerly Irish Life (UK) Holdings plc, from Irish Life and Permanent plc, of which City of Westminster Assurance Company Limited ("CWA") was a wholly-owned subsidiary. CWA is the principal operating subsidiary of CWALH and is a UK based business concentrating on the operation of a life assurance book which is substantially closed to new business. The acquired business contributed revenues of £126,398,000 and net profit of £12,686,000 to the Chesnara plc Group for the period from 2 June 2005 to 31 December 2005. If the acquisition had occurred on 1 January 2005, Chesnara plc Group's revenue would have been £406,005,000 and net profit would have been £18,161,000 for the year ended 31 December 2005.

Details of net assets acquired and goodwill are as follows:

Purchase consideration	**£000**
Cash paid	47,500
Direct costs relating to the acquisition	278
Total purchase consideration	47,778
Fair value of net assets acquired	(47,778)
Goodwill	–

No goodwill arises on the acquisition of CWALH. This is because the principal operating subsidiary of CWALH, CWA, is closed to new business and because the excess of the total purchase consideration paid over the fair value of the identifiable tangible net assets of the CWALH Group at the acquisition date has been established as the fair value of the purchased value attributed to acquired in-force investment and insurance contracts at the acquisition date.

5 Acquisition and disposal of subsidiaries (continued)

Due to the timing of the acquisition, the fair values of the assets and liabilities acquired, which were reported as at 30 June 2005 in the interim financial statements for the six months then ended were provisional and are subject to review up to twelve months after the acquisition date.

As at 31 December the provisional fair values have been updated to reflect the latest information available and the following table which sets out the assets and liabilities at acquisition details the acquiree's carrying amount and the adjustments to the fair values of the net assets acquired which have been reflected in the six months ended 31 December 2005.

The assets and liabilities arising from the acquisition are as follows:

	Provisional fair value at acquisition £000	Adjustments and reclass-ifications £000	Updated fair value at acquisition £000	Acquiree's carrying amount £000
Intangible assets				
Deferred acquisition costs	9,858	–	9,858	9,858
Acquired value of in-force business				
Insurance contracts	19,619	5,234	24,853	–
Investment contracts	12,502	2,752	15,254	–
Investment properties	20,986	–	20,986	20,986
Financial assets				
Equity securities at fair value through income	419,948	–	419,948	419,948
Debt securities at fair value through income	160,605	–	160,605	160,605
Loans and receivables including insurance receivables	16,101	448	16,549	16,101
Derivative financial instruments	678	–	678	678
Deferred tax assets	–	–	–	3,024
Reinsurers' share of insurance contract provisions	8,241	(448)	7,793	8,241
Amounts deposited with reinsurers	–	35,788	35,788	–
Cash and cash equivalents	172,275	–	172,275	172,275
Insurance contract provisions	(344,138)	(3,549)	(347,687)	(344,138)
Financial liabilities				
Investment contracts at fair value through income	(409,865)	(33,985)	(443,850)	(409,865)
Derivative financial instruments	(1,614)	1,408	(206)	(1,614)
Deferred tax liabilities	(7,136)	(7,876)	(15,012)	–
Payables related to direct insurance and investment contracts	(10,027)	–	(10,027)	(10,027)
Deferred income	(13,859)	–	(13,859)	(13,859)
Income taxes	(1,206)	228	(978)	(1,206)
Other payables	(5,190)	–	(5,190)	(5,190)
Net assets	**47,778**	**–**	**47,778**	**25,817**

The following adjustments have been made to the fair value of the net assets at acquisition:

	Increase/ (decrease) in net assets £000
(a) Net increase in insurance and investment contract liabilities to recognise unit enhancements on pension contracts	
– Gross	(760)
– Current tax relief thereon	228
(b) Impact on deferred tax liabilities of reassessment of cumulative timing differences at acquisition date	(6,348)
(c) Consequential impact of adjustments (a) and (b) on acquired value of in-force business	
– Insurance contracts (gross)	5,234
– Investment contracts (gross)	2,752
– Deferred tax thereon	(1,106)
Net increase in net assets	–

There is no net increase in net assets as a result of the update of the fair values of assets and liabilities at acquisition, because, as stated above, the excess of the total purchase consideration paid over the fair value of the identifiable net assets at the acquisition date is established as the fair value of the acquired value of in-force business at the acquisition date.

All other restatements to the provisional fair values of assets and liabilities at acquisition, reflect reclassifications between assets and liabilities and have no impact on the fair value of net assets at acquisition.

Disposal

On the 30 June 2004 the Group disposed of Key Retirement Solutions Limited for a consideration, receivable in cash, of £2,600,000, which, net of cash balances of £256,000 in the subsidiary at that date, gave rise to a net inflow of cash of £2,344,000. This amount is reflected as a cash inflow from investing activities in the Consolidated Statement of Cash Flows. The subsidiary contributed £105,000 to the net profit for the year ended 31 December 2004 and a profit of £1,948,000 arising on the disposal, was also recognised on the income statement for that period.

6 Insurance premium revenue

	Year ended 31 December 2005				Year ended 31 December 2004			
	Unit linked-without DPF £000	Other-without DPF £000	With DPF £000	Total £000	Unit linked-without DPF £000	Other-without DPF £000	With DPF £000	Total £000
Insurance premium revenue	89,023	23,225	3,425	115,673	88,837	31,258	2,740	122,835
Insurance premium ceded to reinsurers	(14,642)	(8,947)	(3,102)	(26,691)	(14,794)	(14,997)	(264)	(30,055)
Net insurance premium revenue	**74,381**	**14,278**	**323**	**88,982**	**74,043**	**16,261**	**2,476**	**92,780**

7 Fees and commission income

	Year ended 31 December 2005			Year ended 31 December 2004		
Fee income	Other £000	Insurance contracts £000	Investment contracts £000	Other £000	Insurance contracts £000	Investment contracts £000
Policy based fees	–	13,858	2,389	–	17,154	292
Fund management based fees	–	2,668	1,823	–	2,057	424
Benefit based fees	–	32,293	135	–	34,518	94
Change in deferred income-gross	–	–	1,702	–	–	736
Change in deferred income-reassurer share	–	–	(78)	–	–	(75)
Total fee income	–	48,819	5,971	–	53,729	1,471
Commission income	–	586	–	–	630	–
Other	–	–	–	2,373	–	–
Total fee and commission income	**–**	**49,405**	**5,971**	**2,373**	**54,359**	**1,471**

Other fee income arose principally in respect of the equity release business of Key Retirement Solutions Limited, a subsidiary company which was sold on 30 June 2004 (see Note 5 on page 69).

8 Investment income

	Year ended 31 December	
	2005 £000	2004 £000
Dividend income	17,901	7,787
Interest income	7,929	1,046
Rental income from investment properties	1,236	149
Net fair value gains and losses		
Equity securities designated as at fair value through income on initial recognition	121,690	29,199
Debt securities designated as at fair value through income on initial recognition	62,773	18,739
Derivative financial instruments	1,844	–
Investment properties	1,318	89
Total investment income	**214,691**	**57,009**

Net fair value gains and losses in respect of holdings in collective investment schemes are included in the line that is most appropriate taking into account the nature of the underlying investments.

No amounts included in net fair value gains and losses of financial instruments were estimated using a valuation technique (2004: £nil).

9 Other operating income

	Year ended 31 December	
	2005 £000	2004 £000
Release of unused provisions	281	–
Recharge of shared property services to tenants	401	665
Administration fees charged to reinsurers	341	467
Professional indemnity insurance recoveries	203	489
Other	–	38
Total other operating income	**1,226**	**1,659**

10 Policyholder claims and benefits

	Year ended 31 December 2005				Year ended 31 December 2004			
	Unit linked-without DPF £000	Other-without DPF £000	With DPF £000	Total £000	Unit linked-without DPF £000	Other-without DPF £000	With DPF £000	Total £000
Claims and benefits paid to policyholders	132,143	31,797	5,409	169,349	129,621	35,868	4,375	169,864
Net increase/(decrease) in insurance contract provisions	91,114	7,501	23,957	122,572	22,436	3,377	(203)	25,610
Total policyholder claims and benefits	223,257	39,298	29,366	291,921	152,057	39,245	4,172	195,474
Recoveries from reinsurers	(27,615)	(4,902)	(28,783)	(61,300)	(24,701)	(2,644)	(3,807)	(31,152)
Net policyholder claims and benefits incurred	**195,642**	**34,396**	**583**	**230,621**	**127,356**	**36,601**	**365**	**164,322**

11 Change in investment contract liabilities

	Year ended 31 December	
	2005 £000	**2004 £000**
Net changes in the fair value of investment contracts designated on initial recognition as fair value through income	85,130	17,200
Reinsurer's share	(3,742)	(1,951)
Net change in investment contract liabilities	**81,388**	**15,249**

Investment contract benefits comprise benefits accruing to holders of investment contracts issued by the Group.

The total amount included in net changes in the fair value of investment contracts which were estimated using a valuation technique was £85,130,000 (2004: £17,200,000).

12 Fees, commission and other acquisition costs

	Year ended 31 December	
	2005 £000	**2004 £000**
Directly expensed costs		
Insurance contracts		
Commission	171	214
New business and renewal costs	203	196
Investment contracts		
Commission	353	492
New business and renewal costs	18	6
Amortisation of deferred acquisition costs		
Insurance contracts	4,009	11,048
Investment contracts-gross	989	220
Investment contracts-reinsurance	(44)	(41)
Total	**5,699**	**12,135**

13 Administrative expenses

	Year ended 31 December	
	2005 £000	**2004 £000**
Depreciation	105	301
Personnel-related costs	2,486	6,905
Costs paid to third-party administrators	8,024	–
Other goods and services	8,060	7,242
Total	**18,675**	**14,448**

Included in Other Goods and Services above are the following amount payable to the Auditor and its associates, exclusive of VAT.

13 Administrative expenses (continued)

	Year ended 31 December	
	2005 £000	2004 £000
Audit services		
Statutory audit	424	221
Audit-related regulatory reporting	61	26
Tax services		
Compliance services	32	5
Other services		
Transaction services	365	–
Other	27	172

14 Other operating expenses

	Year ended 31 December	
Charge for amortisation of intangible assets	2005 £000	2004 £000
Amortisation of acquired value of in-force business		
Insurance contracts	1,771	383
Investment contracts	593	–
Total	**2,364**	**383**
Other		
Increase in provisions	125	71
Direct operating expenses of investment properties		
Revenue-generating properties	116	111
Non revenue-generating properties	17	2
Other	9	145
Total	**267**	**329**

15 Financing costs

	Year ended 31 December	
	2005 £000	2004 £000
Interest expense on bank borrowings	805	–
Share based payments	–	336
Total financing costs	**805**	**336**

Interest expense on bank borrowings is calculated using the effective interest method and is the total interest expense for financial liabilities that are not designated at fair value through income.

The share based payment relates to the grant of an option to Numis Securities Limited which is more fully described in Note 38 (on page 98). The amount represents the difference between the total value of shares which were subject to the option at their option price and the fair value of the option at the date of grant and a corresponding amount has been credited directly to retained earnings.

16 Income tax expense

	Year ended 31 December	
	2005 £000	**2004 £000**
Current tax expense		
Current year	5,274	2,456
Adjustment to prior years	–	(364)
	5,274	2,092
Deferred tax expense		
Origination and reversal of temporary differences	(3,433)	(2,851)
Total income tax expense/(credit)	**1,841**	**(759)**

Reconciliation of effective tax rate on profit before tax

	Year ended 31 December	
	2005 £000	**2004 £000**
Profit before tax	20,456	4,397
Income tax using the domestic corporation tax rate of 30% (2004: 30%)	6,137	1,319
Effect of tax rates in foreign jurisdictions	4	5
Effect of UK taxing bases on insurance profits		
– Offset of franked investment income	(3,790)	(1,868)
– Other	(510)	149
Under/(over) provided in prior years	–	(364)
Total income tax expense/(credit)	**1,841**	**(759)**

17 Deferred acquisition costs

	Insurance contracts		Investment contracts		Total	
	2005 £000	**2004 £000**	**2005 £000**	**2004 £000**	**2005 £000**	**2004 £000**
Balance at 1 January	**5,120**	**16,134**	**3,017**	**3,237**	**8,137**	**19,371**
Additions-acquisition of subsidiary	–	–	9,858	–	9,858	–
Additions-other	3	34	–	–	3	34
Amortisation charged to income	(4,009)	(11,048)	(989)	(220)	(4,998)	(11,268)
Impairment losses	–	–	–	–	–	–
Balance at 31 December	**1,114**	**5,120**	**11,886**	**3,017**	**13,000**	**8,137**
Current	1,114	4,006	1,538	220	2,652	4,226
Non-current	–	1,114	10,348	2,797	10,348	3,911
Total	**1,114**	**5,120**	**11,886**	**3,017**	**13,000**	**8,137**

The amortisation charged to income is recognised in Fees, Commission and Other Acquisition Costs (see Note 12 on page 73).

18 Acquired value of in-force business (AVIF)

	AVIF on insurance contracts £000	AVIF on investment contracts £000	Total £000
Cost			
Balance at 1 January 2004	**8,425**	**–**	**8,425**
Additions	–	–	–
Balance at 31 December 2004	**8,425**	**–**	**8,425**
Additions-acquisition of subsidiary	24,853	15,254	40,107
Balance at 31 December 2005	**33,278**	**15,254**	**48,532**
Amortisation and impairment losses			
Balance at 1 January 2004	**6,224**	**–**	**6,224**
Amortisation for the year	383	–	383
Impairment charge	–	–	–
Balance at 31 December 2004	**6,607**	**–**	**6,607**
Amortisation for the year	1,771	593	2,364
Impairment charge	–	–	–
Balance at 31 December 2005	**8,378**	**593**	**8,971**
Carrying amounts			
At 1 January 2004	**2,201**	**–**	**2,201**
At 31 December 2004	**1,818**	**–**	**1,818**
At 31 December 2005	**24,900**	**14,661**	**39,561**
31 December 2004			
Current	320	–	320
Non-current	1,498	–	1,498
Total	**1,818**	**–**	**1,818**
31 December 2005			
Current	2,757	1,017	3,774
Non-current	22,143	13,644	35,787
Total	**24,900**	**14,661**	**39,561**

The amortisation period of AVIF on insurance contracts is 13 years and the amortisation period for AVIF on investment contracts is 15 years.

The amortisation is charged to income and is recognised in Other Operating Expenses (see Note 14 on page 74).

The carrying amount of AVIF on insurance contracts at 31 December 2004 relates to the acquisition of Premium Life Assurance Company Limited in 1996.

The addition during the year ended 31 December 2005 relates to the acquisition of CWA Life Holdings plc, as described in Note 5 (on page 69).

19 Property and equipment

	Motor vehicles £000	Computer equipment £000	Fixtures, fittings and office equipment £000	Total £000
Cost				
Balance at 1 January 2004	**12**	**5,753**	**637**	**6,402**
Additions	–	122	23	145
Disposals	–	(4,336)	(515)	(4,851)
Transferred on sale of subsidiary company	–	(451)	(32)	(483)
Balance at 31 December 2004	**12**	**1,088**	**113**	**1,213**
Additions	–	2	–	2
Disposals	(12)	(1,090)	(113)	(1,215)
Balance at 31 December 2005	**–**	**–**	**–**	**–**
Depreciation and impairment losses				
Balance at 1 January 2004	**12**	**4,924**	**562**	**5,498**
Depreciation charge for the year	–	277	24	301
Disposals	–	(4,332)	(515)	(4,847)
Transferred on sale of subsidiary company	–	(128)	(14)	(142)
Balance at 31 December 2004	**12**	**741**	**57**	**810**
Depreciation charge for the year	–	95	10	105
Disposals	(12)	(836)	(67)	(915)
Balance at 31 December 2005	**–**	**–**	**–**	**–**
Carrying amounts				
At 1 January 2004	**–**	**829**	**75**	**904**
At 31 December 2004	**–**	**347**	**56**	**403**
At 31 December 2005	**–**	**–**	**–**	**–**
31 December 2004				
Current	–	347	56	403
Non-current	–	–	–	–
Total	**–**	**347**	**56**	**403**

The depreciation charge is recognised in Administrative Expenses (see Note 13 on page 73).

20 Investment properties

	31 December	
	2005 £000	2004 £000
Balance at 1 January	**3,092**	**3,003**
Additions	–	–
Acquisition of subsidiary company	20,986	–
New properties	675	–
Disposals	(649)	–
Fair value adjustments	1,318	89
Impairment losses	–	–
Balance at 31 December	**25,422**	**3,092**
Current	–	–
Non-current	25,422	3,092
Total	**25,422**	**3,092**

20 Investment properties (continued)

Investment properties have been bought for investment purposes in line with the investment strategy of the Group. The properties are independently valued in accordance with International Valuation Standards on the basis of determining the open market value of the investment properties on an annual basis. The latest valuations were conducted as at 31 December 2005.

Income arises from investment properties in two streams:

(i) fair value gains arising as a result of market appreciation in the value of the properties;

(ii) rental income arising from leases granted on the properties.

Both of these amounts are disclosed in Investment Income (see Note 8 on page 72). Expenses incurred in the operation and maintenance of investment properties are disclosed in Other Operating Expenses (see Note 14 on page 74).

21 Financial assets

	31 December	
	2005 £000	2004 £000
Group		
Financial assets by measurement category		
Fair value through income		
Designated at fair value through income on initial recognition	1,412,674	768,228
Derivative financial instruments	16,108	–
Loans and receivables	19,810	15,013
Total	**1,448,592**	**783,241**

	31 December	
	2005 £000	2004 £000
Financial assets at fair value through income		
Equities		
Listed	688,478	187,026
Debt securities-fixed rate		
Government Bonds	192,819	26,527
Listed	189,495	253,621
Debt securities-floating rate		
Listed	1,503	–
Total debt securities	383,817	280,148
Holdings in collective investment schemes	340,379	301,054
Derivative financial instruments	16,108	–
Total	**1,428,782**	**768,228**
Current	273,721	168,519
Non-current	1,155,061	599,709
Total	**1,428,782**	**768,228**

Purchases and sales of 'regular way' financial assets are recognised on the trade date, which is when the Group commits to purchase or sell assets. Other financial assets are derecognised when contractual rights to receive cash flows from the financial assets expire, or where the financial assets have been transferred together with substantially all the risks and rewards of ownership.

	31 December	
	2005 £000	2004 £000
Company		
Investments in subsidiaries		
Countrywide Assured Life Holdings Limited	4,228	4,228
CWA Life Holdings plc	47,778	–
Total	**52,006**	**4,228**
Current	–	–
Non-current	52,006	4,228
Total	**52,006**	**4,228**

Investments in subsidiaries are carried at cost less impairment in the balance sheet.

22 Loans and receivables, including insurance receivables

	31 December	
	2005 £000	2004 £000
Group		
Receivables arising from insurance contracts		
Policyholders	2,651	5,000
Receivables arising from investment contracts		
Policyholders	20	19
Reinsurance receivables	3,250	–
Commission receivables	267	432
Debtor for professional indemnity insurance	122	1,411
Other receivables		
Accrued income	11,165	6,456
Accrued rent	684	–
Related party receivables	130	55
Other	1,521	1,640
Total loans and receivables	**19,810**	**15,013**
Current	19,810	13,996
Non-current	–	1,017
Total	**19,810**	**15,013**

The fair value of loans and receivables is £19,810,000 (2004: £15,013,000).

	31 December	
	2005 £000	2004 £000
Company		
Amounts due from subsidiary companies	1,439	422
Other	33	11
Total loans and receivables	**1,472**	**433**
Current	1,472	433
Non-current	–	–
Total	**1,472**	**433**

The fair value of loans and receivables is £1,472,000 (2004: £433,000).

23 Derivative financial instruments

The Group does not use derivatives as part of any hedging strategies to mitigate risk.

Non-hedge derivatives within unit-linked funds

As part of its Investment management strategy, the Group purchases derivative financial instruments comprising part of its investment portfolio for unit-linked investment funds, which match the liabilities arising on its unit-linked insurance and investment business.

A variety of equity futures are part of the portfolio matching the unit-linked investment and insurance liabilities. Derivatives are used to facilitate more efficient portfolio management allowing changes in investment strategy to be reflected by futures transactions rather than a high volume of transactions in the underlying assets.

All the contracts are exchange-traded futures, with their fair value being the bid price at the balance sheet date.

	31 December 2005		31 December 2004	
	Asset £000	Liability £000	Asset £000	Liability £000
Exchange-traded futures (by geographical investment market)				
Australia	741	(59)	–	–
Switzerland	690	–	–	–
Europe	3,429	–	–	–
UK	1,352	–	–	–
Hong Kong	471	(12)	–	–
Japan	1,258	(345)	–	–
South Korea	3,389	–	–	–
Sweden	242	–	–	–
Singapore	419	–	–	–
USA	3,482	–	–	–
Total exchange traded futures	15,473	(416)	–	–
Fixed interest	635	–	–	–
Total	**16,108**	**(416)**	**–**	**–**
Current	16,108	(416)	–	–
Non-current	–	–	–	–
Total	**16,108**	**(416)**	**–**	**–**

24 Income tax assets

	31 December	
	2005 £000	2004 £000
Income tax assets, which are all current, comprise:		
Group		
Corporation tax recoverable	199	103
Company		
Corporation tax recoverable	150	–

25 Cash and cash equivalents

	31 December	
	2005 £000	2004 £000
Group		
Bank and cash balances	4,481	(81)
Call deposits due within 1 month	75,404	28,818
Call deposits due after 1 month	202,567	15,196
Total cash and cash equivalents	**282,452**	**43,933**
Bank overdrafts	–	–
Cash and cash equivalents in the statement of cash flows	**282,452**	**43,933**

The effective interest rate on short term bank deposits was 4.75% (2004: 4.40%), with an average maturity of 92 days. All deposits included in cash and cash equivalents are capable of being realised as cash within 90 days.

Included in cash and cash equivalents held by the Group are balances totalling £152,322,000 (2004: £5,933,000) held in unit-linked policyholders' funds.

	31 December	
	2005 £000	2004 £000
Company		
Bank and cash balances	180	154
Call deposits due within 1 month	1,031	–
Total	**1,211**	**154**

26 Assets and related liabilities

	Shareholder funds		Policyholder funds				Total	
	31 December		Unit-linked 31 December		Non-linked 31 December		31 December	
	2005 £000	2004 £000	2005 £000	2004 £000	2005 £000	2004 £000	2005 £000	2004 £000
Assets								
Intangible assets								
Deferred acquisition costs	–	–	–	–	13,000	8,137	13,000	8,137
Acquired value of in-force business	39,561	1,818	–	–	–	–	39,561	1,818
Property and equipment	–	403	–	–	–	–	–	403
Investment properties	300	360	25,122	2,732	–	–	25,422	3,092
Financial assets	21,021	38,438	1,147,518	491,899	280,053	252,904	1,448,592	783,241
Reinsurers share of insurance contract provisions	–	–	187,048	164,351	12,515	(9,754)	199,563	154,597
Amounts deposited with reinsurer	–	–	62,697	22,888	–	–	62,697	22,888
Reinsurers share of accrued policyholder claims	–	–	4,810	4,165	–	–	4,810	4,165
Income taxes	199	103	–	–	–	–	199	103
Cash and cash equivalents	51,875	4,083	152,322	5,933	78,255	33,917	282,452	43,933
Interfund balances	40,609	42,859	(29,134)	(33,729)	(11,475)	(9,130)	–	–
Total assets	**153,565**	**88,064**	**1,550,383**	**658,239**	**372,348**	**276,074**	**2,076,296**	**1,022,377**
Liabilities								
Insurance contract provisions	–	–	920,856	532,836	151,208	68,969	1,072,064	601,805
Financial liabilities								
Investment contracts at fair value through income	–	–	629,111	125,403	174,035	181,383	803,146	306,786
Borrowings	20,638	–	–	–	–	–	20,638	–
Derivative financial instruments	–	–	416	–	–	–	416	–
Provisions	438	926	–	–	995	–	1,433	926
Deferred tax liabilities	13,327	1,748	–	–	–	–	13,327	1,748
Reinsurance payables	–	–	–	–	2,049	3,333	2,049	3,333
Payable related to direct Insurance and Investment contracts	–	–	–	–	23,866	14,351	23,866	14,351
Deferred income	–	–	–	–	20,195	8,038	20,195	8,038
Income taxes	3,345	1,198	–	–	–	–	3,345	1,198
Other payables	7,550	4,750	–	–	–	–	7,550	4,750
Total liabilities	**45,298**	**8,622**	**1,550,383**	**658,239**	**372,348**	**276,074**	**1,968,029**	**942,935**
Net assets	**108,267**	**79,442**					**108,267**	**79,442**

This information is presented to illustrate the allocation and matching of assets and liabilities to shareholder funds and to internal policyholder funds.

The Group keeps linked investments separate from other investments and invests them separately, in accordance with the requests of the policyholders. Linked investments are held at the risk of policyholders. Therefore policyholders are entitled to all the gains on investments shown under this heading, but they also have to bear any losses.

27 Solvency and regulatory capital

This Note provides information about the solvency and regulatory capital position of the Group. The Group's regulated life companies fall outside the scope of the FSA's "realistic capital" regime. The Life Assurance business of the Group is mainly non-profit business, comprising both unit-linked and non-linked business. The with-profits liabilities of the Life Assurance business are wholly reassured to Guardian Assurance plc. Therefore, notwithstanding the existence of with-profits business, there is no with-profits fund and a Fund for Future Appropriations is not maintained. The relevant capital requirement for each long-term business fund is therefore the minimum solvency requirement determined in accordance with FSA regulations.

(a) Regulatory capital resources and requirements

The following summarises the capital resources and requirements of Countrywide Assured plc (CA) and City of Westminster Assurance Company Limited (CWA), the Life businesses, as determined for UK regulatory purposes:

	31 December 2005		31 December 2004	
	CA	**CWA**	**CA**	**CWA**
Available capital resources (CR) (£m)	59.2	25.3	57.9	–*
Long-term insurance capital requirement (LTICR) (£m)	25.7	8.4	27.9	–*
Resilience capital requirements (RCR) (£m)	2.0	0.8	2.6	–*
Total capital resource requirements (CRR) (£m)	27.7	9.2	30.5	–*
Target capital requirement cover (£m)	40.5	14.2	44.4	–*
Excess of CR over target requirement (£m)	18.7	11.1	13.5	–*
Ratio of available CR to CRR	214%	275%	190%	–*

* Not applicable as not a member of the Group as at 31 December 2004.

Available capital resources as at 31 December 2005 are stated before provision for dividends which were approved by the respective CA or CWA Board subsequent to that date, but prior to the date of these financial statements. The treatment, which accords with current regulatory requirements, differs from the treatment as at 31 December 2004, when in accordance with regulatory requirements at that time, a dividend approved by the CA Board after that date was deducted from available capital resources at that date. The amounts shown above reflect the positions as they have been reported for regulatory purposes. Had adjustment been made to available capital resources for dividends approved by the respective Boards after 31 December 2005 up to the date of these financial statements, CA's ratio of available CR to CRR would have been 185% and CWA's 158%. Had no adjustment been made to available capital resources for a dividend provided for but not approved as at 31 December 2004, CA's ratio of available CR to CRR would have been 210%.

CA's Board, as a matter of policy, will continue to target CR cover for total CRR at a minimum level of 150% of the LTICR plus 100% of the RCR. The CA solvency position benefited during 2005 from a reduction of £3m to £6m in the Reassurer Default Reserve (held for regulatory solvency purposes only) against the possible default of Guardian Assurance plc ("GA"). This followed a review of publicly available information regarding the financial position of GA.

The CWA target capital requirement cover is expressed as a £5m excess over the total regulatory CRR, as a consequence of a long-standing agreement with the FSA. If the internal target cover for CR to total CRR at 150% of LTICR plus 100% of RCR had been applied, the excess of capital resources would be £1.1m as at 31 December 2005, after allowing for a dividend of £10.8m approved after that date.

Apart from this difference in treatment of target capital requirements, there are no significant inconsistencies in the bases used for the different long-term funds.

27 Solvency and regulatory capital (continued)

(b) Group capital position statement

The following summarises the regulatory capital resources arising in both life and non-life entities, together with a statement of capital resources on a consolidated basis and with a reconciliation to shareholders' net equity established on the IFRS basis:

As at 31 December 2005:	Life business UK non-participating		Life business shareholder		Total life business	Other activities	Consolidation adjustments	Group total	IFRS adjustments	Group total – IFRS basis
	CA £000	CWA £000	CA £000	CWA £000	£000	£000	£000	£000	£000	£000
Shareholder funds outside long-term insurance funds	–	–	57,995	14,073	72,068	36,120	(26,814)	81,374	6,155	87,529
Shareholder funds in long-term insurance funds	9,285	11,453	–	–	20,738	–	–	20,738	–	20,738
Total shareholder funds	9,285	11,453	57,995	14,073	92,806	36,120	(26,814)	102,112	6,155	108,267
Adjustment onto regulatory basis										
– Adjustments to assets	(2,450)	–	(278)	(273)	(3,001)	(54,478)	26,814	(30,665)		
– Other	(5,329)	–	–	–	(5,329)	–	–	(5,329)		
Total available capital resources	**1,506**	**11,453**	**57,717**	**13,800**	**84,476**	**(18,358)**	**–**	**66,118**		

As at 31 December 2004:	Life business UK non-participating CA £000	Life business shareholder CA £000	Total life business £000	Other activities £000	Consolidation adjustments £000	Group total £000	IFRS adjustments £000	Group total – IFRS basis £000
Shareholder funds outside long-term insurance funds	–	55,970	55,970	5,412	(4,228)	57,154	5,490	62,644
Shareholder funds in long-term insurance funds	16,798	–	16,798	–	–	16,798	–	16,798
Total shareholder funds	16,798	55,970	72,768	5,412	(4,228)	73,952	5,490	79,442
Adjustment onto regulatory basis								
– Adjustments to assets	(6,742)	(717)	(7,459)	(5,252)	4,228	(8,483)		
– Other	(7,385)	–	(7,385)	–	–	(7,385)		
Total available capital resources	**2,671**	**55,253**	**57,924**	**160**	**–**	**58,084**		

The tables presented above illustrate Group total capital resources as measured for the purposes of inclusion in the related regulatory returns. These measurements are based on UK GAAP. In order to illustrate the relationship with the total consolidated shareholders' net equity included in the consolidated balance sheet, the tables have been extended to summarise the effect of the measurement of assets and liabilities under IFRS. The nature of the related IFRS adjustments is described in Note 48 (on page 108).

An increase in capital resources available to the Group arose over 2005 as a result of the acquisition of CWA, net of debt financing of £21m. The main components of change in the available capital resources of CA were:

(1) the payment of dividends of £13.2m to its parent company during the year;

(2) the impact of a £10.4m increase in the reserve for redress arising from mortgage endowment complaints, which, together with favourable experience variances in the year, led to a net strain of £7.7m;

(3) the unwinding of valuation margins leading to £18.8m of release in reserves and unanticipated surplus;

(4) a reduction of £3m in the reserve held against possible default by a reassurer.

Of the available capital resources, £15.4m was transferred from long-term insurance funds to shareholder funds during the year.

Subject to the capital management policy of the Group as set out below, capital resources are available for use elsewhere in the Group.

The Group has no formal intragroup funding arrangements.

(c) Technical provisions net of reassurance

(i) The technical provisions established to determine the regulatory capital resources as set out above are:

	31 December 2005			31 December 2004		
	CA £000	CWA £000	Total life business £000	CA £000	CWA £000	Total life business £000
Technical provisions						
Unit-linked						
Unit						
– Insurance contracts	443,819	298,741	742,560	393,532	271,258	664,790
– Investment contracts	119,497	453,573	573,070	104,060	393,070	497,130
Non-unit (sterling)						
– Insurance contracts	40,007	8,813	48,820	37,265	13,391	50,656
– Investment contracts	5,745	3,753	9,498	6,075	3,811	9,886
Non-participating						
– Insurance contracts	32,404	54,145	86,549	29,132	50,623	79,755
– Investment contracts	161,478	13,295	174,773	181,022	14,255	195,277
Total	**802,950**	**832,320**	**1,635,270**	**751,086**	**746,408**	**1,497,494**

(ii) The principal assumptions underlying the calculation of the technical provisions are:

Mortality

A base mortality table is selected which is most appropriate for each type of contract taking into account rates charged to the Group by reinsurers. The mortality rates reflected in these tables are periodically adjusted, allowing for emerging experience and changes in reinsurer rates.

Morbidity

Morbidity tables are derived based on reinsurer tables. These are periodically adjusted to take into account emerging experience where appropriate.

Persistency

In general, no allowance is made for lapses or surrenders within the valuation of insurance contract liabilities. This is a prudent assumption.

Discount rates

The Group has used the following rates of interest in discounting the projected liabilities:

	31 December 2005		31 December 2004	
Rate of interest	**CA**	**CWA**	**CA**	**CWA**
Assurances				
Without profit: non linked business	3.70%	1.85%	3.75%	–*
Without profit: annual premium	3.70%	1.85%	3.90%	–*
Without profit: guaranteed income bonds	4.20%	–	4.50%	–*
Annuities				
Without profit: deferred	3.70%	3.20%	3.90%	–*
Without profit: vested	4.00%	4.00%	4.40%	–*

* Not applicable as not a member of the Group at 31 December 2004

For many of the life insurance products the interest rate risk is managed through asset/liability management strategies that seek to match the interest rate sensitivity of the assets to that of the underlying liabilities. The overall objective of these strategies is to limit the net change in value of assets and liabilities arising from interest rate movements. While it is more difficult to measure the interest sensitivity of the Group's insurance liabilities than those of the related assets, to the extent that the Group can measure such sensitivities, it believes that interest rate movements will generate asset changes that substantially offset changes in value of the liabilities relating to the underlying products.

27 Solvency and regulatory capital (continued)

Under the gross premium method of valuation and to a lesser extent the net premium method of valuation, the long-term business provision is sensitive to the interest rate used when discounting. For annuities in payment and assurances, the provision is sensitive to the assumed future mortality experience of policyholders.

Renewal expenses and inflation

The renewal expenses assumed are based on the charges made to the Group by its two third party insurance administration services providers, with appropriate margins. These are assumed to inflate at a mix of current inflation rates in the UK, being the Retail Price Index and the National Average Earnings Index. Explicit allowance is also made for those Governance expenses which are charged to the long-term funds.

Taxation

The Group has assumed that current tax legislation and tax rates will not change.

The sensitivities of technical provisions and of components of capital to changes in assumptions are materially the same as those detailed in Note 28(c)(iii) (on page 90).

(d) Valuation of options and guarantees

(i) Stochastically-valued options and guarantees

The Group has a small number of guaranteed annuity options, considered in Note 4 (on page 60), which are valued stochastically.

(ii) Deterministically-valued options and guarantees

CA

Certain investment funds, within CA, the "Timed Investment Funds", carry a guarantee that the price at maturity date or death will not be less than the highest price attained between commencement and contract cessation. CA can control the cost of the guarantee by changing the investment policy adopted by each fund.

In respect of this guarantee:

(i) A monthly charge of 1/48 % of the fund value is made.

(ii) Investment conditions were such as to require the establishment of a reserve of £100,000 as at 31 December 2005 (31 December 2004: £199,000).

The reserve for a given fund is derived as the discounted exposure at fund maturity date, the exposure being the difference between guaranteed Timed Investment Fund value and projected fund maturity value, with the latter projected value being derived assuming an immediate fall in value of equities within the fund of 20% and allowing for future investment returns, including presumed future equity investment return of 4.45% per annum.

CWA

The CWA Guaranteed Growth Fund (GGF) is a deposit-based contract which provides a return to policyholders that is linked to the average residential mortgage rate. However, the assets backing the contract are largely held as cash on deposit. There is therefore likely to be a shortfall between the return given to policyholders and the return earned on assets, and CWA reserves for the value of this shortfall.

Other reserves for this product are (i) a "unit" reserve of the current value of the benefits held and (ii) a non-unit reserve for expenses.

The underlying fund at 31 December was £11.0m. 1,165 policies invested in the fund, of which 182 were paying premiums (for a total of approximately £64,000 per annum).

For the valuation of contract liabilities CWA projects for each future year:

– the benefit outgo from the fund
– the investment return from the assets backing the fund
– the difference between these items.

These differences are then discounted and summed to establish the GGF loss reserve.

The following assumptions are used for calculating the loss reserve:

Rate of growth of liability:	5.35% pa
Rate of return on cash:	4.10% pa
Discount rate:	3.70% pa
Retirement age:	90% of business with policyholders retiring at age 65
	10% of business with policyholders retiring at age 70
Terminations before retirement:	3% pa

The reserve for the guarantee at 31 December 2005 was £1.3m. At 31 December 2004, at which date CWA was not part of the Group, the reserve was £1.5m, and at 2 June 2005, the date of acquisition, it was estimated at £1.4m.

(e) Capital management policy

The Group's capital management policy is effected by adherence to the targets set by the Boards of the respective Life businesses regarding the ratio of available capital resources as measured on a regulatory basis to capital resource requirements, as measured on a regulatory basis. These targets are set out under the Regulatory Capital Resources and Requirements section above.

In addition to these constraints the Group would also be constrained should the level of its target capital requirements in the Life Assurance subsidiaries fall below the amount of issued share capital in those subsidiaries. This constraint could, however, be overcome by undertaking a formal capital reduction scheme subject to the sanction of the Courts.

(f) Management of risk

The Group's approach to the management of risk which may have an impact on the measurement of capital resources and requirements, as measured on a regulatory basis, is set out in Note 4 (on page 60) to these financial statements.

28 Insurance contract provisions

(a) Analysis of insurance contract provisions by type

	31 December 2005			31 December 2004		
	Gross £000	Reinsurance £000	Net £000	Gross £000	Reinsurance £000	Net £000
Long-term business						
Unit-linked without DPF	896,110	113,565	782,545	517,462	102,412	415,050
Non-linked without DPF	87,208	589	86,619	19,554	(9,754)	29,308
With DPF	88,746	85,409	3,337	64,789	61,939	2,850
Total insurance contract provisions	**1,072,064**	**199,563**	**872,501**	**601,805**	**154,597**	**447,208**
Current	87,356	7,970	79,386	33,772	6,184	27,588
Non-current	984,708	191,593	793,115	568,033	148,413	419,620
Total	**1,072,064**	**199,563**	**872,501**	**601,805**	**154,597**	**447,208**

28 Insurance contract provisions (continued)

(b) Analysis of movement in insurance contract provisions

Unit-linked without DPF

	Gross £000	Reinsurance £000	2005 Net £000
Balance at 1 January	**517,462**	**102,412**	**415,050**
Addition-acquisition of subsidiary company	287,534	–	287,534
Premiums received	86,129	9,962	76,167
Fees deducted	(23,668)	(1,802)	(21,866)
Reserves released in respect of benefits paid	(87,356)	(14,485)	(72,871)
Investment return	114,622	16,923	97,699
Other movements	1,387	555	832
Balance at 31 December	**896,110**	**113,565**	**782,545**

Non-linked without DPF

	Gross £000	Reinsurance £000	2005 Net £000
Balance at 1 January	**19,554**	**(9,754)**	**29,308**
Addition-acquisition of subsidiary company	60,153	7,793	52,360
Premiums received	25,464	7,684	17,780
Fees deducted	(19,990)	(8,145)	(11,845)
Reserves released in respect of benefits paid	(3,210)	4,976	(8,186)
Investment return	5,417	331	5,086
Other movements	(180)	(2,296)	2,116
Balance at 31 December	**87,208**	**589**	**86,619**

With DPF

	Gross £000	Reinsurance £000	2005 Net £000
Balance at 1 January	**64,789**	**61,939**	**2,850**
Addition-acquisition of subsidiary company	–	–	–
Premiums received	3,425	3,319	106
Fees deducted	(882)	(882)	–
Reserves released in respect of benefits paid	(4,500)	(4,404)	(96)
Investment return	22,477	22,000	477
Other movements	3,437	3,437	–
Balance at 31 December	**88,746**	**85,409**	**3,337**

The residual net liability of £3,337,000 at 31 December 2005 relates to unit linked holdings within policies which have been classified as "With DPF".

(c) Assumptions and sensitivities for insurance contract provisions

(i) Process used to determine the assumptions

The process used to determine the assumptions is intended to result in conservative estimates of the most likely, or expected, outcome. The assumptions are checked to ensure that they are consistent with observed market prices or other published information.

For insurance contracts the Group regularly considers whether the current liabilities are adequate. The assumptions that are considered include the expected number and timing of deaths, other claims and investment returns, over the period of risk exposure. A reasonable allowance is made for the level of uncertainty within the contracts.

For those classes of non-linked and unit-linked business where policyholders participate in profits, the liability is wholly reassured to Guardian Assurance plc ("Guardian"). When performing the gross liability adequacy test allowance is made for expected future bonuses paid by Guardian. This is based on the asset shares of the underlying policies reassured, as provided to the Group by Guardian.

For all the other classes of linked and quasi-linked business, the long-term business provision is calculated on a gross premium basis, by subtracting the present value of future premiums from the present value of future benefits payable under the policy, until it ceases at maturity, or death if earlier. The gross premium method makes explicit allowance for future policy maintenance costs. If the net present value of the future discounted cash flows is positive, no asset is recognised.

For immediate annuities in payment the provision is calculated as the discounted value of the expected future annuity payments under the policies, allowing for mortality, interest rates and expenses.

For the other classes of non-linked business, the provision is calculated on a net premium basis, being the level of premium consistent with a premium stream, the discounted value of which, at the outset of the policy, would be sufficient to cover exactly the discounted value of the original guaranteed benefits at maturity, or at death if earlier, on the valuation basis. The provision is then calculated by subtracting the present value of future net premiums from the present value of the benefits guaranteed at maturity, or death if earlier, as a result of events up to the balance sheet date. Negative provisions do not arise under the net premium method, which makes no allowances for voluntary discontinuances by policyholders, and which only implicitly allows for future policy maintenance costs.

(ii) Assumptions

The principal assumptions underlying the calculation of the insurance contract provisions are:

Mortality

A base mortality table is selected which is most appropriate for each type of contract taking into account rates charged to the Group by reinsurers. The mortality rates reflected in these tables are periodically adjusted, allowing for emerging experience and changes in reinsurer rates.

Morbidity

Morbidity tables are derived based on reinsurer tables. These are periodically adjusted to take into account emerging experience where appropriate.

Persistency

In general, no allowance is made for lapses or surrenders within the valuation of insurance contract liabilities. This is a prudent assumption.

Assurance discount rates

The Group has used the following rates of interest in discounting the projected liabilities of Countrywide Assured plc (CA) and City of Westminster Assurance Company Limited (CWA):

	31 December			
	2005		2004	
Rate of interest	**CA**	**CWA**	**CA**	**CWA**
Assurances				
– without profit: non linked business	3.70%	1.85%	3.75%	–*
– without profit: annual premium	3.70%	1.85%	3.90%	–*
Annuities				
– without profit: deferred	3.70%	3.20%	3.90%	–*
– without profit: vested	4.00%	4.00%	4.40%	–*

* Not applicable as not a member of the Group at 31 December 2004

For many of the life insurance products the interest rate risk is managed through asset/liability management strategies that seek to match the interest rate sensitivity of the assets to that of the underlying liabilities. The overall objective of these strategies is to limit the net change in value of assets and liabilities arising from interest rate movements. While it is more difficult to measure the interest sensitivity of the Group's insurance liabilities than those of the related assets, to the extent that the Group can measure such sensitivities, it believes that interest rate movements will generate asset changes that substantially offset changes in value of the liabilities relating to the underlying products.

28 Insurance contract provisions (continued)

Under the gross premium method and to a lesser extent the net premium method, the long-term business provision is sensitive to the interest rate used when discounting. For annuities in payment and assurances, the provision is sensitive to the assumed future mortality experience of policyholders.

Renewal expenses and inflation

The renewal expenses assumed are based on the charges made to the Group by its two third party insurance administration services providers, with appropriate margins. These are assumed to inflate at a mix of current inflation rates in the UK, being the Retail Price Index and the National Average Earnings Index. Explicit allowance is also made for Governance expenses incurred by the Group.

Taxation

The Group has assumed that current tax legislation and tax rates will not change.

(iii) Changes in assumptions and sensitivity to change in assumptions

Assumptions are adjusted for changes in mortality, investment return, policy maintenance expenses and expense inflation to reflect anticipated changes in market conditions and market experience and price inflation.

The major changes to the bases used for the calculation of the provisions were as follows:

As a consequence of the fact that the valuation basis makes no allowance for lapses, when lapses occur it is necessary to allocate fixed expenses across a small number of in-force policies. Consequently the per policy expense reserve has increased. However, as there are fewer in-force policies and a proportion of the office expenses is variable the net impact has been broadly favourable. Additionally, an allowance of £1m was made for the anticipated imposition of VAT on outsourced administration services.

The reserve held in CWA for guaranteed annuity rates was reduced by £0.5m, making allowance principally for the vesting of policies with the guarantee, changes in unit values and interest rates, and changes to the assumptions made regarding the profile of retirement ages and take-up rates.

Annuitant mortality assumptions within CWA were weakened as a result of a reappraisal of mortality experience leading to release of £0.8m of reserves.

The reinsurer default reserve in CA was reduced by £3m following a re-appraisal of the security of the reinsurer.

The basis for the calculation of the reserve held for complaints, principally mortgage endowment complaints, was strengthened. Further details are given below.

The Group re-runs its valuation models on various bases. An analysis of sensitivity around various scenarios provides an indication of the adequacy of the Group's estimation process in respect of its Life assurance contracts. The table presented below demonstrates the sensitivity of assets and insured liability estimates to particular movements in assumptions used in the estimation process. Certain variables can be expected to impact on Life assurance liabilities more than others, and consequently a greater degree of sensitivity to these variables may be expected.

Impact on reported net of tax profits and equity to changes in key variables:

	Change in variable %	Change in net of tax profits and equity 2005 £m
Investment return	+1	(0.6)
Investment return	-1	0.2
Mortality/morbidity	+10	(0.1)
Policy maintenance expenses	+10	(1.9)

The above sensitivities are calculated as an expected impact on IFRS-based profits, net of reinsurance and tax and the analysis has been prepared for a change in the stated variable, with all other assumptions remaining constant.

The sensitivities to the changes in investment returns are calculated taking into account the consequential changes to valuation assumptions.

The sensitivities to mortality and morbidity (critical illness) rates shown above are calculated on the assumption that there would be no consequential change in rates to policyholders. In practice, Group policy is to pass costs on to policyholders where it considers that the impact of the change is significant (see Note 4 (on page 60) for further information).

An increase in mortality rates would have a negative impact on the CA business due to the preponderance of assurance business. In contrast, there would be a positive impact occurring in the CWA business due to its preponderance of annuity business. On a consolidated Group basis the impacts are closely balanced. A decrease in mortality rates would have the contrary effect in each business but the Group results would remain closely balanced.

Changes in mortality and morbidity rates are not correlated: one may increase whilst the other remains unchanged or reduces. The figure shown above assumes both rates increase by 10%. The effects of separate 10% increases would be an increase in consolidated net of tax profits and equity by £0.5m for increased mortality rates and a reduction in consolidated net of tax profits and equity by £0.6m for increased morbidity rates.

Increases in expenses due to inflation would predominantly be passed on to policyholders through higher policy fees.

The main expense risk is that of unforeseen changes to third party administration expenses, as discussed in Note 4 (on page 60). The impact shown above quantifies a 10% increase in those expenses.

(iv) Provisions for redress in respect of pension transfers and opt-outs and in respect of endowment misselling complaints

Pension transfers and opt-outs

The investment liabilities include an amount of £0.7m in respect of potential compensation payments and associated costs arising from a review of advice provided to customers who were sold personal pension policies by Group representatives between 25 May 1988 and 30 June 1994. This comprises £0.4m for CA policies (2004: £0.45m) and £0.3m for CWA policies. The reviews, which were conducted in accordance with guidelines issued by the FSA and which are now complete, relate to small numbers of unsettled cases where the Group does not have primary responsibility for compensation under the regulatory rules. The Directors are of the opinion that suitable provision has been made for these cases at 31 December 2005.

Endowment misselling complaints

The insurance liabilities include an amount of £18.99m in respect of potential compensation payments arising from endowment misselling complaints. This comprises £15.09m for CA policies (2004: £14.76m) and £3.9m for CWA policies. The corresponding charge to the income statement in respect of the movements in these amounts for CA policies was £9.4m (2004: £16.61m) and for CWA policies was £1.0m. The provision for the costs of redress has been estimated on the basis of the Group's experience in respect of policyholders' propensity to complain, complaint uphold rates and average cost of settlement. It is also based on estimation of the in-force endowment policy population exposed to complaint, taking account of estimated future policy cessation, and of the rate at which policies are expected to become time-barred in accordance with FSA rules.

As the setting of the provision for the rate of redress of endowment misselling complaints relies on estimates of factors which may be materially affected by unanticipated or unforeseen events, it is not possible to determine precisely the level of redress. The Directors are of the opinion that suitable provision has been made taking account of known circumstances.

The assumptions were significantly strengthened during 2005 to take account of the increased propensity of policyholders to register complaints, encouraged both by increasingly active complaint handling companies and by increasing media attention.

The liability for mortgage endowment misselling claims would increase if there were an increase in the number of complaints received, a decrease in the number of policies time-barred, an increase in the complaint uphold rate or an increase in the average amount of redress per settled complaint compared with current assumptions. A decrease in the fund value of the assumed unit growth rate would tend to increase the average redress amount per policy. A 10% increase in assumed propensity to complain would increase reserves by £1.8m. A 10% increase in assumed cost of redress to settle each complaint would increase reserves by £1.5m.

29 Investment contracts at fair value through income and amounts deposited with reinsurer

(a) Analysis by contract type

	31 December 2005			31 December 2004		
	Investment contract liability £000	Amount deposited with reinsurer £000	Net £000	Investment contract liability £000	Amount deposited with reinsurer £000	Net £000
Long-term business						
Unit-linked	629,111	62,184	566,927	125,403	20,864	104,539
Non-linked	12,258	–	12,258	–	–	–
Guaranteed income and guaranteed growth bonds	161,777	–	161,777	181,383	–	181,383
Other	–	513	(513)	–	2,024	(2,024)
Total	**803,146**	**62,697**	**740,449**	**306,786**	**22,888**	**283,898**
Current	101,120	3,975	97,145	92,231	2,859	89,372
Non-current	702,026	58,722	643,304	214,555	20,029	194,526
Total	**803,146**	**62,697**	**740,449**	**306,786**	**22,888**	**283,898**

(b) Movements in investment contract liabilities and amounts deposited with reinsurer:

Unit-linked

	2005		
	Investment contract liability £000	Amount deposited with reinsurer £000	Net £000
Balance at 1 January	125,403	20,864	104,539
Addition-acquisition of subsidiary company	430,868	35,788	395,080
Deposits received	13,214	1,541	11,673
Fees deducted from account balances	(1,951)	(39)	(1,912)
Account balances paid on terminations in the year	(21,768)	(3,693)	(18,075)
Investment yield	83,370	9,036	74,334
Other movements	(25)	(1,313)	1,288
Balance at 31 December	**629,111**	**62,184**	**566,927**

Non-linked

	2005		
	Investment contract liability £000	Amount deposited with reinsurer £000	Net £000
Balance at 1 January	–	–	–
Addition-acquisition of subsidiary company	12,982	–	12,982
Deposits received	50	–	50
Account balances paid on terminations in the year	(1,119)	–	(1,119)
Investment yield	356	–	356
Other movements	(11)	–	(11)
Balance at 31 December	**12,258**	**–**	**12,258**

Guaranteed income and guaranteed growth bonds

	2005		
	Investment contract liability £000	Amount deposited with reinsurer £000	Net £000
Balance at 1 January	181,383	–	181,383
Deposits received	48,468	–	48,468
Account balances paid on terminations in the year	(75,785)	–	(75,785)
Investment yield	6,900	–	6,900
Other movements	811	–	811
Balance at 31 December	**161,777**	**–**	**161,777**

30 Borrowings

Group and Company

	31 December	
	2005 £000	2004 £000
Bank loan	20,638	–
Current	4,063	–
Non-current	16,575	–
Total	**20,638**	**–**

The bank loan which was drawn down on 2 June 2005 under a facility made available on 4 May 2005 is unsecured and is repayable in five equal annual instalments on the anniversary of the draw down date. Accordingly the current portion as at 31 December 2005 being that payable within one year is £4,063,000 and the non-current portion is £16,575,000. The outstanding principal on the loan bears interest at a rate based on the London Inter-bank Offer Rate and is payable in arrears over a period which varies between one and six months at the option of the borrower.

The fair value of the bank loan at 31 December 2005 was £21,000,000.

31 Provisions

	MECR £000	Other complaints redress £000	Onerous contracts £000	ISAA £000	Other £000	Total £000
Balance at 1 January 2004	**–**	**–**	**755**	**–**	**–**	**755**
Provisions made during the year	–	–	197	255	173	625
Provisions used during the year	–	–	(80)	–	–	(80)
Provisions reversed during the year	–	–	(374)	–	–	(374)
Balance at 31 December 2004	**–**	**–**	**498**	**255**	**173**	**926**
Transfers from other payables	1,000	500	–	–	–	1,500
Provisions made during the year	–	–	125	–	–	125
Provisions used during the year	(282)	(223)	(78)	(255)	–	(838)
Provisions reversed during the year	–	–	(107)	–	(173)	(280)
Balance at 31 December 2005	**718**	**277**	**438**	**–**	**–**	**1,433**
31 December 2004						
Current	–	–	185	255	173	613
Non-current	–	–	313	–	–	313
Total	**–**	**–**	**498**	**255**	**173**	**926**
31 December 2005						
Current	475	183	44	–	–	702
Non-current	243	94	394	–	–	731
Total	**718**	**277**	**438**	**–**	**–**	**1,433**

The initial provisions for MECR (see (a) below) and Other Complaints Redress (see (b) below) were established by way of a transfer from Other Balances within Other Payables as this was considered to more properly reflect the nature of the related liability.

(a) Mortgage endowment complaints redress (MECR)

As part of the mortgage endowment complaint redress process (refer to Note 28 Insurance Contract Provisions on page 87), if the complaint is upheld an offer of redress is made to the customer where a loss has occurred. These offers are classified as payables for the first 6 months after they are made, subsequent to which they are reclassified as provisions, as the customer loses the right of redress at the level offered, but continues to have a right to enforce a claim, which the Group has the right to reassess. The provision is established at the original offer level as a prudent estimate of future liabilities.

(b) Other complaints redress

Offers of redress on complaints other than mortgage endowment related are classified in a manner similar to that detailed for MECR above.

(c) Onerous contracts

The Group has a number of onerous operating lease contracts that have been entered into historically, whose activity and current status is described in Note 42 Operating Leases (on page 103). Given the terms of the contracts the Group has created an onerous contract provision for anticipated future net costs. Over the terms of the contracts this provision takes account of the contract terms, future payments and future mitigating income from sublets, contract by contract, to create a view as to the Group's exposure.

This provision comprises three components: provision for vacant properties, provision for properties due to become empty at the end of their sublease periods, and provision for future under-recoveries of costs on subleases entered into.

Within the provision calculation two estimates or judgements are made:

(a) The provision model assumes that if the rent is reduced to 75% of the Group contract, the Group will have 82% sublet occupancy of the properties.

(b) Future cash flows are discounted within the provision model at 4.5%, this being the difference between a cost of capital of 8.5% and a presumed rent review and inflation increase of 4%.

Sensitivities

	Provision at 31 December 2005 £000	Post sensitivity provision £000	Change in provision £000	%
Discount rate – decreased by 1% to 3.5%	438	458	20	+5%
Sublease rent mitigation – from 75% to 65%	438	478	40	+9%
Occupancy mitigation – from 82% to 72%	438	502	64	+15%

(d) Insurance services administration agreement (ISAA)

At 31 December 2004 the Group provided for legal and professional fees associated with an agreement for the provision of third-party insurance administration services. The provision was fully utilised during 2005.

(e) Other

At 31 December 2004, the Group held a provision in respect of potential Value Added Tax liabilities, relating to arrangements with the Countrywide Assured Group plc of which its constituent companies were members prior to the demerger described in Note 45 Related Party Transactions (on page 104). In the event, the liabilities did not crystallise and the provision has been released during the year ended 31 December 2005.

32 Deferred tax liabilities

(a) Recognised deferred tax assets and liabilities

As at 31 December 2005

	Assets £000	Liabilities £000	Net £000
Insurance contract provisions	–	(5,104)	(5,104)
Contingency reserves	120	–	120
Intangible assets			
Deferred acquisition costs	–	(3,705)	(3,705)
Acquired value of in-force business	–	(10,860)	(10,860)
Deferred income	5,743	–	5,743
Realised losses on financial assets	4,349	–	4,349
Unrealised gains on financial assets	–	(3,992)	(3,992)
Property and equipment	122	–	122
Total	**10,334**	**(23,661)**	**(13,327)**
Current	–	–	–
Non-current	10,334	(23,661)	(13,327)
Total	**10,334**	**(23,661)**	**(13,327)**

32 Deferred tax liabilities (continued)

As at 31 December 2004

	Assets £000	Liabilities £000	Net £000
Insurance contract provisions	–	(1,601)	(1,601)
Contingency reserves	120	–	120
Intangible assets			
Deferred acquisition costs	–	(2,233)	(2,233)
Acquired value of in-force business	–	(193)	(193)
Deferred income	2,073	–	2,073
Realised losses on financial assets	–	–	–
Unrealised gains on financial assets	–	–	–
Property and equipment	86	–	86
Total	**2,279**	**(4,027)**	**(1,748)**
Current	–	–	–
Non-current	2,279	(4,027)	(1,748)
Total	**2,279**	**(4,027)**	**(1,748)**

(b) Unrecognised deferred tax assets

	31 December	
	2005 £000	2004 £000
Tax losses arising in pensions business	57,419	56,326
Unrelieved expenses	101,704	124,824
Total	**159,123**	**181,150**

(i) A deferred tax asset has not been recognised in respect of tax losses arising on pension business, because it is uncertain whether future taxable profit arising on pensions business will be available against which the Group can utilise the benefits therefrom.

(ii) A deferred tax asset has not been recognised in respect of unrelieved expenses, because it is not probable that there will be a sufficient level of taxable income arising from income and gains on financial assets, so that the Group can utilise the benefits therefrom.

(c) Movement in temporary differences during the year

	Year ended 31 December 2005				Year ended 31 December 2004		
	Balance at 1 January £000	Acquisition of subsidiary £000	Recognised in income £000	Balance at 31 December £000	Balance at 1 January £000	Recognised in income £000	Balance at 31 December £000
Insurance contact provisions	(1,601)	(3,730)	227	(5,104)	(1,227)	(374)	(1,601)
Contingency reserves	120	–	–	120	120	–	120
Intangible assets							
Deferred acquisition costs	(2,233)	(2,957)	1,485	(3,705)	(5,591)	3,358	(2,233)
Amortised value of in-force business	(193)	(11,266)	599	(10,860)	2,272	(2,465)	(193)
Deferred income	2,073	4,158	(488)	5,743	63	2,010	2,073
Property and equipment	86	–	36	122	(236)	322	86
Realised losses on financial assets	–	(434)	4,783	4,349	–	–	–
Unrealised gains on financial assets	–	(783)	(3,209)	(3,992)	–	–	–
Total	**(1,748)**	**(15,012)**	**3,433**	**(13,327)**	**(4,599)**	**2,851**	**(1,748)**

33 Reinsurance payables

Payable to reinsurers

	31 December	
	2005 £000	2004 £000
Payables in respect of insurance contracts	1,951	2,629
Payables in respect of investment contracts	98	704
Total	**2,049**	**3,333**
Current	2,049	3,333
Non-current	–	–
Total	**2,049**	**3,333**

34 Payables related to direct insurance and investment contracts

	31 December 2005			31 December 2004		
	Gross £000	Reinsurance £000	Net £000	Gross £000	Reinsurance £000	Net £000
Accrued claims	21,169	4,810	16,359	10,835	4,165	6,670
Policyholder premium liabilities	2,697	–	2,697	3,516	–	3,516
Total	**23,866**	**4,810**	**19,056**	**14,351**	**4,165**	**10,186**
Current	23,866	4,810	19,056	14,351	4,165	10,186
Non-current	–	–	–	–	–	–
Total	**23,866**	**4,810**	**19,056**	**14,351**	**4,165**	**10,186**

35 Deferred income

	31 December	
	2005 £000	2004 £000
Balance at 1 January	**8,038**	**8,774**
Additions arising on acquisition of subsidiary company	13,859	–
Release to income	(1,702)	(736)
Balance at 31 December	**20,195**	**8,038**
Current	2,392	736
Non-current	17,803	7,302
Total	**20,195**	**8,038**

The release to income is included in Fee and Commission Income (see Note 7 on page 71).

36 Income tax liabilities

	31 December	
	2005 £000	2004 £000
Income tax liabilities, which are all current, comprise:		
Group		
Corporation tax	3,345	1,182
Income tax withheld on payments to policyholders	–	16
Total	**3,345**	**1,198**
Company		
Corporation tax	–	1

37 Other payables

	31 December	
	2005 £000	2004 £000
Group		
Accrued expenses	3,937	1,126
Other	3,613	3,624
Total	**7,550**	**4,750**
Current	7,550	4,750
Non-current	–	–
Total	**7,550**	**4,750**
Company		
Accrued expenses	750	230
Other	190	306
Total	**940**	**536**
Current	940	536
Non-current	–	–
Total	**940**	**536**

38 Share capital and share premium

Group

	31 December 2005		31 December 2004	
	Number of shares	Share capital £000	Number of shares	Share capital £000
Share capital	104,588,785	41,501	84,564,168	40,500

Under the reverse acquisition basis of accounting referred to in Note 2 (on page 51), at the date of acquisition of Chesnara plc (the legal parent) the amount of issued share capital in the consolidated balance sheet represents the amount of issued share capital of Countrywide Assured Life Holdings Limited (the legal subsidiary) immediately before the acquisition and the deemed cost of acquisition, which as explained in Note 2 is taken as £nil. The number and value of shares, representing the equity structure, reflects the equity structure of Chesnara plc as set out below.

The following sets out changes in Group share capital and share premium during the year ended 31 December 2005.

	Share capital	Share premium
	£000	£000
Balance at 1 January 2005	**40,500**	**–**
Issue and allotment on 10 February 2005 pursuant to exercise of share option	84	1,449
Issue and allotment on 2 June 2005 pursuant to placing and open offer	917	21,083
Expenses incurred in connection with issue of shares pursuant to placing and open offer	–	(2,074)
Balance at 31 December 2005	**41,501**	**20,458**

For details of the issues and allotments during the year see "Company" section below.

Company

The share capital of Chesnara plc comprises:

	31 December 2005 £	31 December 2004 £
Authorised		
Ordinary shares of 5p each	10,050,000	10,050,000
Issued		
Ordinary shares of 5p each	5,229,439	4,228,208

The following sets out changes in the issued share capital and share premium account of Chesnara plc during the year ended 31 December 2005.

Ordinary shares of 5p each

	Issued share capital		Share premium
	Number	£	£
Balance at 1 January 2005	**84,564,168**	**4,228,208**	**–**
Issue and allotment on 10 February 2005 pursuant to exercise of share option	1,691,284	84,564	1,448,754
Issue and allocation on 2 June 2005 pursuant to placing and open offer	18,333,333	916,667	21,083,333
Expenses incurred in connection with issue of shares pursuant to placing and open offer	–	–	(2,074,124)
Balance at 31 December 2005	**104,588,785**	**5,229,439**	**20,457,963**

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. This has been treated as a share based payment in 2004, with respect to broking services provided by Nemis in connection with that listing.

On 10 February 2005, pursuant to a notice of exercise of such option by Numis, the Board approved the issue and allotment of 1,691,284 new ordinary shares of 5p each to rank *pari passu* with the existing ordinary shares of 5p each. The consideration received from Numis in respect of the allotment of shares was £1,533,318, of which £84,564 was credited to the called up share capital account and £1,448,754 was credited to share premium account. On 16 February 2005 the newly issued shares were admitted to trading on the London Stock Exchange.

38 Share capital and share premium (continued)

On 2 June 2005, pursuant to a placing and open offer, the Board approved the issue and allotment of 18,333,333 new ordinary shares of 5p each to rank *pari passu* with the existing ordinary shares of 5p each. The arrangements, which were underwritten by Numis Securities Limited, involved the placing of 9,707,788 ordinary shares at a subscription price of 120p per share and an open offer of 8,625,545 ordinary shares on the basis of 1 new share for every 10 existing ordinary shares, also at a subscription price of 120p per share. The proceeds from the consequential subscription for new ordinary shares were £22,000,000, of which £916,667 was credited to the called up share capital account and of which £21,083,333 was credited to the share premium account. Expenses of £2,074,000 which were incurred in connection with these arrangements were charged to the share premium account. The gross proceeds of £22,000,000 were used to part finance the acquisition of CWA Life Holdings plc, as referred to in Note 5 (on page 69).

39 Retained earnings

Group

Retained earnings attributable to equity holders of the parent company comprise:

	2005 £000	2004 £000
Balance at 1 January	**38,892**	**37,477**
Profit for the year	18,615	5,156
Dividends		
Interim approved and paid for 2004	–	(10)
Interim approved and paid for 2004	–	(4,017)
Final approved and paid for 2004	(6,124)	–
Interim approved and paid for 2005	(5,125)	–
Transfer from retained earnings to redeem preference shares	–	(50)
Grant of share option (see Note 38 on page 98)	–	336
Balance at 31 December	**46,258**	**38,892**

The retained earnings balance represents the amount available for dividend distribution to the equity shareholders of the parent company except for £12,959,000 (31 December 2004: £2,671,000) which is not distributable and which must be retained in subsidiary companies in accordance with the solvency capital requirements pertaining to those subsidiaries.

The first interim dividend in respect of 2004 approved and paid in 2004 was paid by Countrywide Assured Life Holdings Limited ("CALH") to Countrywide plc prior to the demerger referred to in Note 2 (on page 51). This was done to establish the status of CALH as a subsidiary company of Countrywide plc.

The second interim dividend in respect of 2004 approved and paid in 2004 was paid at the rate of 4.75p per share.

The final dividend in respect of 2004 approved and paid in 2005 was paid at the rate of 7.1p per share so that the total dividend paid to the equity shareholders of the parent company in respect of the year ended 2004 was made at the rate of 11.85p per share.

The interim dividend in respect of 2005, approved and paid in 2005, was paid at the rate of 4.9p per share to equity shareholders of the parent company registered at the close of business on 14 October 2005, the dividend record date.

A final dividend of 7.55p per share in respect of the year ended 31 December 2005 payable on 16 May 2006 to equity shareholders of the parent company registered at the date of business 18 April 2006, the dividend record date, was approved by the Directors after the balance sheet date. The resulting total dividend of £7.9m has not been provided for in these financial statements and there are no income tax consequences.

The following summarises dividends per share in respect of the year ended 31 December 2004 and 31 December 2005:

	2005 p	2004 p
Interim	4.90	4.75
Final	7.55	7.10
Total	**12.45**	**11.85**

	2005 £000	2004 £000
Company		
Balance at 31 January	**–**	**–**
Profit for the year	18,773	3,731
Dividends paid		
Interim approved and paid for 2004	–	(4,017)
Final approved and paid for 2004	(6,124)	–
Interim approved and paid for 2005	(5,125)	–
Transfer from retained earnings to redeem preference share	–	(50)
Grant of share option (see Note 38 on page 98)	–	336
Balance at 31 December	**7,524**	**–**

Details of dividends approved and paid are set out in the "Group" section above.

40 Employee benefit expense

	Year ended 31 December	
	2005 £000	2004 £000
Wages and salaries	2,091	5,993
Social security costs	240	651
Pension costs-defined contribution plans	155	261
Total	**2,486**	**6,905**
Average number of employees		
Company	19	8
Subsidiaries	25	214
Total	**44**	**222**

Between 1 January 2004 and 31 May 2005 the Group offered membership of the Countrywide Assured Group plc (CAG) Pension scheme to eligible employees. Under a Deed of Settlement dated 18 March 2004 CAG and the Scheme Trustees had given permission for the Company to participate in the CAG pension Scheme for a period of 12 months following the demerger described in Note 2 (on page 51). Accordingly employees of the Group became deferred members of the CAG Scheme at the end of May 2005. At that time the Group allowed eligible employees to enter the Chesnara plc Stakeholder Scheme, on a basis where employer contributions are made to the scheme at the same rate as would be payable had their membership of the Countrywide Assured Group pension scheme continued, provided that employee contributions also continue to be made at the same rate. The employee may opt to request the Company to pay employer contributions into a personal pension plan, in which instance, employer contributions will be made on the same terms as for the Chesnara plc Stakeholder Scheme.

40 Employee benefit expense (continued)

Employees who joined the Group as a result of the acquisition of CWA Life Holdings plc either continue to be members of the pre-existing defined contribution Group Personal Pension scheme, to which employer and employee contributions are made, or they have opted to join the aforementioned Chesnara plc Stakeholder Scheme.

The Group has for the period covered by these financial statements only made contributions to defined contribution plans to provide pension benefits for employees upon retirement.

The Group has established frameworks for a sharesave plan and for discretionary share option plans which may, at the discretion of the Remuneration Committee, be utilised for granting options to Executive Directors and to other Group employees. No options have been granted in relation to these plans.

41 Earnings per share

Earnings per share is based on the following:

	Year ended 31 December	
	2005	**2004**
Profit for the year (£000)	18,615	5,156
Weighted average number of ordinary shares	96,637,227	84,564,168
Basic earnings per share	19.26p	6.10p
Diluted earnings per share	19.26p	6.09p

The basic and diluted earnings per share in respect of the year ended 31 December 2004 is stated after taking account of profit after tax arising on the sale of a subsidiary company.

The weighted average number of shares in respect of this year ended 31 December 2004, is the number of ordinary shares, entitled to dividend, in issue at that date. Except for the cancellation of 2 ordinary shares on 22 June 2004, the effect of which is not considered to be material, this corresponds to the number of ordinary shares issued by Chesnara plc on 25 May 2004 in accordance with the scheme of demerger described in Note 2 (on page 51). This number of shares has been applied uniformly to the results after tax for the year ended 31 December 2004, as this is considered to be the most meaningful way to present earnings per share for that period, having regard to the basis on which the results have been presented as set out in Note 2 above.

The weighted average number of shares in respect of the year ended 31 December 2005 is based on 84,564,168 shares in issue at the beginning of the period and on the issues of shares during the period as described in Note 38 (on page 98).

The diluted weighted average number of shares is 96,673,130, reflecting an adjustment for the equivalent number of shares that would be issued, for no consideration, had the exercise of the share option described in Note 38 (on page 98) been exercised prior to its actual exercise date of 10 February 2005. There were no further share options outstanding during the year ended 31 December 2005.

42 Operating leases

Leases as lessee

Non-cancellable operating lease rentals are payable as follows:

	31 December 2005				31 December 2004			
	Investment properties £000	Non-investment properties £000	Motor vehicles £000	Total £000	Investment properties £000	Non-investment properties £000	Motor vehicles £000	Total £000
Operating lease rentals								
Less than one year	58	647	25	730	58	642	27	727
Between one and two years	58	647	17	722	58	642	32	732
Between two and five years	44	1,940	–	1,984	102	1,927	–	2,029
More than five years	–	4,848	–	4,848	–	5,476	–	5,476
Expenses recognised in the year in respect of operating leases	**58**	**603**	**25**	**686**	**58**	**548**	**–**	**606**

The Group's investment property portfolio is typically freehold. However it has short-term leasehold interests in two properties, which will both have expired by 2008.

The Group leases a property under an operating lease which it occupies in the course of its day-to-day business. The lease expires on 22 July 2019, with an option to renew the lease after that date. Lease payments are increased every five years to reflect market rentals. The lease does not include any contingent rentals.

The Group leases a number of office premises which are no longer used for Group purposes. The leases typically run for approximately a further 10 years after the balance sheet date. Lease payments are increased every five years to reflect market rentals. None of the leases includes contingent rentals. These leased properties are sublet by the Group. Sublease payments as detailed below are expected to be received during the following years. The Group has recognised a provision of £438,000 at 31 December 2005 (31 December 2004: £498,000) in respect of these leases (see Note 31 Provisions on page 94).

Leases as lessor

The Group subleases out both its investment properties from its investment portfolio and the office premises which are no longer used for Group purposes. The future minimum lease payments under non-cancellable leases are as follows:

	31 December 2005			31 December 2004		
	Investment properties £000	Non-investment properties £000	Total £000	Investment properties £000	Non-investment properties £000	Total £000
Sub lease rentals						
Less than one year	1,551	427	1,978	80	306	386
Between one and two years	931	409	1,340	80	239	319
Between two and five years	2,465	1,223	3,688	215	679	894
More than five years	4,771	2,858	7,629	236	2,067	2,303
Rental income recognised in the year	**1,236**	**311**	**1,547**	**149**	**263**	**412**
Repairs and maintenance costs recognised in the year	**133**	**80**	**213**	**113**	**51**	**164**

43 Contingencies

The Group is subject to insurance solvency regulations and it has complied with all solvency regulations, either in accordance with the EU Directives or with UK regulations framed by the Financial Services Authority. There are no contingencies associated with the Group's compliance with these regulations.

44 Capital commitments

There were no material capital commitments as at 31 December 2005.

45 Related party transactions

(a) Identity of related parties

As set out in Note 2 (on page 51), on 24 May 2004 the company acquired the whole of the issued ordinary share capital of Countrywide Assured Life Holding Limited ("CALH") from Countrywide plc ("Countrywide") which had itself acquired the whole of the issued ordinary 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, and in substance the transactions related to the demerger and the associated issue and listing of Chesnara plc shares on the London Stock Exchange, represent a continuation of the business of CALH. Accordingly, the ultimate holding companies of CALH, being CAG between 1 January 2004 and 22 May 2004 and Countrywide from 22 May 2004 to 24 May 2004 are taken to be related parties, transactions with whom, or with any members of their groups, fall to be disclosed in these financial statements. Subsequent to 24 May 2004 the shares of the Company were widely held and no single shareholder exercised significant influence or control over the Company.

In addition to the foregoing the Company has related party relationships with:

(i) key management personnel who comprise only the directors of the company;

(ii) its subsidiary companies;

(iii) other companies over which its Directors have significant influence: these companies are continuing members of the Countrywide Group with whom CALH had a fellow subsidiary relationship prior to 24 May 2004. Transactions with such companies over the whole of the period covered by these financial statements have been aggregated in the analysis below;

(iv) a child of one of the Directors.

(b) Related party transactions

(i) Material arrangements in connection with Demerger

Contractual

The following material contractual arrangements, not being arrangements entered into in the ordinary course of business, were set in place in connection with the effective demerger of the CALH group from the CAG group on 24 May 2004 ("the Demerger") referred to above. To the extent that these arrangements include representations, warranties and indemnities, such provisions are considered standard in an agreement of that nature save to the extent identified below:

Separation and transitional services agreement

Chesnara plc and Countrywide plc entered into a Separation and Transitional Services Agreement which took effect from 24 May 2004. The agreement deals with a number of administrative arrangements between the Chesnara plc group and Countrywide plc, following the Demerger, in relation to property, tax, information technology, intellectual property (including trade names), access to information for audit and other purposes, share schemes, pensions and various other matters.

The agreement contains an indemnity from Chesnara plc in favour of Countrywide plc in respect of guarantees entered into by CAG relating to Harbour House, Portway, Preston, occupied by members of the Chesnara plc group and reciprocal tax indemnities in respect of certain past and future liabilities of the Countrywide plc group and the Chesnara plc group which may arise following the Demerger in respect of which the liabilities of each party are unlimited.

As soon as reasonably practical after the Demerger, the Countrywide plc group undertook to cease using the word "Assured" in the name of any Countrywide plc group company or any trading name of any Countrywide plc group company. In addition, Countrywide was allowed a period of up to 12 months in which to revise literature and other items which contain the word "Assured".

The agreement provided that neither party would, for a period of three years following 24 May 2004, engage in any campaign, systematically induce, solicit or entice any customer to surrender, terminate, rescind or suspend payment into any policy where it had been arranged or introduced by the other party.

Demerger agreement

Under the Demerger Agreement, Countrywide plc agreed, subject to the satisfaction of certain conditions, to the transfer on 24 May 2004 of CALH to Chesnara plc, in consideration of which, Chesnara plc would allot and issue, as fully paid, ordinary shares in Chesnara plc to Countrywide plc shareholders. Each Countrywide plc shareholder on the register of members at the Demerger record date would receive 1 ordinary share in Chesnara plc for every 1 ordinary share in Countrywide plc it held at that time and would not be required to make any payment for such shares. Under the agreement, Countrywide plc gave no warranties, save as to the ownership of CALH and of the shares in the companies to be transferred.

Deed of Settlement in connection with CAG pension scheme

Under a deed of settlement, dated 18 March 2004, between the Company, CAG, Countrywide Assured Services Limited (CASL) a subsidiary of CALH and the Scheme Trustees, the parties agreed that the Company and CASL should have no further liability to the Trustees and the Scheme under section 75 of the Pensions Act 1995 by virtue of their participation in the Scheme in respect of the accrued pension rights of deferred members in respect of past service and that such liabilities would be borne by CAG. This agreement was subject, in the case of CASL, to payment of £398,000 in respect of a deficit which had arisen with regard to CALH employees who had been members of the defined benefits section of the CAG pension scheme which had been closed in respect of future service. On 18 March 2004, the scheme Trustees included Mike Nower who was, at that date, a director both of Countrywide Assured Group plc and of CALH.

Apart from an interim dividend payment paid to Countrywide plc, as set out in Note 39 (on page 100) there were no other related party transactions or arrangement in connection with the Demerger.

(ii) Transactions with key management personnel

Key management personnel comprise the Directors of the company. There are no executive officers other than certain of the Directors.

Key management compensation is as follows:

	Year ended 31 December	
	2005 £000	2004 £000
Short-term employee benefits	503	387
Post-employment benefits	51	38
Long-term employment benefits	177	132
Total	**731**	**557**

In addition to their salaries the Group also provides non-cash benefits to Directors, and contributes to a post employment defined contribution pension plan on their behalf.

A child of one of the Directors was paid £459 during the year ended 31 December 2005 (year ended 31 December 2004: £489) for temporary employment, such payment being made at the legal minimum wage rate.

The following amounts were payable to Directors in respect of bonuses and incentives:

	31 December	
	2005 £000	2004 £000
Annual bonus scheme	160	–
Long-term incentive plan	309	132
Total	**469**	**132**

45 Related party transactions (continued)

These amounts have been included in Group and Company Accrued Expenses as disclosed in Note 37 (on page 98).

The amounts payable under the annual bonus scheme were payable within one year. No part of the amounts payable under the long-term incentive plan was payable within one year.

(iii) Transactions with subsidiaries

The Company undertakes centralised administration functions, the costs of which it charges back to its operating subsidiaries. The following amounts which effectively comprised a recovery of expenses at no mark up were credited to the income statement of the Company for the respective periods.

	Year ended 31 December	
	2005 £000	2004 £000
	1,947	1,082

(iv) Transactions with companies within the Countrywide Assured Group plc and Countrywide plc Groups

The following transaction are disclosed for the periods covered by these financial statements either because they were with fellow subsidiary companies and/or because they were with companies within the above groups, controlled or significantly influenced by directors of the Company.

	Year ended 31 December	
	2005 £000	2004 £000
Amounts payable		
Remuneration of non-executive directors (included in Administrative expenses: see Note 13 on page 73)	130	111

The fees payable to Terry Marris, a non-executive director were paid with the addition of VAT to his employing company, Countrywide Property Lawyers Limited, a subsidiary of Countrywide plc.

	Year ended 31 December	
	2005 £000	2004 £000
Amounts receivable		
Commission receivable in respect of arrangement of the Groups' insurance and investment contracts (Included in Acquisition Expenses: see Note 12 on page 73)	460	3,271
Administration services (Included in Other Operating Income: see Note 9 on page 72)	144	196
Property services	15	8
Total	**619**	**3,475**

Amounts outstanding in respect of the above transactions at each period end were:

	31 December	
	2005 £000	2004 £000
Payables (included in Other Payables: see Note 37 on page 98)	130	54

(v) Transactions with parent company

Prior to the Demerger on 24 May 2004, referred to above, the Group paid management charges of £150,000 to the Countrywide Assured Group plc, the parent of the Group and a dividend of £10,000 to Countrywide plc, the subsequent parent of the Group.

46 Group entities

Control of the Group

The issued share capital of Chesnara plc the Group parent company is widely held, with no single party able to control 20% or more of such capital or of the rights which such ownership confers.

Group subsidiary companies

Name	Country of incorporation or registration	Ownership interest 31 December	
		2005	2004
Countrywide Assured plc	England & Wales	100% of all share capital(4)	100% of all share capital(4)
Countrywide Assured Life Holdings Limited	England & Wales	100% of all share capital	100% of all share capital
Countrywide Assured Services Limited	England & Wales	100% of all share capital(4)	100% of all share capital(4)
Countrywide Assured Trustee Company Limited	England & Wales	100% of all share capital(4)	100% of all share capital(4)
Premium Life Assurance Holdings Limited	England & Wales	100% of all share capital(1)	100% of all share capital(1)
Reefwise Limited	England & Wales	100% of all share capital(2)	100% of all share capital(2)
Premium Life International Limited (see Note 47)	Guernsey	100% of all share capital(3)	100% of all share capital(3)
Countrywide Assured Commission Services Limited	England & Wales	100% of all share capital(3)	100% of all share capital(3)
The Greenways Management Company (Deepcar) Limited	England & Wales	100% of all share capital(3)	100% of all share capital(3)
Countrywide Assured Consultancy Limited	England & Wales	Dissolved 10/05/05	100% of all share capital(4)
Countrywide Assured Care Limited	England & Wales	Dissolved 11/07/05	100% of all share capital(1)
Premium Life Assurance Company Limited	England & Wales	Dissolved 10/05/05	100% of all share capital(3)
Premium Life Finance Limited	England & Wales	Dissolved 10/05/05	100% of all share capital(3)
Premium Life Investment Management Services Limited	England & Wales	Dissolved 10/05/05	100% of all share capital(3)
Premium Life Unit Trust Managers Limited	England & Wales	Dissolved 10/05/05	100% of all share capital(3)
CWA Life Holdings plc	England & Wales	100% of all share capital Acquired 02/06/05	–
CWA Trustee Company Limited	England & Wales	100% of all share capital(5) Acquired 02/06/05	–
City of Westminster Assurance Company Limited	England & Wales	100% of all share capital(5) Acquired 02/06/05	–

(1) Held indirectly through Countrywide Assured plc
(2) Held indirectly through Premium Life Assurance Holdings Limited
(3) Held indirectly through Reefwise Limited
(4) Held indirectly through Countrywide Assured Life Holdings Limited
(5) Held indirectly through CWA Life Holdings plc

47 Events after the balance sheet date

On 15 March 2006 the Group disposed of its interest in Premium Life International Limited to LCL International Life Assurance Company Limited for the sum of £1. This transaction is not material to the profit before tax, financial position or cash flows of the Group. However, following the disposal there is a reduction of £2,030,000 in the regulatory capital resource requirements of Countrywide Assured plc, which are disclosed in Note 27 (on page 83), and there is a consequential reduction in available capital resources.

48 Explanation of transition to IFRS

These are the Group's first consolidated financial statements prepared in accordance with IFRS.

The accounting policies set out on pages 51 to 58 have been applied in preparing the financial statements of both the Group and the Parent Company for the year ended 31 December 2005, the comparative information presented in these financial statements for the year ended 31 December 2004 and in the preparation of an opening IFRS balance sheet at 1 January 2004 (the Group's date of transition).

In preparing its opening balance sheet, the Group and Parent Company have adjusted amounts reported previously in financial statements prepared in accordance with UK GAAP. An explanation of how the transition from UK GAAP to IFRS has affected the Group's and Parent Company's financial position and financial performance flows is set out in the following tables and the notes that accompany the tables.

For full information relating to the transition, reference can be made to the Company's 2005 interim financial statements which are available on the Company's website, www.chesnara.co.uk.

	31 December 2004 £000	1 January 2004 £000
Group		
Total equity		
Total equity under UK GAAP	**73,952**	**78,739**
Adjustments to conform to IFRS		
Investment contracts		
Release of reserves	2,827	2,964
Deferred acquisition costs	1,627	1,753
Deferred income	(4,837)	(5,302)
Revaluation of financial assets/adjustment to contract liabilities	(251)	(177)
Post balance sheet date event – dividends	6,124	–
Total equity under IFRS	**79,442**	**77,977**

	Year ended 31 December 2004 £000
Profit for the year	
Profit for the year under UK GAAP	**5,364**
Adjustments to conform to IFRS	
Investment contracts	
Release of reserves	(136)
Deferred acquisition costs	(125)
Deferred income	464
Revaluation to financial assets/adjustment to contract liabilities	(75)
Share based payment	(336)
Profit for the year under IFRS	**5,156**

	31 December 2004 £000	1 January 2004 £000
Parent Company		
Total equity		
Total equity under UK GAAP	**4,278**	**–**
Adjustments to conform to IFRS	–	–
Total equity under IFRS	**4,278**	**–**

	Year ended 31 December 2004 £000
Profit for the year	
Profit for the year under UK GAAP	**4,067**
Adjustments to conform to IFRS	
Share based payment	(336)
Profit for the year under IFRS	**3,731**

Under IAS 7 'Cash Flow Statements', movements on cash and cash equivalents are reconciled; under UK GAAP the statement reconciles cash only. The change in the presentation of the cash flow statement under IAS 7 makes no difference to the free cash generated by the Group.

Transitional arrangements on first time adoption of IFRS

Companies are required to apply their IFRS accounting policies retrospectively to determine IFRS opening balance sheets and comparative figures. However, IFRS 1 First-Time Adoption of International Financial Reporting Standards provides a number of exemptions to this general principle. The Group has not taken full advantage of the exemptions to retrospective application set out in IFRS 1 and has applied all relevant standards retrospectively, with the following exception:

The Group has elected to apply IFRS 1, Paragraph 25A, which permits financial assets and liabilities to be designated as fair value through income at the date of transition to IFRS, whereas IAS39 Financial Instruments: Recognition and Measurement would require this designation only to be made on initial recognition.

The Group has also elected not to apply the exemptions from presenting comparative information in accordance with IFRS 4 Insurance Contracts, IAS32 Financial Instruments: Disclosure and Presentation and IAS39 Financial Instruments: Recognition and Measurement, except that the Group has taken advantage of the exemption granted by IFRS 4 from providing comparatives to the movements in insurance contracts provisions set out in Note 28 (on page 87).

Effects of IFRS on financial statements

(a) Accounting for investment contracts: release of reserves

Investment contract liabilities fall to be accounted for in accordance with IAS39 Financial Instruments: Measurement and Recognition. A consequence of this is that certain reserves held in respect of investment contracts under UK GAAP are released under IFRS. This has the effect of increasing shareholder equity. As disclosed in Note 29 (on page 92), the Directors have decided that investment contract liabilities should be measured at fair value, for the reasons stated therein.

(b) Deferred acquisition costs

Under IAS18 Revenue the deferral of acquisition costs attributable to investment contracts varies from the treatment under UK GAAP both as to the amount of costs deferred and as to the amortisation period. Under UK GAAP all acquisition costs, which are directly attributable to investment contracts are deferred and are then subsequently amortised against income over the period in which they are deemed to be recovered from further receipts from policyholders (classified as regular annual premium revenue under UK GAAP). This method leads to a relatively short amortisation period, being some four years on average. Under IAS 18 Revenue only directly attributable incremental costs are deferred. Further, they are subsequently amortised over the lives of the contracts, which are typically considerably longer than four years. As all of the relevant costs had, under UK GAAP, been fully amortised at 1 January 2004, the date of transition from UK GAAP, this adjustment has led to an increase in shareholder equity at that date, with subsequent increased charges to the income statement compared with UK GAAP, in connection with the amortisation of such costs.

48 Explanation of transition to IFRS (continued)

(c) Deferred income

Under UK GAAP front end fees received from policyholders in respect of services to be provided on investment contracts in future periods are recognised as income in the period in which they are received, while under IAS18 Revenue such revenue is recognised in the accounting periods in which services are rendered which has been determined as the life of the contracts. Accordingly an explicit deferred income liability is recognised in respect of front end fees which relate to services to be provided in future periods. This deferral of income has led to a reduction in shareholders' equity at 1 January 2004, the date of transition to IFRS, with subsequent additional amounts credited to the income statement in subsequent periods compared with UK GAAP.

(d) Revaluation of financial assets /adjustment to contract liabilities

Under UK GAAP at the IFRS transition date, 1 January 2004, listed investments were valued on the basis of the market convention applicable to where the investments were primarily traded, which was either last traded or mid-market price. Under IFRS listed investments, which are included in financial assets, are classified as fair value through income and IAS39 requires that the fair value for listed investments be determined at bid value. Insofar as this revaluation from last traded or middle market price to bid value relates to investments held within the unit-linked funds, which are thereby reduced in value, there is an offset by way of a corresponding reduction in insurance contract provisions and in investment contract liabilities carried at fair value through income. There is, however, a small reduction in net equity at 1 January 2004 as a result of these adjustments, relating to surplus asset units held within unit-linked funds, which are not matched by liability units, and to the revaluation of investments held outside the unit-linked funds.

(e) Share based payment

As stated in Note 38 (on page 98) to these consolidated financial statements Numis Securities Limited ("Numis") received, on the admission of Chesnara plc to the official list of the UK Listing Authority on 25 May 2004, an option to subscribe for ordinary shares in Chesnara plc. IFRS 2 Share Based Payment requires the difference between the total value of such shares at their option price and the fair value of the option at the date of grant to be charged as an expense to the income statement. Accordingly, an amount representing the difference was charged to financing costs in the income statement for the year ended 31 December 2004, with a corresponding amount credited directly to retained earnings. This cost, which is not cash-based, was not recognised in the corresponding income statements prepared in accordance with UK GAAP and the adjustment in accordance with IFRS has no net effect on shareholder equity.

(f) Post balance sheet events – dividends

Under IAS10 Events after the Balance Sheet Date dividends declared after the balance sheet date are not recognised as a liability at the balance sheet date, because the proposed dividend does not represent a present obligation under IAS37 Provisions, Contingent Liabilities and Contingent Assets. Under UK GAAP proposed dividends had been recognised in the balance sheet as at 31 December 2004, and these amounts are reversed under IFRS.

Statement of Directors' Responsibilities in relation to the Achieved Profit Basis Supplementary Information

The Directors of Chesnara plc have chosen to prepare supplementary information in accordance with the guidance issued in December 2001 by the Association of British Insurers entitled "Supplementary Reporting for Long-Term Insurance Business (the Achieved Profit Method)" (the guidance). When compliance with the guidance is stated the Directors are required to prepare supplementary information in accordance with that guidance and to disclose and explain any non-compliance.

In preparing the Achieved Profit supplementary information, the Directors have:

- Prepared the supplementary information in accordance with the guidance;
- Selected suitable methodologies and then applied them consistently;
- Determined assumptions on a realistic basis, having regard to past, current and expected future experience and to any relevant external data, and then applied them consistently;
- Made estimates that are reasonable and consistent;
- Described the basis on which the residual assets have been included in the supplementary information.

Independent Auditor's Report to Chesnara plc on the Achieved Profit Basis Supplementary Information

We have audited the Achieved Profit supplementary information ("the supplementary information") of Chesnara plc on pages 113 to 121 in respect of the year ended 31 December 2005. The supplementary information has been prepared in accordance with the guidance issued in December 2001 by the Association of British Insurers entitled "Supplementary Reporting for Long-Term Insurance Business (the Achieved Profit Method)" (the guidance) using the methodology and assumptions set out on pages 116 to 118. The supplementary information should be read in conjunction with the Group financial statements which are on pages 44 to 110.

This report is made solely to the Company in accordance with the terms of our engagement. Our audit work has been undertaken so that we might state to the Company those matters we have been engaged to state 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 audit work, for this report, or for the opinions we have formed.

Respective responsibilities of Directors and Auditor

As described in the basis for preparation on page 115, the directors' responsibilities include preparing the supplementary information on the Achieved Profit basis in accordance with the guidance issued by the Association of British Insurers. Our responsibilities, as independent auditor, in relation to the supplementary information are established in the United Kingdom by the Auditing Practices Board, by our profession's ethical guidance and by the terms of our engagement.

Under the terms of engagement we are required to report to the Company our opinion as to whether the supplementary information has been properly prepared in accordance with the guidance using the methodology and assumptions set out on pages 116 to 118. We also report if we have not received all of the information and explanations we require for this audit.

Basis of audit opinion

We conducted our audit in accordance with International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the supplementary information. It also includes an assessment of the significant estimates and judgements made by the Directors in the preparation of the supplementary information, and of whether the accounting policies applied in the preparation of the supplementary information are appropriate to the Group's circumstances, consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the supplementary information is 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 the supplementary information.

Opinion

In our opinion, the Achieved Profit basis supplementary information for the year ended 31 December 2005 has been properly prepared in accordance with the guidance using the methodology and assumptions set out on pages 116 to 118.

KPMG Audit Plc 30 March 2006
Chartered Accountants and
Registered Auditors
St James Square
Manchester M2 6DS

Summarised Group Profit and Loss Account – Achieved Profit Basis

	Note	Year ended 31 December 2005 £000	Year ended 31 December 2004 £000
Operating profit/(loss) before tax and exceptional items		**12,538**	**(5,882)**
Exceptional items			
Profit on acquisition and sale of subsidiary companies		18,262	1,948
Operating profit/(loss) before tax	3	**30,800**	**(3,934)**
Investment return variances		8,709	1,774
Economic assumption changes		(2,935)	(826)
Achieved profit/(loss) before tax	3	**36,574**	**(2,986)**
Tax		(10,283)	3,455
Achieved profit/(loss) on ordinary activities after taxation	3	**26,291**	**469**
Dividends paid		(11,249)	(4,027)
Retained achieved profit/(loss) for the financial year		**15,042**	**(3,558)**

Reconciliation of Movements in Shareholders' Funds – Achieved Profit Basis

	Year ended 31 December 2005 £000	Year ended 31 December 2004 £000
Shareholder funds at 1 January	**149,187**	**152,745**
Net achieved profit for the period	26,291	469
Dividends paid	(11,249)	(4,027)
Issue of new capital		
Share capital	1,001	–
Share premium	20,458	–
Shareholder funds at 31 December	**185,688**	**149,187**

Statement of Encumbered Capital and Reconciliation to Net Asset Value

	31 December 2005 £000	31 December 2004 £000
Encumbered capital		
Long-term insurance capital requirement	34,150	27,932
Resilience capital requirement	2,766	2,552
	36,916	30,484
Unencumbered capital	29,296	34,109
Net asset value at 31 December	66,212	64,593
Value of policies in-force	119,476	84,594
Embedded value at 31 December	**185,688**	**149,187**

The notes on pages 115 to 121 form part of this supplementary information

Summarised Group Balance Sheet – Achieved Profit Basis

	Note	31 December 2005 £000	31 December 2004 £000 (restated)
Assets			
Value of in force business	8/9	119,476	84,594
Property and equipment		–	403
Reinsurers' share of insurance contract provisions		174,154	147,767
Amounts deposited with reinsurers		60,979	21,105
Investment properties		25,422	3,092
Deferred tax assets		120	87
Financial assets			
Equity securities at fair value through income		688,478	191,189
Holdings in collective investment schemes at fair value through income		340,379	301,054
Debt securities at fair value through income		383,817	280,507
Loans and receivables including insurance receivables		19,810	15,013
Derivative financial instruments		16,108	–
Total financial assets		1,448,592	787,763
Reinsurers' share of accrued policy claims		4,810	4,165
Income taxes		199	103
Cash and cash equivalents		282,452	43,933
Total assets		**2,116,204**	**1,093,012**
Liabilities			
Insurance contract provisions		1,051,913	608,316
Financial liabilities			
Investment contracts at fair value through income		819,306	310,951
Borrowings		20,638	–
Derivative financial instruments		416	–
Total financial liabilities		840,360	310,951
Provisions		1,433	926
Reinsurance payables		2,049	3,333
Payables related to direct insurance and investment contracts		23,866	14,351
Income taxes		3,345	1,198
Other payables		7,550	4,750
Total liabilities		**1,930,516**	**943,825**
Net assets		**185,688**	**149,187**
Shareholders' equity			
Share capital		41,501	40,500
Share premium		20,458	–
Other reserves		50	50
Retained earnings		123,679	108,637
Total shareholders' equity	8/9	**185,688**	**149,187**

The notes on pages 115 to 121 form part of this supplementary information.

Approved by the Board of Directors on 30 March 2006

Christopher Sporborg **Graham Kettleborough**

1 Directors' responsibilities

The statement of directors' responsibilities in relation to the Achieved Profit Basis supplementary information is set out on page 111.

2 Basis of presentation

Supplementary information is presented on pages 113 to 121 which shows summary data relating to the results and financial position of the Group on the Achieved Profit Basis, the objective of which is to provide alternative information to that presented in accordance with International Financial Reporting Standards. The information includes the result of the Group's Life Assurance long-term businesses on a basis determined in accordance with the ABI Guidance "Supplementary reporting for long-term assurance business" (the "Achieved Profit method") issued in December 2001. All other transactions and balances have been determined in accordance with the IFRS accounting policies set out on pages 51 to 58. The comparative figures for the twelve months ended 31 December 2004 have been presented to provide consistent treatment and disclosure between periods.

The supplementary information prepared on the Achieved Profit Basis and comparative figures for the year ended 31 December 2004 are the results and financial position of the Chesnara plc Group as deemed appropriate under the reverse acquisition method of accounting as described in Note 2 to the IFRS financial statements (on page 51). In accordance with that method, the consolidated results and financial position of Chesnara plc are based on the consolidated results and financial position of Countrywide Assured Life Holdings Limited.

Dividends declared after the balance sheet date are not recognised at the balance sheet date, because they do not represent a present obligation. This treatment, which accords with IFRS, represents a change from the previous accounting treatment on the Achieved Profit Basis and amounts previously reported as net assets and embedded value as at 31 December 2004 are, accordingly, restated. Except for these adjustments, there are no other adjustments required, for reporting on the Achieved Profit Basis, as a result of the Group's transition to IFRS as the basis of preparation of its primary financial statements.

The Group acquired CWA Life Holdings plc on 2 June 2005, the principal operating subsidiary of which is City of Westminster Assurance Company Limited ("CWA") which is engaged in long-term assurance business. The Achieved Profit result set out below includes the achieved profit arising within CWA from the date of acquisition to 31 December 2005. The excess of the embedded value of CWA (on the Achieved Profit Basis) over the total purchase consideration as also described in Note 5 to the IFRS financial statements (on page 69) has been treated as an exceptional credit to the Achieved Profit result of the Group for the twelve months ended 31 December 2005, as set out below.

The revision of the economic and demographic assumptions at December 2005 from those adopted at December 2004 would result in a change to opening and closing 2004 Shareholder Funds and components of 2004 Achieved Profit earnings. The effect of these is shown in Supplementary Note 5 following.

3 Components of achieved profit

The pre-tax components of the Achieved Profit result are shown below. The basic operating Achieved Profit result is determined by using the assumptions set out in Supplementary Note 5 following. This result is adjusted to take into account items considered to be short-term variations to these longer-term assumptions to determine the total achieved pre and post-tax result for the respective year.

	Year ended 31 December	
	2005 £000	2004 £000
New business contribution	1,826	664
Existing business contribution		
Expected return	10,526	10,708
Experience variances		
Persistency	6,182	2,854
Mortality/morbidity	(329)	(1,030)
Pensions and complaints redress	(8,381)	(17,556)
Other	2,566	3,541
Operating assumption changes		
Mortality	1,210	–
Persistency	(4,075)	(9,105)
Expenses and deductions, including outsource expenses	214	3,110
Other	1,660	(220)
Expected return on unencumbered capital	1,139	1,152
Operating profit/(loss) before tax and exceptional items	**12,538**	**(5,882)**
Exceptional items		
Profit on acquisition and sale of subsidiary companies	18,262	1,948
Operating profit/(loss) before tax	**30,800**	**(3,934)**
Investment return variances	8,709	1,774
Economic assumption changes		
Investment return	(5,687)	(2,146)
Risk discount rate	2,752	1,320
Achieved profit/(loss) before tax	**36,574**	**(2,986)**
Tax	(10,283)	3,455
Achieved profit after tax	**26,291**	**469**

The exceptional profit arising during the year ended 31 December 2005 relates to the acquisition of CWA Life Holdings plc and represents the excess of the embedded value of that company over the total purchase price.

The exceptional profit arising during the year ended 31 December 2004 relates to the sale of Key Retirement Solutions Limited, being the excess of the net proceeds over its carrying value.

4 Methodology

The Achieved Profit 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.

Residual assets, comprising the excess assets within the long-term fund over and above mathematical reserves, together with the excess of segregated shareholder net assets on a statutory solvency basis over the Capital Resources Requirement ("CRR"), which is regarded as encumbered capital, represent further components of Shareholder Funds.

Recognition, within Shareholder Funds, of the cost of maintaining the CRR at a reporting date is offset within Achieved Profit methodology by the recognition of the discounted value of expected future anticipated net interest and releases of the CRR over the period to expiry of the policies in force. The annual result is impacted by the movement in this cost from year to year which comprises a charge against new business profit with a partial offset for the release of capital requirements for business in force.

The Achieved Profit methodology recognises as profit the movement in Shareholder Funds over a period. Operating profit has been determined upon the principles embodied in paragraph 58, 'Components of Achieved Profits', of the ABI AP Guidance.

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. Experience variances shown in Supplementary Note 3 above have been determined using closing assumptions.

In the derivation of discounted future surplus no recognition is given to future premiums under non-contractual increments or for future Department of Work and Pensions rebate premiums.

5 Key assumptions

Economic and investment assumptions

The table below shows the key economic and investment assumptions used in the calculation of the value of the in-force business, being that subsisting within Countrywide Assured plc ("CA") and City of Westminster Assurance Company Limited ("CWA").

	31 December	
	2005 %	2004 %
Risk discount rate		
CA	8.00	9.00
CWA	7.70	n/a
Future expenses inflation		
CA	3.40	3.10
CWA	2.70	n/a
Future expense charge inflation rate		
CA	3.40	3.10
CWA	2.70	n/a
Future RPI	2.70	2.50
Unit-linked funds		
Income (pre-tax)	3.12	3.30
Capital Growth (pre-tax)	3.07	3.52
Unit-linked funds (total)	**6.19**	**6.82**
Investment returns (pre-tax)		
Government fixed interest	4.10	4.70
Other fixed interest	4.60	5.20
Equity	6.75	7.30
Property	6.75	7.30

The risk discount rate is used to discount projected future cash flows from the business in force to a 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 fixed interest yield assumptions reflect the yield curve for different asset outstanding terms and credit and liquidity risk adjustments. The equity return assumes, over the longer term, a risk premium adjustment over medium term Government Fixed Interest yields.

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 but with some allowance recognised for external industry experience and trends.

Mortality and morbidity decrement assumptions are determined by reference to emerging underlying experience, published industry data and reinsurer rates. Due regard is paid in setting the experience assumptions to policyholder reasonable expectations as mortality and morbidity costs are met by charges against unit accounts.

5 Key assumptions (continued)

The renewal expense assumptions reflect the charges under the Insurance Administration Services Agreement with Liberata Financial Services Limited for CA and the charges under the Insurance and Pensions Services Agreement with CSC Services No 1 Limited for CWA, together with the residual governance expenses attributable to the Life businesses.

Allowance has been made, in both CA and CWA renewal expense assumptions, for additional VAT costs which may arise on third-party insurance administration arrangements. This follows the issue by HM Revenue and Customs of a consultation document in July 2005 entitled "Changes to the VAT exemption for Insurance-related Services". Notwithstanding the fact that the UK Government has subsequently announced a delay in the implementation of the European Court of Justice judgement which gave rise to the consultation document, the Directors believe that it is prudent to continue to make allowance for these costs on the basis on which they had already been established.

During 2003, the CA Life business substantially closed to new business and the allowance for future expenses in the calculation of the embedded value at 31 December 2004 and 31 December 2005 has been based on the Board'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 in CA beyond a 13-year time horizon should be excluded from the value of policies in-force.

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 indexed linked gilt edged securities.

Future fund management expenses are based on current fees charged to the Life businesses.

Tax has been provided at the rates applicable to investment income and expenses relief provided under relevant life company taxation, which is assumed to continue unaltered. A projection of future tax charges, based upon 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 result.

The provision established to cover redress on endowment complaints in both CA and CWA business is based on recent experience of complaints cases, assuming the Life businesses continue to deal with complaints in accordance with the FSA's procedural requirements, including the application of time-barring.

As a result of strengthening the persistency assumptions and of strengthening the complaints redress provisions the residual risk allowed for in the risk margin within the risk discount rate applied by CA has reduced by 0.4 of a percentage point. The effect of making this change has been to increase the Achieved Profit operating profit before tax and exceptional items for the year ended 31 December 2005 by £1.6m.

The portion of a reinsurer default reserve that relates to unit-linked business is assumed to be released within 12 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.

6 Life Assurance reported information at 31 December 2004 restated based on assumptions used at 31 December 2005

The following table restates information on new business contribution and expected return for the year ended 31 December 2004, and on shareholder funds as at that date, using the same economic assumptions adopted at 31 December 2005 to enable comparison. Under Achieved Profit methodology an active approach to assumption setting is generally required.

	31 December 2004 £m
New business contribution: (reported on 2004 economic assumptions)	0.7
New business contribution: (revalued on 2005 economic assumptions)	0.7
Expected return: (reported on 2004 economic assumptions)	10.7
Expected return: (revalued on 2005 economic assumptions)	9.5
Shareholder funds: (reported on 2004 economic assumptions-restated)	149.2
Shareholder funds: (revalued on 2005 economic assumptions)	147.2

7 Sensitivities

(i) Impact of financial assumption changes for the year ended 31 December 2005 or as at 31 December 2005

	New business contribution £m	Shareholder funds £m
Reported at 31 December 2005	1.8	185.7
Risk discount rate +1%		
CA	–	(3.4)
CWA	(0.1)	(2.9)
Total	(0.1)	(6.3)
Risk discount rate -1%		
CA	–	3.6
CWA	0.1	3.3
Total	0.1	6.9
Investment return (pre tax) +1%		
CA	–	4.2*
CWA	0.1	5.3
Total	0.1	9.5
Investment return (pre tax) -1%		
CA	–	(4.2)*
CWA	(0.1)	(5.3)
Total	(0.1)	(9.5)

* For the current range of term assurance products the investment return assumption (net of tax charge) is capped at the effective net of tax investment rate used in the premium review process.

(ii) Impact of a 10% increase in lapse assumptions at 31 December 2005

The table below shows the impact of adopting lapse assumptions at a level of 110% of the actual assumptions adopted at December 2005.

	New business contribution £m	Shareholder funds £m
Reported at 31 December 2005	1.8	185.7
Lapse assumptions +10%		
CA	–	(4.0)
CWA	–	(0.6)
Total	–	(4.6)

The impact of adopting lower lapse assumptions at a level of 90% of the actual assumptions adopted at 31 December 2005 would have resulted in increases in New Business Contribution and Shareholder Funds by amounts of similar magnitude to the movements shown above.

8 Value of policies in-force and embedded value

	2005 £000	2004 £000 (restated)
Value of policies in force		
At 1 January, net of tax	**84,594**	**98,521**
Purchased in-force value arising on the acquisition of CWA Life Holdings plc, net of tax	46,667	–
Gross decrease in the value of policies in force	(13,693)	(19,452)
Taxation	1,908	5,525
At 31 December, net of tax	119,476	84,594
Other net assets at end of period	66,212	64,593
Embedded value at 31 December	**185,688**	**149,187**

The amounts presented as net assets and as embedded value, as at 31 December 2004, have been restated from amounts previously reported for the effect of the addback, of a dividend proposed but not yet paid at the period end. This adjustment was made to align the treatment of dividends proposed but not paid at the period end under Achieved Profit reporting with IFRS, and for the purposes of reporting embedded value.

The following summarises the effect of the adjustments which have been made.

	31 December 2004	
	As previously reported £000	As restated £000
Net assets	58,469	64,593
Embedded value	143,063	149,187

9 Reconciliation of shareholder equity on the IFRS basis to embedded value

	31 December	
	2005 £000	2004 £000
Shareholders' equity on the IFRS basis	**108,267**	**79,442**
Adjustments:		
Deferred acquisition costs		
Insurance contracts	(1,114)	(5,120)
Investment contracts	(11,239)	(2,324)
Deferred income	19,145	6,910
Adjustment to provisions on investment contracts, net of amounts deposited with reinsurers	(16,700)	(4,038)
Adjustments to provisions on insurance contracts, net of reinsurers' share	(34)	62
Revaluation of financial assets/adjustment to contract liabilities	–	359
Acquired in-force value	(28,703)	(1,622)
Deferred tax	2,590	1,638
Sub total	**72,212**	**75,307**
Reinsurer default reserve	(6,000)	(9,000)
Reserve for additional costs	–	(1,714)
Sub total	**66,212**	**64,593**
Value of in-force book	119,476	84,594
Embedded value	**185,688**	**149,187**

The reinsurer default reserve and the reserve for additional costs relate to reserves which are established for FSA prudential reporting. Neither of these reserves are recognised for reporting in accordance with IFRS or for establishing embedded value, either at 31 December 2005 or 31 December 2004, as the case may be, as the events to which they relate were, in the opinion of the Directors, considered to be remote or uncertain. However, the reserves are charged to the shareholder net assets component of embedded value, but are released within the value-in-force calculations. This method is used so that the cost of capital of maintaining the relevant reserves is recognised within the overall embedded value calculation.

The reinsurer default reserve relates to the reserve which is maintained against the effect of possible default by a major reinsurer, Guardian Assurance plc, which is a subsidiary of Aegon NV.

The adjustment for the reserve for additional costs related to VAT which may become assessable on charges made under an Insurance Administration Services Agreement with Liberata Financial Services Limited. Following a decision delivered in the European Court of Justice ("ECJ") in early 2005 in the case of Staatssecretaris Von Financien v Arthur Andersen and Co, Accountants, there was uncertainty whether charges made under such arrangements would be exempt from VAT. However following the issue of a Consultation Document entitled "Changes to the VAT Exemption for Insurance-related Services" by HM Revenue and Customs in July 2005, subsequent to that decision, the Directors are of the opinion that it is appropriate to establish provisions for additional VAT costs as at 31 December 2005 for reporting in accordance with IFRS and for establishing embedded value as at that date. Accordingly, the IFRS treatment accords with the treatment in measuring embedded value and the adjustment in the reconciliation set out above is no longer required as at 31 December 2005. Notwithstanding the fact that the UK Government has announced a delay in the implementation of the ECJ judgement, the Directors believe that it is prudent to continue to maintain such provisions on the basis on which they had already been established.

The assets and liabilities included in the summarised Group Balance Sheet, except value of in-force business, are recognised on the regulatory capital basis. In 2004 financial assets and corresponding regulatory liabilities were valued on a mid-market basis, whereas in 2005 they have been valued on a bid basis. In the IFRS Consolidated Balance Sheet this change in basis has been reflected in the 31 December 2004 restatement.

Chesnara plc

Notice is hereby given that the Annual General Meeting of the Company will be held at the offices of Panmure Gordon (UK) Limited, Moorgate Hall, Moorgate, London EC2M 6XB on 11 May 2006 at 2 pm for the following purposes:

Ordinary business

To consider and if thought fit, to pass the following resolutions which will be proposed as ordinary resolutions:

Resolution 1

To receive and adopt the Financial Statements for the financial year ended 31 December 2005 together with the Reports of the Directors and Auditors thereon.

Resolution 2

To declare a final dividend for the financial year ended 31 December 2005.

Resolution 3

To approve the Directors' Remuneration Report set out in the Financial Statements for the financial year ended 31 December 2005.

Resolution 4

To re-elect Peter Mason who retires by rotation.

Resolution 5

To re-elect Graham Kettleborough who retires by rotation.

Resolution 6

To reappoint KPMG Audit Plc as Auditor of the Company to hold office from the conclusion of this meeting until the conclusion of the next General Meeting at which the Financial Statements are laid before the Company at a remuneration to be determined by the Directors.

Special business

To consider and, if thought fit, pass the following resolutions of which Resolution 7 will be proposed as an ordinary resolution and resolutions 8 and 9 will be proposed as special resolutions.

Resolution 7

That the Directors be and they are generally and unconditionally authorised, pursuant to Section 80 of the Companies Act 1985 ("the Act") to exercise all the powers of the Company to allot relevant securities (as defined in Section 80 of the Act) provided that:

(i) the aggregate nominal value of relevant securities allotted pursuant to this authority shall not exceed £1,742,972 representing 33.33% of the issued ordinary shares of 5p each;

(ii) this authority shall expire on the date of the Annual General Meeting to be held in 2007 or fifteen months after the passing of this resolution whichever occurs first; and

(iii) the Company may make an offer or agreement before the expiry of this authority which would or might require relevant securities to be allotted after this authority has expired and the Directors may allot relevant securities in pursuance of any such offer or agreements as if this authority has not expired.

This authority is to replace the existing like authority which is hereby revoked with immediate effect.

Resolution 8

That, subject to the passing of Resolution 7, the Directors be and they are empowered, pursuant to Section 95 of the Act, to allot equity securities (as defined in Section 94 of the Act) pursuant to the authority contained in the foregoing Resolution numbered 7 as if Section 89(1) of the Act did not apply to such allotment, provided that this power shall be limited to:

(i) the allotment of equity securities in connection with a rights issue or other pre-emptive offer in favour of holders of ordinary shares where the equity securities respectively attributable to the interests of all holders of ordinary shares are proportionate (as nearly as may be) to the respective numbers of ordinary

shares held by them subject to such exclusions or arrangements as the Directors may deem necessary or desirable to deal with fractional entitlements otherwise arising or legal or practical problems under the laws or regulations of any regulatory authority in any territory;

(ii) the allotment of equity securities pursuant to the terms of any share scheme for employees approved by the members in General Meetings; and

(iii) the allotment of equity securities for cash (otherwise than as mentioned in sub-paragraphs (i) and (ii) above) provided that the maximum aggregate nominal value of equity securities allotted does not exceed £261,471 representing approximately 5% of the issued share capital of the Company; and shall expire on the date of the Annual General Meeting of the Company to be held in 2007 or fifteen months after the passing of this resolution whichever occurs first except to the extent that the same is renewed or extended prior to or at such Meeting save that the Company may make an offer or agreement before the expiry of this power which would or might require securities to be allotted after it has expired and the Directors may allot equity securities in pursuance of any such offer or agreement as if the power conferred hereby had not expired.

Resolution 9

That the Company be and is generally and unconditionally authorised for the purposes of Section 166 of the Act to make one or more market purchases (within the meaning of Section 163(3) of the Companies Act 1985) on the London Stock Exchange of ordinary shares of 5p each in the capital of the Company provided that:

(i) the maximum aggregate number of ordinary shares hereby authorised to be purchased is 10,458,878 (representing 10% of the Company's issued share capital);

(ii) the minimum price which may be paid for such ordinary shares is 5p per share;

(iii) the maximum price (exclusive of expenses) which may be paid for such ordinary shares is not more than 5% above the average of the middle market quotations for the ordinary shares derived from the Daily Official List of the London Stock Exchange for the five business days before the purchase is made;

(iv) the authority hereby conferred shall expire at the conclusion of the next Annual General Meeting of the Company held in 2007 or, if earlier, the date 15 months after the date on which the resolution is passed; and

(v) the Company may make a contract or contracts to purchase ordinary shares under the authority hereby conferred prior to the expiry of such authority which will or may be executed wholly or partly after the expiry of such authority, and may make a purchase of ordinary shares in pursuance of any such contract or contracts.

Notes

1. Any Member entitled to attend and vote at this Meeting may appoint a proxy or proxies to attend and on a poll, vote instead of him. A proxy need not be a Member of the Company. A form of proxy for this Meeting is enclosed, and if used should be lodged with the Company's Registrars, Capita Registrars at The Registry, P.O. Box 25, 34 Beckenham Road, Beckenham, Kent, BR3 3BR not less than 48 hours before the time appointed for the holding of the meeting. The appointment of a proxy will not preclude a shareholder from attending and voting at the meeting.
2. There is no Directors' service contract of more than one year's duration with any Director.
3. The Register of Directors' shareholdings and transactions and copies of Directors' service contracts will be available for inspection at the registered office of the Company during normal business hours each business day and at the place of the Annual General Meeting for at least 15 minutes prior to and during the Meeting.
4. Pursuant to Regulation 41 of the Uncertificated Securities Regulations 2001, the time by which a person must be entered on the register of members in order to have the right to attend and vote at the Annual General Meeting is 2pm on 9 May 2006 or, if the Meeting is adjourned, such time being not more than 48 hours prior to the time fixed for the adjourned meeting. Changes to entries on the register of members after that time will be disregarded in determining the right of any person to attend or vote at the meeting.

Additional Information

Approval of the Directors Remuneration Report set out in the Financial Statements (Resolution 3)

The Directors' Remuneration Report Regulations 2002, which came into force on 1 August 2002, stipulates the form of the Report. The Report is set out on pages 31 to 37 of the Financial Statements. Shareholders will be asked to approve this Remuneration Report under Resolution 3.

Authority to Allot Relevant Securities (Resolution 7)

The Company will be asking shareholders to renew the existing authority which the Directors have to allot shares in respect of the authorised but unissued ordinary share capital. Resolution 7 seeks to renew this

authority to issue shares up to an aggregate nominal amount of £1,742,972 representing approximately 33.33% of the issued share capital of the Company.

Disapplication of Pre-emption Rights (Resolution 8)

Resolution 8 will be proposed as a Special Resolution, renewing the Directors' authority to allot shares for cash other than to existing shareholders in proportion to their shareholding up to an aggregate nominal value of £261,471, representing 5% of the Company's issued share capital.

Both these authorities (Resolutions 7 and 8), if given, will expire at the conclusion of the next Annual General Meeting or 15 months after the passing of the resolution, whichever occurs first.

Power to purchase own shares (Resolution 9)

The Companies Act 1985 permits a public company to purchase its own shares in accordance with powers contained in its Articles of Association with the authority of a resolution of shareholders. Such a power would expire at the conclusion of the next Annual General Meeting. With effect from 1 December 2003, listed companies are able to buy their own shares and, instead of cancelling them, hold them in treasury and either sell them for cash or use them for cash or use them for an employee share scheme under the Companies (Acquisition of Own Shares) (Treasury Shares) Regulations 2003. The aggregate nominal value of shares of any class held as treasury shares must not be at any time exceed 10% of the nominal value of the issued share capital of the shares in that class at that time. Your Directors believe that the Company should continue to have the authority to purchase its own shares. However, this authority will only be exercised when the result would be an increase in earnings per share and in the best interests of the Company. Your Directors have no present intention to make use of this authority. Resolution 9 will be proposed as a special resolution at the Annual General Meeting to give the necessary authority.

By Order of the Board

Ken Romney
Company Secretary

Date 30 March 2006

Registered Office and Group Head Office
Harbour House
Portway
Preston
PR2 2PR

AGM Location
Panmure Gordon (UK) Limited's Office
Moorgate Hall
Moorgate
London
EC2M 6XB

Printed by greenaways, a member of the ormolu group. 162839