Press Release

<u>Chesnara plc – Preliminary Results for the year ended 31 December 2005</u>

Strong emerging surplus supports 6.3% final dividend increase

City of Westminster acquisition brings significant benefits to shareholders

[For immediate release]

31 March 2006

Chesnara, the life business run-off specialist, today reported final results for the twelve months to 31 December 2005. Chesnara is committed to offering shareholders an attractive, long term income stream arising from the profits from its life assurance businesses.

- IFRS pre-tax profit on ordinary activities of £20.5m, 19.26p per share (2004 profit: £4.4m, 6.10p per share)
- Purchase of City of Westminster Assurance for £47.8m offers significant merger synergies and increases stability and longevity of income stream
- Exceptional Achieved Profit pre-tax result of £36.6m (2004: loss £(3.0)m) underlines attraction of acquisition strategy
- Adverse mortgage endowment misselling experience leads to additional net increase in provisions of £3.5m (£2.5m net of tax) at year end. Follows increase of £3.9m (£2.7m net of tax) at 30 June 2005
- Persistency adjustments make positive overall contribution
- Embedded Value (pre final dividend payment) now £185.7m (2004:£149.2m) with strong NAV backing of £66.2m (2004:£64.6m)
- Combined capital resource cover ratio remains strong at 178% (post-dividend), comfortably ahead of the Boards target level
- Excess regulatory capital at Group level of £21.3m (post-dividend), equivalent to 158% of requirement
- 7.55p final dividend per share declared (7.1p): increased by 6.3%
- Total dividend for year of 12.45p (11.85p): increased by 5.1%
- Board remains committed to progressive dividend policy

Graham Kettleborough, Chief Executive said:
"At the half year we saw a strong emergence of surplus and the beginning of a healthy contribution from City of Westminster. This has continued into the full year, in line with our expectations, and has supported a substantial increase in the final dividend for the year. Expenses are well controlled, and rising investment markets, together with the benefits of the City of Westminster acquisition support our progressive dividend strategy as evidenced by the increase to the final dividend of 6.3% to 7.55p per share."

This preliminary statement was approved by the Board on 30 March 2006.

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Notes to editors:

Chesnara plc, which was listed on the London Stock Exchange in May 2004, was formed to become the new holding company of the life assurance activities formerly owned by Countrywide plc. Its primary subsidiary – Countrywide Assured plc – is substantially closed to new business and has outsourced its back office functions to Liberata Financial Services. In June 2005, Chesnara confirmed its strategic intentions when it acquired City of Westminster Assurance, a further closed life assurer, for £47.5m.

Financial Highlights

	Year ended 31 December	
Operating profit before tax	**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 shareholder 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.

Chairman's Statement

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 9.

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

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 Note 9. 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. 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 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 polices 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

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 8 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	**2004**
	£000	**£000**
		(restated)
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	31 December 2004 £000 (restated)
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. This gave rise to an amount previously reported as a demerger reserve of £36.3m 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:

Number of policies	31 December 2005 000	31 December 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.

Value in-force	31 December 2005 £m	31 December 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 5. 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 subsiding 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 section 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 business. 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 financial dividend of 7.55p per share, of between nil and 9%, based on recent share price performance.

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 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 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	**2004**
Pre-dividend	**£m**	**£m**
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.

IFRS Reporting

As explained in Note 9, 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 will continue 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.

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.

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

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		13,000	8,137
Acquired value of in-force business			
Insurance contracts		24,900	1,818
Investment contracts		14,661	–
Property and equipment		–	403
Reinsurers' share of insurance contract provisions		199,563	154,597
Amounts deposited with reinsurers		62,697	22,888
Investment properties		25,422	3,092
Financial assets			
Equity securities at fair value through income		688,478	187,026
Holdings in collective investment schemes at fair value through income		340,379	301,054
Debt securities at fair value through income		383,817	280,148
Loans and receivables including insurance receivables		19,810	15,013
Derivative financial instruments		16,108	–
Total financial assets		1,448,592	783,241
Reinsurers share of accrued policyholder claims		4,810	4,165
Income taxes		199	103
Cash and cash equivalents		282,452	43,933
Total assets		**2,076,296**	**1,022,377**
Liabilities			
Insurance contract provisions		1,072,064	601,805
Financial liabilities			
Investment contracts at fair value through income		803,146	306,786
Borrowings	5	20,638	–
Derivative financial instruments		416	–
Total financial liabilities		824,200	306,786
Provisions		1,433	926
Deferred tax liabilities		13,327	1,748
Reinsurance payables		2,049	3,333
Payables related to direct insurance and investment contracts		23,866	14,351
Deferred income		20,195	8,038
Income taxes		3,345	1,198
Other payables		7,550	4,750
Total liabilities		**1,968,029**	**942,935**
Net assets		**108,267**	**79,442**
Shareholders' equity			
Share capital	6	41,501	40,500
Share premium	6	20,458	–
Other reserves		50	50
Retained earnings	7	46,258	38,892
Total shareholders' equity		**108,267**	**79,442**

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 from 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	–	–

Consolidated statement of changes in equity for the year ended 31 December 2005

Year ended 31 December 2005

	Share capital	Share premium	Capital redemption reserve	Retained earnings	Total
	£000	£000	£000	£000	£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	Capital redemption reserve	Retained earnings	Total
	£000	£000	£000	£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.

Notes

1 Basis of Preparation

(a) General

These financial statements have been prepared in accordance with International Financial Reporting Standards including International Accounting Standards and Interpretations (collectively "IFRS") issued by the International Accounting Standards Board ("IASB") and endorsed for use by companies in the EU, and with those parts of the UK Companies Act 1985 applicable to companies reporting under IFRS.

Full details of IFRS policies applied and reconciliations of comparative figures between UK GAAP and IFRSs are available in our Interim Statement, a copy of which is available from our website www.chesnara.co.uk. A brief reconciliation of the main changes is detailed in Note 9.

(b) 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.

2 Status of financial information

The financial information contained in this preliminary announcement does not constitute the Company's consolidated statutory financial statements for the years ended 31 December 2005 or 2004, but is derived from those financial statements. The financial statements for the year ended 31 December 2004, which were prepared under UK GAAP, have been delivered to the Registrar of Companies. The financial statements for the year ended 31 December 2005, prepared under IFRSs will be delivered following the Company's Annual General Meeting. The auditors have reported on those financial statements; their reports were unqualified and did not contain statements under section 237 (2) or (3) of the Companies Act 1985.

The financial statements will be posted to shareholders on 13 April 2006, copies of which will also be available from the Company Secretary, Chesnara plc, Harbour House, Portway, Preston, PR2 2PR.

3 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.

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	**Adjustments and reclassifications**	**Updated fair value at acquisition**	**Acquiree's carrying amount**
	£000	**£000**	**£000**	**£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.

4 Income tax expense

	Year ended 31 December 2005 £000	Year ended 31 December 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	Year ended 31 December 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)**

5 Borrowings

	31 December 2005 £000	31 December 2004 £000
Bank loan	20,638	–

The bank loan which was drawn down on 2 June 2005 under a facility made available in 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.

6 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 1(b), 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 1(b) 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 £000	Share premium £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.

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 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 3.

7 Retained earnings

	Year ended 31 December	
	2005	**2004**
Retained earnings attributable to equity holders of the parent company comprise:	**£000**	**£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 6)	–	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 1(b). 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 6 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	**2004**
	p	**p**
Interim	4.90	4.75
Final	7.55	7.10
Total	12.45	11.85

8 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. 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.

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 6.

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 6 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.

9 Explanation of transition to IFRS

These are the Group's first consolidated financial statements prepared in accordance with IFRS.

In preparing its opening balance sheet, the Group has 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 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
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**

Effects of IFRS in 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. The Directors have decided that investment contract liabilities should be measured at fair value.

(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 IAS18 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.

(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 6 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 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.

10. Forward-looking statements

This document may contain forward-looking statements with respect to certain of the plans and current goals and expectations relating to the future financial condition, business performance and results of Chesnara plc. By their nature, all forward-looking statements involve risk and uncertainty because they relate to future events and circumstances that are beyond the control of Chesnara plc including, amongst other things, UK domestic and global economic and business conditions, market related risks such as fluctuations in interest rates, inflation, deflation, the impact of competition, changes in customer preferences, delays in implementing proposals, the timing, impact and other uncertainties of future acquisitions or other combinations within relevant industries, the policies and actions of regulatory authorities, the impact of tax or other legislation and other regulations in the jurisdictions in which Chesnara plc and its affiliates operate. As a result, Chesnara plc's future condition, business performance and results may differ materially from the plans, goals and expectations expressed or implied in these forward-looking statements.

11. Additional information

Additional information relating to the Company can be found on its website www.chesnara.co.uk.