Chesnara plc

Interim Financial Statements
for the six months ended
30 June 2006
and
Restatement of Supplementary Information
from Achieved Profit to European Embedded Value Basis

Contents

Note on Terminology

As explained in the Chairman's Statement on page 3, on 30 June 2006 the long-term business of City of Westminster Assurance Company Limited, a Group subsidiary, acquired on 2 June 2005, was transferred, under the provisions of Part VII of the Financial Services and Markets Act 2000, to the Group's other principal operating subsidiary, Countrywide Assured plc. The former company is referred to as "CWA" in this document and the latter as "CA". Following the transfer, the whole of the Life operations of the Group subsist within one legal regulated entity, CA. However, within this document reference is made to the "CWA business" and to the "CA business" to continue to identify respectively the long-term business conducted within CWA and the long-term business conducted within CA prior to the transfer.

Chesnara plc

Interim Financial Statements for the six months ended 30 June 2006

Financial Highlights

	6 months ended 30 June		Year ended 31 December
	2006	2005	2005
IFRS basis			
Operating profit	11.5	4.3	21.3
Financing costs	(0.6)	(0.1)	(0.8)
Loss on sale of subsidiary company	(0.3)	–	–
Profit before income taxes	**£10.6m**	**£4.2m**	**£20.5m**
Basic earnings per share	7.34p	3.73p	19.26p
Dividend per share	5.05p	4.90p	12.45p
Shareholders' equity on IFRS basis	**£108.0m**	**£98.1m**	**£108.3m**
European Embedded Value basis (EEV)			
Operating profit	5.9	2.3	10.7
Exceptional item			
Profit on acquisition of subsidiary company	–	30.3	30.3
Investment variances and economic assumption changes	0.9	3.1	10.9
Profit before tax	**£6.8m**	**£35.7m**	**£51.9m**
Covered Business			
Shareholder net worth	71.9	74.6	84.5
Value of in-force business	108.7	113.1	110.0
Embedded value	180.6	187.7	194.5
Acquired embedded value financed by debt	(16.8)	(21.0)	(21.0)
Shareholders' equity in other Group companies	11.9	4.1	2.7
Shareholders' equity on EEV basis	**£175.7m**	**£170.8m**	**£176.2m**
Life annual premium income (AP)	£58.7m	£55.8m	£118.0m
Life single premium income (SP)	£19.3m	£33.4m	£60.1m
Life annualised premium income (AP + 1/10 SP)	£60.6m	£59.1m	£124.0m

In contrast with the IFRS basis of reporting, the EEV basis recognises the discounted value of the expected future cash flows, arising from the long-term business contracts in force at the year end, as a component of shareholder equity. Accordingly, the EEV result recognises, within profit, the movement in this component.

The Group presents supplementary financial information, prepared in accordance with the EEV basis, with effect from 1 January 2006. This first-time adoption of EEV principles and associated disclosures represents a change from the Achieved Profit ("AP") basis of reporting, which was previously adopted by the Group as the basis for presenting supplementary financial information. Restatement of information for comparative periods from the AP basis to the EEV basis, together with explanatory notes, is set out on pages 35 to 37.

Under the EEV basis of reporting, the exceptional profit arising during the six months ended 30 June 2005 and 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 the acquisition date, over the total purchase price. Investment variances and economic assumption changes for the six months ended 30 June 2006 are stated net of a £0.3m loss arising on the sale of a subsidiary company.

I am pleased to present the third interim statements of Chesnara plc ("Chesnara"), which was listed on the London Stock Exchange in May 2004. Originally formed to become the holding company of Countrywide Assured plc on its demerger from Countrywide plc, it acquired City of Westminster Assurance Company Limited, a further closed life assurance company, in June 2005.

Background

Chesnara's original and primary subsidiary, Countrywide Assured plc ("CA"), manages a portfolio of some 162,000 life assurance and personal pension policies whilst its recent acquisition, City of Westminster Assurance Company Limited ("CWA") manages a further 79,000 policies. 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 time 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 the demerger, Chesnara has pursued a policy of delivering enhanced value to shareholders. I am pleased to report two further developments that deliver on that policy during the first half of 2006.

In March we completed the disposal of Premium Life International Limited, a minor subsidiary. In addition to rationalising the Group structure further, this has benefited CA's solvency position by £2.1m. At the end of June the long-term business of CWA was transferred to CA under the provisions of Part VII of the Financial Services and Markets Act 2000 ("the Part VII transfer"). Benefits include the more efficient use of regulatory capital, the relief of tax losses in CA, a reduction in the reporting and regulatory burden and it also offers potential synergies in resource required to manage the business.

On the IFRS basis of reporting Chesnara has posted a pre-tax profit of £10.6m for the half-year ended 30 June 2006 compared with £4.2m for the corresponding period last year. This reflects the continuing strong emergence of surplus in the Life businesses with provisions established at 31 December 2005 for mortgage endowment misselling redress proving to be adequate. The 2006 result has also benefited from a Professional Indemnity ("PI") insurance recovery of £1.1m in respect of administration costs incurred in connection with the handling of misselling claims.

This result allows the Board to recommend an interim dividend of 5.05p (2005: 4.9p), which represents an increase of 3.1% and equates to a total interim dividend of £5.3m.

Chesnara has, for the first time, adopted European Embedded Value ("EEV") principles, as the basis for presenting supplementary financial information in lieu of the Achieved Profit ("AP") basis of reporting. Both the EEV and AP methodologies measure the underlying embedded value of the Group's Life businesses, but EEV principles provide an enhanced framework to improve the comparability and transparency of embedded value reporting on a European-wide basis. Later in this report we set out the impact of the adoption of EEV on Group shareholder equity and reported profits, as previously reported under the AP basis.

On the EEV basis of reporting the Group recognises a pre-tax profit of £6.8m at the half-year position, compared with £5.4m before an exceptional item for the corresponding period last year. This improvement reflects:

(i) the adequacy of existing mortgage endowment misselling provisions established at 31 December 2005 and the benefit of a £1.1m PI insurance recovery as also recognised under IFRS reporting; and

(ii) recognition within the CA business of favourable operating assumption change effects of £4.2m, including adjustment for more favourable reassurance and investment fee terms and £2.8m arising from projected reductions in notional tax chargeable to policyholders as a consequence of the Part VII transfer;

offset by

(i) recognition within the CWA business of adverse operating assumption change effects of £4.4m, which substantially relates to an adjustment to expense assumptions that we now consider it is prudent to make in light of the impending expiry of the outsourcing agreement for the CWA business and our desire to secure a robust long-term solution to this issue.

In addition to the reduction in policyholder tax referred to above, there is also a reduction in projected shareholder tax payable of £3.0m. This amount together with a reduction of currently recognised deferred tax of £0.6m arises as a result of the Part VII transfer. Therefore the total tax synergies arising as result of the transfer, in EEV terms, are £6.4m.

Total shareholder equity, as stated on the EEV basis, before the proposed interim dividend appropriation of £5.3m, has reduced very slightly from £176.2m at 31 December 2005 to £175.7m at 30 June 2006. This reflects net EEV earnings arising in the period of £7.5m offset by the final 2005 dividend paid of £8.0m.

CA's capital solvency ratio (total capital resources to total capital resource requirements as determined by FSA regulatory rules) at 219% is at a healthy premium to the target set by the Board of 150%, having increased from the post dividend level of 178% at 31 December 2005. The Group's solvency ratio has strengthened to 188% from the 31 December 2005 level of 158%, stated after allowing for the proposed interim and final dividends respectively.

Outlook

With the mortgage endowment misselling provision and persistency assumptions proving adequate at the half year, the Board continue to look to the future with optimism. We remain aware of the importance of these issues and, in the light of some continuing uncertainty, will manage them closely. With the key outsourcing contract mitigating the potential future expense issues for CA business, we will turn our attention to achieving a similar long-term outcome for CWA business. Investment markets have provided a positive underpin although growth was slightly less than expected and we foresee further growth in the second half. Following its acquisition, CWA is providing a strong surplus flow and, following the Part VII transfer, we can now collect the positive financial synergies that are available. We believe we are well placed to fulfil our stated objective of delivering a reliable and progressive dividend flow.

The flow of available closed life book consolidation opportunities has undoubtedly slowed. Whilst continuing to pursue our activity in this market place we will also consider the possibility of a return of surplus capital provided there is no clearly superior investment alternative.

The Board wishes to extend its thanks to all employees for their continued contribution to the Group.

Christopher Sporborg
Chairman

5 September 2006

Background

Chesnara plc ("Chesnara"), which was listed on the London Stock Exchange in May 2004, was formed to become the new holding company of Countrywide Assured plc ("CA") which was demerged from Countrywide plc ("Countrywide").

CA was established in 1988 as the life assurance division of Countrywide and sold 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 a portfolio of some 162,000 policies, including those acquired as a result of its purchase of Premium Life in 1995. The portfolio, which primarily consists of endowment and protection policies, reflects CA's history of providing mortgage-related policies to clients of an estate agency-based financial services group.

CA continues to sell and market Guaranteed Income and Growth Bonds through Independent Financial Advisors and directly to investors, and in addition it sells a small amount of life protection business to existing customers.

In June 2005 Chesnara delivered on its stated strategy when it purchased City of Westminster Assurance ("CWA") from Irish Life and Permanent plc for a total purchase consideration of £47.8m. On acquisition CWA was approximately 40% of the size of CA: it is closed to new business and has a more balanced mix of life, pension and annuity products. As at 30 June 2006 CWA's business was merged into CA by way of a transfer under Part VII of the Financial Services and Markets Act 2000 ("the Part VII transfer").

Business Review

During the first half of 2006 Chesnara has continued to pursue its policy of delivering enhanced value to shareholders through focusing its activities on the efficient run-off of its Life businesses. The strong emergence of surplus has contributed to a significant improvement in profit as reported on the IFRS basis, compared with the corresponding position in 2005, and to a very healthy regulatory solvency position. This has been achieved partly by careful management of the endowment misselling exposure for which the provisions established as at 31 December 2005 have proved to be adequate. We have also undertaken a number of initiatives to rationalise and make more efficient the structure of the Life businesses, including the disposal of Premium Life International Limited ("PLI"), and the transfer of the long-term business of CWA to CA under the Part VII transfer. These developments, which are discussed more fully below, have together given rise to a significantly reduced regulatory capital requirement, while the Part VII transfer has also given rise to tax synergies. They also afford future opportunity to establish synergies on the operating expense base of the Life businesses. We continue to actively manage our relationship with the third-party providers of business process outsourcing to the Life businesses to ensure that we receive value for money, that the work performed is of acceptable quality and that it is compliant with FSA regulations.

Part VII Transfer

On 30 June 2006, the long-term business of CWA was transferred to CA under the provisions of Part VII of the Financial Services and Markets Act 2000. Besides reducing the reporting and regulatory burden, financial synergies can now be recognised. These include the more efficient use of regulatory capital, the relief of tax losses in CA and, potentially, synergistic savings in the resource required to manage the business.

In terms of regulatory capital, CWA's long-standing requirement to hold £5m in excess of its stand-alone Capital Resource Requirement has been subsumed into the overall CA solvency position, resulting in a lower overall regulatory capital requirement. The total tax synergies of £6.4m arise from projected reductions in notional policyholder tax of £2.8m, a reduction in projected shareholder tax of £3.0m and the release of a deferred tax provision of £0.6m. We are working to maximise other synergies from the merger of the two businesses. However the magnitude of these is linked to the outcome of future outsourcing arrangements for the CWA book of business.

Disposal of PLI

In March we completed the disposal of Premium Life International Limited, a minor subsidiary, to LCL Group at a book loss of £0.3m. As well as rationalising the Group structure further and reducing reporting requirements the key benefit is a reduction of £2.1m in the Long-Term Insurance Capital Requirement.

Mortgage Endowment Misselling Redress Provision

We are required to write to endowment policyholders at least every two years to appraise them of any potential shortfall in the expected maturity value of their policy. These mailings are governed by the rules and guidance issued by the FSA and the ABI in May 2004. These rules 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 it.

The flow of complaints received by the industry has been stimulated by persistent media coverage and virtually ever-present advertising by, and growth in numbers 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 a higher number of complaints than otherwise would have been expected.

Our strengthening of the provisions held in prior periods has proved adequate and as a result we do not believe it necessary to make further provisions at this time. Indeed, our experience in the first half has allowed us to prudently strengthen future assumptions without further recourse to shareholder funds.

In strengthening the assumptions we have taken into account the levels of complaints received, the positive contribution from the increase in the equity markets during the first half of 2006, the increasing numbers of cases that are expected to become time-barred under the existing rules and the changes to the number of policyholders that will be mailed over the course of the next year. This is predominantly driven by CA's rolling programme of mailing whereby we will mail 80% of the relevant population over the course of the next year compared to 20% during the last year. The CWA business adopted a bulk mailing procedure where mailings are spread over a few months every two years. CWA mailed their endowment policyholder base in the first half of 2005 and mailing will be very limited until early 2007. Whilst the CA time-barred population will grow steadily through to the end of 2007 the CWA endowment population, which is significantly lower than that of CA, is, due to the nature of its mailing profile, largely time-barred, thereby reducing the scope for further upward adjustments to the provision.

Outsourcing Arrangements

Our agreement with Liberata Financial Services to outsource our back office functions for the CA business with effect from 1 February 2005 continues. The agreement, which runs for 10 years, provides Chesnara 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. Service levels have been in line with the agreed standards and the transition project, which will migrate the business to Liberata's systems, is progressing.

The CWA business is also outsourced on a defined per policy cost, albeit to a different supplier – Computer Sciences Corporation ("CSC"). This agreement is currently due to expire in early 2009. With this date approaching Chesnara is investigating the availability of a longer-term solution to the administration of this element of its business.

In January 2005 the Advocate General of the European Court of Justice ruled that outsourced insurance services should, in the main, be subject to VAT. Initially, based on the approach taken by Her Majesty's Revenue and Customs, we created an expense reserve of £1.5m that allowed for VAT being imposed from 1 January 2006. 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. The Directors believe that, faced with this uncertain situation, it remains prudent to maintain the expense reserve.

Our contract with Liberata allows for the sharing, on equal terms, of any VAT imposed. Furthermore, for CA business, we can, under the terms of policyholder contracts, pass on the cost of VAT to policyholders in the majority of cases. In the CWA business the scope to recover costs from policyholders is more limited and there is no cost sharing agreement with CSC.

Persistency

As regards persistency, experience over the first 6 months has been largely in line with our assumptions. Therefore, we do not see the need to make any adjustment to these. On endowment business mailing volumes are set to increase in the latter part of the year and the current assumptions allow for an anticipated increase in policy surrenders.

European Embedded Value

The Group provides financial information supplementary to the Group's primary financial statements prepared in accordance with International Financial Reporting Standards ("IFRS"). With effect from this reporting period the Group has adopted European Embedded Value ("EEV") principles as the basis for providing this supplementary information in lieu of the Achieved Profit ("AP") basis of reporting. AP and EEV methodologies are similar, insofar as both aim to measure the underlying embedded value of the Group's life assurance, pensions and annuity businesses. However, EEV principles provide a framework which is intended to improve the comparability and transparency of embedded value reporting across Europe.

This first-time adoption of EEV principles involves the restatement of supplementary financial information previously reported under the AP basis. The supplementary financial information presented in this report sets out more fully, on pages 35 to 37, the impact of the adoption of EEV on shareholder net equity and profit after tax as previously reported on the AP basis. This may be summarised as follows:

	6 months ended or as at 30 June 2005		Year ended or as at 31 December 2005	
	AP £000	EEV £000	AP £000	EEV £000
Shareholders' equity	180,937	170,834	185,688	176,173
Profit after tax	16,415	29,470	26,291	39,934

The main factors which have impacted shareholder equity are:

(1) Accretion to the embedded value ("EV") of the life insurance, pensions and annuity businesses resulting from the application of the difference between (i) the risk discount rate determined for AP reporting and (ii) the risk discount rate calibrated to a market-consistent valuation, to the cash flows arising on the business in force. This difference arises from the determination of the risk margin on a best-estimate basis in accordance with EEV principles, whereas the AP risk margin was intentionally determined by the Directors on a conservative basis. The diversification of risk through the acquisition of CWA and strengthening of experience assumptions, together with recent improvements in operational experience, lead to a reduction in the appropriate risk margin;

(2) Reduction of EV arising from the recognition of holding company expenses, which it is anticipated will be allocated to the life insurance, pensions and annuity businesses over the life of those businesses. These expenses, which relate to Chesnara Group functions, are recognised under the AP basis only in the financial period in which they are recharged from the holding company; and

(3) Reduction of EV arising from recognition of a reinsurer default reserve to a market-consistent valuation. This contrasts with the treatment under the AP basis, which effectively only reduces the EV for the time cost of maintaining the reserve.

As regards the statement of profit after tax, the main factor which has impacted this is the upward restatement of the exceptional credit arising on the acquisition of CWA on 2 June 2005. This item represents the difference between the purchase price and the value of CWA at the date of acquisition, which has been restated in accordance with EEV principles. This restatement was principally impacted by the adoption of a risk discount rate calibrated to a market-consistent valuation of the acquired cash flows of the in-force business.

Both the EV and AP methodologies recognise profits as they are earned over the life of the underlying long-term businesses and assist in identifying the value being generated by those businesses. As CA and CWA are now substantially closed to new business, the principal underlying components of the results, under both bases, 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) variations in actual experience from that assumed for each component of the in-force policy cash flows and (2) the impact of resetting assumptions for each component of the prospective cash flows. There are, however, significant differences between the profit recognised in accordance with EEV principles and that which would have been reported under the AP basis. It follows from the explanations set out above that these differences will relate principally to

(1) The yield on the business in force, as the discounted cash flows unwind at a rate which is currently some 1.5 to 2.0 percentage points lower than it would otherwise have been on the AP basis;

(2) The recognition of the future stream of holding company expenses, which are a period charge under AP reporting, but which have been recognised up-front under EEV methodology; and

(3) The effect of any mitigation of the reserve required in the event of reinsurer default, where the full amount of the reserve reduction will be recognised under EEV principles, whereas the AP basis would only reflect a reduction in the time cost of holding the reserve.

The adoption of reporting in accordance with EEV principles does not affect the basis of reporting the statutory results, the regulatory capital position or the dividend paying capacity of the Group.

IFRS Result

The following summarises information reflected in the IFRS Income Statement, showing the contribution from the constituent members of the Group. For reporting periods up to 30 June 2006 the principal life subsidiaries were Countrywide Assured plc and City of Westminster Assurance Company Limited.

	CA £000	CWA £000	Parent company £000	Amortisation of AVIF £000	Total £000
Six months ended 30 June 2006					
Operating profit	7,367	5,714	136	(1,751)	11,466
Financing costs	–	–	(628)	–	(628)
Loss on sale of subsidiary company	(248)	–	–	–	(248)
Profit before income taxes	**7,119**	**5,714**	**(492)**	**(1,751)**	**10,590**
Six months ended 30 June 2005					
Operating profit	3,479	1,064	23	(268)	4,298
Financing costs	–	–	(115)	–	(115)
Profit before income taxes	**3,479**	**1,064**	**(92)**	**(268)**	**4,183**
Year ended 31 December 2005					
Operating profit	8,591	14,607	105	(2,042)	21,261
Financing costs	–	–	(805)	–	(805)
Profit before income taxes	**8,591**	**14,607**	**(700)**	**(2,042)**	**20,456**

Notes

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

(2) Financing costs relate to a bank loan 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 is broadly intended to match the pattern of surplus arising from the run off of the underlying CWA insurance and investment contract portfolios.

Overall, the result for the six months ended 30 June 2006 reflects the continuing strong emergence of surplus in both CA and CWA, as the underlying in-force insurance and investment contracts run off. The results for the six months ended 30 June 2005 were materially adversely impacted by increases in provisions for redress and administration costs in connection with mortgage endowment misselling claims. As explained above, we do not consider it necessary to make further increases to these provisions as at 30 June 2006 and this, together with a £1.1m recovery from PI insurers for misselling claims administration costs, which is reflected in the results for the six months ended on that date, underpins the significant improvement in the results, compared with the corresponding prior year six month period.

Other significant factors which have impacted the result attributable to CA for the six months ended 30 June 2006 are:

(1) The recognition of £0.4m of costs incurred in connection with the Part VII transfer. While the synergistic benefits arising from the transfer are, under the IFRS basis, expected to arise principally in future periods, the results have benefited from the release of some £0.6m of deferred tax provisions, thus reducing income tax expense for the six months ended 30 June 2006;

(2) The recognition of a pre-tax book loss of some £0.3m arising on the disposal of Premium Life International Limited. The related benefit arises from a reduction in the cost of maintaining regulatory capital, as the disposal has given rise to a reduction of £2.1m in the Long Term Insurance Requirement (see Solvency and Regulatory Capital section below); and

(3) A charge of £0.9m in respect of the amortisation of deferred acquisition costs relating to insurance contracts (compared with £2.3m for the six months ended 30 June 2005 and £4.0m for the year ended 31 December 2005). As these costs are now almost fully amortised there will, in future, be a greater degree of correlation between distributable surplus arising from the run off of the Life businesses and the reported IFRS profits attributable to them.

EEV Result

Supplementary information prepared in accordance with EEV principles is set out on pages 22 to 33 and is presented to provide alternative information to that provided under IFRS.

The following is a summarised statement of the EEV pre-tax result:

	6 months ended 30 June		Year ended 31 December
	2006 £000	2005 £000	2005 £000
Operating profit of covered business	6,386	2,419	11,353
Other operational loss	(492)	(80)	(700)
Exceptional item			
Profit on acquisition of subsidiary company	–	30,324	30,324
Operating profit before tax	5,894	32,663	40,977
Variation from longer term investment return	487	4,448	14,525
Economic assumption changes	407	(1,378)	(3,598)
Profit before tax	**6,788**	**35,733**	**51,904**

The profit before tax for the six months ended 30 June 2006 has benefited by £0.4m being the positive impact of the PI insurance misselling administration expense recovery, offset by costs incurred in connection with the Part VII transfer and the book loss on the disposal of PLI, referred to in IFRS Result above. Other significant items arising in the period are:

(i) Favourable operating assumption change effects of £1.4m in respect of projected deductions from linked funds arising from revisions to reinsurance terms and investment management fees;

(ii) A favourable operating assumption change effect of £2.8m arising from a projected reduction in notional tax chargeable to policyholders, as a consequence of the Part VII transfer. Together with concomitant projected future tax savings of £3.0m in shareholder tax, and the release of a deferred tax provision of £0.6m, both of which are reflected through tax in the EEV income statement, this gives rise to a projected total saving in future tax of £6.4m and the net of tax result for this period has benefited by this amount; and

(iii) In respect of the CWA business, net adverse operating assumption change effects of £4.4m which substantially relates to an adjustment to expense assumptions, which we consider that it is prudent to make in the light of the impending expiry of the current third-party business process outsource arrangements for that business and the desire to secure a robust long-term solution.

The results for the six months ended 30 June 2005 and the year ended 31 December 2005 reflect an exceptional credit of £30.3m (£20.3m net of tax) relating to the acquisition of CWA. This amount represents the difference between the total purchase price and the embedded value of CWA on acquisition, which has now been restated in accordance with EEV principles. Under the AP basis, the exceptional credit was reported as £18.3m (£13.1m net of tax) for the year ended 31 December 2005. The upward revaluation at the acquisition date arises principally from the application of a lower risk discount rate to the projected cashflows from the acquired in-force business.

Shareholders' Equity and Embedded Value of Covered Business – EEV Basis

The consolidated balance sheet prepared in accordance with EEV principles may be summarised as:

	30 June 2006 £000	30 June 2005 £000	31 December 2005 £000
Value of in-force business	108,703	113,149	109,961
Other net assets	67,046	57,685	66,212
	175,749	**170,834**	**176,173**
Represented by:			
Embedded value ("EV") of covered business	180,589	187,699	194,437
Less: amount financed by borrowings	(16,800)	(21,000)	(21,000)
EV of covered business attributable to shareholders	163,789	166,699	173,437
Net equity of other Group companies	11,960	4,135	2,736
Shareholders' equity	**175,749**	**170,834**	**176,173**

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

Number of policies	30 June 2006 000	30 June 2005 000	31 December 2005 000
Endowment	80	92	85
Protection	93	112	102
Annuities	4	4	4
Pensions	54	56	55
Other	10	10	10
Total	**241**	**274**	**256**

Value in-force	30 June 2006 £m	30 June 2005 £m	31 December 2005 £m
Endowment	72.8	84.4	76.7
Protection	72.3	79.9	80.7
Annuities	3.5	4.3	3.4
Pensions	37.9	37.6	39.6
Other	4.9	4.4	4.7
Total at product level	**191.4**	**210.6**	**205.1**
Valuation adjustments			
Holding company expenses	(23.8)	(26.0)	(25.5)
Other	(22.2)	(31.4)	(28.9)
Cost of capital	(3.1)	(4.7)	(3.1)
Value in-force pre-tax	**142.3**	**148.5**	**147.6**
Taxation	(33.6)	(35.4)	(37.6)
Value in-force post-tax	**108.7**	**113.1**	**110.0**

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 fund to shareholder funds of the Life company and on the full distribution of reserves from the Life company to Chesnara.

The following summarises the capital resources and requirements of the Life company for regulatory purposes, before and after making provision for dividend payments from the Life company to Chesnara, which were approved after the respective period ends. There is no such dividend relating to 30 June 2006.

Subsequent to the Part VII transfer on 30 June 2006, referred to above, the capital requirements and, accordingly, the regulatory solvency position of the Life businesses, subsist entirely within one regulated entity, Countrywide Assured plc ("CA"). Prior to that date the capital requirements and regulatory position were determined separately for the two regulated Life companies. However, the prior period information presented below shows the information in a pro-forma aggregated format, for the sake of comparison with the current period. The Directors do not consider that it is misleading to present the prior period information, which was previously reported on a separate-entity basis, in this way.

	30 June		31 December
	2006 £m	2005 £m	2005 £m
Pre-dividend			
Available capital resources ("CR")	71.9	74.6	84.5
Long-term insurance capital requirement ("LTICR")	30.5	34.8	34.1
Resilience capital requirement ("RCR")	2.4	3.0	2.8
Total capital resources requirement ("CRR")	32.9	37.8	36.9
Target capital requirement cover	48.1	56.2	54.7
Excess of CR over target requirement	23.8	18.4	29.8
Ratio of available CR to CRR	219%	197%	229%
Post-dividend			
Available capital resources ("CR")	71.9	70.4	65.7
Long-term insurance capital requirement ("LTICR")	30.5	34.8	34.1
Resilience capital requirement ("RCR")	2.4	3.0	2.8
Total capital resources requirement ("CRR")	32.9	37.8	36.9
Target capital requirement cover	48.1	56.2	54.7
Excess of CR over target requirement	23.8	14.2	11.0
Ratio of available CR to CRR	219%	186%	178%

The CA Board, as a matter of policy, continues to target CR cover for total CRR at a minimum level of 150% of the LTICR and 100% of the RCR. Up until 30 June 2006, the CWA target capital requirement cover was expressed as a £5m excess over the regulatory CRR, as a consequence of a long-standing agreement with the FSA. With effect from 30 June 2006 the CRR of the transferred business is determined on the same basis as the existing CA business, so that, overall, the Group benefits to the extent that the total CRR is lower than if the £5m excess had continued to be applied to the transferred business. Further, CA's solvency position has benefited from the disposal of PLI, referred to above, which has reduced the LTICR by £2.1m.

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

Insurance Group Directive

In accordance with the EU Insurance Group Directive, the Group calculates the excess of the aggregate of regulatory capital employed over the aggregate minimum solvency requirement imposed by local regulators. The following sets out these calculations pre and post the recognition of interim and final dividends for the financial year, but approved by the Board and paid to Group shareholders after the respective dates:

	30 June		31 December
	2006 £m	2005 £m	2005 £m
Pre-dividend			
Available group capital resources	67.0	57.7	66.2
Group regulatory capital requirement	(32.9)	(37.8)	(36.9)
Excess	34.1	19.9	29.3
Cover	204%	153%	179%
Post-dividend			
Available group capital resources	61.7	52.6	58.3
Group regulatory capital requirements	(32.9)	(37.8)	(36.9)
Excess	28.8	14.8	21.4
Cover	188%	139%	158%

The regulatory requirement is that available group capital resources should be at least 100% of capital requirements.

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 "Regulatory capital resources and requirements" above.

Following the Part VII transfer, as at 30 June 2006, it is intended to establish, during the second half of 2006, an Individual Capital Assessment for the Life businesses on a combined basis.

Investment Funds

The Board continues to have a conservative approach to the investment of shareholder funds, which underpins our strong solvency position. The benchmark of 70% cash and 30% fixed interest has been maintained.

On policyholder investment funds, and in particular the CA Managed Fund, which represents a significant proportion of these funds, performance during the half year was held back by costs of transferring the funds formerly managed by Hendersons to Schroders and relatively poor market performance. The fund grew at 1.27% during the half year and was behind the ABI Life Balanced Managed Fund average of 1.63%. The switch to Schroders was made not only for operational efficiency but was also based on their medium to long term performance which, if continued, is expected to be to the advantage of CA's policyholders.

Developments

In the second half of the year Chesnara will continue to investigate further consolidation opportunities, work with our outsource partners to ensure delivery of acceptable service levels at expected per policy rates, complete the project to release capital from CWA, make strong progress on our Treating Customers Fairly project and maintain our close management of the mortgage endowment and persistency issues.

Consolidation

Having completed the acquisition of CWA and the transfer of its long-term business to CA it is apparent that operating and financial synergies can be obtained from the consolidation of suitably sized life assurance companies. During this reporting period there has been little opportunity to progress any value-enhancing acquisitions in the small to medium sector of the market. The Board continues to believe that, in time, suitable targets will become available and it will progress these where it believes value can be added.

Outsourcing

Our experience to date with service delivery on the Liberata contract has been good and we now move strongly into the migration phase where we will work with Liberata to ensure a quality transition to their systems. The CWA outsourcing contract falls due for renewal in early 2009 and, in anticipation of needing to review those arrangements, we are looking at opportunities to replace that contract somewhat earlier to remove uncertainty as to future pricing.

Capital Release

Whilst the long-term business of CWA was transferred to CA, the company itself remains an authorised entity and has capital of £3m. In order to release this capital we have applied to the FSA for the deauthorisation of CWA and, on receipt of this, we will undertake a Court process which, we expect, to result in the release of this capital back to the Group.

Regulatory and Legal

The Company has established projects in both of its Life businesses to ensure it meets the regulatory requirements under TCF. These projects are reasonably well advanced and further focus will be given to them to ensure we meet the FSA's recently announced "implementation stage" target date of March 2007.

In May, HM Revenue and Customs issued a consultation paper on the taxation of life insurers whilst the Association of British Insurers have, during the course of the year, issued a number of Good Practice Guides. Of particular note is a paper issued in June which provides guidance on the management of Unit Linked funds. We are well advanced in our actions relating to this and other Good Practice Guides and will be closely monitoring, and contributing to, the debate on life insurance taxation where appropriate.

Mortgage Endowments and Persistency

In the first half of 2006 neither of these challenging issues have given rise to particular concern. However, we remain aware that they are both primary drivers of current and future profitability and therefore both will remain as key areas of focus for management.

Outlook

The results in the first six months have benefited from the positive effects of the Part VII transfer and there being no requirement to adjust the mortgage endowment redress and persistency assumptions, both of which have proved adequate.

The increasing incidence of time barring limits the scope for adjustment to the mortgage endowment provision, but it is too early to have complete confidence that the provision is totally adequate for future needs. Persistency has stabilised but may be threatened by any economic downturn or increases in interest rates over and above those currently expected. In the absence of negative influences in either of these key areas the challenges to positive performance of the Group are limited.

On the acquisition front we will continue to search for opportunities in the small to medium sector. In the absence of any suitable propositions the Board will consider alternative uses for surplus capital including appropriate methods of returning it to shareholders.

Prospects for the equity markets, which were challenging in the first half-year, look positive and, based on discussion with our Investment Managers, we expect to see steady growth in the short and medium term.

The underlying emergence of surplus from realisation of the value of the in-force business should continue strongly, albeit at a lower level as the policy numbers decrease. Future surpluses will, however, be enhanced by the reasonably predictable future contribution from CWA.

Dividend

We have signalled that we aim to provide a reliable and progressive dividend payment. With the continuing healthy emergence of surplus from the underlying product base and the strong solvency position the Board are able to recommend an interim dividend of 5.05p, which represents an increase of 3.1% over the 2005 interim payment.

Graham Kettleborough
Chief Executive Officer

5 September 2006

Consolidated Interim Income Statement for the six months ended 30 June 2006

	Note	Unaudited 6 months ended 30 June 2006 £000	Unaudited 6 months ended 30 June 2005 £000	Year ended 31 December 2005 £000
Insurance premium revenue		57,267	54,900	115,673
Insurance premium ceded to reinsurers		(11,216)	(12,838)	(26,691)
Net insurance premium revenue		**46,051**	**42,062**	**88,982**
Fee and commission income				
Insurance contracts		22,539	23,959	49,405
Investment contracts		4,161	1,299	5,971
Investment income		38,885	61,529	214,691
Total revenue (net of reinsurance payable)		**111,636**	**128,849**	**359,049**
Other operating income		504	512	1,226
Net Income		**112,140**	**129,361**	**360,275**
Policyholder claims and benefits incurred	3	(85,566)	(108,662)	(291,921)
Reinsurers' share of claims and benefits incurred		13,412	17,504	61,300
Net policyholder claims and benefits incurred		(72,154)	(91,158)	(230,621)
Change in investment contract liabilities		(14,968)	(23,451)	(85,130)
Reinsurers' share of investment contract liabilities		579	1,201	3,742
Net change in investment contract liabilities		(14,389)	(22,250)	(81,388)
Fees, commission and other acquisition costs		(1,865)	(3,124)	(5,699)
Administrative expenses		(10,081)	(7,741)	(18,675)
Other operating expenses				
Charge for amortisation of intangible assets		(1,915)	(460)	(2,364)
Other		(270)	(330)	(267)
Total expenses		**(100,674)**	**(125,063)**	**(339,014)**
Operating profit		**11,466**	**4,298**	**21,261**
Financing costs		(628)	(115)	(805)
Loss on sale of subsidiary company		(248)	–	–
Profit before tax		**10,590**	**4,183**	**20,456**
Income tax expense		(2,913)	(871)	(1,841)
Profit for the period	5	**7,677**	**3,312**	**18,615**
Basic earnings per share	4	7.34p	3.73p	19.26p
Diluted earnings per share	4	7.34p	3.73p	19.26p

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 Interim Balance Sheet at 30 June 2006

	Note	Unaudited 30 June 2006 £000	Unaudited 30 June 2005 £000	31 December 2005 £000
Assets				
Intangible assets				
Deferred acquisition costs		11,508	15,466	13,000
Acquired value of in-force business				
Insurance contracts		23,495	21,081	24,900
Investment contracts		14,152	12,398	14,661
Property and equipment		–	299	–
Reinsurers' share of insurance contract provisions		198,835	169,301	199,563
Amounts deposited with reinsurers		61,455	23,120	62,697
Investment properties		26,982	24,092	25,422
Financial assets				
Equity securities at fair value through income		684,551	629,660	688,478
Holdings in collective investment schemes at fair value through income		335,278	320,049	340,379
Debt securities at fair value through income		372,012	379,546	383,817
Loans and receivables including insurance receivables		24,679	23,246	19,810
Derivative financial instruments		16,788	1,991	16,108
Total financial assets		1,433,308	1,354,492	1,448,592
Reinsurers share of accrued policyholder claims		5,072	6,052	4,810
Income taxes		147	105	199
Cash and cash equivalents		282,537	284,658	282,452
Total assets		**2,057,491**	**1,911,064**	**2,076,296**
Liabilities				
Insurance contract provisions		1,065,270	984,570	1,072,064
Financial liabilities				
Investment contracts at fair value through income		794,902	732,412	803,146
Borrowings	6	16,496	21,000	20,638
Derivative financial instruments		371	–	416
Total financial liabilities		811,769	754,850	824,200
Provisions		1,237	642	1,433
Deferred tax liabilities		13,327	8,420	13,327
Reinsurance payables		1,935	2,904	2,049
Payables related to direct insurance and investment contracts		25,037	26,272	23,866
Deferred income		19,159	21,379	20,195
Income taxes		2,788	2,845	3,345
Other payables		9,011	12,531	7,550
Total liabilities		**1,949,533**	**1,812,975**	**1,968,029**
Net assets		**107,958**	**98,089**	**108,267**
Shareholders' equity				
Share capital		41,501	41,501	41,501
Share premium		20,458	20,458	20,458
Other reserves		50	50	50
Retained earnings	5	45,949	36,080	46,258
Total shareholders' equity		**107,958**	**98,089**	**108,267**

Consolidated Interim Statement of Cash Flows for the six months ended 30 June 2006

	Unaudited 6 months ended 30 June		Year ended 31 December
	2006 £000	2005 £000	2005 £000
Profit for the year	**7,677**	**3,312**	**18,615**
Adjustments for:			
Depreciation	–	105	105
Amortisation of deferred acquisition costs	1,492	2,529	4,998
Amortisation of acquired in-force value	1,914	460	2,363
Tax expense	2,913	871	1,841
Interest receivable	(13,672)	(12,690)	(7,929)
Dividends receivable	(18,472)	(6,343)	(17,901)
Change in fair value of investment properties	(1,560)	(227)	(1,344)
Fair value losses/(gains) on financial assets	15,275	(27,309)	(75,786)
Loss on sale of property and equipment	–	1	300
Loss on sale of subsidiary company	248	–	–
Interest received	13,534	14,454	9,545
Dividends received	14,175	4,469	18,473
Interest expense	628	115	805
Changes in operating assets and liabilities (excluding the effect of acquisitions)			
Increase in intangible assets related to investment and insurance contracts	–	–	(8,936)
Decrease/(increase) in financial assets	3,986	54,102	(3,537)
Decrease/(increase) in reinsurers share of insurance contract provisions	466	(8,350)	(37,818)
Decrease/(increase) in amounts deposited with reinsurers	1,242	(232)	(4,021)
(Increase)/decrease in other loans and receivables	(434)	110	9,706
(Decrease)/increase in insurance contract provisions	(5,871)	26,176	122,572
(Decrease)/increase in investment contract liabilities	(8,244)	15,828	52,510
(Decrease)/increase in provisions	(196)	2,318	507
Decrease in reinsurance payables	(114)	(429)	(1,284)
Increase in payables related to direct insurance and investment contracts	1,171	11,921	9,515
Increase/(decrease) in other payables	415	755	(5,199)
Cash generated from operations	**16,573**	**81,946**	**88,100**
Income tax paid	(3,418)	(1,585)	(4,217)
Net cash from operating activities	**13,155**	**80,361**	**83,883**
Cash flows from investing activities			
Acquisition of subsidiary, net of cash acquired	–	124,496	124,497
Disposal of subsidiary, net of cash disposed of	(295)	–	–
Purchases of property and equipment	–	(2)	(2)
Net cash from investing activities	**(295)**	**124,494**	**124,495**
Cash flows from financing activities			
Proceeds from the issue of share capital	–	23,533	23,533
(Repayment of)/proceeds from borrowings	(4,200)	21,000	21,000
Payment of transaction costs	–	(2,539)	(2,539)
Dividends paid	(7,986)	(6,124)	(11,249)
Interest paid	(589)	–	(604)
Net cash (utilised by)/generated from financing activities	**(12,775)**	**35,870**	**30,141**
Net increase in cash and cash equivalents	**85**	**240,725**	**238,519**
Cash and cash equivalents at beginning of period	**282,452**	**43,933**	**43,933**
Cash and cash equivalents at end of period	**282,537**	**284,658**	**282,452**
In the cash flow statement proceeds from the sale of property and equipment comprise:			
Net book amount	–	1	300
Loss on sale	–	(1)	(300)
Proceeds from sale	**–**	**–**	**–**

Consolidated Interim Statement of Changes in Equity for the six months ended 30 June 2006

	Unaudited Six months ended 30 June 2006				
	Share capital £000	Share premium £000	Capital redemption reserve £000	Retained earnings £000	Total £000
Equity shareholders' funds at 1 January 2006	**41,501**	**20,458**	**50**	**46,258**	**108,267**
Profit for the period representing total recognised income and expenses	–	–	–	7,677	7,677
Dividends paid	–	–	–	(7,986)	(7,986)
Equity shareholders' funds at 30 June 2006	**41,501**	**20,458**	**50**	**45,949**	**107,958**

	Unaudited Six months ended 30 June 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	–	–	–	3,312	3,312
Dividends paid	–	–	–	(6,124)	(6,124)
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 30 June 2005	**41,501**	**20,458**	**50**	**36,080**	**98,089**

	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**

1. Basis of preparation

The financial information presented herein has been prepared in accordance with the accounting policies used for the Chesnara plc Annual Report and Accounts for the year ended 31 December 2005.

The financial information shown in this half year review is unaudited and does not constitute statutory accounts within the meaning of Section 240 of the Companies Act 1985.

The financial statements for the year ended 31 December 2005, which were prepared under IFRS, have been reported on by the company's auditors and delivered to the Registrar of Companies. The report of the auditors was unqualified and did not contain statements under Section 237 (2) or (3) of the Companies Act 1985.

2. Transfer of long-term business fund

On 30 June 2006, under the provisions of Part VII of the Financial Services and Markets Act 2000, the long-term business of City of Westminster Assurance Ltd ("CWA") was transferred to Countrywide Assured plc ("CA"). As a result, the whole of the FSA regulated activity of the Group effectively subsists within CA with effect from that date.

The transfer gives rise to a number of recognised and prospective benefits within the combined CA entity, including the determination of the capital requirement of the business, savings on operational expenses and the relief of some accumulated tax losses in CA.

3. Policyholder claims and benefits incurred

Policyholder claims and benefits incurred for the six months ended 30 June 2006 include an amount of £1,116,882 representing a recovery under a professional indemnity insurance policy of previously recognised misselling complaints administration costs.

4. Earnings per share

Earnings per share is based on the following:

	Unaudited 6 months ended 30 June		Year ended 31 December
	2006	2005	2005
Profit for the period (£000)	7,677	3,312	18,615
Weighted average number of ordinary shares	104,588,785	88,685,668	96,637,227
Basic earnings per share	7.34p	3.73p	19.26p
Diluted earnings per share	7.34p	3.73p	19.26p

The weighted average number of ordinary shares in respect of the six months ended 30 June 2005 and the year ended 31 December 2005 is based on

(i) 84,564,168 shares in issue at the beginning of the period

(ii) 1,691,284 shares issued on 10 February 2005 pursuant to exercise of a share option

(iii) 18,333,333 shares issued on 2 June 2005 pursuant to a placing and open offer

The weighted average number of ordinary shares in respect of the six months ended 30 June 2006 is based on 104,588,785 shares in issue at the beginning and end of the period.

The diluted average number of shares in respect of the six months ended 30 June 2005 was 88,757,474 and in respect of the year ended 31 December 2005 was 96,673,130. The dilution reflects the adjustment for the equivalent number of shares that would have been issued for no consideration had the exercise of a share option, granted to Numis Securities Limited for broking services, provided in connection with the admission of the company to the Official List of the UK Listing Authority, been exercised prior to its actual exercise date of 10 February 2005.

4. Earnings per share (continued)

Other than the option described in the preceding paragraph there were no other share options outstanding during the periods covered by these financial statements. Accordingly, there is no dilution of the average number of ordinary shares in issue in respect of the six months ended 30 June 2006.

5. Retained earnings

	Unaudited 6 months ended 30 June		Year ended 31 December
	2006 £000	2005 £000	2005 £000
Balance at 1 January	**46,258**	**38,892**	**38,892**
Profit for period	7,677	3,312	18,615
Dividends			
Final approved and paid for 2004	–	(6,124)	(6,124)
Interim approved and paid for 2005	–	–	(5,125)
Final approved and paid for 2005	(7,986)	–	–
Balance at 30 June/31 December	**45,949**	**36,080**	**46,258**

The final dividend in respect of 2004, approved and paid in 2005, was paid at the rate of 7.1p per share.

The interim dividend in respect of 2005, approved and paid in 2005, was paid at the rate of 4.9p per share.

The final dividend in respect of 2005, approved and paid in 2006, was paid at the rate of 7.55p per share, so that the total dividend paid to the equity shareholders of the parent company in respect of the year ended 31 December was 12.45p per share.

An interim dividend of 5.05p per share in respect of the year ending 31 December 2006 payable on 11 October 2006 to equity shareholders of the parent company registered at the close of business on 15 September 2006, the dividend record date, was approved by the Directors after 30 June 2006. The resulting interim dividend of £5.3m has not been provided in these financial statements.

The following summarises dividend per share information in respect of the year ended 31 December 2005 and the year ending 31 December 2006:

	2006	2005
Interim dividend	5.05p	4.90p
Final dividend		7.55p
Total for the year		**12.45p**

6. Borrowings

	Unaudited 30 June		31 December
	2006 £000	2005 £000	2005 £000
Bank Loan	16,496	21,000	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 amounts on the anniversary of the draw-down date. 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 30 June 2006 was £16,800,000 (30 June 2005 and 31 December 2005: £21,000,000)

7. Forward looking statements

This document may contain forward-looking statements with respect to certain of the plans and current expectations relating to 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 jurisdiction in which Chesnara plc and its subsidiaries operate. As a result, Chesnara plc's actual future condition, business performance and results may differ materially from the plans, goals and expectations expressed or implied in these forward looking statements.

8. Approval of interim report

This interim report was approved by the Board of Directors on 5 September 2006. A copy of the report is being sent to all shareholders on 18 September 2006 and will be available to the public at the company's registered office, Harbour House, Portway, Preston PR2 2PR, UK and at www.chesnara.co.uk.

Summarised Consolidated Interim Income Statement for the six months ended 30 June 2006 (unaudited)

	Note	Six months ended 30 June 2006 £000	Six months ended 30 June 2005 £000	Year ended 31 December 2005 £000
Operating profit of covered business	**6**	**6,386**	**2,419**	**11,353**
Other operational result		(492)	(80)	(700)
Operating profit		**5,894**	**2,339**	**10,653**
Exceptional Item				
Profit on acquisition of subsidiary company		–	30,324	30,324
Variation from longer-term investment return		487	4,448	14,525
Effect of economic assumption changes		407	(1,378)	(3,598)
Profit before tax		**6,788**	**35,733**	**51,904**
Tax		774	(6,263)	(11,970)
Profit for the period		**7,562**	**29,470**	**39,934**
Earnings per share				
Based on profit for the period before exceptional item, net of attributable tax		7.23p	8.42p	20.34p
Based on profit for the period		7.23p	33.23p	41.32p
Diluted earnings per share				
Based on profit for the period before exceptional item, net of attributable tax		7.23p	8.42p	20.34p
Based on profit for the period		7.23p	33.20p	41.31p

Summarised Consolidated Interim Balance Sheet at 30 June 2006 (unaudited)

	Note	30 June 2006 £000	30 June 2005 £000	31 December 2005 £000
Assets				
Value of in-force business	5,8	108,703	113,149	109,961
Property and equipment		–	299	–
Reinsurers' share of insurance contract provisions		173,426	164,076	174,154
Amounts deposited with reinsurers		59,738	21,500	60,979
Investment properties		26,982	24,092	25,422
Deferred tax assets		122	1,080	120
Financial assets				
Equity securities at fair value through income		684,551	629,660	688,478
Holdings in collective investment schemes at fair value through income		335,278	320,049	340,379
Debt securities at fair value through income		372,012	379,546	383,817
Loans and receivables including insurance receivables		24,679	23,246	19,810
Derivative financial instruments		16,788	1,991	16,108
Total financial assets		1,433,308	1,354,492	1,448,592
Reinsurers' share of accrued policy claims		5,072	6,052	4,810
Income taxes		147	105	199
Cash and cash equivalents		282,537	284,658	282,452
Total assets		**2,090,035**	**1,969,503**	**2,106,689**
Liabilities				
Insurance contract provisions		1,046,071	986,017	1,051,913
Financial liabilities				
Investment contracts at fair value through income		811,340	746,458	819,306
Borrowings		16,496	21,000	20,638
Derivative financial instruments		371	–	416
Total financial liabilities		828,207	767,458	840,360
Provisions		1,237	642	1,433
Reinsurance payables		1,935	2,904	2,049
Payables related to direct insurance and investment contracts		25,037	26,272	23,866
Income taxes		2,788	2,845	3,345
Other payables		9,011	12,531	7,550
Total liabilities		**1,914,286**	**1,798,669**	**1,930,516**
Net assets		**175,749**	**170,834**	**176,173**
Shareholders' equity				
Share capital		41,501	41,501	41,501
Share premium		20,458	20,458	20,458
Other reserves		50	50	50
Retained earnings		113,740	108,825	114,164
Total shareholders' equity	5,8	**175,749**	**170,834**	**176,173**

Summarised Consolidated Interim Statement of Changes in Equity for the six months ended 30 June 2006 (unaudited)

	Six months ended 30 June		Year ended 31 December
	2006 £000	2005 £000	2005 £000
Shareholders' equity at 1 January	**176,173**	**126,029**	**126,029**
Profit for the period representing total recognised income and expense	7,562	29,470	39,934
Dividends paid	(7,986)	(6,124)	(11,249)
Issue of ordinary shares pursuant to exercise of option	–	1,533	1,533
Issue of ordinary shares pursuant to placing and open offer	–	22,000	22,000
Expenses incurred in connection with issue of ordinary shares pursuant to placing and open offer	–	(2,074)	(2,074)
Shareholders' equity at 30 June/31 December	**175,749**	**170,834**	**176,173**

1. Basis of presentation

This section sets out the detailed methodology followed for producing these Group financial statements which are supplementary to the Group's primary financial statements which have been prepared in accordance with International Financial Reporting Standards ("IFRS"). These financial statements have been prepared in accordance with the European Embedded Value ("EEV") principles issued in May 2004 by the European CFO Forum and supplemented by Additional Guidance on EEV Disclosures issued by the same body in October 2005. The principles provide a framework intended to improve comparability and transparency in embedded value reporting across Europe.

This first time adoption of EEV principles and associated disclosures represents a change from the Achieved Profit ("AP") basis of reporting, which has previously been adopted by the Group as the basis for presenting supplementary financial information. The adoption of EEV principles does not affect the basis of reporting the statutory results, the regulatory capital position or the dividend paying capacity of Chesnara plc.

The Directors consider that the EEV methodology is a refinement of the AP basis previously adopted by the Group and represents a more meaningful basis of reporting the underlying value of the business and the underlying drivers of performance.

Information relating to the restatement of supplementary financial information, from reporting in accordance with the AP basis to reporting in accordance with EEV principles, is provided in the schedules and explanatory notes following these notes.

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 was engaged in long-term insurance business. The summary consolidated income statement prepared on the EEV basis for the comparative six months ended 30 June 2005 and year ended 31 December 2005 includes the profit arising within CWA from the date of acquisition to 30 June 2005 and to 31 December 2005 respectively. The excess of the embedded value of CWA, established on the EEV basis, over the total purchase consideration, has been treated as an exceptional credit to the profit of the Group for the six months ended 30 June 2005 and for the year ended 31 December 2005.

2. Covered business

The Group uses EEV methodology to value its individual life assurance, pension and annuity business, which has been written, with only insignificant exceptions, in the UK ("covered business"). This business comprises the Group's long-term business operations, being those contracts falling under the definition of long-term insurance business for UK regulatory purposes.

The Group has no business activities other than those relating to the covered business. In particular, the operating activities of the holding company, Chesnara plc, are treated as an integral part of the covered business. Under EEV principles no distinction is made between insurance and investment contracts, as there is under IFRS, which accords these classes of contracts different accounting treatments.

On 30 June 2006, under the provisions of Part VII of the Financial Services and Markets Act 2000, the long-term business of CWA was transferred to Countrywide Assured plc ("CA"), the primary operating subsidiary company of the Group. As a result, the whole of the covered business of the Group effectively subsists within CA with effect from that date. The transfer gives rise to benefits which have been recognised within the covered business, including determination of the capital requirement of the covered business on a combined basis and reduced costs relating largely to audit and consultancy fees. The impact of these, together with the consequential relief of tax losses in CA, which had not hitherto been recognised in the cashflow projections relating to the value of business in force, has been recognised in these financial statements as at 30 June 2006 and for the six months then ended. In addition, the transfer affords the opportunity for synergistic savings in the resource required to manage the covered business. The effect of this has not been recognised in these financial statements, as related plans have neither been approved by the Directors nor implemented.

3. Methodology

(a) Embedded Value

Overview

Shareholders' equity comprises the embedded value of the covered business, together with the net equity of other Group companies, including that of the holding company which is stated after writing down fully the carrying value of the covered business.

3. Methodology (continued)

The embedded value of the covered business is the aggregate of the shareholder net worth ("SNW") and the present value of future shareholder cash flows from in-force covered business (value of in-force business) less any deduction for the cost of required capital. It is stated after allowance has been made for aggregate risks in the business. SNW comprises those amounts in the long-term business, which are either regarded as required capital or which represent surplus assets within that business.

New business

Much of the covered business is in run-off and is, accordingly, substantially closed to new business. The Group does still sell significant numbers of guaranteed bonds but, overall, the contribution from new business to the results established using EEV methodology is not material. Accordingly, not all of those items related to new business values, which are recommended by the EEV guidelines, are reported in this supplementary financial information.

Value of in-force business

The cash flows attributable to shareholders arising from in-force business are projected using best estimate assumptions for each component of cash flow.

The present value of the projected cash flows is established by using a discount rate which reflects the time value of money and the risks associated with the cashflows which are not otherwise allowed for. There is a deduction for the cost of holding the required capital, as set out below.

Taxation

The present value of the projected cash flows arising from in-force business takes into account all tax which is expected to be paid under current legislation, including tax which would arise if surplus assets within the covered business were eventually to be distributed.

The value of the in-force business has been calculated on an after-tax basis and is grossed up to the pre-tax level for presentation in the income statement. The amount used for the grossing up is the amount of shareholder tax payable in the policyholder fund plus any direct tax charge within the shareholder fund.

Cost of capital

The cost of holding the required capital to support the covered business (see 3b below) is reflected as a deduction from the value of in-force business and is determined as the difference between the amount of the required capital and the projected release of capital and investment income.

Financial options and guarantees

The principal financial options and guarantees are (i) guaranteed annuity rates offered on some unit-linked pension contracts and (ii) a guarantee offered under Timed Investment Funds that the unit price available at the selected maturity date (or at death, if earlier) will be the highest price attained over the policy's life. The cost of these options and guarantees has been assessed, in principle, on a market-consistent basis, but, in practice, this has been carried out on approximate bases, which are appropriate to the level of materiality of the results.

Allowance for risk

Allowance for risk within the covered business is made by:

(1) Setting required capital levels by reference to the Directors' assessment of capital needs;

(2) Setting the risk discount rate, which is applied to the projected cash flows arising on the in-force business, at a level which includes an appropriate risk margin; and

(3) Explicit allowance for the cost of financial options and guarantees and for reinsurer default.

(b) Level of Required Capital

The level of required capital of the covered business reflects the amount of capital that the Directors consider necessary and appropriate to manage the business. In forming their policy the Directors have regard to the minimum statutory requirements and an internal assessment of the market, insurance and operational risks inherent in the underlying products and business operations. The capital requirement resulting from this assessment represents 150% of the long-term insurance capital requirement ("LTICR") together with 100% of the resilience capital requirement ("RCR"), as set out in FSA regulations.

3. Methodology (continued)

The required capital is provided by the retained surplus in the long-term business fund and the retained earnings and issued share capital in the shareholder fund.

(c) Risk Discount Rate

The risk discount rate ("RDR") is a combination of the risk-free rate and a risk margin. The risk-free rate reflects the time value of money and the risk margin reflects any residual risks inherent in the covered business and makes allowance for the risk that future experience will differ from that assumed. In order to reduce the subjectivity when setting the RDR, the Board has decided to adopt a 'bottom up' market-consistent approach to allow explicitly for market risk.

Using the market-consistent approach each cash flow is valued at a discount rate consistent with that used in the capital markets: in accordance with this, equity-based cash flows are discounted at an equity RDR and bond-based cash flows at a bond RDR. In practice a short-cut method known as the "certainty equivalent" approach has been adopted. This method assumes that all cash flows earn the risk-free rate of return and are discounted at the risk-free rate. In general, and consistent with the market's approach to valuing financial instruments for hedging purposes, the risk-free rate is based on swap yields. Where, however, non-linked business is substantially backed by government bonds, the yields on these assets have been taken.

Within the risk margin allowance also needs to be made for non-market risks. For some of these risks, e.g. mortality and expense risk, it is assumed that the shareholder can diversify away any uncertainty where the impact of variations in experience on future cash flows is symmetrical. For those risks that are assumed to be diversifiable no adjustment to the risk margin has been made. For any remaining risks that are considered to be non-diversifiable risks there is no risk premium observable in the market and therefore a constant margin of 50 basis points has been added to the risk margin. The RDR is determined by equating the results from the traditional embedded value approach, including the assumed actual investment returns and traditional cost of capital, to that derived using the market-consistent method, this process being known as calibration of the RDR. The risk margin is then the difference between the derived RDR and the risk-free rate. The selection of the assumed actual investment returns and the reported cost of capital will have no impact on the reported result, as changes in these produce corresponding changes in the RDR.

A market-consistent valuation approach also generally requires consideration of 'frictional' costs of holding shareholder capital: in particular, the cost of tax on investment returns and the impact of investment management fees can reduce the face value of shareholder funds. In the Group's case, the expenses relating to corporate governance functions eliminate any taxable investment return in shareholder funds, while investment management fees are not material.

The risk margin established on the basis set above is normally calculated at each financial year end. The margin determined at 31 December 2005 has been employed also as at 30 June 2005 and as at 30 June 2006. In order to establish the opening position as at 1 January 2005 for the covered business of Countrywide Assured plc ("CA"), at which time City of Westminster Assurance Company Limited ("CWA") was not yet a member of the Group, the risk margin employed is the risk margin of CA as a separate entity as at 31 December 2005. Further, in order to establish the acquisition date value of CWA as at 2 June 2005, the risk margin employed is the risk margin of CWA as a separate entity as at 31 December 2005.

(d) Analysis of Profit

The contribution to operating profit, which is identified at a level which reflects an assumed longer-term level of investment return, arises from three sources:

(i) New business;

(ii) Return from in-force business; and

(iii) Return from shareholder net worth.

Additional contributions to profit arise from:

(i) Variances between the actual investment return in the period and the assumed long-term investment return; and

(ii) The effect of economic assumption changes.

3. Methodology (continued)

The contribution from new business represents the value recognised at the end of each period in respect of new business written in that period, after allowing for the cost of acquiring the business, the cost of establishing the required technical provisions and after making allowance for the cost of capital.

The return from in-force business is calculated using closing assumptions and comprises:

(i) The expected return, being the unwind of the discount rate over the period applied to establish the value of in-force business at the beginning of the period;

(ii) Variances between the actual experience over the period and the assumptions made to establish the value of business in force at the beginning of the period; and

(iii) The net effect of changes in future assumptions, made prospectively at the end of the period, from those used in establishing the value of business in force at the beginning of the period, other than changes in economic assumptions.

The contribution from shareholder net worth comprises the actual investment return on residual assets in excess of the required capital.

(e) Assumption setting

The introduction of EEV reporting in lieu of reporting in accordance with the AP Basis does not alter the fundamental approach to determining the assumptions used to establish the present value of the future cash flows of the covered business. There is a requirement under EEV methodology to use best estimate demographic assumptions and to review these at least annually with the economic assumptions being determined at each reporting date. This approach is broadly that adopted for AP reporting and therefore the current practice will continue as detailed below.

Each year the demographic assumptions are reviewed as part of year-end processing and hence were last reviewed in December 2005. For mid-year reporting, the previous year-end assumptions are usually considered in light of recent experience, particularly persistency, to ensure robustness, but are not necessarily expected to change.

The detailed projection assumptions, including mortality, morbidity, persistency and expenses reflect recent operating experience. Allowance is made for future improvement in annuitant mortality based on experience and externally published data. Favourable changes in operating experience, particularly in relation to expenses and persistency, are not anticipated until the improvement in experience has been observed. Holding company expenses (for the Chesnara Group such expenses relate largely to listed company functions) are allocated to the covered business as the whole business of the Chesnara Group is the transaction of life assurance business through the subsidiary companies. Hence the expense assumptions used for the cash flow projections include the full cost of servicing this business.

The economic assumptions are reviewed and updated at each reporting date based on underlying investment conditions at the reporting date. The assumed discount rate and inflation rates are consistent with the investment return assumptions.

In addition, the current AP demographic assumptions used at December 2005 are considered to be best estimate and consequently no further adjustments are required to comply with EEV principles. The assumptions required in the calculation of the value of the annuity rate guarantee on pension business have been set equal to best-estimate assumptions.

4. Assumptions

(a) Investment returns (pre-tax)

The assumed future pre-tax returns on fixed interest and RPI linked securities are set by reference to redemption yields available in the market at the end of the reporting period. The corresponding return on equities and property is equal to the fixed interest gilt assumptions plus an appropriate risk margin. For linked business the aggregate return has been determined by reference to the benchmark asset mix within the Managed Funds.

	30 June		31 December
	2006	2005	2005
Equity risk premium	2.7%	2.7%	2.7%
Property risk premium	2.7%	2.7%	2.7%
Investment return			
Fixed Interest	4.7%	4.2%	4.1%
Equities	7.4%	6.9%	6.8%
Property	7.4%	6.9%	6.8%
Inflation			
Expenses	3.6%	3.3%	3.4%

(b) Actuarial assumptions

The demographic assumptions used to determine the value of the in-force business have been set at levels commensurate with the underlying operating experience identified in the periodic actuarial investigations.

(c) Taxation

Projected tax has been determined assuming current tax legislation and rates continue unaltered, except where future tax rates or practices have been announced.

(d) Expenses

The expense levels are based on internal expense analysis investigations and are appropriately allocated to the new business and policy maintenance functions. These have been determined by reference to:

(i) The outsourcing agreements in place with our third-party business process administrators;

(ii) Anticipated revisions to the terms of such agreements as they fall due for renewal; and

(iii) Corporate governance costs relating to the covered business.

The expense assumptions also include the expected future holding company expenses which will be recharged to the covered business.

No allowance has been made for future productivity improvements in the expense assumptions.

(e) Risk discount rate

The risk-free rate is set by reference to the sterling bid swap rates available in the market at the end of the reporting period. Where, however, non-linked business is substantially backed by government bonds, the yields on these assets have been used.

An explicit constant margin of 50 basis points is added to the risk-free rate to cover any remaining risks that are considered to be non-market, non-diversifiable risks, as there is no risk premium observable in the market. This margin gives due recognition to the fact that:

(i) The covered business is substantially closed to new business;

(ii) There is no significant exposure in the with-profits business, which is wholly reassured;

(iii) Expense risk is limited as a result of the outsourcing of substantially all policy administration functions to third-party business process administrators; and

(iv) For much of the Life business the Group has the ability to vary risk charges made to policyholders.

4. Assumptions (continued)

	30 June		31 December
	2006	2005	2005
Risk-free rate	4.8%	4.3%	4.2%
Non-diversifiable risk	0.5%	0.5%	0.5%
Risk margin	0.9%	0.9%	0.9%
Risk discount rate	6.2%	5.7%	5.6%

5. Analysis of shareholders' equity

	30 June		31 December
	2006 £000	2005 £000	2005 £000
Covered business			
Required capital	48,120	56,216	54,749
Free surplus	23,766	18,334	29,727
Shareholder net worth	71,886	74,550	84,476
Value of in-force business	108,703	113,149	109,961
Embedded value of covered business	**180,589**	**187,699**	**194,437**
Less: amount financed by borrowings	(16,800)	(21,000)	(21,000)
Embedded value of covered business attributable to shareholders	163,789	166,699	173,437
Net equity of other Group companies	11,960	4,135	2,736
Total shareholders' equity	**175,749**	**170,834**	**176,173**
The movement in the value of in-force business comprises:			
Value at beginning of period	**109,961**	**61,437**	**61,437**
Acquired in-force value arising on the acquisition of CWA Life Holdings plc	–	53,804	53,804
Amount charged to operating profit	(1,258)	(2,092)	(5,280)
Value at end of period	**108,703**	**113,149**	**109,961**

On 2 June 2005, the Group drew down £21m on a bank loan facility, in order to part fund the acquisition of CWA Life Holdings plc, referred to in Note 1 above. This effectively represented a purchase of part of the underlying value in force of CWA by way of debt finance and it follows that the embedded value of the covered business is not attributable to equity shareholders of the Group to the extent of the outstanding balance on the loan account at each balance sheet date. The loan is repayable in five equal annual instalments on the anniversary of the draw-down date, the funds for the repayment effectively being provided by way of the realisation of the underlying value of in-force business of the covered business. In accordance with this, £4.2m of the loan was repaid on 2 June 2006, leaving principal outstanding at that date of £16.8m.

6. Analysis of profit of covered business

	Six months ended 30 June		Year ended 31 December
	2006 £000	2005 £000	2005 £000
New business contribution	444	121	1,147
Return from in-force business			
Expected return	5,477	3,645	9,087
Experience variances	2,511	(1,634)	(563)
Operating assumption changes	(3,060)	(256)	542
Return on shareholder net worth	1,014	543	1,140
Operating profit	**6,386**	**2,419**	**11,353**
Variation from longer-term investment return	487	4,448	14,525
Effect of economic assumption changes	407	(1,378)	(3,598)
Profit before tax	**7,280**	**5,489**	**22,280**
Tax	774	2,061	(2,068)
Profit after tax	**8,054**	**7,550**	**20,212**

The profit of covered business varies from amounts presented in the summarised consolidated income statement in respect of the pre-tax result of the holding company presented as "other operational result", any tax pertaining thereto, which is included in "other tax", and profit on acquisition of subsidiary company and related tax, which are exceptional items. The variation from longer-term investment return for the six months ended 30 June 2006 is stated net of a loss of £248,000 arising on the sale of a subsidiary company.

7. Sensitivities to alternative assumptions

The following table shows the sensitivity of the embedded value of the covered business as reported at 31 December 2005 to variations in the assumptions adopted in the calculation of the embedded value. Sensitivity analysis is not provided in respect of the new business contribution for the year ended 31 December 2005 as the reported level of new business contribution is not considered to be material (see Note 3a) above). It largely relates to guaranteed bond business, where a close asset/liability matching approach leaves values largely insensitive to changes in experience.

Embedded Value ("EV") of covered business as at 31 December 2005	**£194.4m**
	Change in EV (£m)
Economic sensitivities	
100 basis point increase in risk discount rate	(7.1)
100 basis point reduction in yield curve	(1.1)
10% decrease in equity and property values	(4.5)
Operating sensitivities	
10% decrease in maintenance expenses	2.9
10% decrease in lapse rates	6.0
5% decrease in mortality/morbidity rates	
Assurances	2.0
Annuities	(0.5)
Reduction in the required capital to statutory minimum	1.4

7. Sensitivities to alternative assumptions (continued)

The key assumption changes represented by each of these sensitivities are as follows:

Economic sensitivities

(i) 100 basis point increase in the risk discount rate. The 5.6% RDR increases to 6.6%;

(ii) 100 basis point reduction in the yield curve. The fixed interest return is reduced by 1% and the equity/property returns are also reduced by 1%, thus maintaining constant equity/property risk premiums. The rate of future inflation has also been reduced by 1% so that real yields remain constant. In addition the risk discount rate has also reduced by 1%; and

(iii) 10% decrease in the equity and property values. This gives rise to a situation where, for example, a Managed Fund unit liability with a 60% equity holding would reduce by 6% in value.

Operating sensitivities

(i) 10% decrease in maintenance expenses, giving rise to, for example, a base assumption of £20 per policy pa reducing to £18 per policy pa;

(ii) 10% decrease in persistency rates giving rise to, for example, a base assumption of 10% of policy base lapsing pa reducing to 9% pa;

(iii) 5% decrease in mortality/morbidity rates giving rise to, for example, a base assumption of 100% of the parameters in a selected mortality/morbidity table reducing to 95% of the parameters in the same table; and

(iv) The sensitivity to the reduction in the required capital to the statutory minimum shows the effect of reducing the required capital from 150% of the LTICR plus 100% RCR to the amounts of 100% LTICR plus 100% RCR, being the minimum requirement prescribed by FSA regulation.

In each sensitivity calculation all other assumptions remain unchanged except where they are directly affected by the revised economic conditions: for example, as stated, changes in interest rates will directly affect the risk discount rate.

The sensitivities to changes in the assumptions in the opposite direction will result in changes of similar magnitude to those shown in the above table but in the opposite direction.

8. Reconciliation of shareholders' equity on the IFRS basis to shareholders' equity on the EEV basis

	30 June		31 December
	2006 £000	2005 £000	2005 £000
Shareholders' equity on the IFRS basis	**107,958**	**98,089**	**108,267**
Adjustments			
Deferred acquisition costs			
Insurance contracts	(234)	(2,817)	(1,114)
Investment contracts	(10,647)	(11,989)	(11,239)
Deferred income	18,141	20,302	19,145
Adjustment to provisions on investment contracts, net of amounts deposited with reinsurers	(17,915)	(14,474)	(16,700)
Adjustments to provisions on insurance contracts, net of reinsurers' share	(59)	(1,447)	(34)
Acquired in-force value	(27,292)	(23,226)	(28,703)
Deferred tax	3,094	(753)	2,590
Reinsurer default reserve	(6,000)	(6,000)	(6,000)
Group shareholder net worth	**67,046**	**57,685**	**66,212**
Value of in-force business	108,703	113,149	109,961
Shareholders' equity on the EEV basis	**175,749**	**170,834**	**176,173**
Group shareholder net worth comprises:			
Shareholder net worth in covered business	71,886	74,550	84,476
Shareholder's equity in other Group companies	11,960	4,135	2,736
Debt finance	(16,800)	(21,000)	(21,000)
Total	**67,046**	**57,685**	**66,212**

The reinsurer default reserve adjustment relates to a reserve which is established for FSA prudential reporting and which is recognised for reporting on the EEV basis, but not for reporting on the IFRS basis. The reserve is not recognised for reporting in accordance with IFRS as the events to which they relate are, in the opinion of the Directors, considered to be remote or uncertain. However, the reserve is charged to the shareholder net worth component of the embedded value of the covered business, as this is held to be consistent with the market-consistent valuation approach adopted in accordance with EEV principles. The reserve is maintained against the effect of possible default by a major reinsurer, Guardian Assurance plc, which is a subsidiary of Aegon NV. Action is currently being taken to mitigate the extent of loss that would arise in the event of such default, but the outcome is not sufficiently certain at 30 June 2006.

Independent Review Report by KPMG Audit Plc to Chesnara plc

Introduction

We have been instructed by the Company to review the financial information for the six months ended 30 June 2006, which comprises the Consolidated income statement, the Consolidated balance sheet, the Consolidated statement of changes in equity, the Consolidated statement of cash flows and the related notes ("the Financial Information") and to review the EEV basis supplementary information for the six months ended 30 June 2006, which comprises the Summarised consolidated income statement, the Summarised consolidated balance sheet, the Summarised consolidated statement of changes in equity and the related notes ("the Supplementary Information").

The Supplementary Information has been prepared in accordance with the European Embedded Value Principles issued in May 2004 by the European CFO Forum as supplemented by the Additional Guidance on European Embedded Value Disclosures issued in October 2005 (together the 'EEV Principles') using the methodology and assumptions set out in notes 3 and 4 to the Supplementary Information.

We have read the other information contained in the Interim Financial Statements and considered whether it contains any apparent misstatements or material inconsistencies with either the Financial Information or the Supplementary Information.

This report is made solely to the Company in accordance with the terms of our engagement to assist the Company in meeting the requirements of the Listing Rules of the Financial Services Authority and also to provide a review conclusion to the Company on the Supplementary Information. Our reviews have been undertaken so that we might state to the Company those matters we are required to state to it in this report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Company for our review work, for this report, or for the conclusions we have reached.

Directors' responsibilities

The Interim Financial Statements, including the Financial Information and the Supplementary Information contained therein, is the responsibility of, and has been approved by, the Directors. The Directors are responsible for preparing the Financial Information in accordance with the Listing Rules of the Financial Services Authority which require that the accounting policies and presentation applied to the interim figures should be consistent with those applied in preparing the preceding annual financial statements except where any changes, and the reasons for them, are disclosed. The Directors have accepted responsibility for preparing the Supplementary Information in accordance with the EEV Principles and for determining the assumptions used in the application of those principles.

Review work performed

We conducted our review of the Financial Information in accordance with guidance contained in Bulletin 1999/4 issued by the Auditing Practices Board for use in the UK. We conducted our review of the Supplementary Information having regard to that Bulletin. A review consists principally of making enquiries of group management and applying analytical procedures to the Financial Information, the Supplementary Information and underlying financial data and, based thereon, assessing whether the accounting policies and presentation have been consistently applied unless otherwise disclosed. A review excludes audit procedures such as tests of controls and verification of assets, liabilities and transactions. It is substantially less in scope than an audit performed in accordance with International Standards on Auditing (UK & Ireland) and therefore provides a lower level of assurance than an audit. Accordingly we do not express an audit opinion on the Financial Information or the Supplementary Information.

Review conclusions

On the basis of our reviews we are not aware of any material modifications that should be made either to the Financial Information or to the EEV basis Supplementary Information as presented for the six months ended 30 June 2006.

KPMG Audit Plc 5 September 2006
Chartered Accountants
St James Square
Manchester M2 6DS

Introduction

The first-time adoption of EEV principles and associated disclosures represents a change from the AP basis of reporting, which has previously been adopted by the Group as the basis for presenting supplementary financial information.

The following tables and notes set out and explain the reconciliations between amounts previously reported under AP methodology for the comparative periods presented in these supplementary financial statements and the amounts as they are now restated in accordance with EEV principles. The reconciliations set out the impact on the components of shareholder equity as at 30 June 2005 and 31 December 2005 and on the changes in shareholder equity for the six months ended and the year ended on those dates respectively.

Reference should also be made to Note 3(e) to the Supplementary Information, which sets out the relationship between assumptions used to establish the present value of the future cash flows of the covered business on an AP basis with those used in accordance with EEV principles.

Reconciliation of the components of shareholder equity at 30 June 2005

	Note	AP as reported £000	Cost of capital £000 (a)	Indexation increases on business in force £000 (b)	Holding company expenses £000 (c)	Reinsurer default reserve £000 (d)	Risk discount rate £000 (e)	Tax £000 (f)	EEV as restated £000
Covered business									
Shareholder net worth		74,550	–	–	–	–	–	–	74,550
Value of in-force business		123,252	(2,415)	2,695	(22,409)	(3,111)	19,338	(4,201)	113,149
Embedded value of covered business		**197,802**	**(2,415)**	**2,695**	**(22,409)**	**(3,111)**	**19,338**	**(4,201)**	**187,699**
Net equity of non-covered business		(16,865)	–	–	–	–	–	–	(16,865)
Total shareholder equity		180,937	**(2,415)**	**2,695**	**(22,409)**	**(3,111)**	**19,338**	**(4,201)**	**170,834**

Reconciliation of the components of shareholder equity at 31 December 2005

	Note	AP as reported £000	Cost of capital £000 (a)	Indexation increases on business in force £000 (b)	Holding company expenses £000 (c)	Reinsurer default reserve £000 (d)	Risk discount rate £000 (e)	Tax £000 (f)	EEV as restated £000
Covered business									
Shareholder net worth		84,476	–	–	–	–	–	–	84,476
Value of in-force business		119,476	(2,201)	2,676	(22,124)	(3,123)	19,742	(4,485)	109,961
Embedded value of covered business		**203,952**	**(2,201)**	**2,676**	**(22,124)**	**(3,123)**	**19,742**	**(4,485)**	**194,437**
Net equity of non-covered business		(18,264)	–	–	–	–	–	–	(18,264)
Total shareholder equity		**185,688**	**(2,201)**	**2,676**	**(22,124)**	**(3,123)**	**19,742**	**(4,485)**	**176,173**

Reconciliation of consolidated statement of changes in equity for the six months ended 30 June 2005

	AP as reported £000	Net adjustments £000	EEV as restated £000
Shareholders' equity at 1 January	**149,187**	**(23,158)**	**126,029**
Profit for the period representing total recognised income and expense	16,415	13,055	29,470
Dividends paid	(6,124)	–	(6,124)
Issue of ordinary shares pursuant to exercise of option	1,533	–	1,533
Issue of ordinary shares pursuant to placing and open offer	22,000	–	22,000
Expenses incurred in connection with issue of ordinary shares pursuant to placing and open offer	(2,074)	–	(2,074)
Shareholders' equity at 30 June	**180,937**	**(10,103)**	**170,834**

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

	AP as reported £000	Net adjustments £000	EEV as restated £000
Shareholders' equity at 1 January	**149,187**	**(23,158)**	**126,029**
Profit for the period representing total recognised income and expense	26,291	13,643	39,934
Dividends paid	(11,249)	–	(11,249)
Issue of ordinary shares pursuant to exercise of option	1,533	–	1,533
Issue of ordinary shares pursuant to placing and open offer	22,000	–	22,000
Expenses incurred in connection with issue of ordinary shares pursuant to placing and open offer	(2,074)	–	(2,074)
Shareholders' equity at 31 December	**185,688**	**(9,515)**	**176,173**

Notes to the restatement of supplementary financial information from the AP to the EEV basis.

(a) Cost of capital

For AP reporting the cost of capital was determined as the face value of the statutory minimum capital required to be maintained in accordance with FSA Pillar 1 regulations less the discounted value of future releases of that capital, after allowing for net investment returns. Accordingly, the level of capital was taken as 100% of the Long Term Insurance Capital Requirement ("LTICR") plus 100% of the Resilience Capital Requirement ("RCR") as set out in FSA Regulations.

As a result of the restatement in accordance with EEV principles, the level of required capital has increased so that it is determined to be 150% of the LTICR plus 100% of the RCR. Prior to the transfer, referred to in Note 2, the capital requirement for CWA covered business was determined to be £5m over the minimum statutory requirement.

The amount shown in the restatement table is the cost of holding the additional capital, such cost being determined using the same method as that used under AP methodology.

(b) Indexation increases on business in force

Within the value of in-force business for CA, as determined for AP reporting, credit was taken for indexation increases on policies where the policy contained contractual automatic increase options. However, for CWA business, the value of any such options was included in the value of new business when they were exercised and no benefit was taken for prospective increases within the in-force value.

EEV principles permit the continuance of the method of recognising the value of such options when they are written rather than when they are exercised. The amount shown in the restatement table is the effect of allowing for such options within the in-force value of CWA covered business.

No credit is taken within the in-force value under either AP or EEV methodologies for future DWP rebates and pension annuity vestings. These will continue to be treated as new business in the period of receipt.

(c) Holding company expenses

For AP reporting no allowance was made within the in-force value for future holding company expenses. In accordance with EEV principles, the in-force value is determined after making allowance for all Chesnara Group function expenses, which it is anticipated will be allocated to the covered business over the life of that business.

The holding company expenses are charged against the shareholder fund and there is a consequential effect on the amount of tax payable within the shareholder fund. This gives rise to a second order effect on the cost of holding the required capital, as frictional costs are reduced.

The amount shown in the restatement table reflects the effect of including the additional holding company expenses within the in-force value together with the associated impact on the cost of required capital.

(d) Reinsurer default reserve

For AP reporting credit was taken in the in-force value for the release of a reinsurer default reserve, which had been charged against shareholder net assets. This method was used effectively to recognise the cost of capital of maintaining the reserve.

In accordance with EEV principles a market-consistent embedded value methodology is used. The Directors consider that the release of the reserve within the in-force value is inconsistent with this methodology. Accordingly, the amount in the restatement table reflects the reversal of the release of the reserve within the in-force value.

(e) Risk discount rate

All of the preceding restatement items have been quantified by applying the risk discount rate determined under AP reporting to the cash flows related to the restatement items. The amount shown in the restatement table as the risk discount rate adjustment is the result of the application of the difference between (i) the risk discount rate determined for AP reporting and (ii) the risk discount rate established on a calibrated traditional embedded value basis, to the cash flows arising on the business in force, as adjusted for all of the other restatement items, including the associated impact on the cost of required capital.

This difference arises from the fact that the AP risk margin within the risk discount rate was intentionally determined by the Directors on a conservative basis, to recognise uncertainty surrounding lapse and expense assumptions and the adequacy of provisions for misselling redress. In accordance with EEV principles, this subjectivity is removed from the assessment of the risk discount rate, as assumptions are explicitly determined on a best-estimate basis. The Directors consider that the acquisition of CWA and the subsequent transfer of its long-term business to CA diversify the risks inherent in each separate entity, thus requiring a lower overall risk margin. In addition, operational experience up to 30 June 2006 and strengthening of expense assumptions as at that date have removed some of the operational uncertainty referred to above, contributing to the reduction in the required risk margin.

(f) Tax

All of the effects shown in the restatement table are gross of tax. The amount shown as the tax adjustment in the restatement table is the aggregate effect on future tax payable of all of the preceding restatement items.

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