Chesnara plc Interim Management Statement

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Interim Management Statement for the period from 1 January 2011 to 17 November 2011

18 November 2011

This statement relates primarily to the financial position of Chesnara plc (the 'Group') as at 30 September 2011 and to its financial performance during the first three quarters of the year. Where events and transactions have occurred since the end of the third quarter, which are estimated to have a material impact on management's core expectation of the financial position and/or financial performance of the Group, then these are identified, together with a broad indication of their impact.

Background

Investment Markets

Global investment market performance has continued to have a significant influence on the Group's results in the third quarter. Whereas the effects of these influences were mixed in the first half of the year they have been more uniformly adverse during the third quarter. This is reflected both in equity markets, where the leading UK and Swedish indices suffered declines over the quarter of some 14% and 20% respectively, and in bond markets where, for example, yields in UK bond markets declined significantly over the whole range of the yield curve. The impact of these market movements is explained more fully in the EEV and IFRS sections below.

Should similar conditions be present at the year end then EEV will, in line with guidance provided by sensitivities published at the half year, be lower than previous expectations. The diminution in EEV does not adversely impact the regulatory solvency position and cash generating capacity of the Group, in the short to medium term, which remains strong.

Outsourcing Costs

In order to introduce a greater degree of certainty in connection with our policy administration and accounting arrangements and to continue to avoid the adverse effects of fixed and semi-fixed costs on the UK run-off portfolios, we have entered into negotiations with potential partners as regards future provision of these services. While this will significantly extend the term of the current arrangements it is clear that a higher level of per policy costs will need to be recognised. Therefore, based on indicative terms received to date, we have adjusted our future expense assumptions at the end of the third quarter giving rise, on a Group-wide basis, to a £7.7m net of tax reduction in EEV. The associated net of tax reduction reflected in the IFRS result for the third quarter is £3.4m in respect of Countrywide Assured ('CA') and £2.4m in respect of Save & Prosper ('S&P').

Part VII Transfer

During the third quarter the arrangements for the transfer of the S&P long-term business funds into CA, under the provisions of Part VII of the Financial Services and Markets Act 2000, progressed significantly, with the initial Court Hearing held successfully on 20 September 2011. Whilst we cannot be certain of the effective date of the transfer we remain on target for the process to be completed by the year end, thereby delivering significant regulatory capital and fiscal benefits to the Group.

EEV

The movement in Group European Embedded Value ('EEV'), since the position last reported in the interim financial statements for the six months ended 30 June 2011, is set out in the following table:

	Quarter ended 30 September 2011	Six months ended 30 June 2011	Quarter ended 30 September 2010	Year ended 31 December 2010
	£m	£m	£m	£m
EEV at beginning of period	**340.1**	**354.6**	**255.1**	**262.6**
Modelling adjustments	-	(5.3)	-	13.2
Profit arising on acquisition of S&P	-	-	-	40.7
Result for the period, net of tax				
CA	(11.1)	1.6	10.1	18.8
S&P	(24.8)	3.8	-	(0.9)
Movestic	(9.2)	(6.3)	4.9	3.5
Other Group Activities	(0.5)	(0.6)	(0.8)	(2.3)
Foreign exchange reserve movement	(5.8)	4.5	9.2	9.5
Dividends paid	-	(12.2)	-	(16.3)
Issue of new shares	-	-	-	22.6
Sale of treasury shares	-	-	-	3.2
EEV at end of period	**288.7**	**340.1**	**278.5**	**354.6**

EEV of £288.7m as at 30 September 2011 is stated before appropriation of a dividend of £6.8m which was paid on 14 October 2011. EEV of £278.5m as at 30 September 2010 is stated before appropriation of a dividend of £5.9m which was paid on 12 October 2010.

The adverse EEV result for the quarter, for all operating segments, has been dominated by the investment market influences referred to above. The impact is analysed below:

			Net of tax increase/(reduction) in EEV
			£m
CA:	(i)	equity market falls reflected principally through lower deductions from policyholder funds	(5.2)
	(ii)	positive impact of declining bond yields	3.5
S&P:	(i)	equity market falls	(8.8)
	(ii)	impact of declining bond yields on with profits strain	(15.0)
Movestic:	(i)	equity market falls	(16.0)

It is notable that while declining bond yields have had an adverse impact on S&P, reflected in an increased with profits strain arising from the higher cost of guarantees to policyholders, they have had a favourable impact on CA due to the different characteristics of its policy portfolio.

In summary, equity market falls and declining bond yields in the third quarter have given rise to net of tax reduction in Group EEV of £30m and £11.5m respectively. Since the quarter end equity market performance has reversed somewhat with, for example, the FTSE All-

Share recovering some 7% (as at close on 16 November). Equity markets remain volatile while bond yields continue to be subdued.

Other significant influences on the EEV result for the quarter are:

CA
(i) £4.9m net of tax reduction due to increased estimated future outsourcing costs; offset by
(ii) continuing favourable lapse and mortality experience, together £0.5m.

S&P
(i) £2.8m net of tax reduction due to increased estimated future outsourcing costs.

Movestic
(i) £3.3m favourable impact of the introduction, in September 2011, of a charge on policyholders who transfer their pension arrangements to an alternative supplier; and
(ii) £1.6m positive result arising in the Risk and Health business.

In addition, a 5.6% weakening of the Swedish Krona against sterling in the third quarter gave rise to an adverse foreign exchange translation difference of £5.8m over the quarter following from the re-translation of Movestic's Krona-denominated embedded value.

IFRS

The IFRS result arising in the quarter ended 30 September 2011 is set out in the following table:

	Quarter ended 30 September 2011	**Six months ended 30 June 2011**	**Quarter ended 30 September 2010**	**Year ended 31 December 2010**
	£m	**£m**	**£m**	**£m**
Beginning of the period				
Pre-tax result	3.8	n/a	12.0	n/a
Tax	(0.6)	n/a	(4.2)	n/a
Post-tax result	3.2	n/a	7.8	n/a
Pre-tax result arising in the period				
Profit arising on business combinations				
S&P	-	-	-	15.5
Aspis	-	-	-	0.4
CA	0.4	8.0	7.8	25.7
S&P	(13.9)	(1.2)	-	0.2
Movestic	2.0	(1.2)	(0.5)	(3.6)
Other Group Activities	(1.1)	(1.8)	(0.8)	(3.9)
	(12.6)	3.8	6.5	34.3
Tax arising in the period	6.5	(0.6)	(1.8)	(4.5)
Post-tax result arising in the period	(6.1)	3.2	4.7	29.8
Cumulative result to end of period				
Pre-tax result	(8.8)	3.8	18.5	34.3
Tax	5.9	(0.6)	(6.0)	(4.5)
Post-tax result	(2.9)	3.2	12.5	29.8

The total IFRS pre-tax result for the quarter has been dominated by investment market influences and increased estimated outsourcing costs as referred to above. The following are the principal factors underlying the pre-tax results of the operating segments:

CA

(i) a positive impact of £1.4m arising from investment market influences. This arises principally from the combined impact of falling bond yields on the actuarial valuation interest rate, which gives rise to an increase in actuarial liabilities, and on the capital value of matching assets and is in contrast to the impact of falling bond yields on the S&P segment; and

(ii) an adverse impact of £4.3m (£3.4m net of tax) arising from revised estimated outsourcing costs.

With the natural surplus arising in the period as the business runs off, the overall CA result at the cumulative Q3 position remains robust and is only slightly behind expectations.

S&P

As previously reported, the S&P IFRS result is very sensitive to falling bond yields, which give rise to lower actuarial valuation rates. The impact is reflected principally as a with profits strain which relates to the potential increased cost to shareholders of meeting the cost of guarantees principally within the pensions portfolio. Of the strain of £8m arising in the quarter some £6m is attributable to falling bond yields while the balance is attributable to declining equity markets. This demonstrates the sensitivity to falling bond yields which will reverse when yields recover.

The S&P result has also been adversely impacted in the quarter to the extent of £2.7m arising from the impact of declining investment markets on other actuarial reserves and of £3.1m (£2.4m net of tax) arising from revised estimated outsourcing costs.

Movestic

Movestic posted a strong result for the quarter, with core operating divisions operating close to or above break even. The result was enhanced by the impact of falling interest rates on the cost of financial reinsurance as measured on an IFRS basis.

The following are the key performance indicators relating to Movestic:

Premium Income	**Three quarters ended 30 September 2011**	**Three quarters ended 30 September 2010**	**Year ended 31 December 2010**
	£m	**£m**	**£m**
Total premium income*			
Pensions and savings	178.0	200.0	263.0
Risk insurance	29.4	28.4	38.4
Total	207.4	228.4	301.4

Overall premium has reduced as we have exited some low or non-profitable lines of business and market conditions have tempered investor appetite.

New business premium income*			
Pensions and savings	36.4	38.9	52.9
Risk insurance**	1.4	7.5	8.1
Total	37.8	46.4	61.0

*Translated into £ at constant rate of SEK10.3 = £ (Quarter3 2011 average rate).

** New Business risk insurance premium statistics for 2010 include Aspis renewal premiums: they are excluded from New Business statistics in 2011.

Market share of unit-linked pensions business	Q2 11	Q1 11	Q4 10	Q3 10
	%	%	%	%
Total business	5.6	4.7	5.8	3.1
Company-paid contribution business	11.3	12.5	11.3	10.1

Market share figures are not yet available for Q3. However we expect market share to be in line with recent quarters.

	30 September 2011	30 September 2010	31 December 2010
Assets under management*	£1,149.6m	£1,178.3m	£1,278.4m

*Translated at a constant rate of SEK10.7 = £ (30 September 2011 closing rate).

Policy attrition	Quarter ended 30 September 2011	Quarter ended 30 September 2010	Year ended 31 December 2010
	%	%	%
Surrenders	14.1	10.7	13.4
Transfers	5.4	4.7	4.6
Lapses	16.3	14.3	19.8

Fund performance	Quarter ended 30 September 2011	Quarter ended 30 September 2010	Year ended 31 December 2010
	No of Funds	No of Funds	No of Funds
Outperformed against relevant index	16	17	18
Underperformed against relevant index	25	12	12
No relevant index	7	6	6

Market conditions have proved challenging particularly as Movestic's funds are, in general terms, overweight in Sweden, small cap, value and emerging markets. Fund performance has suffered which has arrested improvement in surrender and transfer rates. Lapses have improved from last year and, with the introduction of a penalty charge on transfers from September, we are seeing early signs of improvement in that area. In response to poor relative performance from some of our fund managers and feedback from our distributors we have changed a number of managers and introduced a number of new funds – all of which have been well received.

Cash Generation

As indicated above, notwithstanding a number of adverse influences, the CA IFRS outturn at the cumulative Q3 position is only slightly behind expectations. Accordingly, the underlying cash generation within CA, which is, in the short term, the principal source of debt and equity servicing within the Group, is only slightly lower than expected. The prospect of cash generation from S&P has clearly diminished in the short term. However, the completion of the Part VII Transfer process described above is expected to give rise to a significant cash release in the short to medium term. Capital contributions in the form of cash to finance the development of Movestic continue to be in accordance with our original plans.

The regulatory solvency positions of the separate segments and of the Group, which could act as a constraint on the transfer and disposition of cash which is generated, remain in a healthy position, as demonstrated in the Solvency section below.

European Exposure

Shareholder funds within Chesnara, CA and S&P have negligible direct exposure to the Euro as funds continue to be held in sterling and sterling-denominated fixed interest securities. Shareholder funds within Movestic have negligible direct exposure to the Euro as funds continue to be held in cash, fixed interest securities and a low risk Swedish investment fund. The fixed interest holdings are in Swedish government bonds. Overall, therefore, direct shareholder exposure is limited.

Solvency

The underlying emergence of surplus in CA, and hence the capacity of the Group to continue to pursue its dividend policy, remains strong. Accordingly, the ratio of regulatory capital resources to regulatory capital requirements on the Pillar 1 basis in CA has improved from 254% as at 30 June 2011 to 286% as at 30 September 2011, while the corresponding ratio for S&P has declined from 269% as at 30 June 2011 to 238% as at 30 September 2011. However, S&P's requirements are now measured on a Pillar 2 basis and this currently places an additional constraint on any possible transfer from S&P to Chesnara. As indicated in the earlier section the Group is not reliant on S&P in the short term to meet its debt and equity financing requirements.

The regulatory solvency ratio of Movestic has improved from 189% as at 30 June 2011 to 213% as at 30 September 2011, following a planned cash transfer of £2.4m by way of a capital contribution from Chesnara during the quarter.

The corresponding Group solvency ratio, calculated in accordance with the Insurance Groups Directive, is 193% as at 30 September 2011. This compares to a ratio of 198% as at 30 June 2011 and with a regulatory requirement of 100%.

Market Opportunity

We continue to see a number of potential acquisition opportunities and we will progress these where we see value and a clear strategic fit. We remain open-minded as to location in the UK and Western Europe, and, as ever, we will continue to apply strict financial and risk criteria when we assess them.

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Notes to Editors

Chesnara plc, which listed on the London Stock Exchange in May 2004, is the owner of Countrywide Assured plc ("CA"), Save & Prosper Insurance (Save & Prosper') and Movestic Livförsäkringar AB ('Movestic'). CA is a UK life assurance subsidiary that is substantially closed to new business. In June 2005 Chesnara acquired a further closed life insurance company - City of Westminster Assurance ("CWA") - for £47.8m. With effect from 30 June 2006, CWA's policies and assets were transferred into CA plc.

Movestic, a Swedish life assurance company which originally focused on pensions and savings, was acquired on 23 July 2009 for £20m. The company is open to new business and seeks to grow its position in the Swedish unit-linked market. Its proposition was strengthened in February 2010 with the acquisition of the operations of Aspis Försäkringar Liv AB which has a risk and health product bias.

Save & Prosper Insurance Limited, and its subsidiary, Save & Prosper Pensions Limited were acquired on 20th December 2010 for £63.5m in cash. This was funded by raising a new debt facility of £40m and a placing of new and treasury shares which raised £26.7m. The companies are closed to new business and operate an outsourced business model which is complementary to Chesnara's existing UK operations.