

STRONGHOLD INSURANCE COMPANY LIMITED

**REPORT & ACCOUNTS
1999**

Company Registration No. 736581



Contents

	Page
Directors and Management	2
Report of the Directors	3
Statement of Directors' Responsibilities in respect of the Accounts	4
Report of the Auditors	5
Statement of Accounting Policies	6 - 7
Profit and Loss Account	8
Statement of Total Recognised Gains and Losses	9
Reconciliation of Movements in Shareholder's Funds	9
Balance Sheet	10 - 11
Statement of Cash Flows	12
Notes to the Accounts	13 - 19

Directors and Management

Directors

J M Massey - Chairman
A M Duffy
H Sopher
K F Watkins

Managing Director

K F Watkins

Secretary

R E Townsend FCIS FCII

Auditors

Ernst & Young

Managing Agents

Cavell Management Services Limited
Rose Lane Business Centre Rose Lane Norwich NR1 1JY England
Telephone: (01603) 599300 Facsimile: (01603) 599432

Registered Office

P O Box 62 Rose Lane Norwich NR1 1JY England

Report of the Directors

The Directors present their report and the accounts of the Company for the year ended 31 December 1999.

Principal activity and business review

The Company ceased to write new business in 1987 : accordingly the DTI withdrew its authority for the Company to accept contracts of insurance and reinsurance.

The principal activity of the Company continues to be the management of the claims and liabilities which will extend for an indefinite period.

Results and dividends

After allowing for taxation, there was a loss for the year of US\$778,000 (1998 - profit US\$3,934,000). The Directors do not recommend the payment of a dividend for the year (1998 - Nil).

Directors

The names of the Directors at the date of this Report appear on page 2. All of the Directors served throughout the year.

The Directors at 31 December 1999 had the following interests in the share capital of the holding company, Stronghold Holdings Limited :

	At 31 December 1999 Ordinary shares	At 31 December 1998 Ordinary shares
A M Duffy	40	40
H Sopher	40	40
K F Watkins	20	20

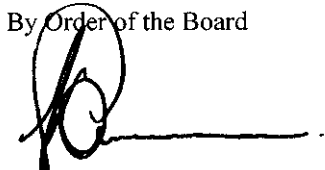
Year 2000 compliance

To protect the Company from potential Year 2000 problems, the reinsurance systems were closed for year end processing on 24 December 1999. No problems arose over the year end period and none has since materialised. The Company remains vigilant in respect of potential problems in this area in the future.

Introduction of the euro

Since 1 January 1999 the Company handles accounts involving payments and receipts in euros. The run-off manager has upgraded its computer software to handle the euro and its implications. The total cost to the Company of implementing these changes was not material.

By Order of the Board



R E TOWNSEND
Secretary

8 June 2000

Statement of Directors' Responsibilities in respect of the Accounts

Company law requires the Directors to prepare accounts for each financial year which give a true and fair view of the state of affairs of the Company and of the profit or loss of the Company for that period. In preparing those accounts the Directors are required to:

- . select suitable accounting policies and then apply them consistently;
- . make judgements and estimates that are reasonable and prudent;
- . state whether applicable accounting standards have been followed, subject to any material departures disclosed and explained in the accounts; and
- . prepare the accounts on the going concern basis unless it is inappropriate to presume that the Company will continue in business.

The Directors are responsible for keeping proper accounting records which disclose with reasonable accuracy at any time the financial position of the Company, and to enable them to ensure that the accounts comply with the Companies Act 1985. They are also responsible for safeguarding the assets of the Company and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

Report of the Auditors to the Members of Stronghold Insurance Company Limited

We have audited the accounts on pages 6 to 19 which have been prepared on the basis of the accounting policies set out on pages 6 and 7.

Respective responsibilities of the Directors and Auditors

As described on page 4 the Company's Directors are responsible for the preparation of the accounts in accordance with applicable United Kingdom law and accounting standards. It is our responsibility to form an independent opinion, based on our audit, on those accounts and to report our opinion to you. Our responsibilities, as independent auditors, are established in the United Kingdom by Statute, the Auditing Standards Board and by our profession's ethical guidance.

Basis of opinion

We conducted our audit in accordance with auditing standards issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the accounts. It also includes an assessment of the significant estimates and judgements made by the Directors in the preparation of the accounts, 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 accounts are free from material misstatement, whether caused by fraud or other irregularity or error. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the accounts.

Fundamental uncertainties

In forming our opinion, we have considered the adequacy of the disclosures made in the financial statements concerning the level of uncertainty in respect of :

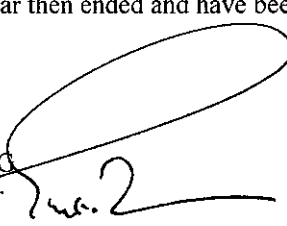
- a. the ultimate liability in respect of the technical provisions relating to gross claims outstanding, related reinsurance recoveries and claims handling expenses. The ultimate liability will vary as a result of subsequent information and events and these may result in significant adjustments to the amounts provided. Details of the circumstances relating to this fundamental uncertainty are described in Note 15.
- b. the adequacy of the current resources of the Company to meet its likely future requirements. As stated in the Statement of Accounting Policies, Basis of preparation, on page 6, the accounts have been prepared on a going concern basis. This basis could be invalidated if the resources of the Company were exhausted by adverse adjustments arising from the resolution of the above uncertainties. The accounts do not include any adjustments which would result from the going concern basis becoming inappropriate.

In view of the significance of these uncertainties we consider that they should be drawn to your attention but our opinion is not qualified in this respect.

Opinion

In our opinion the accounts give a true and fair view of the state of affairs of the Company as at 31 December 1999 and of its profit for the year then ended and have been properly prepared in accordance with the Companies Act 1985.

ERNST & YOUNG
Registered Auditor
Cambridge



8 June 2000

Statement of Accounting Policies

(a) Basis of preparation

These accounts are prepared in compliance with Section 255 of, and Schedule 9A to, the Companies Act 1985 and in accordance with applicable accounting standards. They also comply with the Statement of Recommended Practice on Accounting for Insurance Business issued by the Association of British Insurers.

In preparing the accounts for the year ended 31 December 1999, the Directors, having regard to the uncertainties expressed in Note 15 as to the amounts at which the Company's technical provisions will ultimately be settled, consider that the Company has adequate financial resources to meet its day to day obligations as they fall due. Accordingly the accounts have been prepared on a going concern basis, without including any adjustments that would be required should the financial resources of the Company prove inadequate.

(b) Technical account

- (i) Premiums are accounted for and recorded in the technical account in the year of notification.
- (ii) Provision for claims outstanding comprises provisions for the estimated ultimate cost of claims notified but not settled at the date of the balance sheet and for claims incurred but not notified at that date; the provision reflects anticipated reinsurance and other recoveries, and takes into account future claims handling costs.

The provision for claims outstanding for environmental and asbestos losses, and other losses for Casualty classes, are included after taking into account the future attributable investment earnings.

(c) Investment return

Investment return comprises interest and dividends on an accruals basis, together with realised and unrealised investment gains and losses. Realised gains and losses are calculated as the difference between net sale proceeds and cost or, if previously revalued, the valuations as at the last balance sheet date. Unrealised gains and losses are calculated as the difference between the valuation of investments at the balance sheet date and cost or, if previously revalued, the valuation as at the last balance sheet date. An allocation of the investment return from the non-technical account to the general business technical account is made on the basis of the relationship between average technical provisions and average shareholders' funds.

(d) Investments

Financial investments are stated at market value. Listed securities are taken at middle market value after adjustments for accrued interest, and other investments are stated at Directors' valuation. Unrealised gains and losses are taken to the profit and loss account.

(e) Foreign currencies

To protect the Company from potential Year 2000 problems the systems were closed for the year end using exchange rates ruling on 24 December 1999 rather than the balance sheet date. The financial effects of this change are not material.

Foreign currency transactions are translated to United States dollars at the rate applicable when recorded in the books, with the exception of transactions in sterling and Canadian dollars, which are translated at rates ruling on 24 December 1999.

Assets and liabilities are shown in the balance sheet at rates ruling on 24 December 1999.

Foreign currency translation gains and losses are taken directly to reserves.

Statement of Accounting Policies

(f) Deferred taxation

Deferred taxation, to the extent that it is likely to crystallise in the foreseeable future, is provided for using the liability method.

STRONGHOLD INSURANCE COMPANY LIMITED
**Profit and Loss Account
for the year ended 31 December 1999**

	Notes	1999		1998	
		US\$'000	US\$'000	US\$'000	US\$'000
Technical account - General business					
<i>Discontinued operations</i>					
Gross premiums written	1		172		196
Outwards reinsurance premiums			<u>818</u>		<u>520</u>
Earned premiums, net of reinsurance			(646)		(324)
Allocated investment return transferred from the non-technical account			<u>3,052</u>		<u>7,712</u>
Total technical income			<u>2,406</u>		<u>7,388</u>
Gross claims paid		37,157		29,931	
Reinsurers' share		<u>28,247</u>		<u>15,481</u>	
Net claims paid		8,910		14,450	
Gross change in the provision for claims		(59,636)		(2,834)	
Reinsurers' share		<u>(54,168)</u>		<u>7,838</u>	
Net change in the provision for claims		(5,468)		(10,672)	
Claims incurred net of reinsurance	3,4	3,442		3,778	
Net operating expenses	5	<u>30</u>		<u>(5)</u>	
Total technical charges			3,472		3,773
Balance on the general business technical account			<u>(1,066)</u>		<u>3,615</u>
Non-technical account					
Balance on the general business technical account			(1,066)		3,615
Investment income	7	6,856		7,754	
Unrealised gains on investments		-		1,310	
Investment expenses and charges	8	(2,134)		(1,033)	
Unrealised losses on investments		(1,382)		-	
Allocated investment return transferred to the general business technical account		<u>(3,052)</u>		<u>(7,712)</u>	
			288		319
(Loss)/profit on ordinary activities before taxation			<u>(778)</u>		<u>3,934</u>
Tax on ordinary activities	9		-		-
(Loss)/profit on ordinary activities after taxation			<u>(778)</u>		<u>3,934</u>

STRONGHOLD INSURANCE COMPANY LIMITED

**Statement of Total Recognised Gains and Losses
for the year ended 31 December 1999**

	1999 US\$'000	1998 US\$'000
(Loss)/profit on ordinary activities after taxation	(778)	3,934
Currency translation differences on foreign currency net investment	179	(129)
Total recognised gains/(losses) related to the year	<u>(599)</u>	<u>3,805</u>

Historical Cost Profits and Losses

The inclusion of unrealised gains and losses in the profit and loss account to reflect the marking to market of investments in the balance sheet is not deemed to be a departure from the unmodified historical cost basis of accounting. Accordingly, a separate note of historical cost profits and losses is not given.

**Reconciliation of Movements in Shareholder's Funds
for the year ended 31 December 1999**

	1999 US\$'000	1998 US\$'000
Opening shareholder's funds	8,761	4,956
Total recognised gains/(losses) related to the year	(599)	3,805
Closing shareholder's funds	<u>8,162</u>	<u>8,761</u>

STRONGHOLD INSURANCE COMPANY LIMITED

Balance Sheet as at 31 December 1999

	Notes	1999 US\$'000	1998 US\$'000
Assets			
Investments			
Other financial investments	11	99,208	118,741
Deposits with ceding undertakings		<u>1,141</u>	<u>1,213</u>
		<u>100,349</u>	<u>119,954</u>
Reinsurers' share of technical provisions			
Claims outstanding	15	209,884	264,397
Debtors			
Debtors arising out of reinsurance operations		29,639	27,710
Other debtors	12	<u>453</u>	<u>35</u>
		<u>30,092</u>	<u>27,745</u>
Other assets			
Cash at bank and in hand		11,895	5,583
Prepayments and accrued income			
Accrued interest and rent		2,275	2,108
Other prepayments and accrued income		<u>66</u>	<u>-</u>
		<u>2,341</u>	<u>2,108</u>
Total assets		<u>354,561</u>	<u>419,787</u>

STRONGHOLD INSURANCE COMPANY LIMITED

Balance Sheet as at 31 December 1999

	Notes	1999 US\$'000	1998 US\$'000
Liabilities			
Capital and Reserves			
Called up share capital	13	48,079	48,079
Profit and loss account		(39,917)	(39,318)
Shareholder's funds attributable to equity interests	14	<u>8,162</u>	<u>8,761</u>
Technical provisions			
Claims outstanding	15	328,215	388,516
Deposits received from reinsurers		14,945	17,464
Creditors			
Arising out of reinsurance operations		2,629	4,567
Other creditors including taxation and social security		<u>6</u>	<u>4</u>
		<u>2,635</u>	<u>4,571</u>
Accruals and deferred income		604	475
Total liabilities		<u>354,561</u>	<u>419,787</u>



H SOPHER
Director

8 June 2000



K F WATKINS
Managing Director

STRONGHOLD INSURANCE COMPANY LIMITED
**Statement of Cash Flows
for the year ended 31 December 1999**

	Notes	1999 US\$'000	1998 US\$'000
Net cash outflow from operating activities	16	<u>(10,251)</u>	<u>(6,388)</u>
Cash flows were invested as follows:			
Decrease in cash holdings		(3,429)	(6,500)
Net portfolio investment			
Fixed interest securities		(6,822)	112
Net investment of cash flows	17	<u>(10,251)</u>	<u>(6,388)</u>

Movement in opening and closing cash and portfolio investments

	1999 US\$'000	1998 US\$'000
Net cash outflow for the period	(3,429)	(6,500)
Cash (outflow)/inflow : portfolio investments	(6,822)	112
Movement arising from cash flows	<u>(10,251)</u>	<u>(6,388)</u>
Non-cash movements	(232)	-
Changes in market values and exchange rates	(2,738)	1,356
Total movement in cash and portfolio investments	<u>(12,757)</u>	<u>(5,032)</u>
Cash and portfolio investments net of financing at 1 January	124,324	129,356
Cash and portfolio investments net of financing at 31 December	<u>111,103</u>	<u>124,324</u>

Notes to the Accounts

1 Premiums

Premium income substantially relates to reinstatement premiums and is attributable to discontinued operations.

2 Segmental information

	1999 US\$'000	1998 US\$'000
<i>Technical account</i>		
Gross premiums earned	172	196
Gross claims incurred	22,479	(27,097)
Gross operating expenses	(3)	8
Gross technical result	22,648	(26,893)
Reinsurance balance	(26,766)	22,796
Net technical result	(4,118)	(4,097)

All premiums relate to general reinsurance business concluded in the United Kingdom.

3 Claims incurred net of reinsurance

	Gross US\$'000	Reins. US\$'000	Net US\$'000
1999			
Claims paid	30,873	28,247	2,626
Claims handling expenses paid	6,284	-	6,284
	37,157	28,247	8,910
Outstanding claims carried forward	328,215	209,884	118,331
Outstanding claims brought forward	387,851	264,052	123,799
	(59,636)	(54,168)	(5,468)
Claims incurred	(22,479)	(25,921)	3,442
1998			
Claims paid	24,364	15,481	8,883
Claims handling expenses paid	5,567	-	5,567
	29,931	15,481	14,450
Outstanding claims carried forward	388,516	264,397	124,119
Outstanding claims brought forward	391,350	256,559	134,791
	(2,834)	7,838	(10,672)
Claims incurred	27,097	23,319	3,778

Notes to the Accounts

4 Claims handling expenses paid

Claims handling expenses include:

	1999 US\$'000	1998 US\$'000
Auditors' remuneration - audit services	42	42
- non-audit services	17	-

5 Net operating expenses

	1999 US\$'000	1998 US\$'000
Acquisition costs - gross	3	(8)
- reinsurance	(27)	(3)
- net	<u>30</u>	<u>(5)</u>

6 Directors' emoluments

The total remuneration received by the Directors for the year is as follows:

	1999 US\$	1998 US\$
Fees	117,223	120,633
Other emoluments	<u>317,943</u>	<u>277,637</u>
	<u>435,166</u>	<u>398,270</u>

The highest paid director received emoluments of US\$303,103 (1998 - US\$294,277).

7 Investment income

	1999 US\$'000	1998 US\$'000
Income from other investments	6,856	7,733
Gains on the realisation of investments	-	21
	<u>6,856</u>	<u>7,754</u>

8 Investment expenses and charges

	1999 US\$'000	1998 US\$'000
Investment management expenses	167	174
Interest payable - Short-term loans and overdrafts	-	-
- Reinsurance balances	618	859
Losses on the realisation of investments	<u>1,349</u>	<u>-</u>
	<u>2,134</u>	<u>1,033</u>

Notes to the Accounts

9 Taxation

No provision has been made in the accounts for corporation tax on the assessable profits for the year as they have been set off against losses of previous years.

10 Deferred taxation

No provision has been made in the accounts for deferred taxation.

Details of the full potential recovery for deferred taxation not provided are given below:

	1999 US\$'000	1998 US\$'000
Realisation of investments at values stated in the balance sheet	330	627
Short-term timing differences	(579)	(2,381)
Accelerated capital allowances	(2)	(2)
Trading losses available for carry forward	<u>(5,438)</u>	<u>(4,188)</u>
	<u>(5,689)</u>	<u>(5,944)</u>

11 Investments

	Current value		Historical cost	
	1999 US\$'000	1998 US\$'000	1999 US\$'000	1998 US\$'000
Other financial investments				
Debt securities and other fixed income securities (listed)	99,208	108,993	98,896	105,424
Deposits with credit institutions	-	9,748	-	9,748
	<u>99,208</u>	<u>118,741</u>	<u>98,896</u>	<u>115,172</u>

The facility provided to the Company in respect of its letter of credit liabilities is secured by a charge over certain of the Company's investments in debt securities and other fixed income investments.

12 Other debtors

	1999 US\$'000	1998 US\$'000
Amounts due from group undertakings	16	6
Other debtors	<u>437</u>	<u>29</u>
	<u>453</u>	<u>35</u>

Notes to the Accounts

13 Share capital

	1999 US\$'000	1998 US\$'000
<i>Authorised</i>		
30,000,000 ordinary shares of £1 each	<u>53,445</u>	<u>53,445</u>
<i>Issued and fully paid</i>		
27,000,000 ordinary shares of £1 each	<u>48,079</u>	<u>48,079</u>

14 Shareholder's funds

	Share capital US\$'000	Profit & loss a/c US\$'000	Total US\$'000
1999			
Balance at 1 January	48,079	(39,318)	8,761
Currency translation differences on foreign currency net investment		179	179
Retained loss for the financial year		(778)	(778)
Balance at 31 December	<u>48,079</u>	<u>(39,917)</u>	<u>8,162</u>
1998			
Balance at 1 January	48,079	(43,123)	4,956
Currency translation differences on foreign currency net investment		(129)	(129)
Retained profit for the financial year		3,934	3,934
Balance at 31 December	<u>48,079</u>	<u>(39,318)</u>	<u>8,761</u>

Notes to the Accounts

15 Claims outstanding

	Gross US\$'000	Reins. US\$'000	Net US\$'000
1999			
Provision before discounting	456,714	348,250	108,464
Discounting adjustment	(151,410)	(138,366)	(13,044)
	<u>305,304</u>	<u>209,884</u>	<u>95,420</u>
Claims handling expenses	32,079		32,079
Discounting adjustment	(9,168)		(9,168)
	<u>22,911</u>	<u>-</u>	<u>22,911</u>
	<u>328,215</u>	<u>209,884</u>	<u>118,331</u>
1998			
Provision before discounting	510,133	398,113	112,020
Discounting adjustment	(148,970)	(133,716)	(15,254)
	<u>361,163</u>	<u>264,397</u>	<u>96,766</u>
Claims handling expenses	33,157		33,157
Discounting adjustment	(5,804)		(5,804)
	<u>27,353</u>	<u>-</u>	<u>27,353</u>
	<u>388,516</u>	<u>264,397</u>	<u>124,119</u>

The level of the gross technical provisions has been set on the basis of information which is currently available, including potential outstanding loss advices, experience of development of similar claims and case law. The methods used, and estimates made, are reviewed regularly. The level of the related reinsurance recoveries is dependent upon both the accuracy of the estimated gross technical provisions and the ultimate ability to pay of the underlying security. The reinsurance recoveries are stated net of the provision for estimated future irrecoverable amounts. The level of the provision for claims handling expenses is dependent upon the settlement of gross technical provisions, collection of related reinsurance recoveries and changes in the factors influencing these.

Whilst the Directors consider that the gross provision for claims and the related reinsurance recoveries, together with the provision for claims handling expenses, are fairly stated on the basis of the information currently available to them, the ultimate liability will vary as a result of subsequent information and events and may result in significant adjustments to the amounts provided. Adjustments to the technical provisions are reflected in the financial statements for the period in which the adjustments are made.

Technical provisions for environmental and asbestos losses, and other losses for Casualty classes, are included after taking into account the future attributable investment earnings at an assumed compound discount rate of 4.5% (1998 - 4%) per annum. The assumed settlement pattern for gross claim payments results in an average term for the liabilities of 11.07 years (1998 - 8.90 years). This settlement pattern has been derived from the historic development of claims payments appropriate for the types of claims within these classes, in particular those relating to environmental and asbestos losses. Separate discount factors are applied to the insurance funds for each underwriting year. The unwinding of the discount, included within claims incurred net of reinsurance, during the year was immaterial.

During the year a positive run-off deviation of US\$15.5m (1998 - positive US\$12.6m) was experienced in respect of environmental and asbestos losses.

An excess of loss arrangement was entered into with European International Reinsurance Company on 1 October 1996 and a provision for reinsurance recoveries under this arrangement has been included within the provision for claims outstanding as shown above.

Notes to the Accounts

16 Reconciliation of result before tax to net cash flow from operating activities

	1999 US\$'000	1998 US\$'000
(Loss)/profit on ordinary activities before tax	(778)	3,934
Realised investment losses/(gains)	1,349	(21)
Unrealised investment losses/(gains)	1,382	(1,310)
Decrease in provision for claims outstanding	(5,468)	(10,672)
(Increase)/decrease in debtors	(2,351)	1,451
Decrease in creditors	(1,807)	(74)
Increase in deposits with ceding undertakings	(22)	(60)
(Decrease)/increase in deposits received from reinsurers	(2,495)	352
Realised exchange (losses)/gains	(61)	12
Net cash outflow from operating activities	<u>(10,251)</u>	<u>(6,388)</u>

17 Movement in cash and portfolio investments

	At 1 Jan 1999 US\$'000	Cash flow US\$'000	Non-cash movements US\$'000	Changes to market value and currencies US\$'000	At 31 Dec 1999 US\$'000
Cash at hand and in bank	15,331	(3,429)	-	(7)	11,895
Fixed income securities	108,993	(6,822)	(232)	(2,731)	99,208
	<u>124,324</u>	<u>(10,251)</u>	<u>(232)</u>	<u>(2,738)</u>	<u>111,103</u>

Notes to the Accounts

18 Related parties

Companies treated as related parties of the Company for disclosure purposes under Financial Reporting Standard 8, together with the nature of the relationship, are listed below :

Parent undertaking
Stronghold Holdings Limited

Companies related to the Directors
Isis Consulting, Inc.

19 Related party transactions

Details of the emoluments paid to Directors can be found in note 6.

Ms A M Duffy and Mr H Sopher, directors of Stronghold Insurance Company Limited, are also directors of Isis Consulting Inc. During 1999 Isis provided Stronghold with consultancy services for fees totalling US\$705,496, of which US\$69,550 was outstanding at 31 December 1999.

As at 31 December 1999 a balance of US\$15,971 was outstanding from the parent undertaking.

20 Holding company

The Company is a subsidiary undertaking of Stronghold Holdings Limited, the ultimate parent undertaking, which is registered in England. Copies of the accounts of the parent undertaking can be obtained from Clifford Chance, 200 Aldersgate Street, London EC1A 4JJ, England.