Registered number 56631

MIDLAND ASSURANCE LIMITED

REPORT AND FINANCIAL STATEMENTS

31 DECEMBER 2005

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Company information

Directors

M C Chessher
M D E Gilbert (appointed 24 January 2006)
P J James
I C R Stuart
A J Thompson

Secretary

P F Worthington

Registered office

The Zurich Centre
3000 Parkway
Whiteley
Fareham
Hampshire
PO15 7JZ

Auditors

PricewaterhouseCoopers LLP
Southwark Towers
32 London Bridge Street
London
SE1 9SY

Directors' report

The directors present their report and audited financial statements for the year ended 31 December 2005.

Principal activities and review of the business

The Company is engaged in running off a portfolio liability business in the United Kingdom. The Company's insurance business is 100% net quota shared to another group company.

On 14 October 2005 the Company increased its issued share capital by issuing 3,000,000 ordinary shares to Eagle Star Insurance Company Limited (ESI), for the sum of £3,000,000.

On 19 December 2005 application was made to the Court for approval of a portfolio transfer under Part VII of the Financial Services and Markets Act 2000 (the Part VII) to effect a reorganisation of the insurance business of the Company's parent company, ESI and certain of the Company's fellow subsidiaries.

As part of the Part VII reorganisation the business of the Company will be transferred to ESI except for business relating to employers' liability in the United Kingdom which will be transferred to Zurich Insurance Company.

The Part VII will also provide for the Company to be dissolved, without winding up, at a future date.

The Part VII was subject to a second Court hearing on 27 March 2006 with an effective date of 1 April 2006.

Results

The results for the year are shown in the profit and loss account on pages 8 and 9.

Dividends

The directors do not propose the payment of a dividend for the year (2004: £nil).

Directors

The names of the directors at the date on which the accounts were approved are shown on page 1.

The following secretary resigned during the year:

J C Atkinson (resigned 07 August 2005)

Directors' interests

The Company is a wholly owned subsidiary of Zurich Financial Services, a company incorporated in Switzerland. As such, no director had any interests in shares and debentures required to be disclosed under the United Kingdom Companies Act 1985.

No directors had material interests in contracts of significance with the Company or any subsidiary company of Zurich Financial Services during the year.

Directors' report

Creditor payment policy

All external creditors, excluding amounts due in respect of the settlement of insurance and reinsurance claims, are settled by other group companies.

Financial Instruments

Financial risk management objectives

The Company is exposed to financial risk through its financial assets, financial liabilities, reinsurance assets and policyholder liabilities. In particular, the key financial risk is that the proceeds from financial assets are not sufficient to fund the obligations arising from policies as they fall due. The most important components of this financial risk are interest rate risk, currency risk, credit risk and liquidity risk.

The Company manages these positions within an asset liability management (ALM) framework that has been developed to achieve investment returns in excess of obligations under insurance contracts. The principal technique of the Company's ALM is to match assets to the liabilities arising from insurance contracts by reference to the type of benefits payable to contract holders.

The Company's ALM is integrated with the management of the financial risks associated with the Company's other financial assets and liabilities not directly associated with insurance and investment liabilities. The Company does not use hedge accounting.

Interest rate risk

Interest rate risk arises primarily from investments in fixed interest securities. In addition, to the extent that claims inflation is correlated to interest rates, liabilities to policyholders are exposed to interest rate risk.

The Company monitors interest rate risk by calculating the mean duration of the investment portfolio and of the policyholder liabilities. The mean duration is an indicator of the sensitivity of the assets and liabilities to changes in current interest rates.

Any gap between the mean duration of the assets and the estimated mean duration of the liabilities is minimised by means of buying and selling fixed interest securities of different durations.

Currency risk

The Company is exposed to currency risk in respect of liabilities under policies of insurance denominated in currencies other than sterling. The Company seeks to mitigate the risk in cases where the currency liabilities are material by matching the estimated foreign currency denominated liabilities with assets denominated in the same currency.

Directors' report

Credit risk

Credit risk is the risk that a counterparty will be unable to pay amounts in full when due. Key areas where the Company is exposed to credit risk are:

- exposure to corporate bonds,
- reinsurers' share of insurance liabilities,
- amounts due from reinsurers in respect of claims already paid,
- amounts due from insurance contract holders, and
- amounts due from insurance intermediaries.

The Company places limits on its exposure to a single counterparty, or groups of counterparty, and to geographical and industry segments.

Reinsurance is used to manage insurance risk. This does not, however, discharge the Company's liability as primary insurer. If a reinsurer fails to pay a claim, the Company remains liable for the payment to the policyholder. The creditworthiness of reinsurers is considered on an annual basis by reviewing their financial strength prior to finalisation of any contract. In addition, the recent payment history of reinsurers is used to update the reinsurance purchasing strategy.

Liquidity risk

Liquidity risk is the risk that cash may not be available to pay obligations when due at a reasonable cost. The Board sets limits on the minimum proportion of maturing funds available to meet such calls and on the minimum level of borrowing facilities that should be in place to cover anticipated liabilities and unexpected levels of demand.

Auditors

The directors have taken advantage of the elective regime, under Section 386 of the United Kingdom Companies Act 1985, for the dispensation from the annual appointment of auditors. The auditors, PricewaterhouseCoopers LLP, have signified their willingness to continue in office.

By order of the Board

Paul Worthington

P F Worthington
Company Secretary
29 March 2006

Statement of directors' responsibilities

The following statement sets out the responsibilities of the directors in relation to the financial statements of the Company. The report of the auditors, shown on pages 6 and 7, sets out their responsibilities in relation to the financial statements.

Company law requires the directors to prepare financial statements for each financial year, which give a true and fair view of the state of affairs of the Company as at the end of the financial period and of the profit or loss for the financial period. In preparing those financial statements, the directors are required to:

- Select appropriate policies and apply them consistently, subject to any material departures being disclosed and explained;
- Make judgements and estimates that are reasonable and prudent;
- State whether applicable accounting standards have been followed; and
- Prepare the financial statements on the going concern basis, unless they consider that to be inappropriate.

The directors confirm that they have complied with the above requirements in preparing the financial statements.

The directors are responsible for ensuring that the Company keeps sufficient accounting records to disclose with reasonable accuracy the financial position of the Company and to enable them to ensure that the financial statements comply with the United Kingdom Companies Act 1985.

They are also responsible for taking reasonable steps to safeguard the assets of the Company, and in that context to have proper regard to the establishment of appropriate systems of internal control with a view to the prevention and detection of fraud and other irregularities.

Independent auditors' report to the shareholders of Midland Assurance Limited

We have audited the financial statements of Midland Assurance Limited for the year ended 31 December 2005 which comprise the Profit and Loss Account, the Balance Sheet and the related notes. These financial statements have been prepared under the accounting policies set out therein.

Respective responsibilities of directors and auditors

As described in the Statement of Directors' Responsiblities the company's directors are responsible for the preparation of the financial statements in accordance with applicable law and United Kingdom Accounting Standards (United Kingdom Generally Accepted Accounting Practice).

Our responsibility is to audit the financial statements in accordance with relevant legal and regulatory requirements and International Standards on Auditing (UK and Ireland). This report, including the opinion, has been prepared for and only for the company's members as a body in accordance with Section 235 of the Companies Act 1985 and for no other purpose. We do not, in giving this opinion, accept or assume responsibility for any other purpose or to any other person to whom this report is shown or into whose hands it may come save where expressly agreed by our prior consent in writing.

We report to you our opinion as to whether the financial statements give a true and fair view and are properly prepared in accordance with the Companies Act 1985. We also report to you if, in our opinion, the Directors' Report is not consistent with the financial statements, if the company has not kept proper accounting records, if we have not received all the information and explanations we require for our audit, or if information specified by law regarding directors' remuneration and transactions is not disclosed.

We read the Directors' Report and consider the implications for our report if we become aware of any apparent misstatements within it.

Basis of audit opinion

We conducted our audit in accordance with International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board, except that the scope of our work was limited as explained below.

An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the financial statements. It also includes an assessment of the significant estimates and judgements made by the directors in the preparation of the financial statements, and of whether the accounting policies are appropriate to the company's circumstances, consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or other irregularity or error. However the evidence available to us was limited in respect of the claims outstanding within gross technical provisions in the balance sheet as the company believes that it is not practicable to allocate claims between this entity and the parent company, Eagle Star Insurance Company Limited ("the parent"). The ultimate cost of settlement rests with the parent as claims attributable to Midland Assurance Limited are reinsured to it via a 100% net quota share. Consequently, the evidence available to us was also limited in respect of the claims outstanding within the reinsurers' share of technical provisions in the balance sheet and the claims paid and change in the provisions for claims, both gross and reinsurers' share, in the profit and loss technical account.

In forming our opinion we also evaluated the overall adequacy of the presentation of information in the financial statements.

Independent auditors' report to the shareholders of Midland Assurance Limited

Qualified opinion arising from limitation on audit scope

Except for any adjustments that might have been found to be necessary had we been able to obtain sufficient evidence concerning the gross and reinsurers' share of claims outstanding and the gross and reinsurers' share of claims paid and change in the provisions for claims, in our opinion the financial statements give a true and fair view of the state of the company's affairs at 31 December 2005 and of its profit for the year then ended and have been properly prepared in accordance with the Companies Act 1985. In respect alone of the limitation on our work relating to the gross claims technical provisions and gross claims paid we have not obtained all the information and explanations that we consider necessary for the purposes of our audit.

PricewaterhouseCoopers LLP

PricewaterhouseCoopers LLP
Chartered Accountants and Registered Auditors
London
30 March 2006

Profit and loss account
Technical account - general business
for the year ended 31 December 2005

£000's	Notes	2005	2004
Claims incurred, net of reinsurance			
Claims paid			
Gross amount		**(26,004)**	(32,198)
Reinsurers' share		**26,004**	32,198
		-	-
Change in the provision for claims			
Gross amount		**(45,483)**	(57,777)
Reinsurers' share		**45,483**	57,777
		-	-
Claims incurred, net of reinsurance		**-**	-
Balance on the technical account for general business		**-**	-

All figures relate to discontinued operations

Profit and loss account
Non-technical account
for the year ended 31 December 2005

£000's	Notes	2005	2004
Balance on the general business technical account		-	-
Investment income	7	1,189	629
Profit on ordinary activities before tax		**1,189**	629
Tax on profit on ordinary activities	8	-	-
Profit on ordinary activities after tax and profit for the financial year		**1,189**	629

All figures relate to discontinued operations

The Company has no recognised gains or losses other than the profit for the above financial years.

Reconciliation of movements in shareholders' funds
for the year ended 31 December 2005

£000's	Share capital	Profit and loss account	2005	2004
Opening shareholders' funds	21,000	3,289	**24,289**	3,660
Increase in share capital	3,000	-	**3,000**	20,000
Profit attributable to shareholders' funds	-	1,189	**1,189**	629
Net addition to shareholders' funds	3,000	1,189	**4,189**	20,629
Closing shareholders' funds	24,000	4,478	**28,478**	24,289

Balance Sheet
as at 31 December 2005

£000's	Notes	2005	2004
Assets			
Investments			
Other financial investments	9	**27,996**	23,819
Reinsurers' share of technical provisions			
Claims outstanding	12	**521,717**	476,234
Debtors			
Debtors arising out of reinsurance operations		**-**	8
Other debtors	10	**406**	373
		406	381
Other assets			
Cash at bank and in hand		**20**	19
Prepayments and accrued income			
Accrued interest and rent		**109**	98
Total assets		**550,248**	500,551

Balance Sheet
as at 31 December 2005

£000's	Notes	2005	2004
Liabilities			
Capital and reserves			
Called up share capital	11	**24,000**	21,000
Profit and loss account		**4,478**	3,289
Shareholders' funds attributable to equity interests		**28,478**	24,289
Technical provisions - gross			
Claims outstanding	12	**521,717**	476,234
Creditors			
Creditors arising out of reinsurance operations		**53**	28
Total liabilities		**550,248**	500,551

The financial statements on pages 8 to 19 were approved by the Board on 29 March 2006 and were signed on its behalf by

P J James
Director

Accounting policies
for the year ended 31 December 2005

Basis of preparation

The financial statements have been prepared in accordance with Section 255 of, and Schedule 9A to, The United Kingdom Companies Act 1985 and with the Association of British Insurers' Statement of Recommended Practice on Accounting for Insurance Business (ABI SORP) dated December 2005.

The financial statements have been prepared in accordance with applicable accounting standards.

The Company has taken advantage of the exemption in FRS1 (Revised) and has not prepared a cash flow statement as the Company is a wholly owned subsidiary of a parent company that prepares a cash flow statement.

Basis of accounting for general insurance business

The results for all classes of business are accounted for on an annual basis whereby the incurred cost of claims, commission and related expenses are charged against the earned proportion of premiums, net of reinsurance as follows:

i) Claims incurred

Claims incurred comprise claims and related expenses paid in the year and changes in the provisions for outstanding claims, including provisions for claims incurred but not reported and related expenses, together with any other adjustments to claims from previous years. Where applicable, deductions are made for salvage and other recoveries.

ii) Claims provisions

Provision is made at the year-end for the estimated cost of claims incurred but not settled at the balance sheet date, including the cost of claims incurred but not yet reported to the Company. The estimated cost of claims includes expenses to be incurred in settling claims and a deduction for the expected value of salvage and other recoveries. The Company takes all reasonable steps to ensure that it has appropriate information regarding its claims exposures. However, given the uncertainty in establishing claims provisions, it is likely that the final outcome will prove to be different from the original liability established.

Accounting policies
for the year ended 31 December 2005

ii) Claims provisions (continued)

The estimation of claims incurred but not reported ("IBNR") is generally subject to a greater degree of uncertainty than the estimation of the cost of settling claims already notified to the Company, where more information about the claim event is generally available, particularly in the liability classes. Claims IBNR may often not be apparent to the insured until many years after the event giving rise to the claims has happened. Classes of business where the IBNR proportion of the total reserve is high will typically display greater variations between initial estimates and final outcomes because of the greater degree of difficulty of estimating these reserves. Classes of business where claims are typically reported relatively quickly after the claim event tend to display lower levels of volatility. In calculating the estimated cost of unpaid claims the Company uses a variety of estimation techniques, which for most classes of business are based upon statistical analyses of historical experience, which assumes that the development pattern of the current claims will be consistent with past experience. Where such techniques are inappropriate, exposure based techniques or industry benchmarking may be applied. In particular, there continues to be a wide range of uncertainty around the estimate relating to asbestos, pollution and health claims because of, for example, the potential long delay between exposure and the onset of illness or disability. Therefore the future number, timing and amount of such claims is more difficult to estimate. (Further details on the inherent uncertainties in these claims provisions are provided in note 13.) However, the level of provision has been set on the basis of the information that is currently available. The methods used, and the estimates made, are regularly reviewed. Allowance is made, however, for changes or uncertainties which may create distortions in the underlying statistics or which might cause the cost of unsettled claims to increase or reduce when compared with the cost of previously settled claims including:

- changes in company processes which might accelerate or slow down the development and/or recording of paid or incurred claims compared with the statistics from previous periods
- changes in the legal environment
- the effects of inflation
- changes in the mix of business
- the impact of large losses
- movements in industry benchmarks

A component of these estimation techniques is usually the estimation of the cost of notified but not paid claims. In estimating the cost of these the Company has regard to the claim circumstance as reported, any information available from loss adjusters and information on the cost of settling claims with similar characteristics in previous periods.

Large claims impacting each relevant business class are considered separately, and may be measured on a case by case basis or projected separately in order to allow for the possible distortive effect of the development and incidence of these large claims.

Where possible the Company adopts multiple techniques to estimate the required level of provisions. This assists in giving greater understanding of the trends inherent in the data being projected. The projections given by the various methodologies also assist in setting the range of possible outcomes. The most appropriate estimation technique is selected taking into account the characteristics of the business class and the extent of the development of each accident year.

Provisions are calculated gross of any reinsurance recoveries. A separate estimate is made of the amounts that will be recoverable from reinsurers based upon the gross provisions and having due regard to collectability.

iii) Discounted claims provision

On third party liability business, due to the long delay between the inception date of the policy and the final settlement of the claim, the outstanding claims provisions are discounted to take account of the expected investment income receivable between inception and settlement on the assets held to cover the provisions.

iv) Reinsurance recoveries

Reinsurance recoveries in respect of estimated claims incurred but not reported are assumed to be consistent with the historical pattern of such recoveries, adjusted to reflect changes in the nature and extent of the Company's reinsurance programme over time. An assessment is also made of the recoverability of reinsurance recoveries having regard to market data on the financial strength of each of the reinsurance companies. Reinsurance recoveries are discounted on a basis consistent with the related gross claims provisions.

Investments

Investments are stated at current value. For this purpose, listed investments are stated at market value on the balance sheet date.

Investment return

Investment return comprises all investment income, realised investment gains and losses and movements in unrealised gains and losses, net of investment expenses, charges and interest.

Dividends are recorded on the date on which shares are quoted ex-dividend. Interest, rents and expenses are accounted for on an accruals basis.

Realised gains and losses on investments, other than investments in group undertakings, carried at market value are calculated as the difference between net sales proceeds and purchase price. Movements in unrealised gains and losses on investments represent the difference between the valuation at the balance sheet date and their purchase price or, if they have been previously valued, their valuation at the last balance sheet date, together with the reversal of unrealised gains and losses recognised in earlier accounting periods in respect of investment disposals in the current period.

Notes to the accounts
for the year ended 31 December 2005

1 Segmental analysis

The Company only operates in the general insurance sector and all its business is managed from the UK. Therefore all of the net assets of the Company relate to segments of business in operations managed entirely in the UK.

Gross claims incurred and the reinsurance balance by class of business are analysed as follows:

£000's	**2005**	**2005**
	Gross claims incurred	**Reinsurance balance**
Direct		
UK employers liability	**70,961**	**(70,961)**
Reinsurance Acceptances		
Third party liability	**526**	**(526)**
Total	**71,487**	**(71,487)**

	2004 Gross claims incurred	2004 Reinsurance balance
Direct		
UK employers liability	89,944	(89,944)
Reinsurance Acceptances		
Third party liability	31	(31)
Total	89,975	(89,975)

2 Movement in prior year's provision for claims outstanding

An adverse run-off deviation of **£73,713,000** was experienced during the year in respect of employers liability (2004: adverse run-off deviation of £193,558,000 in respect of employers liability).

3 Net operating expenses

All management expenses have been borne by the Company's immediate holding company.

Notes to the accounts
for the year ended 31 December 2005

4 Auditors' remuneration

Auditors' remuneration expenses have been borne by the Company's immediate holding company.

5 Staff costs

Employees in the UK working on behalf of the Company are employed by either Eagle Star Direct Services Limited, Zurich UK General Employee Services Limited or Zurich UK General Services Limited. These employees may also work on behalf of any other Zurich Financial Services' companies.

The principal disclosures in respect of these staff appear in the accounts of Eagle Star Direct Services Limited, Zurich UK General Employee Services Limited and Zurich UK General Services Limited, copies of which can be obtained from The Secretary ,The Zurich Centre, 3000 Parkway, Whiteley, Fareham, Hampshire, PO15 7JZ.

6 Directors' emoluments

No remuneration was payable to the directors during the period in relation to their service as directors of the company (2004: £nil).

7 Investment income, expenses and charges

£000's	2005	2004
Investment income		
Income from other investments	**1,189**	629
Investment income	**1,189**	629
Gains on the realisation of investments	-	-

8 Taxation

£000's	2005	2004
United Kingdom corporation tax:		
Current tax on income for the period	-	-
Tax on profit on ordinary activities	-	-

8 Taxation (continued)

The tax assessed for the year is lower than the standard rate of corporation tax in the UK (30%). The differences are explained below:

£000's	**2005**	2004
Profit on ordinary activities before tax	**1,189**	629
Profit on ordinary activities multiplied by standard rate *of corporate tax in the UK of 30% (2004: 30%)*	**357**	189
Losses surrendered free from other group companies	**(357)**	(189)
Current tax charge/(credit) for the year	**-**	-

9 Other financial investments

£000's	**2005**	2004
Shares and other variable-yield securities and units in unit trusts	**27,996**	23,819
	27,996	23,819

Included in the carrying values above are amounts in respect of listed investments as follows:

Shares and other variable-yield securities and units in unit trusts	**27,996**	23,819
	27,996	23,819

The historical cost of total other financial investments is **£27,996,000** (2004: £23,819,000).

10 Other debtors

£000's	**2005**	2004
Amounts due from group undertakings	**406**	373
	406	373

Notes to the accounts
for the year ended 31 December 2005

11 Share capital

£000's	2005	2004
Allotted, called up and fully paid:		
24,000,000 (2004: 21,000,000) ordinary shares of £1 each	24,000	21,000
	24,000	21,000
Authorised:		
30,000,000 (2004: 30,000,000) ordinary shares of £1 each	30,000	30,000
	30,000	30,000

12 Claims outstanding

The claims of the UK liability business have been discounted as follows:

	Discount rates		
Class of business	**2005**	2004	**Mean term of gross liabilities**
Liability	**4.50 %**	4.50 %	**10.37 years** (2004: 10.96)

The period that is estimated to elapse before claims are settled is determined using an analysis of historical settlement patterns.

The discounting of claims provisions has had no effect on either net assets or profit after taxation due to the fact that the whole of the Company's insurance business is reinsured.

Gross claims provisions before discounting were **£817,921,000** (2004: £766,583,000).

13 Inherent uncertainty

There is material inherent uncertainty attaching to the run-off of certain of the Company's insurance liabilities and related reinsurance recoveries as explained on page 13. The provisions held in respect of the liability class of business, which includes asbestos, are material to the Financial Statements. Future changes in these reserves arising from the effects of the uncertainties could have a material effect on the Company's results and shareholders' funds in future periods. However, taking account of the full reinsurance protection in place with the parent undertaking, the Directors consider that it is unlikely that future deterioration in these claims reserves will impair the Company's ability to continue as a going concern. Accordingly they have concluded that it is appropriate to prepare the accounts on a going concern basis.

Notes to the accounts
for the year ended 31 December 2005

14 Ultimate parent company

The Company's ultimate parent company is Zurich Financial Services, which is incorporated in Switzerland. Copies of the consolidated financial statements of Zurich Financial Services can be obtained from The Secretary, Zurich Financial Services, Mythenquai 2, 8002 Zurich, Switzerland.

Eagle Star Insurance Company Limited is the parent company of the smallest group of companies, of which the Company is a wholly owned subsidiary, for which group accounts are prepared. Copies of the consolidated financial statements of Eagle Star Insurance Company Limited can be obtained from The Secretary, The Zurich Centre, 3000 Parkway, Whiteley, Fareham, Hampshire, PO15 7JZ.

15 Related party transactions

The Company has taken advantage of an exemption from FRS8 not to disclose transactions with Zurich Financial Services' group undertakings. Balances with Zurich Financial Services' group undertakings are shown in note 10.

There were no material transactions with any other related party.

The directors of the Company and its key management had no material transactions with any related parties of the Zurich Financial Services Group. The term 'director' and 'key management' includes members of their families.