

STRONGHOLD INSURANCE COMPANY LIMITED

REPORT & ACCOUNTS
1998

Company Registration No. 736581



STRONGHOLD INSURANCE COMPANY LIMITED

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STRONGHOLD INSURANCE COMPANY LIMITED

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
Rose Lane Business Centre Rose Lane Norwich NR1 1JY England
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Registered Office

Rose Lane Business Centre Rose Lane Norwich NR1 1JY England

STRONGHOLD INSURANCE COMPANY LIMITED

Report of the Directors

The Directors present their report and the accounts of the Company for the year ended 31 December 1998.

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 profit for the year of US\$3,934,000 (1997 - US\$1,043,000). The Directors do not recommend the payment of a dividend for the year (1997 - 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 1998 had the following interests in the share capital of the holding company, Stronghold Holdings Limited :

	At 31 December 1998 Ordinary shares	At 31 December 1997 Ordinary shares
A M Duffy	40	40
H Sopher	40	40
K F Watkins	20	20

Year 2000 compliance

The Company is fully alert to the Year 2000 problem and to the technology, systems and associated business issues. The operation of the business depends not only on the run-off manager's computer systems but also to some degree on those of customers, intermediaries and reinsurers. This could expose the Company to further risk in the event that there is a failure by other parties to remedy their own Year 2000 issues.

A company-wide programme, designed to address the impact of the Year 2000 on the business, has been commissioned by the run-off manager and is under way.

Work has been completed to amend all critical business systems of the run-off manager to make them Year 2000 ready and, following comprehensive testing phases, live implementation was achieved during the final quarter of 1998.

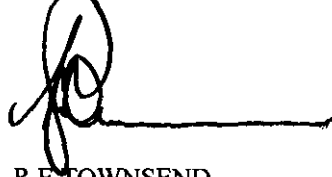
Given the complexity of the problem, it is not possible for any organisation to guarantee that no Year 2000 problems will remain, because at least some level of failure may still occur. However, the Board believes that it will achieve an acceptable state of readiness and will also provide resources to deal promptly with significant subsequent failures or issues that might arise.

Report of the Directors

Introduction of the euro

During 1998, the run-off manager appointed a project manager and undertook a high-level analysis of the introduction of the euro. 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

A handwritten signature in black ink, appearing to be 'R E TOWNSEND', followed by a horizontal line extending to the right.

R E TOWNSEND
Secretary

7 June 1999

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 7 to 20 which have been prepared on the basis of the accounting policies set out on pages 7 and 8.

Respective responsibilities of the Directors and Auditors

As described on page 5 the Company's Directors are responsible for the preparation of the accounts. It is our responsibility to form an independent opinion, based on our audit, on those accounts and to report our opinion to you.

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 :

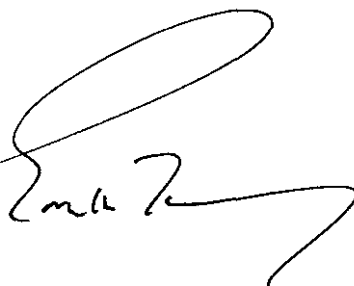
- a. the ultimate liability in respect of the technical provisions relating to gross claims outstanding, related reinsurance recoveries and claims handling expenses. The ultimate liability will vary as a result of subsequent information and events and these may result in significant adjustments to the 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 7, 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 1998 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
Norwich



7 June 1999

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 1998, 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 the Casualty classes written in the United Kingdom 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

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 year end rates.

Assets and liabilities are shown in the balance sheet at rates ruling on 31 December 1998.

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 1998**

	Notes	1998		1997	
		US\$'000	US\$'000	US\$'000	US\$'000
Technical account - General business					
<i>Discontinued operations</i>					
Gross premiums written	1		196		252
Outwards reinsurance premiums			520		180
Earned premiums, net of reinsurance			(324)		72
Allocated investment return transferred from the non-technical account			7,712		7,069
Total technical income			7,388		7,141
Gross claims paid		29,931		21,192	
Reinsurers' share		15,481		11,598	
Net claims paid		14,450		9,594	
Gross change in the provision for claims		(2,834)		(31,267)	
Reinsurers' share		7,838		(27,993)	
Net change in the provision for claims		(10,672)		(3,274)	
Claims incurred net of reinsurance	3,4	3,778		6,320	
Net operating expenses	5	(5)		-	
Total technical charges			3,773		6,320
Balance on the general business technical account			3,615		821
Non-technical account					
Balance on the general business technical account			3,615		821
Investment income	7	7,754		7,604	
Unrealised gains on investments		1,310		499	
Investment expenses and charges	8	(1,033)		(812)	
Unrealised losses on investments		-		-	
Allocated investment return transferred to the general business technical account		(7,712)		(7,069)	
			319		222
Profit on ordinary activities before taxation			3,934		1,043
Tax on ordinary activities	9		-		-
Profit on ordinary activities after taxation			3,934		1,043

STRONGHOLD INSURANCE COMPANY LIMITED

**Statement of Total Recognised Gains and Losses
for the year ended 31 December 1998**

	1998 US\$'000	1997 US\$'000
Profit on ordinary activities after taxation	3,934	1,043
<i>Currency translation differences</i> on foreign currency net investment	(129)	491
Total recognised gains/(losses) related to the year	<u>3,805</u>	<u>1,534</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 Shareholders' Funds
for the year ended 31 December 1998**

	1998 US\$'000	1997 US\$'000
Opening shareholders' funds	4,956	3,422
Total recognised gains/(losses) related to the year	3,805	1,534
Closing shareholders' funds	<u>8,761</u>	<u>4,956</u>

STRONGHOLD INSURANCE COMPANY LIMITED**Balance Sheet
as at 31 December 1998**

	Notes	1998 US\$'000	1997 US\$'000
Assets			
Investments			
Other financial investments	11	118,741	124,317
Deposits with ceding undertakings		<u>1,213</u>	<u>1,145</u>
		<u>119,954</u>	<u>125,462</u>
Reinsurers' share of technical provisions			
Claims outstanding	15	264,397	256,536
Debtors			
Debtors arising out of reinsurance operations		27,710	28,119
Other debtors	12	<u>35</u>	<u>953</u>
		<u>27,745</u>	<u>29,072</u>
Other assets			
Cash at bank and in hand		5,583	5,039
Prepayments and accrued income			
Accrued interest and rent		2,108	2,090
Other prepayments and accrued income		<u>-</u>	<u>92</u>
		<u>2,108</u>	<u>2,182</u>
Total assets		<u>419,787</u>	<u>418,291</u>

STRONGHOLD INSURANCE COMPANY LIMITED**Balance Sheet
as at 31 December 1998**

	Notes	1998 US\$'000	1997 US\$'000
Liabilities			
Capital and Reserves			
Called up share capital	13	48,079	48,079
Profit and loss account		(39,318)	(43,123)
Shareholders' funds attributable to equity interests	14	<u>8,761</u>	<u>4,956</u>
Technical provisions			
Claims outstanding	15	388,516	391,112
Deposits received from reinsurers		17,464	17,103
Creditors			
Arising out of reinsurance operations		4,567	4,638
Other creditors including taxation and social security		4	22
		<u>4,571</u>	<u>4,660</u>
Accruals and deferred income		475	460
Total liabilities		<u>419,787</u>	<u>418,291</u>



J M MASSEY
Chairman

7 June 1999



K F WATKINS
Managing Director

STRONGHOLD INSURANCE COMPANY LIMITED
**Statement of Cash Flows
for the year ended 31 December 1998**

	Notes	1998 US\$'000	1997 US\$'000
Net cash (outflow)/inflow from operating activities	16	(6,388)	16,555
Interest paid		-	(3)
Financing			
Injection of share capital		-	3,422
	17	<u>(6,388)</u>	<u>19,974</u>
Cash flows were invested as follows:			
(Decrease)/Increase in cash holdings		(6,500)	16,586
Net portfolio investment			
Fixed interest securities		112	3,388
Net investment of cash flows		<u>(6,388)</u>	<u>19,974</u>
Movement in opening and closing cash and portfolio investments			
		1998 US\$'000	1997 US\$'000
Net cash (outflow)/inflow for the period		(6,500)	16,586
Cash inflow : portfolio investments		112	3,388
Movement arising from cash flows		<u>(6,388)</u>	<u>19,974</u>
Changes in market values and exchange rates		1,356	653
Total movement in cash and portfolio investments		<u>(5,032)</u>	<u>20,627</u>
Cash and portfolio investments net of financing at 1 January		129,356	108,729
Cash and portfolio investments net of financing at 31 December		<u>124,324</u>	<u>129,356</u>

Notes to the Accounts

1 Premiums

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

2 Segmental information

	1998	1997
<i>Technical account</i>	US\$'000	US\$'000
Gross premiums earned	196	252
Gross claims incurred	(27,097)	10,075
Gross operating expenses	8	(3)
Gross technical result	(26,893)	10,324
Reinsurance balance	22,796	(16,572)
Net technical result	(4,097)	(6,248)

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
1998			
Claims paid	24,364	15,481	8,883
Claims handling expenses paid	5,567	-	5,567
	<u>29,931</u>	<u>15,481</u>	<u>14,450</u>
Outstanding claims carried forward	388,516	264,397	124,119
Outstanding claims brought forward	391,350	256,559	134,791
	<u>(2,834)</u>	<u>7,838</u>	<u>(10,672)</u>
Claims incurred	<u>27,097</u>	<u>23,319</u>	<u>3,778</u>
1997			
Claims paid	20,898	11,598	9,300
Claims handling expenses paid	294	-	294
	<u>21,192</u>	<u>11,598</u>	<u>9,594</u>
Outstanding claims carried forward	391,112	256,536	134,576
Outstanding claims brought forward	422,379	284,529	137,850
	<u>(31,267)</u>	<u>(27,993)</u>	<u>(3,274)</u>
Claims incurred	<u>(10,075)</u>	<u>(16,395)</u>	<u>6,320</u>

STRONGHOLD INSURANCE COMPANY LIMITED

Notes to the Accounts**4 Claims handling expenses paid**

Claims handling expenses include:

	1998 US\$'000	1997 US\$'000
Auditors' remuneration - audit services	42	41

5 Net operating expenses

	1998 US\$'000	1997 US\$'000
Acquisition costs		
- gross	(8)	3
- reinsurance	(3)	3
- net	<u>(5)</u>	<u>-</u>

6 Directors' emoluments

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

	1998 US\$	1997 US\$
Fees	120,633	127,891
Other emoluments	277,637	152,985
	<u>398,270</u>	<u>280,876</u>

7 Investment income

	1998 US\$'000	1997 US\$'000
Income from other investments	7,733	7,439
Gains on the realisation of investments	21	165
	<u>7,754</u>	<u>7,604</u>

8 Investment expenses and charges

	1998 US\$'000	1997 US\$'000
Investment management expenses	174	136
Interest payable - Short-term loans and overdrafts	-	3
- Reinsurance balances	859	673
	<u>1,033</u>	<u>812</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:

	1998 US\$'000	1997 US\$'000
Realisation of investments at values stated in the balance sheet	627	620
Short-term timing differences	(2,381)	(5,999)
Accelerated capital allowances	(2)	-
	<u>(1,756)</u>	<u>(5,379)</u>

11 Investments

	Current value		Historical cost	
	1998 US\$'000	1997 US\$'000	1998 US\$'000	1997 US\$'000
Other financial investments				
Debt securities and other fixed income securities (listed)	108,993	107,550	105,424	105,234
Deposits with credit institutions	9,748	16,767	9,748	16,767
	<u>118,741</u>	<u>124,317</u>	<u>115,172</u>	<u>122,001</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

	1998 US\$'000	1997 US\$'000
Amounts due from group undertakings	6	-
Other debtors	29	953
	<u>35</u>	<u>953</u>

Notes to the Accounts

13 Share capital

	1998 US\$'000	1997 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 Shareholders' funds

	Share capital US\$'000	Profit & loss a/c US\$'000	Total US\$'000
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>
1997			
Balance at 1 January	48,079	(44,657)	3,422
Currency translation differences on foreign currency net investment		491	491
Retained loss for the financial year		1,043	1,043
Balance at 31 December	<u>48,079</u>	<u>(43,123)</u>	<u>4,956</u>

Notes to the Accounts

15 Claims outstanding

	Gross US\$'000	Reins. US\$'000	Net US\$'000
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>
1997			
Provision before discounting	531,417	406,245	125,172
Discounting adjustment	(159,059)	(149,709)	(9,350)
	<u>372,358</u>	<u>256,536</u>	<u>115,822</u>
Claims handling expenses	22,735		22,735
Discounting adjustment	(3,981)		(3,981)
	<u>18,754</u>	<u>-</u>	<u>18,754</u>
	<u>391,112</u>	<u>256,536</u>	<u>134,576</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 the Casualty classes are included after taking into account the future attributable investment earnings at an assumed compound discount rate of 4% (1997 - 4%) per annum. The assumed settlement pattern for gross claim payments results in an average term for the liabilities of 8.90 years (1997 - 9.10 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\$12.6m (1997 - adverse US\$7.9m) 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.

STRONGHOLD INSURANCE COMPANY LIMITED

Notes to the Accounts

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

	1998 US\$'000	1997 US\$'000
Profit on ordinary activities before tax	3,934	1,043
Realised investment gains	(21)	(165)
Unrealised investment gains	(1,310)	(499)
Decrease in provision for claims outstanding	(10,672)	(3,274)
Decrease in debtors	1,451	81,355
Decrease in creditors	(74)	(63,700)
(Increase)/decrease in deposits with ceding undertakings	(60)	132
Increase in deposits received from reinsurers	352	1,669
Interest paid	-	3
Realised exchange gains/(losses)	12	(9)
Net cash (outflow)/inflow from operating activities	<u>(6,388)</u>	<u>16,555</u>

17 Movement in cash and portfolio investments

	At 1 Jan 1998 US\$'000	Cash flow US\$'000	Changes to market value and currencies US\$'000	At 31 Dec 1998 US\$'000
Cash at hand and in bank	21,806	(6,500)	25	15,331
Fixed income securities	107,550	112	1,331	108,993
	<u>129,356</u>	<u>(6,388)</u>	<u>1,356</u>	<u>124,324</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 1998 Isis provided Stronghold with consultancy services for fees totalling US\$485,500, of which US\$154,643 was outstanding at 31 December 1998.

As at 31 December 1998 a balance of US\$5,866 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.