

Chesnara plc

Report and Accounts
For the Year Ended
31 December 2004

Financial Calendar

22 March 2005	Results announced for the year ended 31 December 2004
30 March 2005	Ex dividend date
31 March 2005	Published Report and Accounts issued to shareholders
1 April 2005	Dividend record date
26 April 2005	Annual General Meeting
29 April 2005	Dividend payment date
September 2005	Interim results announced for the six months ended 30 June 2005

Key Contacts

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Financial Highlights

Modified Statutory Solvency Basis (MSSB)	Year ended 31 December	
	2004	2003
	£m	£m
Operating profit/(loss) before tax	2.7	(15.5)
Profit on sale of discontinued operation	1.9	-
Profit/(loss) on ordinary activities before tax	<u>4.6</u>	<u>(15.5)</u>
Shareholders' funds	<u>74.0</u>	<u>78.7</u>
 Achieved Profit Basis		
Operating loss before tax and exceptional items	(5.9)	(44.7)
Profit on sale of a discontinued operation	1.9	-
Other investment variances and economic assumption changes	1.0	0.2
Loss on ordinary activities before tax	<u>(3.0)</u>	<u>(44.5)</u>
 Embedded Value		
Value in-force	84.6	98.5
Net asset value	58.5	54.2
Shareholders' funds	<u>143.1</u>	<u>152.7</u>
Life annual premium income (API)	<u>£123.3m</u>	<u>£146.0m</u>
Life single premium income (SPI)	<u>£78.9m</u>	<u>£27.7m</u>
Life annualised premium income (API + 1/10 SPI)	<u>£131.2m</u>	<u>£149.0m</u>
Basic earnings/(loss) per share (MSSB)	<u>6.34p</u>	<u>(12.73)p</u>
Diluted earnings/(loss) per share	<u>6.33p</u>	<u>(12.73)p</u>
Final dividend per share	<u>7.1p</u>	<u>-</u>
Full-year dividend per share	<u>11.85p</u>	<u>-</u>

Chairman's Statement

I am pleased to present the first annual statements of Chesnara plc, the company formed to hold the life assurance operations of Countrywide Assured Group plc ("CAG"). These operations were demerged from CAG on 24 May 2004 and Chesnara plc was then listed on the London Stock Exchange on 25 May 2004.

Background

Chesnara's primary subsidiary - Countrywide Assured plc ("CA") - administers a portfolio of some 208,000 life assurance and personal pension policies. It continues to service its existing clients and to sell and market Guaranteed Income and Growth Bonds. As a substantially closed book, it is expected that the embedded value of the Group will decline over time, as the number of policies in force reduces and surplus emerging in the life business is distributed by way of dividends. As the portfolio runs off, the regulatory capital supporting the life business may also be reduced and returned to shareholders.

Business Review

Throughout the year we have seen a strong and steady emergence of underlying surplus from the policy-based cashflows. In the first six months of the year, the results were adversely affected by mortgage endowment mis-selling claims experience. However, the considered action taken in response to this challenge resulted in a more positive second half result.

On the Modified Statutory Solvency Basis ("MSSB"), Chesnara has posted a pre-tax profit of £4.6m for the year ended 31 December 2004 (2003: pre-tax loss of £15.5m). This is after taking a total charge of £16.6m for mortgage endowment complaints redress, an acceleration of £1.7m in the amortisation of Deferred Acquisition Costs, being a charge to profits, and a credit of £1.9m in respect of the sale of Key Retirement Solutions Limited ("KRS").

In the first half, the level of provision required for mortgage endowment complaints redress required strengthening over and above that set out in the Supplementary Listing Particulars issued on 10 May 2004, this as a consequence of adverse experience in the early months of the year. Subsequently, on 25 May 2004, the Financial Services Authority and the Association of British Insurers issued new rules and guidance regarding endowment complaints. Chesnara sought clarification and guidance on the new regime and, as a result, the Board decided that further significant strengthening of the provision was required. I am pleased to be able to report that, in the second half of the year, it has not been necessary to further increase the provision for mortgage endowment complaints redress as this strengthening has proved adequate.

During the year we realised a one-off profit of £1.9m on the sale, to its management, of KRS, an independent financial adviser, which specialises in the sale of equity release products.

On the operational side, management maintained close control of expenditure and ensured the business ran within its budgeted operating costs.

Despite the adverse impact of the increase in the mortgage endowment redress provision on earnings in the first half of the year, the strong emergence of surplus throughout the year enables the Board to recommend a final dividend of 7.1p per share, making a total dividend for the year of 11.85p. The total payment for the year of £10.15m exceeds our stated target of £10m to ensure no dilution of return to shareholders following the exercise of share options awarded to Numis Securities Limited in connection with the listing of Chesnara plc.

On the alternative Achieved Profit basis of reporting the pre-tax loss for the year ended 31 December 2004 is £3.0m (2003: pre-tax loss of £44.5m). A major factor affecting this result, over and above the charge for mortgage endowment complaints redress, is a reduction of £6.2m in the value of policies in force consequent upon persistency experience and updated persistency assumptions for Protection policies.

During the year, our Protection policy base was not demonstrating the expected convergence of actual experience to assumed underlying rates. The Board reflected this in their assessment of the Value In-Force at the half-year and a further adjustment to the persistency assumptions, but of a lower order, was necessary at the year-end. However, these adjustments are offset by expense savings that will be generated as a result of the terms negotiated with our outsourcing partner. The successful negotiations resulted in the transfer of our 'back office' operations and 184 employees to Liberata Financial Services Limited on 1 February 2005. This arrangement largely mitigates the fixed and semi-fixed expense issues that are associated with a declining book of business.

The Embedded Value has, after the dividend appropriation of £10.15m, reduced from £152.7m at 31 December 2003 to £143.1m at 31 December 2004, the Net Asset Value has increased by £4.3m from £54.2m to £58.5m. Whereas the Net Asset Value represented 35% of Embedded Value at 31 December 2003 it has increased to 41% at the 2004 year-end.

CA's capital requirement (the ratio of available capital resources to capital resource requirements) remains at a premium to the target level of 150% set by the Board and in excess of the actual level of 157% at 1 January 2004. At 31 December 2004 it had, after allowing for the final dividend, increased to 190%. New insurance regulations mean that, from 2005 onwards, the FSA will use a new methodology, Individual Capital Assessment, ("ICA"), to assess the financial strength of life companies. CA completed its ICA during the second half of 2004 and submitted it to the FSA, from whom the company expects to receive guidance during 2005.

Outlook

Rising investment markets have helped the recovery of the Life Assurance sector and the increased consolidation activity which has taken place over the last year has highlighted the value inherent in well-managed life companies. We look forward, with confidence, to the year ahead and will continue to focus on delivering a stable and progressive dividend flow to shareholders.

The Board wishes to extend its thanks to all employees for their contribution and dedication in what has been a particularly challenging year.

Christopher Spborg
Chairman
21 March 2005

Directors Information

Christopher H Sporborg CBE

Aged 65, is the Non-executive Chairman of Chesnara plc. He is also Chairman of the Remuneration Committee and the Nomination Committee. He was formerly Deputy Chairman of Hambros PLC, Deputy Chairman of Hambros Bank Limited and Chairman of Hambro Insurance Services Group PLC. At Hambros, he was responsible for the acquisition of Birstow Eves PLC in 1985 and the formation of Hambro Countrywide plc, now Balanus Limited, a subsidiary of Countrywide plc, and, in 1988, the creation of the life company then called Hambro Guardian Assured Limited and now part of the Chesnara plc group of companies. He is Chairman of Countrywide plc, Atlas CopCo UK Holdings Limited and a director of Getty Images Inc., Lindsey Morden Group Inc. and the Horserace Totalisator Board.

Graham Kettleborough

Aged 48, is the Chief Executive of Chesnara plc. He joined Countrywide Assured plc in July 2000 with responsibility for marketing and business development and was appointed as Managing Director and to the Board in July 2002. Prior to joining Countrywide Assured plc, he was Head of Servicing and a Director of the Pension Trustee Company at Scottish Provident. He has lifetime experience of the Life Assurance industry, primarily in customer service, marketing, product and business development, gained with Scottish Provident, Prolific Life, City of Westminster Assurance and Target Life.

Ken Romney

Aged 53, is the Finance Director and Company Secretary of Chesnara plc. He joined Countrywide Assured plc in 1989 and became a member of the Board in 1997. He has worked in the life assurance industry for the last 21 years. He was Chief Accountant at Laurentian Life (formerly Imperial Trident) up to 1987 and was Financial Controller at Sentinel Life between 1987 and 1989. He worked for Price Waterhouse in their audit division until 1983 in both the UK and South Africa. He is a Fellow of the Institute of Chartered Accountants in England and Wales.

Frank Hughes

Aged 47, is the Business Services Director of Chesnara plc. He joined Countrywide Assured plc in November 1992 as an IT Project Manager and was appointed to the Board as IT Director in May 2002. He has 21 years' experience in the life assurance industry, primarily in IT, gained with Royal Life, Norwich Union and CMG.

Peter Mason

Aged 54, is the Senior Independent Non-executive Director of Chesnara plc and is Chairman of the Audit Committee. He also serves on the Remuneration and Nomination Committees. He joined the Board of Countrywide Assured Group plc as Non-executive Director in May 1992 and is currently a Non-executive Director of Countrywide plc and Countrywide Assured plc. He is the Investment Director and Actuary of Neville James Group, an investment management company. He was admitted as a Fellow of the Institute of Actuaries in 1979.

Mike Gordon

Aged 57, is an Independent Non-executive Director of Chesnara plc and serves on the Audit Committee, the Remuneration Committee and the Nomination Committee. He spent 12 years as Group Sales Director of Skandia Life Assurance Holdings. He is a Non-executive Director of Countrywide plc and of Bankhall Investment Management Limited, a Skandia-owned subsidiary.

Terry Marris

Aged 55, is a Non-executive Director of Chesnara plc and serves on the Audit Committee, the Remuneration Committee and the Nomination Committee. He joined Countrywide Assured Group plc in 1992 and was Managing Director of Countrywide Assured plc until July 2002 and is currently Chairman of Countrywide plc's Conveyancing Division. He was formerly a Director of Countrywide Assured Group plc. Previous roles included senior management positions at Lloyds Bank and General Accident.

Operating and Financial Review

The Business, its Objectives and Strategy

Background

Chesnara plc, which was listed on the London Stock Exchange on 25 May 2004, was formed to become the new holding company of the life assurance activities formerly owned by Countrywide Assured Group plc ("CAG"). Details relating to the demerger are set out in Note 1 to the financial statements.

The demerger followed a year-long review by CAG which had, inter alia, been considering ways in which to rationalise its corporate structure around its estate agency, professional property services and life businesses. In the context of the different business profiles and investment propositions offered by these businesses and, as the activities of the life business are fundamentally different in nature from the rest of the members of the CAG group, it was considered that a separate listing would be appropriate for the life business. This listing would enable shareholders to better assess the risk and rewards associated with the life business and its cash flows and would allow management to create additional value for shareholders through greater focus as an independent business.

Chesnara's principal subsidiary - Countrywide Assured plc ("CA") - was established in 1988 as the life assurance division of CAG, selling mortgage-related life assurance products through CAG's financial services division. In 1995, CA acquired Premium Life Assurance Company Limited, a life assurance company, and integrated it into its existing operations. In August 2002, CAG entered into a distribution agreement with Friends Provident Life and Pensions Limited ("Friends Provident") which resulted in new business being switched to Friends Provident in August 2003. As part of these arrangements, we continued to write significant volumes of protection business under a reinsurance agreement with Friends Provident from September 2002 to August 2003, at which point CAG's business was placed directly with Friends Provident. Following the consequent substantial closure to new business CA continues to administer an existing portfolio of some 208,000 policies which, by number are 38% endowment, 48% protection and whole life and 14% other. This split reflects our history of providing mortgage-related policies to the estate agency-based financial services sales force of CAG and our strategic decision to exit the endowment market in 2001 and sell only protection products in this marketplace.

Most of the endowment and other investment-related business is unit-linked and although there is a small amount of with profits business (less than 2.5% by policy count) this is wholly reinsured to Guardian Assurance plc ("Guardian"). Guardian is now a subsidiary of Aegon N.V., one of the world's largest insurance groups. The investment management of the related unit-linked funds is predominantly outsourced to Schroders plc ("Schroders") and Henderson Global Investors plc ("Hendersons") with the remainder being managed by Invesco Perpetual Asset Management Limited.

CA continues to sell and market Guaranteed Income and Growth Bonds through Independent Financial Advisers and directly to investors, resulting in £73.5m of single premium income in 2004 (2003: £23.1m). In addition it sells a small amount of life protection business to existing customers, as well as offering them a limited range of other financial products supplied by third parties. Chesnara is not currently seeking any new major distribution outlets but will consider writing new business, in partnership with third party distributors, where acceptable levels of risk and reward are available.

As part of the demerger Chesnara inherited an Independent Financial Adviser – Key Retirement Solutions Limited ("KRS") - one of the leaders in the marketing of property-related equity release products and associated financial services. Originally it was an appointed representative of CA and it adopted IFA status in May 2001. The future of KRS within Chesnara had been the subject of discussion with its management prior to demerger, as there appeared to be little strategic fit or synergy with the existing operations. Therefore, Chesnara agreed to sell KRS to its management, with limited warranties, for cash in the sum of £2.8m (£2.6m net of the settlement of outstanding debt and costs of disposal). The sale by CA was completed on 30 June 2004 and, as KRS was held at nil value in that company, the net proceeds of £2.6m represent a one-off addition to its pre-tax profit on both the Modified Statutory Solvency and Achieved Profit bases. At the date of disposal the net assets of KRS were £0.7m so that a pre-tax and net-of-tax profit of £1.9m is recognised in the consolidated profit and loss account. Continuing service and underlease arrangements with KRS allow CA to recover an element of its fixed overhead base.

Objectives of the Business

Chesnara's priority is to maximise shareholder returns through the efficient and compliant management of the existing business. It will seek to add value through the sale of Guaranteed Income and Growth Bonds and may also choose to sell other low risk products in order to enhance future cash flows. In addition, Chesnara believes that there are opportunities for consolidation in the small to medium sector of closed books and run-off situations in the life assurance industry. It will, therefore, continue to investigate these where there is potential to enhance shareholder value.

As Chesnara has successfully concluded the outsourcing of its back office to Liberata Financial Services Limited ("Liberata"), a significant element of its expense base is now directly linked to the reducing policy base. This removes the fixed and semi-fixed cost issues that would have had a potentially damaging effect on shareholder returns. Our focus on customer retention has been captured in the service and performance levels agreed with Liberata and therefore, barring external factors, a reasonably predictable level of income can be expected to flow from the policy base.

Chesnara management retains regulatory responsibility for the business and will build on these requirements to ensure that key risks are identified and managed to maximise the flow of emerging surplus. As CA is regulated, as described below, management will operate with a level of prudence but will seek to ensure that shareholders receive distributions consistent with the constraints on the business. In the absence of any value-enhancing consolidation opportunities or other developments that require capital then there is, in the medium term, the possibility of the release of surplus capital to shareholders.

The following is a summary of the key strengths and resources which underpin the Group's ability to meet its objectives:

Financial strength – Chesnara has a strong balance sheet and is well capitalised. CA maintains capital resource cover well in excess of regulatory capital requirements.

Knowledge and experience – Chesnara has a strong Board and management team with an average of over 15 years' experience in managing life assurance business. The senior management team also has experience in the integration and management of closed books within a highly regulated environment.

Regulatory record – Chesnara has a strong focus on compliance and risk management and it maintains a close relationship with CA's primary regulator, the FSA. All issues raised in its last formal FSA "Arrow" assessment in 2002 were cleared in good time and, although there are some points that have been raised as a result of themed reviews, we regard these as being of minor consequence. The next formal Arrow assessment is scheduled for the second quarter of 2005.

Future development costs – As a consequence of outsourcing the back office to Liberata, future development costs are likely to be lower than as a stand alone entity as, following migration, they will be incurred on a shared platform. This arrangement also offers the benefit of consultation with other platform users in the definition of development requirements. Such developments are expected to be funded out of emerging surplus and these, to a degree, are allowed for in calculating the value of the business. Some development costs may, under the terms of the policies, be passed to policyholders and this will limit the effect on shareholder returns.

Structure of the Business

Chesnara operates from a single site and is based in Preston in Lancashire. Throughout 2004 it maintained a workforce of some 200 engaged in the maintenance and servicing of CA customer contracts and associated support functions. Prior to the sale of KRS, the Group employed a further workforce of some 41 in Preston and a home-based sales force of around 35 in that operation. Following the demerger, CA re-established its plan to outsource the CA back office functions in order to reduce the significant cost inefficiencies that would arise with fixed and semi-fixed costs on a diminishing policy base. This resulted in the completion of an Insurance Administration Services Agreement with Liberata, which took effect from 1 February 2005. As a result of this, some 184 people transferred to Liberata on that date under a TUPE arrangement.

The agreement with Liberata, which runs for 10 years, provides Chesnara with a defined level of cost per policy, during the term, and mitigates a number of risks including:

- the impact of increasing per policy costs which would affect both policy competitiveness and returns to shareholders
- the failure to retain resource with key skills, knowledge and experience against a backdrop of reducing policy numbers and consequent headcount reductions

- the inevitable disparity between maintaining key resource levels and funding necessary systems developments to meet ongoing business requirements (e.g. of a legal and regulatory nature) and the reducing income with which to support them.

Chesnara now has just 14 employees and will concentrate on corporate governance, fulfilment of regulatory responsibilities, management of the outsourcing arrangement and the identification of development opportunities with a view to maximising the total return to shareholders.

Legal and Regulatory

CA is regulated by the Financial Services Authority ("FSA"). As a result it is subject to both the general operation of the Financial Services and Markets Act 2000 and the regulatory processes of the FSA. Whilst the weight of Conduct of Business rules has reduced slightly following the substantial closure to new business we are still subject to the full weight of prudential regulation. This falls largely on the areas of solvency, capital adequacy and policyholder protection and is the subject of progressive development to bring it in line with the likely development of EU Directives and will, therefore, continue to bring challenges to Chesnara.

Of particular note are the following:

- the change to the Appointed Actuary regime where, as from 31 December 2004, the Board is required, inter alia, to take responsibility for proper provision for long-term insurance liabilities and for the adequacy of capital resources in relation to capital requirements.
- the introduction of the Individual Capital Assessment ("ICA") regime, in accordance with Policy Statement 04/16 Integrated Prudential Sourcebook issued in July 2004, which the FSA will, in future, use to assess the financial strength of life companies. CA completed its ICA during the second half of 2004 and submitted it to the FSA. The Company expects to receive guidance on this from the FSA during 2005.

As part of the regulatory process CA continues to be subject to a regime of periodic and themed reviews by the FSA and of the development and maintenance of an ongoing risk mitigation programme.

In addition, we are undertaking preparatory work on the introduction of International Financial Reporting Standards where we are required to report on this basis in respect of our results for the six months ending 30 June 2005.

Key Dependencies

We continue to rely on a number of key relationships for the successful and efficient conduct of our business:

Reinsurance – CA has transferred part of its exposure to certain risks to other insurance companies through reinsurance arrangements. Under such arrangements, other insurers have assumed a portion of the losses and expenses associated with reported and unreported losses in exchange for a portion of the policy premiums.

Outsourcing – CA has transferred most of its operational functions to Liberata under an Insurance Administration Services Agreement referred to above. Having undertaken appropriate due diligence on Liberata, CA is confident of its ability to undertake the transferred operations to agreed standards. The contract duration is 10 years and, during this time, CA will maintain a close relationship with Liberata and monitor their financial and operational performance.

Systems – While under the direct management of CA the business maintained adequate operational systems and maintained, and regularly tested, a Business Continuity Plan. With the transfer of operations to Liberata the systems and the continuity plan have been transferred to them. As part of the agreement Chesnara will support Liberata's intention to migrate CA's mainframe systems to their modern and flexible Amarta system. The related agreement also provides for Liberata to manage the systems, including provision for business continuity, required by the Chesnara governance team.

Investment management – CA has outsourced the management of its own and policyholder investments, predominantly to Schroders and Hendersons. Ongoing monitoring of their performance is maintained and is formally reviewed each month by internal management and every quarter with the Investment Managers.

Actuarial function – The Appointed Actuary regime ended on 31 December 2004. In its place CA was required to appoint a Head of Actuarial Function and a With-Profits Actuary. In order to maintain continuity

and minimise the level of fixed resource within Chesnara, CA have appointed their former Appointed Actuary, Peter Wright of Tillinghast-Towers Perrin, to these new roles.

Chesnara is now a small professional knowledge-based team which is resourced to deliver known requirements. As such it will, from time to time, require external resource to facilitate new and/or unexpected developments. In the main, it aims to build on its existing relationships but will closely monitor the availability, quality and cost of suitable alternatives.

Operating Review

Basis of Accounting

The Company reports primarily on the Modified Statutory Solvency Basis ("MSSB") and will continue to provide supplementary information on the Achieved Profit ("AP") basis. While the AP method is value based and recognises profits as they are earned over the lives of the underlying insurance policies, MSSB recognises profit on the basis used for regulatory reporting, modified principally by the deferral of costs incurred in the acquisition of new business arising in the current year (Deferred Acquisition Costs) and by the amortisation of costs deferred from previous years. Adjustments are also made to certain long-term reserves which have been established for prudential reasons. As the Company was substantially closed to new business in August 2003 and reinsured its new business to Friends Provident with effect from September 2002, there has been a significant reduction in the amount of acquisition costs deferred into future periods. The significant related charges to profit continued through 2004 and the remaining deferred costs of £5.1m at 31 December 2004 are expected to be almost wholly amortised by the end of 2005, so that, during 2006, there will no longer be significant charges to profit arising from this modification.

MSSB Result

The following summarises information in the non-technical account, together with headline statistics:

	Year ended 31 December	
	2004	2003
	£000	£000
Operating profit/(loss) from continuing operations	2,536	(15,510)
Operating profit from a discontinued operation	109	151
	<u>2,645</u>	<u>(15,359)</u>
Profit on disposal of a discontinued operation	1,948	-
Profit/(loss) on ordinary activities before tax	<u>4,593</u>	<u>(15,359)</u>

New Business:

- Policies arranged	<u>2,339</u>	<u>36,941</u>
- Life annual premium income (API)	<u>£3.3m</u>	<u>£17.3m</u>
- Life single premium income (SPI)	<u>£73.5m</u>	<u>£21.2m</u>
- Life annualised premium income (API + 1/10 SPI)	<u>£10.7m</u>	<u>£19.4m</u>
Policies in force at period end	<u>208,000</u>	<u>255,000</u>
Headcount (average FTE)	<u>222</u>	<u>293</u>

The profit arising on the sale of a discontinued operation, KRS, is more fully described in "Background" above.

During March 2004, the residual pipeline of new business reinsured with Friends Provident had been either issued or cancelled and this signalled the final stage in CA's substantial closure to annual premium new business. Consequently, and as expected, the volume of such new issued business was minor compared with 2003. As the terms of the reinsurance agreement with Friends Provident were such that this reinsured business was incurred at a loss in the life business, the new business strain arising from this source in the

technical account has, accordingly, been stemmed. The results for 2003 also included a write-down, in the non-technical account, of £3.8m in respect of Group Relief Receivable as part of the arrangements for the demerger of the life business from CAG.

The results for both 2004 and 2003 were materially adversely affected by significant increases in provisions for redress and administration costs in connection with mortgage endowment mis-selling claims. While these provisions were increased by £14.0m in 2003, a further £16.6m was charged to the technical account in 2004. The following sets out the background to the decisions by the Board to increase the provisions during 2004.

CA is required to write to its endowment policyholders at least every two years and, where appropriate, to appraise them of any potential shortfall in the expected maturity value of their policy. During the first half of the year the company completed this endowment re-projection mailing programme, which began in May 2003, whereby virtually all endowment policyholders received the required mailing. During the early months of 2004 it became apparent that, with a background of heightened media coverage, an underlying increase in the level of complaints was occurring. This media coverage was concentrated when the House of Commons Treasury Select Committee issued a report, "Restoring confidence in long-term savings: Endowment mortgages," on 9 March 2004. This experience led the Board to decide that it needed to strengthen the provision for redress on future mortgage endowment mis-selling claims by £4.8m (£3.4m net of tax). Supplementary Listing Particulars relating to this were issued on 10 May 2004.

On the day that Chesnara plc was listed - 25 May 2004 - the FSA and the ABI issued new rules and guidance in respect of endowment re-projection mailings. These new rules also included an immediate change in the time-bar rules. There is now a requirement to give clear notification to policyholders of an individual "cut-off" date by which they must complain (if they are minded to do so). If a policyholder does not submit a complaint by the cut-off date, then the company has the right to refuse to consider it, thus "time-barring" the complaint. The cut-off date is now stated in new-style, focussed review letters, which highlight potential shortfalls, and also in any other "key communications" with policyholders. A more immediate effect was that a number of CA policyholders, who would have become time-barred in the second half of 2004, have had the time period in which they have the right to complain extended. After a period during which Chesnara sought clarification and guidance on the new regime, the Board decided that these new rules were likely to have a material effect on its results due to the temporary deferral of expected time-barring and the likelihood of an increased propensity to complain due to the detailing of the cut-off date. Therefore it further strengthened the provision for mortgage endowment mis-selling claims redress at 30 June 2004 by £11.75m (£8.2m net of tax) leading to total charges to pre-tax profit in respect of increases in the provision for the six month period of £16.6m (£11.6m net of tax). After strengthening, the provision amounted to £20.5m at 30 June 2004 and was £14.8m at 31 December 2004. The experience in the second half of the year was broadly in line with the assumptions underlying the strengthened position at 30 June 2004. The Board continues to monitor the adequacy of the provision, particularly in the light of the customer response to the ongoing mailing programme, which accords with the new regulatory rules and guidance described above.

Surplus arising on the run-off of the product portfolio emerged strongly during the year. The absence of further charges to profit in the second half of the year in respect of strengthening provisions for mortgage endowment mis-selling claims helped the recovery of the full year pre-tax operating profit on continuing operations to £2.5m, in contrast with a loss of £6.5m on the equivalent position at the half-year. The impact of worse persistency experience on the Protection portfolio led to a lower emergence of surplus on business which had not been reinsured with Friends Provident, but this was offset by the ability to release provisions against the segment of the portfolio reinsured with Friends Provident. The persistency experience on this segment was also worse than expected, but, as explained above, this business was written at a loss to the life business. Consequently, the overall effect of worse than expected persistency experience on the non-reinsured segment of the Protection portfolio was offset by the positive impact of worse than expected persistency experience on the reinsured segment of the portfolio.

The amortisation of Deferred Acquisition Costs charged to the technical account was £11.0m (2003: £17.8m), which included an accelerated write-off of £1.7m, following from worse than expected persistency experience in the amortisation profile at the beginning of the year. Operating expenses for managing the run-off of the life portfolio continued to fall in 2004 in line with reducing policy numbers and were within planned levels. As indicated in "Structure of the Business" above, a significant proportion of these costs will now be incurred through a 10-year Insurance Administration Services Agreement with Liberata.

Achieved Profit Result

Supplementary information on the Achieved Profit basis as produced in the financial statements on pages 72 to 79 is presented to provide alternative information to that presented under MSSB. The Achieved Profit basis recognises profits as they are earned over the life of an insurance policy and assists in identifying the value being generated by the life business. The result determined under this method reflects the movement in the life business embedded value. As the Group's life assurance operations are now substantially closed to new business the principal underlying components of the achieved result are the expected return from the business in force (being the yield at the risk discount rate on the related policy cashflows as they fall into surplus) together with (1) variances of actual experience from that assumed for each component of the policy in-force cashflows and (2) the impact of resetting assumptions for each component of the prospective cashflows.

The following is a summarised statement of our AP results:

	Year ended 31 December	
	2004	2003
	£'000	£'000
Operating achieved loss before tax and exceptional items	(5,882)	(44,745)
Investment return variances		
- Profit on sale of a discontinued operation	1,948	-
- Trading result of discontinued operation	109	151
- Other	1,665	(1,212)
Effect of economic assumption changes		
- Investment return	(2,146)	3,855
- Risk discount rate	1,320	(2,533)
Achieved loss before tax	<u>(2,986)</u>	<u>(44,484)</u>
Tax	3,455	(1,899)
Achieved profit /(loss) after tax	<u>469</u>	<u>(46,383)</u>

The achieved pre-tax loss for the year of £3.0m has arisen largely as a result of the strengthening, by £16.6m, of provisions for redress and costs in connection with mortgage endowment complaints more fully described in "MSSB Results" above. In addition, persistency experience over the year has differed between our two major product lines. On Endowment business there has been convergence of actual experience towards our underlying persistency assumptions and we do not see the need to make any significant alterations to these. However, on Protection business, although there has, during the year, been favourable persistency experience of £2.9m (£2.3m net of tax) against the underlying assumptions relevant to the year, the expected convergence to longer-term assumptions has failed to materialise at the expected rate. In recognition of this we are increasing the longer-term lapse assumptions and are also extending the temporary lapse assumption, at a lower rate, for a further six months. The effect of these adjustments, which relate to expected experience after 31 December 2004, is to reduce the value in-force, and hence the Achieved Profit result, by £9.1m (£7.2m net of tax).

Other items of significance impacting the AP result include:

- (1) an increase in the value in force of £1.1m following a reduction of the risk discount rate used to discount future cashflows arising from the in-force portfolio, from 9.25% to 9.00%, in line with an easing down of longer-term risk-free market rates over 2004. This represents the rate at which the discounted policy-based cashflows unwind within the AP result and, besides a lower in-force base, leads to a reduction in expected return compared to 2003. The Board believe that it is appropriate that this rate, which is higher than the average rate used by the Life Business peer group, is conservatively set;
- (2) an increase of £3.0m in the value-in-force following the revision of assumptions relating to the operating costs of maintaining the in-force portfolio. These have been adjusted to reflect changes in the nature and timing of projected costs in accordance with the specific terms of the Insurance Administration Services Agreement with Liberata.

The overall net-of-tax achieved result is a small profit of £0.5m, after recognising a net credit in respect of taxation of £3.5m. There has been a loss of symmetry between the pre-tax operating loss and the effective rate of tax credit which results from how changes in assumptions and business mix affect the pattern of expected future taxation

The net-of-tax achieved profit represents the movement on embedded value before dividend distributions.

Embedded Value

The embedded value, set out in Note 8 to Achieved Profit – Supplementary Information in the financial statements which follow, comprises:

	31 December 2004 £000	31 December 2003 £000
Share capital	4,228	4,228
Demerger reserve	36,272	36,272
Capital redemption reserve	50	-
Retained earnings	13,537	8,395
Undistributed surplus	<u>4,382</u>	<u>5,329</u>
Net asset value	58,469	54,224
Value in-force (after cost of capital)	84,594	98,521
Embedded Value	<u><u>143,063</u></u>	<u><u>152,745</u></u>

The embedded value at 31 December 2004, which represents the value of the Group's net assets attributable to shareholders, together with an estimate of the net present value of profits attributable to shareholders from the policies in-force, is stated after providing total dividends of £10.15m in respect of the year then ended. No dividend was payable in respect of the year ended 31 December 2003.

The table below sets out the components of the in-force value by major product lines at each period end:

	31 December 2004 000	31 December 2003 000
Number of policies		
- Endowments	78	94
- Protection	99	129
- Other	31	32
Total	<u><u>208</u></u>	<u><u>255</u></u>

	31 December 2004 £m	31 December 2003 £m
Value in-force		
- Endowments	49.3	52.4
- Protection	45.0	70.3
- Other	<u>3.3</u>	<u>4.7</u>
Total value in-force at product line level	97.6	127.4
Valuation adjustments	3.0	(7.4)
Cost of capital	<u>(4.4)</u>	<u>(4.4)</u>
Total in-force value (pre tax)	96.2	115.6
Tax	(11.6)	(17.1)
Total in-force value (post tax)	<u><u>84.6</u></u>	<u><u>98.5</u></u>

The value in-force represents the discounted value of the future expected surpluses arising from the policies in-force at each respective period end. The future surpluses are calculated by using realistic assumptions for each component of the cash flow.

Certain factors affecting the value in-force are not calculated at product line level and these are shown as "valuation adjustments". As at 31 December 2004, the calculation methodology was changed, as a consequence of the Insurance Administration Services Agreement with Liberata, such that a provision to cover company operating expenses, which had previously been treated as a valuation adjustment, was taken up within the product line level calculations. The amount reallocated amounted to approximately £10m, so that, on a like-for-like comparison with the position at 31 December 2003, the total value in-force at product line level at 31 December 2004 would have been some £10m higher and the valuation

adjustments would have been correspondingly lower by some £10m. The calculation at 31 December 2003 has not been restated to take account of this change in methodology.

Apart from the impact of this methodology change and from the natural realisation of the value in-force into surplus, the value in-force attributed to the Protection product line reflects the effect of actual persistency experience, together with the effect of an increase in underlying lapse assumptions.

Policyholder Funds Investment Return

The Managed Fund, which represents a highly significant proportion of policyholder funds under management, returned 4.1% over the year. The underlying performance was compromised due to the necessity, in the first half of the year, to move the unit pricing basis from that of an expanding fund to one of a contracting fund, as one would expect in a substantially closed book scenario. The effect of this was to depress the unit price of this fund by approximately 4.5%, which largely explains its underperformance when compared to the average of 8.7% achieved by the ABI Life Balanced Managed Funds sector. Apart from the impact on policyholders' policy values, this underperformance has also led to an increase in the overall cost of mortgage endowment complaints redress and has led to a reduction of value-in-force, as future charges, based on fund values, have been reduced. The fund, however, benefited from the improving markets and outperformed the sector average in the last two quarters of 2004.

Returns to Shareholders

Returns to shareholders are underpinned by the emergence of surplus in and transfer of surplus from the long-term insurance fund to shareholder funds and by the return on shareholder net assets representing shareholder net equity. The surplus arises from the realisation of value in-force, which effectively unwinds at the risk discount rate used to discount the underlying cash flows: at 31 December 2004 this rate was reset at 9.0% (31 December 2003: 9.25%). The return on shareholder net assets is determined by the Group's investment policy. Shareholder funds bear central Group governance costs which cannot be fairly attributed to the long-term insurance fund and which arise largely in connection with the status of Chesnara plc as a listed company.

No dividend was paid to the Group's holding company in respect of 2003, in order to ensure a robust opening position for 2004 in the light of the prospective demerger. The Listing Particulars issued in connection with the subsequent demerger and listing on the London Stock Exchange stated that Chesnara was targeting a dividend in respect of the year ended 31 December 2004, subject to no unforeseen circumstances, of approximately £10m. In the event, despite a number of negative influences which had arisen at the half-year position, the strong continuing emergence of surplus from the underlying policy base, together with a strong regulatory solvency position, has enabled the Board to meet the stated target, with aggregate dividends proposed of £10.15m for the year ended 31 December 2004.

The dividend target and distribution is set within the context of the Board's policy of maintaining capital resources available at 150% of capital resource requirements within the Group's life insurance operation.

The Board's continuing primary aim is to provide a stable and progressive dividend flow to shareholders within the context of the emergence of surplus in the life business. As the Chesnara plc shares have only been listed since the end of May 2004, it is too early to discern meaningful trends in share price performance. However, for the greater part of 2004, the shares traded at an implied yield of between 11.5% and 12.0%, bearing in mind the dividend intention stated in the Listing Particulars. There has been a well publicised consolidation of that part of the life industry which focuses on the run-off of closed policy portfolios. Sentiment relating to this activity appears to underpin a recent strengthening of the Company's share price, such that, in the early part of 2005, the implied yield reduced to approximately 10%.

Financial Review

Solvency and Regulatory Capital

Capital Requirements Cover

The regulatory capital of life insurance companies in the UK is calculated by reference to FSA prudential regulations and has received significant publicity over the past year, much of it relating to "with-profits" companies. The rules are designed to ensure that companies have sufficient assets to meet their liabilities in specified adverse circumstances. As such, there is a restriction on the full transfer of surplus from the

long-term business fund to shareholders fund and on the full distribution of reserves from the Life company, CA to Chesnara. In practice, CA has historically aimed to maintain a solvency margin of admissible assets over actuarially determined liabilities to policyholders at 150% of the required regulatory minimum margin. CA's with-profits funds (comprising £59.8m of long-term liabilities to policyholders at 31 December 2004 (2003: £59.8m)) are wholly reinsured, and, therefore, as a predominantly linked office, the area of regulation dealing with with-profits funds is not expected to be onerous.

In spite of significant increases in the mortgage endowment complaints redress provision in the first half of 2004, CA remains in a strong solvency position, as illustrated by the following regulatory capital resource and requirements information:

Countrywide Assured plc	31 December 2004 £m	1 January 2004 £m
Available capital resources (CR)	<u>57.9</u>	<u>49.3</u>
Long-term insurance capital requirement (LTICR)	27.9	31.0
Resilience capital requirement (RCR)	<u>2.6</u>	<u>0.5</u>
Total capital resources requirement (CRR)	<u>30.5</u>	<u>31.5</u>
Target capital requirement cover	<u>44.4</u>	<u>47.0</u>
Ratio of available CR to CRR	<u>190%</u>	<u>157%</u>
Excess of available assets over target capital requirements cover	<u>13.5</u>	<u>2.3</u>

Notes:

(1) Comparative information is shown as at 1 January 2004, rather than 31 December 2003, in order to reflect the impact of the EU Solvency I Directive, which was implemented with effect from that date. This required, inter alia, the minimum guarantee fund maintained by long-term insurers to be increased to 3m euros. In addition, a further margin of solvency was introduced on permanent health business and the Directive also required that the solvency margin for unit-linked business be increased by the equivalent of 25% of the prior financial year's net administrative expenses pertaining to such business. As all of these items have an impact on CA's capital resources and requirements position, it is more meaningful to provide a comparison with the related position on 1 January 2004.

(2) With effect from 31 December 2004, under new regulatory requirements, the required regulatory minimum margin was replaced by a capital resources requirement, which is the sum of the previous required minimum margin, now termed the long-term insurance capital requirement, and the previous resilience mathematical reserve, now termed the resilience capital requirement. The position as at 1 January 2004 has been restated and re-termed to reflect this.

(3) The targeted capital requirements cover, previously set by the Board at 150% of the required minimum margin is now construed as the sum of 150% of the long-term capital requirement and 100% of the resilience capital requirement.

The position at 31 December 2004 is stated after recognising aggregate dividends proposed during the year of £10.15m. The capital resources position benefited during the year from the settlement for cash by Countrywide Assured Group plc of outstanding inter-company debt of £2.2m, as part of the demerger arrangements. This amount, which was previously treated as inadmissible as a capital resources component, has been offset by an increase in the resilience capital requirement, of a similar order of magnitude, with respect to the mortgage endowment complaints redress provision.

The Board as a matter of policy, will continue to target capital resource cover for the LTICR at 150% and for the RCR at 100%. It can be seen, therefore, that with an overall ratio of available capital resources to total capital resource requirements of 190%, based on current assumptions, Chesnara is in a favourable position to pursue a progressive dividend policy.

Guardian Default Reserve

Following the implementation of the Insurers (Reorganisation and Winding Up) Regulations 2004, CA maintains a reserve of £9m at 31 December 2004 relating to possible default by Guardian, with whom it had aggregate reinsured liabilities at 31 December 2004 of £184.0m (2003: £180.0m). This reserve was reduced from £11m at 31 December 2003, following a review of the financial condition of Guardian.

This reserve is maintained to establish the regulatory capital requirements position and, therefore, serves to restrict the amount which may be transferred from CA's long-term business fund to shareholder funds. It is not, however, recognised for MSSB reporting purposes, as the likelihood of default under the reinsurance arrangements is considered by the Board of CA to be remote. For AP reporting purposes the reserve, which has written down the shareholders net asset value component of embedded value, is released back in establishing the value of the policies in-force component (see "Embedded Value" section above). There is, however, a cost to shareholders in maintaining the reserve and this was recognised at £1.2m within the cost of capital adjustments to the Embedded Value at 31 December 2004 (31 December 2003: £1.7m).

FRS 27

FRS 27 for Life Assurance was published in December 2004 with a view to full compliance for accounting periods commencing on or after 23 December 2005. The standard has relevance to the Group in respect of disclosure of capital available to its Life Assurance business and in respect of guarantees. The level of long-term liabilities in respect of with-profits business is less than £500m. Accordingly, no disclosure of realistic liabilities for that class of business is required under FRS 27, nor is any available capital resource allocated to it.

The Accounting Standards Board ("ASB") has, in view of the tight timescales to implementation, agreed to modifications to the disclosure requirements for 2004. These modified requirements are set out in a Memorandum of Undertaking ("MOU") to which the ASB, the Association of British Insurers and representatives of the life insurance industry are signatories. The various disclosures required by the MOU are set out below.

The life assurance business of the Group, which is transacted within the long-term funds of approved insurance companies, is mainly non-profit business, comprising both unit-linked and non-linked business. The with-profits liabilities of the life assurance business are significantly less than £500m and are wholly reinsured to Guardian.

The capital available in respect of the life assurance business is summarised in the table below:

	Countrywide Assured plc £m	Other Group Companies £m	Group Total £m
Shareholder net equity	73.4	0.5	73.9
Adjustments on regulatory basis			
- adjustments to assets	(6.7)	-	(6.7)
- other	(8.8)	-	(8.8)
Available capital resources	<u>57.9</u>	<u>0.5</u>	<u>58.4</u>

The "Capital Requirements Cover" section above indicates the capital resources requirement within CA, which restricts the transferability to Shareholders of available capital resources

Guarantees

Within the reinsured business, there are 49 policies with guaranteed cash options. This liability is fully reinsured to Guardian and, as a result, fulfilment of guaranteed terms is not expected to have a material impact on the Group.

Certain Premium Series funds, the "Timed Investment Funds", carry a guarantee that the price at maturity date or death will not be less than the highest price attained between commencement and contract cessation. The Company can control the cost of the guarantee by changing the investment policy adopted by each fund.

In respect of this guarantee:

- (i) A monthly charge of 1/48% of the fund value is made
- (ii) Investment conditions were such as to require the establishment of a reserve of £199,000.

The reserve for a given fund is derived as the discounted exposure at fund maturity date, the exposure being the difference between guaranteed Timed Fund value and projected fund maturity value, with the

latter projected value being derived assuming an immediate fall in value of equities within the fund of 20% and allowing for future investment returns, including presumed future equity investment return of 5.2% per annum.

Individual Capital Assessments

In July 2004 the FSA published Policy Statement 04/16 "Integrated Prudential Sourcebook for Insurers", which includes final policy statements on capital requirements for life companies. The provisions, which took effect from 31 December 2004, include a framework for life companies to undertake individual self assessments of their capital needs and provide for individual capital guidance by the FSA. This typically involves placing a realistic value on the assets and liabilities of the life company and making explicit allowance in the valuation for the actual business risks. CA completed its first individual capital assessment during the second half of 2004 and submitted it to the FSA, from whom it expects to receive guidance.

Financial Groups Directive

Regulation PRU 8.3 of the FSA Integrated Prudential Sourcebook has implemented the Financial Groups Directive in the United Kingdom, which amends the Insurance Groups Directive and as a result of which the minimum solvency capital requirement of an insurance group will be calculated at the level of an insurer's parent undertaking (in addition to the "solo" calculation made at the level of an insurance subsidiary itself). The objective of these calculations is to test whether there is double gearing of capital arising from investments in other group insurance companies and financial firms, and whether there is excessive group leveraging due to the financial structure of a parent holding company. The main practical consequence for the Life business is likely to be that Chesnara will be required to carefully manage its long-term capital structure, particularly in relation to any significant long-term borrowing, other than subordinated debt. The FSA has proposed that the new group capital adequacy requirements will be introduced as a firm test from financial years beginning in 2006, although the results of the parent undertaking test will be made public from the end of 2005.

International Financial Reporting Standards ("IFRS")

The Company, which will adopt IFRS with effect from the 2005 interim results, has completed substantial preliminary impact and product classification analysis. The process for restating the 1 January 2004 Balance Sheet is well advanced and work continues on the restatement of 2004 results and in assessing the nature and extent of required disclosures. The introduction of IFRS will impact the results and financial position on the Modified Statutory Solvency Basis and we will continue to provide Achieved Profit results as Supplementary information.

The major areas of impact on the Accounts which have been identified relate to:

- (i) the provisions of IFRS 4 which requires investment contracts sold by the Group, being primarily Guaranteed Growth and Guaranteed Income Bonds and certain pension contracts, to be accounted for under IAS 39, Financial Instruments and IAS 18, Revenue. IAS 18 requires initial charges, arising on new business, to be spread over the term of the contract, rather than being recognised as income at the time of sale. Further, the incremental costs of acquiring the business, principally commission payments, are to be capitalised and amortised over the term of the contract. These adjustments will give rise to a Deferred Acquisition Cost asset and a Deferred Income liability in the Balance Sheet. Premiums received on investment contracts are accounted for as deposits with only the product margins arising being reported in the income statement, rather than the amount of the single premium.

IAS 39, Financial Instruments, is currently being re-drafted by the IASB after the EU-endorsed version precluded the use of the fair value measurement of liabilities. The Company has, as a result of this, measured the relevant liabilities on an amortised cost basis in accordance with the EU-endorsed version of the Standard. There is some uncertainty as to whether the revised version which, it is understood, will allow the measurement of liabilities at fair value in specified circumstances, will be endorsed by the EU. However, in the event that fair value measurement does become permissible, then this is the basis that the Company will adopt for certain of its liabilities, provided that they fall within the specified circumstances.

- (ii) the provisions of IAS 37, Provisions, Contingent Liabilities and Contingent Assets, which requires that provisions be made for costs associated with vacant leased properties
- (iii) the provisions of IFRS 2, Share-based Payment
- (iv) the timing of the recognition of dividends, whereby dividends declared after the balance sheet date must not be accrued at that date
- (v) significant presentational changes in the Income Statement and Balance Sheet

(vi) significant additional disclosure requirements.

Our initial assessment, taking into account the net effect of all the required adjustments, is that there will be no significant difference to the shareholders net equity position at 1 January 2004, and that there is unlikely to be a significant impact on reported 2004 earnings. This is based on the measurement of certain liabilities at amortised cost. In the event that a EU-endorsed version of IAS 39 does permit fair value measurement of these liabilities, this will be adopted by the Company and, it is estimated, that there will be a net reduction of some £2m in shareholder net equity at 1 January 2004 in respect of all IFRS-based adjustments required to comply with IFRS.

The information presented in this IFRS section is unaudited and is also subject to amendment as there is some uncertainty in relation to the operation and adoption of key standards.

European Embedded Value Principles

In May 2004, a forum of Chief Financial Officers drawn from major European insurance companies launched the European Embedded Value Principles and agreed to adopt them in calculating embedded values included as supplementary financial reporting from the end of 2005.

The Company is considering the adoption of these principles in 2005 and will provide an update in the 2005 interim statements, including, if appropriate, an indication of the likely impact on the results and financial position of the Company under supplementary financial reporting.

Capital Structure, Treasury Policy and Liquidity

The Group's operations are financed through retained earnings and through the current emergence of surplus. It has no borrowings and does not make use of financial reinsurance or similar arrangements. There is no trading in any currencies other than sterling. Cash available for more than three months is normally transferred to fund managers for longer-term investment.

The Board continues to have a conservative approach to the investment of shareholder funds, which underpins our strong solvency position. This approach targets the investment of 90% of available funds in cash or fixed interest securities. The equity content which, on the back of investment gains had increased to nearly 15% of the funds at the 2003 year-end, was reduced to 13% by the 2004 year-end. In the first half of 2004, rising interest rates affected the capital values of fixed interest securities, but the position was eased somewhat by the year-end.

The profile and mix of investment asset holdings between fixed interest stocks and cash on deposit is such that realisations to support dividend distributions can be made in an orderly and efficient way.

Other factors which may place a demand on capital resources in the future include the costs of unavoidable large scale systems development such as those which may be involved with Euro conversion and the requirement to finance possible acquisitions of other closed life books and businesses in run-off. To the extent that ongoing administration of the life business is performed within the terms of the Insurance Administration Services Agreement with Liberata, the Group is sheltered, to a degree, from these development costs as they are likely to be on a shared basis, as common platforms are developed. In particular, the agreement caps the potential costs of Euro conversion. To the extent that the Group proposes to acquire closed life businesses in the future, it is intended that this could be done through a suitable combination of equity and debt financing and, to a lesser degree, from own resources. This would be done, however, within the constraints of not diluting returns to shareholders and of the operation of regulatory rules regarding the level of debt finance which may be borne by Insurance Groups (see Financial Groups Directive section above).

Cash Flows

The Group's longer-term cashflow cycle is currently characterised by the inflow to shareholders funds of transfers from the long-term insurance fund, which are supported by the emergence of surplus within those funds. These flows are used to support dividend distributions to shareholders.

Going Concern

The Group's cashflow position described above supports its ability to trade in the short-term. Projections of surplus arising in the insurance funds indicate that these are at levels which should be able to continue to

withstand normal business risks. In addition, CA prepares an annual "Financial Condition Report", as recommended by the Institute of Actuaries. This report is based on a review of the Company's ability to withstand a number of adverse scenarios. The last report published in 2004 indicated that the Company is able to withstand, over the medium to longer term, the impact of these adverse scenarios, including a number of them in combination.

Corporate Governance

The Directors are committed to achieving a high standard of corporate governance including compliance with the principles and practices of the Combined Code on Corporate Governance (the "Code"), as published by the Financial Reporting Council in July 2003 and as appended to the Listing Rules.

The following statement, together with the Directors Remuneration Report on pages 28 to 34, describes how the principles set out in the Code have been applied by the Company and details the Company's compliance with the Code's provisions for the period from 24 May 2004 (the date of the Demerger, which is more fully described in the Directors Report and which is co-incident with the Introduction of the whole of the Company's issued share capital to the Official List of the London Stock Exchange) to 31 December 2004.

Exceptions to Compliance with the Combined Code

The following is a summary of those provisions of the Combined Code with which the Company does not currently comply.

- The Chairman of the Board, Christopher Sporborg, was not independent on appointment. He is currently Chairman of the Remuneration Committee.
- Terry Marris, a non-executive director, is not independent. He is currently a member of the Audit and Remuneration Committees.

In addition, there are certain provisions of the Combined Code which the Company intends to fulfil, but which it has not yet fulfilled by virtue of the fact that it was listed on 25 May 2004 and has not yet completed a full annual cycle of activity. These, together with an explanation of the detailed areas of non-compliance set out above, are clearly indicated in the sections which follow and in the Directors Remuneration Report on pages 28 to 34.

The Board

The Board comprises a non-executive chairman, three other non-executive directors and three executive directors, each of whom served throughout the period under review.

Biographical details of all directors are given on page 8. The Board, which is planned to meet eight times during the year, has a schedule of matters reserved for its consideration and approval. These matters include:

- setting corporate strategy
- approving the annual budget and medium-term projections
- reviewing operational and financial performance
- approving major acquisitions, investments and capital expenditure
- reviewing the Group's system of financial and business controls and risk management
- approving appointments to the Board
- appointment of the Company Secretary
- approval of policies relating to directors' remuneration.

This schedule will be reviewed annually. In addition, under FSA Prudential Regulation, the Directors of Countrywide Assured plc, the Company's principal operating subsidiary, who are currently co-incident with the Directors of the Company, have responsibility for maintenance and projections of solvency and for assessment of capital requirements, based on risk assessments, and for estimating the level of long-term business provisions.

The responsibilities that the Board has delegated to the Executive Management of the business include: the implementation of the strategies and policies of the Group as determined by the Board; monitoring of operational and financial results against plans and budget; prioritising the allocation of capital, technical and human resources and developing and managing risk management systems.

The Roles of the Chairman and Chief Executive

The division of responsibilities between the Chairman of the Board, Christopher Sporborg, and the Chief Executive, Graham Kettleborough, is clearly defined and has been approved by the Board. The Chairman leads the Board in the determination of its strategy and in the achievement of its objectives and is responsible for organising the business of the Board, ensuring its effectiveness and setting its agenda. The

Chairman has no day-to-day involvement in the business of the Group. The Chief Executive has direct charge of the Group on a day-to-day basis and is accountable to the Board for the financial and operational performance of the Group.

Senior Independent Director

The Board has appointed Peter Mason as Senior Independent Director. He is always available to meet shareholders on request and to ensure that the Board is aware of shareholder concerns not resolved through the existing mechanisms for shareholder communication.

Directors and Directors' Independence

Terry Marris was, within the last five years, an employee of Countrywide Assured Services Limited, a subsidiary company of Countrywide Assured Life Holdings Limited ("CALH") and held the position of Managing Director of Countrywide Assured plc, the principal operating subsidiary company of CALH. He resigned these positions in July 2002. Except for this, no non-executive director:

- has been an employee of the Group within the last five years
- has, or has had, within the last three years, a material business relationship with the Group
- receives remuneration other than a director's fee
- has close family ties with any of the Group's advisers, directors or senior employees
- holds cross directorships or has significant links with other directors through involvement in other companies or bodies
- represents a significant shareholder
- has served on the Board for more than nine years

Christopher Sporborg, the non-executive Chairman has had, since 1988, considerable involvement with the formation and direction of the life operations acquired by the Company, including a position, which he still holds, as Chairman of Countrywide Assured plc. He is not, therefore, regarded as independent on appointment as Chairman of the Company.

Christopher Sporborg, Peter Mason and Mike Gordon are also directors of Countrywide plc, the ultimate holding company of Countrywide Assured Group plc ("CAG"), which was, until 22 May 2004, the ultimate holding company of CALH, whose subsidiary companies had material business relationships with fellow-subsubsidiary companies within the CAG group.

Peter Mason is a non-executive director of Countrywide Assured plc, a position which he has held since 1 October 1990 and he is also a non-executive director of Countrywide Assured Life Holdings Limited, a position which he has held since 18 November 1991. The Board has carefully considered this long-standing relationship with the subsidiary companies acquired by the Company and concludes that he can be considered to be independent as regards his non-executive directorship of the Company. His knowledge, experience and financial expertise are beneficial to Chesnara plc as a newly listed company.

Notwithstanding the relationships described above, the Board considers all of the non-executive directors to be independent in character and judgement. The Board is of the view that the considerable specific experience and knowledge of these Directors in the business of the Group companies outweighs any residual risk in connection with the relationships described, whilst the overall balance of the Board provides significant independence of mind and judgement. Further, as referred to in Note 36 to the financial statements, "Related Party Transactions", Chesnara plc entered into a Separation and Transitional Services Agreement with Countrywide plc in connection with the Demerger referred to above, the provisions of which substantially mitigate the risk presented by the current directorship of Countrywide plc of Messrs Sporborg, Mason and Gordon.

For the reasons outlined above, the Board considers Peter Mason and Mike Gordon to be independent in terms of the requirements of the Code. The Board further considers that these Independent Directors are of sufficient calibre and number that their views carry significant weight in the Company's decision-making.

The Directors are given access to independent professional advice, at the Company's expense, when the Directors deem it necessary in order for them to carry out their responsibilities.

Details of the Chairman's professional commitments are included in his biography on page 8. He does perform a number of pro-bono roles, but the Board is satisfied that these are not such as to interfere with his performance, which is based around a commitment of between fifty and sixty hours in any three-month period.

Professional Development

Through their previous connections with the CAG group and the CALH group, all of the Directors who served during the period under review had, on their appointments, considerable knowledge and experience of the business of the Chesnara plc group, including, significantly, the wider FSA regulatory environment as to Conduct of Business and Prudential Regulation. The Directors were advised, on their appointment, of their legal and other duties and obligations as Directors of a listed Company. This has been supplemented by the adoption and circulation to each Director of a written Code of Conduct, covering all aspects of the specific operation of Corporate Governance standards and of policies and procedures within the Group. Throughout their period in office, the Directors have, through the conduct of business at scheduled Board meetings, been continually updated on the Group's business and on the competitive and regulatory environment in which it operates.

There have been no further appointments since the Demerger on 24 May 2004 referred to above. However, a detailed induction programme will be undertaken for all such future appointments embracing the Code of Conduct referred to above and up to date information on the strategy and financial and operating performance of the Group.

Information

Regular reports and information are circulated to the Directors in a timely manner in preparation for Board and Committee meetings. The Board of Chesnara plc is entirely co-incident with that of Countrywide Assured plc ("CA"), its principal operating subsidiary company, which holds scheduled quarterly meetings, which are themselves serviced by detailed regular reports and information covering the following areas:

- Report on Earnings
- Actuarial Report
- Compliance Report (including coverage of risk management functions)
- Investments Report
- Capital Expenditure Report

This subsidiary Board also receives a Financial Condition Report and an Individual Capital Assessment Report relating to the life business on an annual basis.

The quarterly meetings of the CA Board are timed to be held immediately prior to Chesnara plc Board meetings.

On a monthly basis, the Directors receive summary high level information which enables them to maintain continuing oversight of the Group's and management's performance against objectives.

In addition to these structured processes, the papers are supplemented by information which the Directors require from time to time in connection with major events and developments, where critical views and judgements are required of Board members outside the normal reporting cycle.

Performance Evaluation

No annual evaluation of the performance of the Board, its principal Committees and individual Directors, as required by the Code, has yet been completed. Following the Demerger on 24 May 2004 referred to above, the Board do not consider that it is appropriate to undertake such an evaluation until a full first year's operating and reporting cycle has been completed. Accordingly, it is intended to conduct the first annual evaluation shortly after the end of May 2005 and consideration will be given to the use of an independent adviser to facilitate this.

It is the Chairman's intention to devise a series of questionnaires to provide a framework for the evaluation process and to provide a means of making year to year comparisons. There will be five questionnaires in total, one for each of the Board, individual Directors, the Remuneration Committee, the Nomination Committee and the Audit Committee. Consideration is being given to the assistance of an independent adviser to facilitate the evaluation process. It is intended that individual Director assessments will be discussed by the Chairman with the relevant Directors on a one to one basis.

Led by the Senior Independent Director, the non-executive Directors will meet annually to conduct a performance evaluation of the Chairman, using similar methods to those described above.

Company Secretary

The Company Secretary, Ken Romney, is responsible for advising the Board, through the Chairman, on all governance matters. The Directors have access to the advice and services of the Company Secretary.

Board Committees

The Board has established the committees set out below to assist in the execution of its duties. Each of these committees operates according to written terms of reference and the Chairman of each committee reports to the Board. The constitution and terms of reference of each committee will be reviewed annually to ensure that the committees are operating effectively and that any changes considered necessary are recommended to the Board for approval. The terms of reference of each committee are available on the Company's website at www.chesnara.co.uk or, upon request, from the Company Secretary.

The attendance record of each of the Directors at scheduled Board and Committee meetings for the period under review is:

	Scheduled Board	Nomination Committee	Remuneration Committee	Audit Committee
Non-executive Chairman - Christopher Sporborg	5(5)	1(1)	1(1)	n/a
Non-executive Director – Peter Mason	5(5)	1(1)	1(1)	2(2)
Non-executive Director – Terry Marris	5(5)	1(1)	1(1)	1(2)
Non-executive Director – Mike Gordon	3(5)	1(1)	1(1)	2(2)
Executive Director – Graham Kettleborough	5(5)	n/a	n/a	n/a
Executive Director – Ken Romney	5(5)	n/a	n/a	n/a
Executive Director – Frank Hughes	5(5)	n/a	n/a	n/a

The figures in brackets indicate the maximum number of meetings in the period during which the individual was a Board member. The information above relates to the period from 24 May 2004 to 31 January 2005.

Nominations Committee

During the period under review, the Nominations Committee comprised Christopher Sporborg (who also served as Chairman of the Committee), Peter Mason, Terry Marris and Mike Gordon. The Committee considers the mix of skills and experience that the Board requires and seeks the appointment of directors to meet its assessment of what is required to ensure that the Board is effective in discharging its responsibilities.

During the period, the Committee met once and considered the continuing mix of skills and experience of the Directors. There were no new appointments during the period.

The appointment of the Chairman of the Board as Chairman of the Nominations Committee does not comply with the provisions of the Code, as he is not regarded as independent. This position will be reviewed at the next meeting of the Nominations Committee.

The terms of reference of the Committee are available on the Company's website at www.chesnara.co.uk or, upon request, from the Company Secretary.

Remuneration Committee

Full details of the composition and work of the Remuneration Committee is provided in the Directors' Remuneration Report on pages 28 to 34.

Audit Committee

During the period under review, the Audit Committee comprised Peter Mason (who also acted as Chairman), Mike Gordon, the other independent non-executive Director, and Terry Marris. Insofar as Mr Marris is not considered to be independent, this arrangement does not comply with the provisions of the Code, which requires all members of the Audit Committee to be independent. However, the Board is satisfied as to Mr Marris' independence of character, mind and judgement and believes that his

considerable experience and knowledge of the life business outweighs any residual risk arising from his appointment. The Board is satisfied that Peter Mason has recent and relevant financial experience. On invitation, the Chief Executive, the Finance Director, the Head of Internal Audit and the external Auditor attend meetings to assist the Committee in fulfilment of its duties. The Committee met twice during the period under review. A full annual cycle has not yet been completed subsequent to the Demerger on 24 May 2004, referred to above, and there are, accordingly, certain Committee functions, required to be performed by the Code, which have not yet been performed, but which it is intended will be performed within the full annual cycle. These include:

- review of appointment of the external Auditor
- a meeting between committee members and the external Auditor without an executive director or a member of the Company's senior management being present
- a review of the nature and volume of non-audit services provided by the external auditors to ensure that a balance is maintained between objectivity and value added
- reviewing and approving the audit fee and non-audit fees
- reviewing the Group's whistle-blowing procedures

The role of the Audit Committee is to assist the Board in discharging its duties and responsibilities for financial reporting, corporate governance and internal control. The Committee is also responsible for making recommendations to the Board in relation to the appointment, re-appointment, and removal of the external Auditor. The Committee's duties include keeping under review the scope and results of the audit work, its cost effectiveness and the independence and objectivity of the Auditor.

During the period under review, the Audit Committee discharged its responsibilities by:

- reviewing the Group's draft financial interim results statement prior to Board approval and reviewing the external Auditor detailed report thereon
- reviewing the appropriateness of the Group's accounting policies
- reviewing and approving the audit fee estimates
- reviewing the external Auditor plan for the audit of the Group's financial statements which included an assessment of key risks and confirmation of Auditor independence
- reviewing and approving the Internal Audit plan for the internal audit of the Group's internal controls, embracing operating, financial and business controls
- reviewing an annual report on the Group's systems of internal control and its effectiveness and reporting to the Board on the results of the review
- reviewing regular reports from the Head of Internal Audit
- reviewing the report on high level risks by executive management

Auditors independence and objectivity

The external Auditor, KPMG Audit Plc and its associates, provide some non-audit services primarily in the provision of taxation and regulatory advice and in relation to Corporate transactions that may arise from time to time. In order to ensure that auditor objectivity and independence are safeguarded, the following procedures have been put in place:

Audit-related services

These relate to formalities such as shareholder and other circulars, regulatory reports and work on acquisitions and disposals. This is work that the external Auditor performs in its capacity as Auditor, where the nature of the work is closely allied to that on the audit of the annual financial statements. Accordingly, this work will be undertaken by the external Auditor unless unusual circumstances apply.

Tax advice

The external Auditor will be used when particularly relevant and all other significant tax advice will be put out to tender.

General advice

All sizeable projects are put out to tender. The external Auditor will be invited to tender, provided that both parties are satisfied that the nature of the contract will not present a threat to the independence of the Auditor.

These safeguards have been approved by the Audit Committee and it is intended that they will be reviewed when required in the light of internal developments or in the external circumstances of the Company. The Auditor reports to both the Directors and the Audit Committee with regard to compliance with professional and regulatory requirements and best practice.

Details of the fees paid to the Auditor, and its associates, for non-audit services during the year are provided in Note 11 to the financial statements on page 54.

Relations with Shareholders

The Chief Executive, Graham Kettleborough, accompanied by the Finance Director, Ken Romney, meet with institutional shareholders on a regular basis and are available for additional meetings when required. Should they consider it appropriate, institutional shareholders are able to meet with the Chairman, Christopher Sporborg, the Senior Independent Director, Peter Mason and any other Director. The Chairman is responsible for ensuring that appropriate channels of communication are established between the Chief Executive and the Finance Director on the one part and the shareholders on the other and is responsible for ensuring that the views of shareholders are known to the Board. This will include twice yearly feedback prepared by the Group's brokers on meetings the Executive Directors have held with institutional shareholders.

Annual and interim reports are distributed to other parties who may have an interest in the Group's performance and those reports, together with a wide range of information of interest to existing and potential shareholders, are made available on the Company's website, www.chesnara.co.uk.

Regular meetings are also held with industry analysts and commentators so that they are better informed in formulating opinions and making judgements on the Group's performance. Private investors are encouraged to attend the Annual General Meeting ("AGM") at which the opportunity is provided to ask questions on each proposed resolution. The Chairmen of the Board Committees will be available to answer such questions as appropriate. Details of the resolutions to be proposed at the AGM on 26 April 2005 can be found in the notice of the meeting on pages 83 to 85.

Internal Control

The Board is ultimately responsible for the Group's system of internal control and for reviewing its effectiveness. In establishing the system of internal control, the Directors have regard to the materiality of relevant risks, the likelihood of risks occurring and the costs of mitigating risks. It is, therefore, designed to manage rather than eliminate the risks which prevent the Company meeting its objectives and, accordingly, only provides reasonable and not absolute assurance against the risk of material mis-statement or loss.

In accordance with "Internal Control: Guidance for Directors on the Combined Code" (The "Turnbull Guidance") the Board confirms that there is an ongoing process for identifying, evaluating and managing the significant risks faced by the Group, that this process has been in place for the year under review and up to the date of approval of the Annual Report and Accounts and that the process is regularly reviewed by the Board and accords with the guidance.

In accordance with regulatory requirements of the Financial Services Authority, the Group's principal operating company, CA has established and maintains a risk and responsibility regime. This ensures that the identification, assessment and control of risk is firmly embedded within the organisation and that there are procedures for monitoring and update of the same. The CA Compliance function reviews and reports quarterly on this regime to the CA Board. This process is supplemented by the establishment and maintenance of high level risk registers for both CA and Chesnara, which ensures that, against various appropriate classes of risk, there is identification, assessment and control of the material risks subsisting within these organisations. The maintenance of the high level risk registers is the responsibility of the executive management, who report on them quarterly to the CA Board and to each Chesnara Audit Committee meeting.

As stated above, the memberships of the Boards of Chesnara and CA are co-incident and the scheduled quarterly Board Meetings of the latter are immediately followed by corresponding Board meetings of the former, who thereby monitor effective oversight of the maintenance and effectiveness of controls subsisting within CA. In addition the Chesnara Board confirms that it has undertaken a formal annual review of the effectiveness of the system of internal control for the year ended 31 December 2004 and that it has taken account of material developments between that date and the date of approval of the Annual Report and Accounts. The Board confirms that these reviews took account of reports by the Internal Audit Department on the operation of controls, internal financial controls, management assurance on the maintenance of controls and reports from the external Auditor on matters identified in the course of statutory audit work.

The Board also confirms the continuing appropriateness of the maintenance of an Internal Audit Function, which reports to the Senior Independent Director.

Going Concern

The Directors Statement on Going Concern is included in the Directors Report on Page 38.

Directors' Remuneration Report

The Remuneration Committee

The Remuneration Committee (the "Committee") determines the overall pay policy, the remuneration packages and service contracts of the Executive Directors of the Company including the operation of bonus schemes. It also monitors the remuneration of other senior employees of Chesnara plc.

The Committee comprises Christopher Sporborg as Chairman, Peter Mason, Mike Gordon and Terry Marris. The Company Secretary, Ken Romney, acts as Secretary to the Committee, and provides advice on legal and regulatory issues relating to remuneration policy. At the request of the Committee, Graham Kettleborough, the Chief Executive also attends and makes recommendations to the Committee regarding changes to the remuneration packages of individual directors (excluding himself) or policy generally. Such recommendations are discussed by the Committee and adopted or amended as it sees fit. No director is present at any part of the Committee meeting at which his own remuneration or contractual terms are being discussed. The membership and terms of reference of the Committee will be reviewed at least annually and the terms of reference are available on the Company's website at www.chesnara.co.uk or, upon request, from the Company Secretary. Details of the number of meetings held and the attendance can be found in the Corporate Governance Report on Page 25.

The appointments of the Chairman of the Board as Chairman of and of Terry Marris as a member of, the Committee do not comply with the provisions of the Combined Code, which requires all members of the Committee to be independent. However, the Board considers that Messrs Sporborg and Marris are independent in character, mind and judgement and that the considerable knowledge and experience they have of the Group companies outweighs any residual risk in this regard. The position will be reviewed at the next meeting of the Committee.

Remuneration Policy

The Committee aims to set remuneration at an appropriate level to attract, retain and motivate executives of the necessary calibre. An annual review of remuneration is undertaken to ensure reward levels are appropriate to the duties and responsibilities of the roles with a suitable balance between the fixed and variable elements of overall reward. In determining salary levels due regard is given to external market data relating to both financial services sector companies and listed companies of similar size. Market median reward levels are used when formulating and reviewing policy.

The annual bonus scheme is designed to incentivise the Directors to achieve the corporate targets set for the year. The long-term incentive plan, which is cash-based, is aligned with the delivery of value to shareholders and the incentivisation and retention of Directors. The annual bonus scheme is pensionable whilst the long-term plan is not. The Committee may award other discretionary bonuses to the Directors where they consider extraordinary value has been created or significant achievement has occurred.

The Company has, having received advice from Pinsent Masons, solicitors to the Company, who were appointed by the Board, established frameworks for approved and unapproved discretionary share option plans and a sharesave plan, none of which was utilised.

Basic Salary

The Committee reviews salaries annually taking into consideration individual and company performance, the responsibilities and accountabilities of each role, the experience of each individual and his or her marketability and future potential, and market data relating to both financial services sector companies and listed companies of similar size.

Executive directors' remuneration also includes non-pensionable benefits in kind by way of a company car, life assurance and private medical insurance.

Bonus Schemes

The 2004 Annual Bonus Scheme was designed to incentivise the Executive Directors. In order to align performance with shareholder interests, Directors are incentivised on achievement of the budgeted MSSB pre-tax profit. The scheme was designed to generate an award of 25% of basic salary on achievement of 90% of the target, and a maximum award of 50% of basic salary for achievement of, or exceeding, the target. A pro rata sliding scale applied between these points and no award was generated for achievement below 90% of the target. The Committee may consider allowances for exceptional factors that are deemed to be outside of management's control. No payment was made under this scheme in respect of 2004. Any

benefit payable under the Annual Bonus Scheme is pensionable, as this is considered to be a significant retention feature of such an arrangement.

The Remuneration Committee, in recognition of the extraordinary commitment which led to the successful listing of Chesnara plc, awarded discretionary bonuses to the Executive Directors in the sum of £30,000 to Graham Kettleborough and £20,000 each to Ken Romney and Frank Hughes. Such discretionary awards are treated as pensionable for the same reasons as the Annual Bonus Scheme.

The Management Performance Incentive Plan was designed as a long-term cash based incentive for Executive Directors. In order to align performance with shareholder interests, Directors are incentivised on achievement of budgeted FSA profits before tax (but excluding any movements on the Guardian Default Reserve (refer to the "Solvency and Regulatory Capital" section within the Operating and Financial Review) and net shareholder income. The scheme is based on four performance periods – H2 2004, 2005, 2006 and H1 2007. The bonus threshold starts at 75% of the performance target and is scaled up pro rata such that full entitlement is earned on achievement of the targeted figure. If the performance target is exceeded in any one period then the excess earned can be locked in to the bonus pool subject to an overall cap of 200% of salary. The bonus pool will be released by way of two equal payments subject to continued service. The first instalment is payable at the end of H2 2007 and the second at the end of H2 2008 thereby encouraging loyalty. Awards made under this plan are non-pensionable.

The table below sets out the details of the awards made to the Executive Directors under the above scheme in 2004.

Management Performance Incentive Plan – awards made in 2004

	Amount awarded in respect of the half-year ended 31 December 2004
Graham Kettleborough	£52,286
Ken Romney	£40,403
Frank Hughes	£40,403

Share Options

The Board has established frameworks for a sharesave plan and approved and unapproved discretionary share option plans which may, at the discretion of the Remuneration Committee, be utilised for granting options to Executive Directors and other employees. During 2004 no such options were granted.

Service Contracts

The Executive Directors, who were all appointed on 1 March 2004, have service contracts with a rolling twelve-month notice period. Compensation on termination of service contracts will be decided on a case-by-case basis having regard to the particular circumstances.

Pension Policy

Since the Demerger (refer to Note 1 to the financial statements) the Executive Directors have, with the permission of Countrywide Assured Group plc and the Trustees of their pension scheme, been members of the defined contribution section of this scheme to which both they, and the Company, contribute. This arrangement ceases with effect from 24 May 2005. The Executive Directors will have the option of joining the Chesnara Stakeholder Scheme or establishing a Personal Pension plan. In either event the Company contribution will be unchanged. Prior to demerger Ken Romney was a member of the defined benefit scheme and the Company capped its liability to the Trustees in respect of Mr Romney and others with a single payment. In consideration of his loss of membership of the defined benefit section of the scheme, the Board agreed to enhance the employer contribution rate in respect of his membership of the defined contribution section of the scheme. Accordingly the employer contribution rate was uplifted from 8% of pensionable emoluments to 18% of pensionable emoluments.

Non-Executive Directors

The remuneration of the non-executive directors is determined by the Board as a whole in accordance with the Articles of Association. Non-executive directors do not have service contracts with the Company, neither are they eligible for bonuses, pensions or participation in Company share option schemes. Initial terms of appointment were as follows:

	Date of expiry of initial term of appointment
Christopher Sporborg (Chairman)	30 September 2004
Peter Mason	31 October 2005
Mike Gordon	30 April 2005
Terry Marris	1 March 2007

On 7 October 2004, the Board agreed to reappoint Christopher Sporborg, for a period expiring on 31 December 2005. Mike Gordon and Terry Marris retire by rotation at the forthcoming AGM, at which a resolution proposing their re-election will be tabled. Normally the Board expects re-appointment to be for a term of three years.

Directorate

The following served as directors of Chesnara plc from its incorporation on 29 October 2003 to 1 March 2004:

Pinsents Director Limited
Pinsents Company Services Limited

These corporate directors, owned by Pinsent Masons, solicitors, Legal Advisers to Chesnara plc, held office merely for the purposes of incorporating the Company and resigned on 1 March 2004 in favour of the directors set out below:

Chairman

Christopher Sporborg (appointed 1 March 2004)

Non-Executive Directors

Peter Mason (appointed 1 March 2004)

Terry Marris (appointed 1 March 2004)

Mike Gordon (appointed 1 March 2004)

Executive Directors

Graham Kettleborough (appointed 1 March 2004)

Ken Romney (appointed 1 March 2004)

Frank Hughes (appointed 1 March 2004)

As explained in Note 1 to the financial statements, on 24 May 2004 Chesnara plc acquired the whole of the issued ordinary share capital of Countrywide Assured Life Holdings Limited ("CALH") from Countrywide plc, which had itself, on 22 May 2004, acquired the whole of the issued ordinary share capital of CALH from Countrywide Assured Group plc ("CAG"). These arrangements were effected to secure the demerger from CAG of CALH, which, together with its subsidiary companies, comprised the Life Business of CAG.

Accordingly, the relevant directors for whom disclosure is made in this report, besides those who served as directors of Chesnara plc from 1 March 2004 to 31 December 2004 as set out above, are those who served as directors of CALH from 1 January 2003 to 24 May 2004. With the exception of Mike Nower, who resigned as a director of CALH on 25 May 2004, all of the other directors of CALH over that relevant period, being Christopher Sporborg, Peter Mason and Terry Marris, were appointed as non-executive directors of Chesnara plc on 1 March 2004. On 1 March 2004, Mike Gordon was also appointed as a non-executive director of Chesnara plc and Graham Kettleborough, Ken Romney and Frank Hughes were appointed as executive directors of Chesnara plc. Christopher Sporborg, Mike Nower, Peter Mason, Terry Marris and Mike Gordon were also serving directors of CAG between 1 January 2003 and 22 May 2004, and Christopher Sporborg, Mike Nower, Peter Mason, and Mike Gordon were serving directors of Countrywide plc between 22 May 2004 and 24 May 2004, when CALH was under the ownership of those respective companies.

The relevant emoluments in the disclosures which follow are those made by CALH or its subsidiary companies between 1 January 2003 and 24 May 2004 and those made by Chesnara plc or its subsidiary companies between 1 March 2004 and 31 December 2004. The disclosure of all other relevant interests and arrangements are made by virtue of the ownership of CALH as set out above.

Directors' Remuneration

The auditors are required to report on this and the remaining sections of the Remuneration Report.

Total Directors' remuneration for the year ended 31 December 2004 is shown below with comparative figures for the year ended 31 December 2003.

	Year ended 31 December 2004	Year ended 31 December 2003
	£000	£000
Aggregate emoluments:		
Fees to non-executive directors	111	10
Emoluments to executive directors	519	294
Company contributions to pension schemes	38	30
Total	668	334

The following table, which has been prepared in accordance with regulatory requirements, sets out the constituents of Directors emoluments for the year-ended 31 December 2004:

	Salaries and Fees	Bonuses	Deferred Bonuses	Benefits	Total 2004	Total 2003
	£000	£000	£000	£000	£000	£000
Executive Directors						
Graham Kettleborough	106	30	52	16	204	119
Ken Romney	83	20	40	17	160	93
Frank Hughes	82	20	40	13	155	82
	<u>271</u>	<u>70</u>	<u>132</u>	<u>46</u>	<u>519</u>	<u>294</u>
Non-Executive Directors						
Christopher Sporborg	42	-	-	-	42	-
Peter Mason	27	-	-	-	27	10
Terry Marris	21	-	-	-	21	-
Mike Gordon	21	-	-	-	21	-
	<u>111</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>111</u>	<u>10</u>
Other						
Mike Nower	-	-	-	-	-	-
Total	382	70	132	46	630	304

The fees payable to Terry Marris were paid, with the addition of VAT, to his employing company, Countrywide Property Lawyers Limited, a subsidiary of Countrywide plc.

The following table sets out each Director's pension benefits for the years ended 31 December 2004 and 31 December 2003.

	Company contributions to money purchase scheme	
	2004	2003
	£000	£000
Graham Kettleborough	11	9
Ken Romney	19	-
Frank Hughes	8	6
	<u>38</u>	<u>15</u>

Ken Romney was a member of the Defined Benefit Section of the Countrywide Assured Group Pension Scheme. On 31 December 2003 he became a deferred member of that scheme and, from that date, he became a member of the Defined Contribution Section. The actuarial valuation at 31 December 2003 indicated a deficit of £96,000 in respect of Ken Romney. As explained in Note 35 to the financial statements, full provision was made, as at 31 December 2003, for this deficit. Company contributions in respect of Ken Romney's membership of the Defined Benefits Section of the Countrywide Assured Group Pension Scheme for the year ended 31 December 2003 were £15,180.

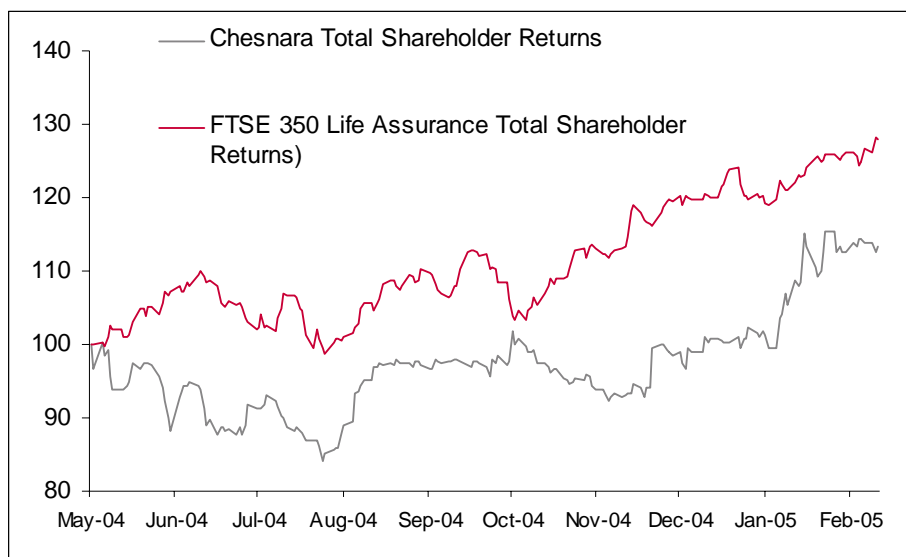
Under a deed of settlement dated 18 March 2004, as explained in Note 35 to the financial statements, no member of the Chesnara plc group has any further liability to the Scheme Trustees in respect of the accrued pension rights of deferred members, in respect of past service, such liabilities being borne by Countrywide Assured Group plc, a subsidiary of Countrywide plc. Accordingly, the Directors do not consider that it is necessary to disclose, in respect of Ken Romney, the transfer value of his accrued pension, the increase in his accrued pension, the transfer value of such increase on the total accrued pension for the respective periods and at the respective period ends reported on in this report.

Graham Kettleborough and Frank Hughes were members of the Defined Contribution Section of the Countrywide Assured Group Pension Scheme during the years ended 31 December 2003 and 31 December 2004.

Terry Marris and Mike Nower have personal pension plans to which the Countrywide plc group and the Countrywide Assured Group plc group contributed. None of these contributions was made by companies within the Countrywide Assured Life Holdings Limited group between 1 January 2003 and 24 May 2004 or by companies within the Chesnara plc group from 24 May 2004 to 31 December 2004.

No pension contributions were made by companies within the CALH group between 1 January 2003 and 24 May 2004 or by companies within the Chesnara plc group from 24 May 2004 to 31 December 2004 in respect of Christopher Sporborg, Peter Mason or Mike Gordon.

Performance Graph



The above graph shows a comparison of the Company's total shareholder return ("TSR") performance against the FTSE Life Assurance sector index. The Company considers this to be the most appropriate index, given that its activities are centred on life assurance. The graph has been prepared in accordance with section 234B of the Companies Act 1985, except that it shows the TSR for the Company and the relevant index from 25 May 2004 to 31 December 2004 only. The Company was first listed on the London Stock Exchange on 25 May 2004.

Directors' Interests in Shares

Directors interests in the ordinary shares of Chesnara plc were as set out below (number of shares):

	31 December 2004		31 December 2003	
	Beneficial	Non-Beneficial	Beneficial	Non-Beneficial
Christopher Sporborg	75,000	-	-	-
Peter Mason	2,500	-	-	-
Terry Marris	52,708	-	-	-
Mike Gordon	-	-	-	-
Graham Kettleborough	14,677	-	-	-
Ken Romney	14,072	-	-	-
Frank Hughes	4,694	-	-	-

There were no changes in the Directors' shareholdings in Chesnara plc between 31 December 2004 and 21 March 2005.

None of the Directors had either a beneficial or a non-beneficial holding in the ordinary share capital of CALH between 1 January 2003 and 24 May 2004, the date of the acquisition of CALH by Chesnara plc.

Directors' interests in the ordinary shares of Countrywide Assured Group plc ("CAG") at 31 December 2003 and 22 May 2004, the date of the disposal of CALH by CAG to Countrywide plc, were as set out below (numbers of shares):

	22 May 2004		31 December 2003	
	Beneficial	Non-Beneficial	Beneficial	Non-Beneficial
Christopher Sporborg	300,000	-	267,410	-
Peter Mason	10,000	-	10,000	-
Terry Marris	210,832	-	110,150	-
Mike Gordon	-	-	-	-
Graham Kettleborough	17,724	-	4,100	-
Ken Romney	56,288	-	38,122	-
Frank Hughes	18,776	-	19,353	-
Mike Nower	273,180	-	263,195	-

None of the Directors had either a beneficial or a non-beneficial holding in the ordinary share capital of Countrywide plc between 22 May 2004, the date of the acquisition of CALH by Countrywide plc from CAG, and 24 May 2004, the date of the acquisition of CALH from Countrywide plc by Chesnara plc.

Directors' Share Options

Details of the entitlements of the Directors to share options in Countrywide Assured Group plc between 31 December 2003 and 22 May 2004, the date of the disposal of Countrywide Assured Life Holdings Limited to Countrywide plc are as follows:

Director	At 31 December 2003		Waived/ Lapsed	At 22 May 2004	Exercise Price £	Market price at exercise £		From	To	Scheme
	Granted	Exercised				£	£			
Terry Marris	133,333	(133,333)		-	1.40	1.86	April 2001	April 2005	Executive (1996)	
	250,000	(250,000)		-	1.31	1.86	Mar 2002	Mar 2006	Executive (1996)	
	2,500	(2,500)		-	0.00	1.96	May 2004	Mar 2006	Deferred Incentive(1996)	
	-	71,425	(71,425)	-	1.40	1.96	May 2004	Mar 2006	Deferred Incentive(1996)	
	44,740	(44,740)		-	1.40	1.815	April 2000	April 2005	Executive Share Bonus	
	5,171	(3,467)	(1,704)	-	0.744	1.96	Nov 2005	May 2006	SAYE (1996)	
	80,000	(80,000)		-	1.065	1.90	April 2004	April 2011	Executive (1996)	
	100,000	(100,000)		-	1.51	1.96	April 2007	April 2009	Deferred Incentive(1996)	
	100,000	(100,000)		-	1.51	1.96	April 2005	April 2012	Executive (1996)	
	6,172	(4,361)	(1,811)	-	1.224	1.96	Nov 2007	May 2008	SAYE (1996)	
	721,916	71,425	(789,826)	(3,515)	-					

Director	At 31 December 2003			Waived/ Lapsed	At 22 May 2004		Exercise Price £	Market price at exercise £		Scheme
	Granted	Exercised						From	To	
Mike Nower	5,230	(5,230)			-	0.752	1.588	Nov 2001	May 2004	SAYE (1996)
	133,333				133,333	1.40		April 2001	April 2005	Executive (1996)
	245,000				245,000	1.31		May 2002	May 2006	Executive (1996)
	5,050				5,050	0.00		May 2004	May 2006	Deferred Incentive(1996)
	32,680				32,680	1.535		Mar 2002	Mar 2007	Executive Share Bonus
	6,622	(4,440)	(2,182)		-	0.744	1.76	Nov 2004	April 2005	SAYE (1996)
	80,000				80,000	1.065		April 2004	April 2011	Executive (1996)
	175,000				175,000	1.51		April 2007	April 2009	Deferred Incentive(1996)
	175,000				175,000	1.51		April 2005	April 2012	Executive (1996)
	5,099				5099	1.224		Nov 2007	May 2008	SAYE (1996)
863,014	-	(9,670)	(2,182)	851,162						
Graham Kettleborough	40,000	(40,000)			-	1.065	1.96	April 2004	April 2011	Executive (1996)
	10,735	(3,150)	(7,585)		-	1.224	1.96	Nov 2007	May 2008	SAYE (1996)
	50,735	-	(43,150)	(7,585)	-					
Ken Romney	4,627	(3,102)	(1,525)		-	0.744	1.96	Nov 2004	April 2005	SAYE (1996)
	40,000	(40,000)			-	1.065	1.96	April 2004	April 2011	Executive(1996)
	6,441	(1,890)	(4,551)		-	1.224	1.96	Nov 2007	May 2008	SAYE (1996)
	51,068	-	(44,992)	(6,076)	-					
Frank Hughes	20,000	(20,000)			-	1.125	1.96	Sept 2000	Sept 2007	Executive (1995)
	40,000	(40,000)			-	1.065	1.96	April 2004	April 2011	Executive (1996)
	4,445	(2,980)	(1,465)		-	0.744	1.96	Nov 2004	April 2005	SAYE (1996)
	7,246	(2,126)	(5,120)		-	1.224	1.96	Nov 2007	May 2008	SAYE (1996)
	71,691	-	(65,106)	(6,585)	-					

Subsequent to 22 May 2004, Mike Nower's options, as set out above, were converted into equivalent options in Countrywide plc.

No options have been granted in respect of any Chesnara plc Share Option Scheme between 24 May 2004 and 21 March 2005.

The aggregate of gains made on the exercise of options in the shares of Countrywide Assured Group plc for the year ended 31 December 2004 was £672,169 (2003: £31,725).

Approved by the Board of Directors on 21 March 2005 and signed on its behalf by:

Christopher Sporborg

Graham Kettleborough

Directors' Report

The Directors present their report and the audited consolidated accounts of Chesnara plc for the year ended 31 December 2004.

The Company was incorporated and registered as PINCO 2042 plc on 29 October 2003 and changed its name to Chesnara plc on 22 December 2003.

Results and dividends

The Group consolidated profit and loss account for the year ended 31 December 2004, prepared on a Modified Statutory Solvency Basis and set out on page 42, shows:

	2004	2003
	£000	£000
Profit/(loss) after tax	<u>5,364</u>	<u>(10,769)</u>

A first interim dividend of £10,000 was proposed and paid by Countrywide Assured Life Holdings Limited ("CALH") to Countrywide plc prior to the Demerger referred to in the 'Activities' section below. This was done to establish the status of CALH as a subsidiary company of Countrywide plc in connection with the Demerger arrangements.

A second interim dividend of 4.75p per ordinary share was paid by Chesnara plc on 24 September 2004. The Board recommends payment of a final dividend of 7.1p per ordinary share on 29 April 2005 to shareholders on the register at the close of business on 1 April 2005.

No dividends were paid or proposed by CALH during the year ended 31 December 2003.

Activities

On 24 May 2004, Chesnara plc acquired the whole of the issued ordinary share capital of Countrywide Assured Life Holdings Limited ("CALH") from Countrywide plc, which had, itself, acquired the whole of the ordinary issued share capital of CALH on 22 May 2004 from Countrywide Assured Group plc ("CAG"). These arrangements were effected to secure the demerger from CAG of CALH, which, together with its subsidiary companies, comprised the Life Business of CAG.

Information relating to the scheme of demerger and the subsequent introduction of Chesnara plc to the Official List of the London Stock Exchange, including, inter alia, detailed financial information on CALH and pro forma financial information on the Chesnara plc group, was included in a document entitled "Chesnara plc – Introduction to the Official List" (the "Listing Particulars"), dated 18 March 2004, and in a document entitled "Supplementary listing particulars relating to the introduction to the Official List" (the "Supplementary Listing Particulars"), dated 10 May 2004. Copies of both the Listing Particulars and the Supplementary Listing Particulars may be obtained from the Chesnara plc Registered Office at Harbour House, Portway, Preston, PR2 2PR, UK or at www.chesnara.co.uk.

Further information may also be found in Note 1 to the financial statements on page 47.

CALH, together with its subsidiary companies, comprises the whole of the operations and trading activities of Chesnara plc, except for certain costs which are incurred centrally by Chesnara plc in connection with its Corporate Governance activities, and which are fully recharged by way of a Group management charge to its principal operating subsidiary companies.

The principal activities and a review of the Group's business and operations during the year, significant events and future prospects are contained in the Chairman's Statement and in the Operating and Financial Review on pages 9 to 21.

Directors

Pinsents Director Limited and Pinsents Company Services Limited served as corporate Directors of the Company from its incorporation on 29 October 2003 to 1 March 2004.

The present directors are listed on page 30. All of the present directors served from 1 March 2004 to 31 December 2004 and there have been no changes between that date and 21 March 2005.

With the exception of Mike Nower, who resigned as a director of CALH on 25 May 2004, all of the other directors of CALH between 1 January 2003 and 24 May 2004, being Christopher Sporborg, Peter Mason and Terry Marris were appointed, on 1 March 2004, as non-executive directors of the Company. On 1 March 2004, Mike Gordon was also appointed as a non-executive director of the Company and Graham Kettleborough, Ken Romney and Frank Hughes were appointed as executive directors of the Company.

The non-executive directors who served as Chairmen and members of the Nominations and Audit Committees of the Board are set out in the Corporate Governance Report on pages 22 to 27. Information in respect of the Chairman and members of the Remuneration Committee and in respect of directors' service contracts is included in the Directors Remuneration Report on pages 28 to 34, which also includes details of directors' interests in shares and share options.

On 7 October 2004, the Chairman, Christopher Sporborg, was re-appointed for a period expiring on 31 December 2005.

Pursuant to the Articles of Association, Terry Marris and Mike Gordon will retire by rotation at the Annual General Meeting and, being eligible, offer themselves for re-election. No director seeking re-election has a service contract with the Company.

No director had any material interest in any significant contract in the Company or in any of the subsidiary companies during the year.

Substantial Shareholdings

The following substantial interests in the Company's ordinary share capital at 31 December 2004 have been notified to the Company:

Name of substantial shareholder	Total number of ordinary shares held	Percentage of the issued share capital as at	Revised percentage following exercise of option
		31 December 2004	10 February 2005
Allianz AG (including 13,761,338 (16.27%) held by Veer Palthe Voute NV, a subsidiary company)	13,797,203	16.3%	16.0%
Scottish Widows Investment Partnership Limited	5,026,044	5.9%	5.8%
UBS Global Asset Management Holding (No. 2) Limited	4,535,214	5.4%	5.3%
Witmer Asset Management LLC	3,896,173	4.6%	4.5%
JP Morgan Securities Limited	3,501,031	4.1%	4.2%
Standard Life Group	3,287,883	3.9%	3.8%
Fidelity International Limited	3,135,898	3.7%	-
Morgan Stanley Securities Limited	2,842,536	3.4%	3.3%
Legal & General Group plc	2,749,967	3.3%	3.2%

The issued share capital of Chesnara plc was increased to 86,255,452 following the allotment of shares in connection with the option exercised by Numis Securities Limited on 10 February 2005 (refer to Note 24 to the financial statements on page 61). The percentage holdings have been recalculated to reflect this.

Subsequent to 31 December 2004 the following shareholders have notified changes in their shareholdings to the Company:

Name of substantial shareholder	Date of notification	Total number of ordinary shares held	Percentage of the issued share capital
Allianz AG (including 16,469,638 (19.09%) held by Veer Palthe Voute NV, a subsidiary company)	1 March 2005	16,495,253	19.1%

On 10 February 2005, Fidelity International Limited notified Chesnara plc that they no longer had a notifiable interest in the share capital of the Company.

The other substantial shareholder interests remained unchanged at 15 March 2005 and no other person holds 3% or more of the issued share capital of the Company.

There were no significant contracts with substantial shareholders during the year.

Charitable Donations and Political Contributions

Charitable donations made by Group companies during the year ended 31 December 2004 were £nil (2003:£nil). No political contributions were made during the year ended 31 December 2004 (2003: £nil).

Employees

The average number of employees during the year is set out in Note 6 to the financial statements.

Chesnara plc has a policy of keeping employees informed of its affairs through regular internal communication and meetings with the Directors. Employees are encouraged to involve themselves in the performance of the Company and to suggest initiatives that will lead to improvement or the mitigation of risk. Chesnara plc strives to provide its employees with clear and fair terms of employment and clean, healthy and safe working conditions. The Company has a fair remuneration policy and offers equal opportunities to all present and potential employees. It believes that its best interests are served by encouraging its employees to develop skills and progress in their careers and recognises the value and significant contribution its employees are able to make to the success of the business.

Equal Opportunities

Chesnara is committed to a policy of equal opportunity in employment and believes that this is essential to ensuring its success. Chesnara plc will continue to select, recruit, train and promote the best candidates based on suitability for the role and treat all employees and applicants fairly regardless of race, gender, marital status, ethnic origin, religious beliefs or disability. Chesnara plc will ensure that no employee suffers harassment or intimidation.

Disabled Employees

Chesnara plc will provide employment for disabled persons wherever the requirements of the Group allow and if applications for employment are received from suitable applicants. If existing employees become disabled, every reasonable effort will be made to achieve continuity of employment.

Health, Safety and Welfare at Work

Chesnara plc places great importance on the health, safety and welfare of its employees. Relevant policies, standards and procedures are reviewed on a regular basis to ensure that any hazards or material risks are removed or reduced to minimise or, where possible, exclude the possibility of accident or injury to employees or visitors.

The policies, standards and procedures are communicated to employees through contracts of employment, the staff handbook and employee briefings and all employees have a duty to exercise responsibility and do everything possible to prevent injury to themselves and others,

Social, Environmental and Ethical Issues

Chesnara plc takes seriously its responsibilities for social, ethical and environmental issues and recognises the importance of developing and maintaining high standards.

We aim to be sensitive to the cultural, social and economic needs of our local community and endeavour to protect and preserve the environment where we operate.

We seek to be honest and fair in our relationships with our customers and provide the standards of products and services that have been agreed.

Being an office-based financial services company, Chesnara plc believes that its activities do not materially contribute to pollution or cause material damage to the environment. However, the Company takes all practicable steps to minimise its effects on the environment and encourages its employees to conserve energy, minimise waste and recycle work materials.

Creditors Payment Policy

It is Chesnara plc's policy to pay creditors in accordance with the CBI Better Practice Payment Code (available at www.payontime.co.uk) on supplier payments. The number of creditor days outstanding at 31 December 2004, based on the consolidated Accounts was 4 for the Group (2003: 6) and 6 for the Company (2003: n/a).

Going Concern Statement

After making appropriate enquiries, the Directors confirm that they are satisfied that the Company and the Group have adequate resources to continue in business for the foreseeable future. Accordingly, they continue to adopt the going concern basis in the preparation of the Accounts.

Auditors

The auditors, KPMG Audit Plc were appointed as first auditors of the Company and, in accordance with section 384 of the Companies Act 1985, a resolution for the re-appointment of KPMG Audit Plc as auditors of the Company is to be proposed at the forthcoming Annual General Meeting.

Approved by the Board on 21 March 2005 and signed on its behalf by:

Ken Romney
Company Secretary

Directors' Responsibilities Statement

Company law requires the Directors to prepare Accounts for each financial year that give a true and fair view of the state of affairs of the Company and of the Group and of the profit or loss for that period. In preparing those Accounts, the Directors are also 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 being disclosed and explained in the Accounts
- prepare the Accounts on a going concern basis unless it is inappropriate to presume that the Group 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 which enable them to ensure that the Accounts comply with the Companies Act 1985. They have general responsibility for taking such steps as are reasonably open to them to safeguard the assets of the Company and the Group and, hence, for taking reasonable steps for the prevention and detection of fraud and other irregularities.

Report of the Independent Auditors to the members of Chesnara plc (formerly PINCO 2042)

We have audited the financial statements on pages 41 to 71. We have also audited the information in the Directors' Remuneration Report that is described as having been audited.

This report is made solely to the company's members, as a body, in accordance with section 235 of the Companies Act 1985. Our audit work has been undertaken so that we might state to the company's members those matters we are required to state to them in an auditor's report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the company and the company's members as a body, for our audit work, for this report, or for the opinions we have formed.

Respective responsibilities of directors and auditors

The directors are responsible for preparing their Annual Report and the Directors' Remuneration Report. As described on page 39, this includes responsibility for preparing the financial statements in accordance with applicable United Kingdom law and accounting standards. Our responsibilities, as independent auditors, are established in the United Kingdom by statute, the Auditing Practices Board, the Listing Rules of the Financial Services Authority, and by our profession's ethical guidance.

We report to you our opinion as to whether the financial statements give a true and fair view and whether the financial statements and the part of the Directors' Remuneration Report to be audited have been 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 or the Listing Rules regarding directors' remuneration and transactions with the group is not disclosed.

We review whether the corporate governance statement on pages 22 to 27 reflects the company's compliance with the nine provisions of the 2003 FRC Code specified for our review by the Listing Rules, and we report if it does not. We are not required to consider whether the Board's statements on internal control cover all risks and controls, or form an opinion on the effectiveness of the group's corporate governance procedures or its risk and control procedures.

We read the other information contained in the Annual Report, including the corporate governance statement and the unaudited part of the Directors' Remuneration Report, and consider whether it is consistent with the audited financial statements. We consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the financial statements.

Basis of audit 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 financial statements and the part of the Directors' Remuneration Report to be audited. 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 group'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 and the part of the Directors' Remuneration Report to be audited 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 financial statements and the part of the Directors' Remuneration Report to be audited.

Opinion

In our opinion:

- the financial statements give a true and fair view of the state of affairs of the company and the group as at 31 December 2004 and of the profit of the group for the year then ended; and
- the financial statements and the part of the Directors' Remuneration Report to be audited have been properly prepared in accordance with the Companies Act 1985.

KPMG Audit Plc,
Chartered Accountants and Registered Auditor
St James' Square, Manchester,
M2 6DS

21 March 2005

Consolidated profit and loss account Long term business technical account

		Year ended 31 December (restated)	
		2004	2003
		£000	£000
Earned premiums, net of reinsurance	Note		
	3		
Gross premiums written		202,230	173,724
Outward reinsurance premiums		(31,193)	(31,399)
		<u>171,037</u>	<u>142,325</u>
Investment income	4	32,475	32,003
Unrealised gains on investments		31,086	55,825
Other technical income, net of reinsurance		956	6,990
		<u>235,554</u>	<u>237,143</u>
Claims incurred, net of reinsurance			
Claims paid			
Gross amount		(196,153)	(187,346)
Reinsurers' share		27,063	24,104
Change in the provision for claims	26		
Gross amount		(337)	(4,397)
Reinsurers' share		(582)	3,169
		<u>(170,009)</u>	<u>(164,470)</u>
Change in other technical provisions, net of reinsurance, not shown under other headings	26		
Long term business provision, net of reinsurance			
Gross amount		(10,614)	37,995
Reinsurers' amount		2,010	(8,468)
Other technical provisions, net of reinsurance		(26,983)	(77,923)
		<u>(205,596)</u>	<u>(212,866)</u>
Net operating expenses	5	(21,726)	(29,865)
Investment expenses and charges	7	(3,612)	(3,897)
Other technical charges, net of reinsurance	9	(341)	(436)
Allocated investment return transferred to the non-technical account	2/8	8	507
		<u>(231,267)</u>	<u>(246,557)</u>
		4,287	(9,414)
Tax attributable to the long term business	12	419	4,940
Balance on the technical account for long term business		<u>4,706</u>	<u>(4,474)</u>

The notes and information on pages 47 to 71 form part of these accounts.

Consolidated profit and loss account

Non-technical account

	Note	Year ended 31 December			(restated) 2003 £000
		Discontinued Operation 2004 £000	Continuing Operations 2004 £000	Total 2004 £000	
Balance on the long term business technical account		-	4,706	4,706	(4,474)
Tax credit attributable to the balance on the long term business technical account	12	-	(419)	(419)	(4,940)
Pre-tax profit/(loss) arising on long term business		-	4,287	4,287	(9,414)
Allocated investment return transferred from the long-term business technical account	2/8	-	(8)	(8)	(507)
Other income		2,382	721	3,103	4,325
Other charges		(2,273)	(2,464)	(4,737)	(9,763)
Operating profit/(loss)		109	2,536	2,645	(15,359)
Profit on sale of a discontinued operation	10	1,948	-	1,948	-
Other profits/(losses)		-	-	-	-
Profit/(loss) on ordinary activities before tax	11	2,057	2,536	4,593	(15,359)
Tax on profit/(loss) on ordinary activities	12				
- current				(2,080)	(547)
- deferred				2,851	5,137
Profit/(loss) on ordinary activities after tax				5,364	(10,769)
Dividends paid and proposed	13			(10,151)	-
Retained loss for the period transferred to reserves				(4,787)	(10,769)
Basic earnings/(loss) per share (pence)	14			6.34p	(12.73)p
Diluted earnings/(loss) per share	14			6.33p	(12.73)p
Dividend per share	13			11.85p	-

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 deemed not 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.

There were no recognised gains or losses other than the amounts included in the profit and loss accounts shown above.

The notes and information on pages 47 to 71 form part of these accounts

Reconciliation of movements in shareholders' funds

		2004	2003
	Note	£000	£000
Shareholder funds at 1 January		78,739	89,508
Profit/(loss) for the financial period		5,364	(10,769)
Dividends paid and proposed	13	<u>(10,151)</u>	<u>-</u>
Shareholder funds at 31 December		<u>73,952</u>	<u>78,739</u>

The notes and information on pages 47 to 71 form part of these accounts

Consolidated balance sheet

ASSETS		31 December 2004 £000	31 December 2003 £000
	Note		
Investments			
Land and buildings	17	360	450
Other financial investments	18	278,030	269,974
		<u>278,390</u>	<u>270,424</u>
Assets held to cover linked liabilities	19	<u>502,128</u>	<u>474,280</u>
		<u>780,518</u>	<u>744,704</u>
Reinsurers' share of technical provisions	26		
Long term business provisions		51,284	49,275
Technical provisions for linked liabilities		124,997	120,515
Claims outstanding		5,063	5,645
		<u>181,344</u>	<u>175,435</u>
Debtors			
Debtors arising out of direct insurance operations	20	5,007	4,691
Other debtors	21	3,155	13,402
		<u>8,162</u>	<u>18,093</u>
Other assets			
Tangible assets	22	403	904
Cash at bank and in hand		39,257	23,880
Other – present value of acquired in-force business	23	1,622	1,963
		<u>41,282</u>	<u>26,747</u>
Prepayments and accrued income			
Deferred acquisition costs		5,120	16,135
Other prepayments and accrued income		6,942	6,466
		<u>12,062</u>	<u>22,601</u>
Total assets		<u>1,023,368</u>	<u>987,580</u>
LIABILITIES			
Capital and reserves			
Called up share capital	24	4,228	4,228
Capital redemption reserve	25	50	-
Demerger reserve	25	36,272	36,272
Profit and loss account	25	33,402	38,239
Shareholders' funds attributable to equity interests		<u>73,952</u>	<u>78,739</u>
Technical provisions	26		
Long term business provision		295,031	284,417
Claims outstanding		10,835	10,498
		<u>305,866</u>	<u>294,915</u>
Technical provisions for linked liabilities	26	<u>622,590</u>	<u>591,125</u>
Provision for other risks and charges	28	<u>2,752</u>	<u>6,155</u>
Creditors			
Creditors arising out of direct insurance operations		6,194	5,681
Other creditors	29	11,978	10,785
Bank overdrafts		36	180
		<u>18,208</u>	<u>16,646</u>
Total liabilities		<u>1,023,368</u>	<u>987,580</u>

The notes and information on pages 47 to 71 form part of these accounts

Approved by the Board of Directors on 21 March 2005 and signed on its behalf by:

Christopher Sporborg

Graham Kettleborough

Company balance sheet

ASSETS	Note	31 December 2004 £000	31 December 2003 £000
Investments			
Investments in Group undertakings	18	<u>4,228</u>	<u>-</u>
Debtors			
Dividends receivable		6,125	-
Other debtors	21	<u>421</u>	<u>-</u>
		<u>6,546</u>	<u>-</u>
Other assets			
Cash at bank and in hand		<u>154</u>	<u>-</u>
Prepayments and Accrued Income			
		11	-
Total assets		<u>10,939</u>	<u>-</u>
LIABILITIES			
Capital and reserves			
Called up share capital	24	4,228	-
Capital redemption reserve	25	50	-
Profit and loss account	25	-	-
Shareholders' funds attributable to equity interests		<u>4,278</u>	<u>-</u>
Creditors			
Amounts falling due within one year		-	-
Dividend proposed	29	6,124	-
Other creditors	29	<u>537</u>	<u>-</u>
		<u>6,661</u>	<u>-</u>
Total liabilities		<u>10,939</u>	<u>-</u>

The notes and information on pages 47 to 71 form part of these accounts

Approved by the Board of Directors on 21 March 2005 and signed on its behalf by:

Christopher Sporborg

Graham Kettleborough

Consolidated cash flow statement

	Note	Year Ended 31 December	
		2004 £000	2003 £000
Net cash inflow from operating activities	30	9,044	(7,470)
Taxation		(202)	349
Capital expenditure	22	(145)	(46)
		<u>8,697</u>	<u>(7,167)</u>
Acquisitions and disposals			
- Disposal of subsidiary	10	2,750	-
- Cash balances transferred on disposal		(408)	-
		<u>2,342</u>	<u>-</u>
Equity dividends paid	13	(4,027)	-
Net cash inflow/(outflow) of the Group excluding long-term business		<u>7,012</u>	<u>(7,167)</u>
The cash flows were invested as follows:			
Portfolio investments			
Purchases:			
Equities		11,256	10,234
Fixed income securities		1,228	11,058
Deposits		41,500	129,551
		<u>53,984</u>	<u>150,843</u>
Sales:			
Equities		(1,397)	(11,369)
Fixed income securities		(9,072)	(12,932)
Deposits		(42,674)	(131,693)
		<u>(53,143)</u>	<u>(155,994)</u>
Net purchase/(sales) of portfolio investments	31/32	841	(5,151)
Increase/(decrease) in cash and short-term deposits, net of overdrafts	31/32	6,171	(2,016)
Net investment of cash flows		<u>7,012</u>	<u>(7,167)</u>

In accordance with FRS1, this statement excludes the cashflows of the long-term business fund.

Included in the cash flows above is the net consideration of £2,750,000 received in respect of the sale of a subsidiary, which represents the full consideration received upon disposal. The associated cash balance transferred upon disposal of the same subsidiary, as reflected above, amounted to £407,961.

The notes and information on pages 47 to 71 form part of these accounts

Notes to the Accounts

(forming part of the financial statements)

1 Life business demerger and acquisition by Chesnara plc

On 24 May 2004, Chesnara plc acquired the whole of the issued ordinary share capital of Countrywide Assured Life Holdings Limited ("CALH") from Countrywide plc, which had, itself, acquired the whole of the ordinary issued share capital of CALH on 22 May 2004 from Countrywide Assured Group plc ("CAG"). These arrangements were effected to secure the demerger from CAG of CALH, which, together with its subsidiary companies, comprised the Life Business of CAG.

On the acquisition of CALH, Chesnara plc issued, as fully paid, 2.5p ordinary shares to the shareholders of CAG ("the CAG shareholders") as recorded on the shareholders register on 21 May 2004, pro rata to their holding in CAG, such that they received one ordinary share in Chesnara plc for every two ordinary shares held in CAG. On 25 May 2004, the existing ordinary shares of 2.5p in Chesnara plc were consolidated into ordinary shares of 5p each on the basis of one new share for every two old shares, so that, in effect, the CAG shareholders received one ordinary 5p share in Chesnara plc for every four ordinary shares previously held in CAG.

Information relating to this scheme, including, inter alia, detailed financial information on CALH and pro forma financial information on the Chesnara plc Group, was included in a document entitled "Chesnara plc – Introduction to the Official List" (the "Listing Particulars"), dated 18 March 2004, and in a document entitled "Supplementary listing particulars relating to the introduction to the Official List" (the "Supplementary Listing Particulars"), dated 10 May 2004. Copies of both the Listing Particulars and the Supplementary Listing Particulars may be obtained from the Chesnara plc Registered Office at Harbour House, Portway, Preston, PR2 2PR, UK or at www.chesnara.co.uk.

CALH, together with its subsidiary companies, comprises the whole of the operations and trading activities of Chesnara plc, except for certain costs which are incurred centrally by Chesnara plc in connection with its Corporate Governance activities, and which are fully recharged by way of a Group management charge to its principal operating subsidiary companies.

2 Accounting policies

Basis of Preparation

The consolidated accounts of the Group have been prepared in accordance with the provisions of section 255A of, and with the special provisions relating to insurance groups of Schedule 9A to, the Companies Act 1985.

The consolidated financial information has also been prepared in accordance with applicable accounting standards, consistently applied, and under the historical cost convention, modified to include the revaluation of investments, and complies with the Statement of Recommended Practice ("SORP") on Accounting for Insurance Business issued by the Association of British Insurers, as revised in November 2003 and in accordance with the Companies Act 1985, except as stated under "Fixed Assets" below.

The Company's Accounts have been prepared in accordance with section 226 of, and schedule 4 to the Companies Act 1985, adopting the exemption conferred by section 230 of that Act of omitting the profit and loss account.

The results for the financial year ended 31 December 2004 are the results and financial position of the Chesnara plc group applying the merger accounting convention. In accordance with that convention, the consolidated results and financial position of Chesnara plc are based on the consolidated results and financial position of CALH.

The comparative financial information for the year ended 31 December 2003 has been presented to provide consistent treatment and disclosure between periods and the Accounts include the results of the Company and its subsidiary undertakings made up to the stated period ends.

Other than in respect of the acquisition of CALH by Chesnara plc, when merger accounting has been applied, the acquisition method of accounting has been adopted for all other acquisitions and disposals. Under this acquisition accounting method, the results of subsidiary undertakings acquired or disposed of in the period are included in the consolidated profit and loss account from the date of acquisition or up to the date of disposal.

Change in Accounting Policy

In order to comply with the revised SORP, as referred to above, the Directors have decided to report using smoothed investment assumptions. This represents a change in the accounting policies referred to above and the results arising on the long-term business technical account and the non-technical account have, accordingly, been restated. As a result of the change, allocations of investment return are made from the long-term business technical account to the non-technical account, being the difference between the longer-term investment return and the actual return on investments of the long-term business, which are directly attributable to shareholders. The longer-term investment return is an estimate of the long-term trend investment return for the relevant category of investment having regard to past performance, current trends and future requirements. There is no impact on the reported result or net assets as a result of these changes.

Premiums

Premiums are accounted for on a receivable basis or, in the case of unit-linked business, when the liability is recognised. Premiums are stated gross of commission, taxes and premium levies. Reinsurance premiums are charged when they become payable.

Claims

Claims are accounted for in the accounting period in which they are due or notified. Surrenders are accounted for in the accounting period in which they are paid. Claims include policyholder bonuses allocated in anticipation of a bonus declaration. Reinsurance recoveries are accounted for in the same period as the related claim.

Acquisition Costs

Acquisition costs comprise all direct and indirect costs arising from the conclusion of insurance contracts. An explicit deferred acquisition cost asset has been established in the balance sheet. Deferred acquisition costs are amortised at a rate based on the pattern of anticipated margins in respect of the related policies. Deferral of costs has been limited to the extent that there are available future margins.

Long-Term Business Provision

The computations made to determine the long-term business provision are made by suitably qualified personnel on the basis of recognised actuarial methods with due regard to the actuarial principles laid down in European law and by actuarial best practice in the UK. The methodology takes into account the risks and uncertainties of the particular class of long-term business written.

For certain classes of business where policyholders participate in surpluses, the net premium valuation method has been used to calculate the Long-Term Business Provision. The net premium is calculated such that it would be sufficient at the outset of the policy to provide only the discounted value of the original guaranteed death and maturity benefits. The provision is then calculated by subtracting the present value of future net premiums from the present value of future benefits (including attaching bonuses). This method makes implicit allowance for both future expenses of maintaining the policy and sharing in future profits. For other classes which do not participate in surplus and are not linked to specific pools of assets, a net premium method has also been used to calculate the Long-Term Business Provision. This method uses the net premium calculated as described above to establish the provision.

Under the net premium method the amount of the provision is sensitive to the interest rate used when discounting and, to a lesser extent, the assumed future mortality experience of policyholders. For single premium policies, including guaranteed income bonds and annuity business, the Long-Term Business Provision is calculated as the present values of future benefits and expenses.

Technical Provision for Linked Liabilities

For those policies where benefits are linked to specific pools of assets, the Technical Provision for Linked Liabilities is calculated as the number of units attaching to each policy multiplied by the appropriate unit price at the balance sheet date. In addition, a cash flow projection, using prudent assumptions, is undertaken for each policy to establish whether or not future inflows are sufficient to cover future outflows (after allowing for an immediate fall in the value of the units). If not, an additional provision is included in the Long Term Business Provision. The additional provision is sensitive to the assumed level of policy maintenance expenses and to the degree of the immediate fall in the value of the units.

Investment Income

Interest is shown gross, before deduction of income tax, and is accounted for on an accruals basis. Dividend income excludes any related recoverable tax credits and is credited to income when the investments are listed as ex-dividend.

Investment income, realised gains and losses, expenses and charges are included in the long-term business technical account in so far as they relate to investments which are directly connected with the carrying on of long-term business.

Realised gains or losses represent the difference between net sales proceeds and purchase price.

Unrealised Gains and Losses on Investments

Unrealised gains and losses on investments represent the difference between the current value of investments at the balance sheet date and their purchase price. The movement in unrealised investment gains and losses on investments includes an adjustment for previous recognised unrealised gains and losses disposed of in the accounting period.

Investments

All investments, including those classified as assets held to cover linked liabilities, are stated at their current value.

Listed investments are valued on the basis of the market convention where primarily traded which is either last traded or middle market price.

Debt securities and other fixed income securities are stated at current value.

Properties are valued on an open market basis. Valuations are undertaken by professional valuers at intervals of not more than three years. In the intervening years values are reviewed by the directors and adjustments made to the Accounts as appropriate.

Present Value of Acquired In-Force Business

The purchased present value of in-force ("PVIF") business at the acquisition date is amortised during the year by reference to the pattern by which surplus emerges on the relevant block of business. The amortisation charge for the year is charged to "other technical charges" in the technical account. The carrying value of the amortised PVIF is reviewed annually for impairment.

Taxation

The charge for taxation is based on the profit for the year and takes into account taxation deferred because of timing differences between the treatment of certain items for taxation and accounting purposes.

(i) Long-term insurance business – technical account

Current tax is the amount estimated to be payable or recoverable as a result of the application of the rules for the taxation of life insurance companies to the items included in the long-term business technical account (other than the investment return allocated from the non-technical account), together with any necessary prior period adjustments.

(ii) Non-technical account

Tax on profit on ordinary activities comprises current tax, deferred tax and the reversal of the tax credit representative of shareholders' share of the total tax on long-term business.

Current tax is the amount estimated to be payable or recoverable as a result of the application of the rules for the taxation of life insurance companies to the items included in both the non-technical and the long-term business technical account, together with any necessary prior period adjustments.

The balance on the long-term business technical account transferred to the non-technical account is net of the total tax attributable to long-term business. Accordingly, in order for shareholders' profits on long-term business to be presented on a pre-tax basis in the non-technical account, a tax credit, representative of shareholders' share of the total tax on long-term business is added. The credit is calculated at the effective rate implied by the tax charged or credited in respect of shareholders' profits in the long-term business technical account. An equal and opposite amount is included in the tax charge in the non-technical account.

Deferred taxation

Full provision for deferred tax liabilities has been made in accordance with FRS 19, Deferred Taxation.

The Group has chosen not to discount the deferred tax asset or liability, to reflect the time value of money, as permitted by FRS 19. Deferred tax assets are only recognised to the extent that they will be relieved in the foreseeable future.

Leases

The rental costs relating to operating leases are charged to the profit and loss account on a straight-line basis over the life of the lease.

Fixed Assets

Fixed Assets are stated at cost or valuation less accumulated depreciation. Depreciation is provided to write-off the cost less the estimate of residual value of tangible assets by equal instalments over their estimated useful economic life as follows:

Leasehold	20%
Motor vehicles	25%
Computer equipment	20%
Fixtures, fittings and office equipment	20%

In accordance with Statement of Standard Accounting Practice 19, no depreciation or amortisation is provided in respect of freehold investment properties.

This treatment may be a departure from the requirements of the Companies Act concerning depreciation of fixed assets. However, these properties are not held for consumption but for investment and the directors consider that systematic annual depreciation would be inappropriate. The accounting policy adopted is therefore necessary for the financial information to give a true and fair view. Depreciation or amortisation is only one of the many factors reflected in the annual valuation and the amount which might otherwise have been shown cannot be separately identified or quantified.

Capitalisation of internal software development costs

Internal costs that are incurred during the development of significantly and separately identifiable computer software for use in the business are capitalised where the software is integral to the generation of future economic benefits. Costs that may be capitalised are limited to payroll costs, which are allocated on a time-spent basis, and charges made by third party contractors. The software is depreciated on a straight line basis once it is ready for business use at the rate of 20%.

Pensions

The Group participates in the Countrywide Assured Group pension scheme. The scheme has two sections of membership, a defined benefit section, providing benefits based on final pensionable pay and a defined contribution section.

The assets of the scheme are held separately from those of the Group.

For the defined contribution section of the scheme, the amounts charged to the profit and loss account represent the contributions payable to the scheme in respect of the accounting period.

The Group is unable to identify its share of the underlying assets and liabilities of the defined benefit section of the scheme on a consistent and reasonable basis and therefore, as required by FRS 17, "Retirement benefits", accounts for the scheme as if it were a defined contribution scheme. As a result, the amount charged to the profit and loss account represents the contributions payable to the scheme in respect of the accounting period.

3 Analysis of turnover, operating profit/(loss) and gross premium written

(a) Turnover	Year ended 31 December	
	2004	2003
	£000	£000
Earned premiums, net of reinsurance		
Periodic premiums (gross)	123,349	146,004
Single premiums (gross)	78,881	27,720
	<u>202,230</u>	<u>173,724</u>
Outward reinsurance premiums	(31,193)	(31,399)
	<u>171,037</u>	<u>142,325</u>
Turnover arising in IFA business (discontinued activity)	2,373	4,291
Total turnover	<u>173,410</u>	<u>146,616</u>

	Year ended 31 December	
	2004	2003
	£000	£000
(b) Operating profit/(loss)		
Continuing operations	2,536	(15,510)
Discontinued operations	109	151
	<u>2,645</u>	<u>(15,359)</u>
 (c) Gross premiums written		
Individual premiums	<u>202,230</u>	<u>173,724</u>
Periodic premiums	123,349	146,004
Single premiums	<u>78,881</u>	<u>27,720</u>
	<u>202,230</u>	<u>173,724</u>
 Premiums from non-participating contracts	104,885	57,539
Premiums from participating contracts	3,685	3,989
Premiums from investment linked contracts	<u>93,660</u>	<u>112,196</u>
	<u>202,230</u>	<u>173,724</u>
 Premiums from life business	186,228	155,701
Premiums from pension business	9,028	9,731
Premiums from permanent health business	<u>6,974</u>	<u>8,292</u>
	<u>202,230</u>	<u>173,724</u>

No segmental analysis is provided as the Group has only one segment.

4 Investment Income

	Year ended 31 December	
	2004	2003
	£000	£000
Income from other investments	32,431	32,000
Shareholder fund realised gains	44	3
	<u>32,475</u>	<u>32,003</u>

5 Net operating expenses

	Year ended 31 December	
	2004	2003
	£000	£000
Acquisition costs:		
Commission for direct insurance business	(87)	(1,154)
Other	208	3,467
Change in gross deferred acquisition costs	<u>11,014</u>	<u>17,793</u>
	11,135	20,106
Administration expenses	<u>10,591</u>	<u>9,759</u>
	<u>21,726</u>	<u>29,865</u>

Commission is stated net of reinsurance commission received.

6 Staff costs

	Year ended 31 December	
	2004	2003
	£000	£000
Wages and salaries	5,993	8,019
Social security costs	651	555
Pension costs	261	681
Total	<u>6,905</u>	<u>9,255</u>
Average number of employees	<u>222</u>	<u>293</u>

Information regarding Directors' emoluments and other interests is provided in the Directors' Remuneration Report on pages 28 to 34.

7 Investment expenses and charges

	Year ended 31 December	
	2004	2003
	£000	£000
Investment management expenses	1,647	1,469
Loss on realisation of investments	1,965	2,428
	<u>3,612</u>	<u>3,897</u>

8 Allocated investment return

The expected longer-term rates of investment return on different categories of business are derived by considering the nature of the assets and making assumptions about the likely returns that those assets might achieve in the long-term.

These rates of return are then applied to the amount of assets in each category below to derive an expected return over each period. The calculations are performed in respect of discrete six-month periods.

The technical account shows the actual return on the investments over the period, together with an adjustment between the actual and expected return. This produces a smoothed return on the assets, compared with the actual return.

The Directors have determined the longer-term rates of investment return to be as follows:

	6 months ended 31 December 2004	6 months ended 30 June 2004	6 months ended 31 December 2003	6 months ended 30 June 2003
Equities and property	7.70%	7.60%	7.10%	7.10%
Fixed interest	5.30%	5.20%	4.70%	4.70%
Unit funds	7.22%	7.12%	6.57%	6.57%
Deferred Acquisition Costs	4.50%	4.50%	4.50%	4.50%
Other interest-bearing assets	3.75%	3.75%	4.00%	4.00%
Non interest-bearing assets	-	-	-	-

The Company first made a disclosure of expected investment return compared with actual investment return in its interim financial statements, for the six months ended 30 June 2004, which included a comparison with the year ended 31 December 2003.

A comparison of the expected longer-term rates of investment return with the actual return has now been carried out over the 2-year period 1 January 2003 to 31 December 2004. This comparison will be built up to 5 years by 31 December 2007.

The relevant figures for the periods under review are as follows:

	Year ended 31 December	
	2004	2003
	£000	£000
Actual return attributable to shareholders	3,127	2,768
Expected longer-term return	3,135	3,275
Shortfall of actual return over expected return	<u>(8)</u>	<u>(507)</u>

The sensitivity of the rates of expected longer-term investment return used in each period is as follows:

	Year ended 31 December	
	2004	2003
	£000	£000
Effect of increasing investment return by 1%	655	717
Effect of decreasing investment return by 1%	(668)	(720)

Non-interest bearing assets are not taken into account in the above sensitivity calculations.

9 Other technical charges

Other technical charges include £341,000 in the year ended 31 December 2004 (2003: £411,000) relating to the amortisation of the purchased present value of in-force business of Premium Life Assurance Company Limited (see Note 23).

10 Discontinued operation

(i) Profit on sale

On 30 June 2004 the Group disposed of its interest in Key Retirement Solutions Limited ("KRS"), its wholly-owned IFA subsidiary, by way of the sale for cash of its entire issued share capital, to a company controlled by the KRS executive management. The proceeds on sale of £2.8m were attributed £0.2m as to the repayment of a subordinated loan payable to another subsidiary company with the balance of £2.6m attributed to the sale of shares. Under the disposal method of accounting the cumulative net of tax profits and losses of KRS have been recognised in the consolidated group profit and loss account up to the date of disposal such that, after the deduction of expenses incurred in connection with the disposal, a profit of £1.9m has been realised on the sale. As the previous write-downs of the investment in KRS in the accounts of its parent company had not been allowed as a charge against taxable profits for corporation tax purposes and as the profit on sale does not exceed those write-downs, accordingly no taxable profit arises on the disposal.

(ii) Operating Profit

	Year ended 31 December	
	2004	2003
	£000	£000
Other income	2,382	4,305
Other charges	<u>(2,273)</u>	<u>(4,154)</u>
Operating profit	<u>109</u>	<u>151</u>

11 Profit on ordinary activities before tax

Profit on ordinary activities before tax is stated:	Year ended 31 December	
	2004 £000	2003 £000
After crediting		
Income from listed investments	1,620	1,666
Operating lease income – land and buildings	110	110
After charging		
Depreciation	301	557
Amounts payable on other operating leases	827	1,687
Amounts payable to the Auditor and its associates, exclusive of VAT		
Audit services		
- statutory audit	221	73
- audit-related regulatory reporting	26	12
Tax services		
- compliance services	5	54
Other services		
- IFRS advisory support	136	-
- other	36	19

12 Taxation

(a) Taxation on profit on ordinary activities

UK Corporation Tax at 30% (2003: 30%)	Year ended 31 December			
	Technical Account		Non-Technical Account	
	2004 £000	2003 £000	2004 £000	2003 £000
Current tax for the year	2,537	36	(92)	386
Adjustment in respect of prior years	(115)	125	(250)	
Current tax attributable to shareholders profits at effective rate	-	-	2,422	161
Total current tax	<u>2,422</u>	<u>161</u>	<u>2,080</u>	<u>547</u>
Deferred tax	(2,841)	(5,101)	(10)	(36)
Deferred tax attributable to shareholders profits at effective rate (see Note 28)	-	-	(2,841)	(5,101)
Total deferred tax	<u>(2,841)</u>	<u>(5,101)</u>	<u>(2,851)</u>	<u>(5,137)</u>
Tax on profit on ordinary activities	<u>(419)</u>	<u>(4,940)</u>	<u>(771)</u>	<u>(4,590)</u>

(b) Reconciliation of actual tax charge to UK corporation tax rate

	Year ended 31 December	
	2004	2003
	£000	£000
Profit/(loss) on ordinary activities before tax	4,593	(15,359)
Tax at UK rate of 30% on profit on ordinary activities	1,378	(4,607)
Effects of:		
Adjustment in respect of prior years	(365)	125
Deferred tax charge for the period	2,851	5,137
Write-down of amounts due from Countrywide Assured Group plc	-	1,267
Effect of UK tax bases of insurance profits	(1,784)	(1,375)
Total current tax charge (see above)	<u>2,080</u>	<u>547</u>

(c) Deferred Tax

The components of the deferred tax liabilities are as follows. The balances have not been discounted

	31 December	31 December
	2004	2003
	£000	£000
Deferred acquisition costs	1,536	4,840
Long-term business technical provision	375	(88)
Capital allowances	(85)	(63)
	<u>1,826</u>	<u>4,689</u>

(d) Movement in Deferred Tax

	31 December	31 December
	2004	2003
	£000	£000
Deferred tax liability at beginning of year	4,689	9,826
Deferred tax released in profit and loss account for year	(2,851)	(5,137)
Transferred on disposal of discontinued operation (see Note 10)	(12)	-
Deferred tax liability at end of year	<u>1,826</u>	<u>4,689</u>

(e) Factors that may affect future tax charges

The company anticipates that the effective tax rate will not materially alter in future years.

13 Dividends paid and proposed

	Year Ended 31 December	
	2004	2003
	£000	£000
First interim dividend (paid)	10	-
Second interim dividend (paid)	4,017	-
Final dividend (proposed)	6,124	-
	<u>10,151</u>	<u>-</u>

The first interim dividend was proposed and paid by Countrywide Assured Life Holdings Limited ("CALH") to Countrywide plc prior to the demerger referred to in Note 1. This was done to establish the status of CALH as a subsidiary company of Countrywide plc.

The second interim dividend of 4.75p per share was paid on 24 September 2004 to shareholders of Chesnara plc registered at the close of business on 27 August 2004, the dividend record date.

The final dividend proposed of 7.1p per share will be paid on 29 April 2005 to shareholders registered at the close of business on 1 April 2005, the dividend record date. The total dividend paid and proposed to Chesnara plc shareholders in respect of the year ended 31 December 2004 is 11.85p per share.

14 Earnings/(loss) per share

The basic earnings/(loss) per share is calculated as follows:

	Year ended 31 December	
	2004	2003
Profit/(loss) on ordinary activities for the year after tax (£000)	5,364	(10,769)
Weighted average number of shares	<u>84,564,168</u>	<u>84,564,168</u>
Basic earnings/(loss) per share	<u>6.34p</u>	<u>(12.73)p</u>
Diluted earnings/(loss) per share	<u>6.33p</u>	<u>(12.73)p</u>

The basic earnings per share for the year ended 31 December 2004 is stated after taking account of profit on sale of a discontinued operation.

The weighted average number of shares is the number of ordinary shares, entitled to dividend, in issue at 31 December 2004. Except for the cancellation of 2 ordinary shares on 22 June 2004, the effect of which is not considered to be material, this corresponds to the number of ordinary shares issued by Chesnara plc on 25 May 2004 in accordance with the scheme of demerger described in Note 1 above. The diluted weighted average number of shares is 84,683,419, the difference, compared to the weighted average number of shares used in the basic earnings per share calculation, being the equivalent number of shares that would be issued for no consideration, if the share option described in Note 24 below were exercised. There were no further share options outstanding at 31 December 2004.

The number of shares has been applied uniformly to the results after tax for all periods reported in this statement, despite the fact that the ordinary shares in Chesnara plc were issued on 25 May 2004, as this is considered to be the most meaningful way to present earnings and loss per share, having regard to the basis on which such results have been presented as set out in Note 2 above.

The earnings per share information presented in the Listing Particulars referred to in Note 1 above followed the same method of presentation except that the weighted average number of shares of 82,273,819 was based on the number of Countrywide Assured Group plc ordinary shares in issue at 31 December 2003, adjusted for the prospective Chesnara plc share consolidation of one Chesnara plc share for every four Countrywide Assured Group plc shares.

15 Profit for the financial year after tax

The Company has not presented its own profit and loss account as permitted by section 230 of the Companies Act 1985. The Group profit for the year includes a profit before dividends of £10,190,995 (2003: £ nil) dealt with in the accounts of the Company.

16 Operating lease commitments

	31 December 2004 £000	31 December 2003 £000
Land and buildings with commitments expiring after 5 years	<u>642</u>	<u>698</u>
Other		
- equipment with commitments expiring in 1 year	1	9
- equipment with commitments expiring in 2 to 5 years	<u>58</u>	<u>46</u>
	<u>59</u>	<u>55</u>
	<u>701</u>	<u>753</u>

17 Land and buildings

	31 December 2004 £000	31 December 2003 £000
Land and buildings at market value comprise:		
Freehold properties	<u>360</u>	<u>450</u>
Land and buildings at historical cost comprise:		
Freehold properties	<u>196</u>	<u>196</u>

The latest valuation of the investment property was undertaken on an open-market value basis, in December 2004, by Countrywide Property Management Limited, a subsidiary company of Countrywide plc.

18 Other financial investments

Group	31 December 2004 £000	31 December 2003 £000
Market value		
Shares and other variable yield securities and units in unit trusts	16,330	6,033
Debt securities and other fixed income securities	207,900	208,807
Deposits with credit institutions	<u>53,800</u>	<u>55,134</u>
	<u>278,030</u>	<u>269,974</u>
Cost		
Shares and other variable yield securities and units in unit trusts	5,745	5,275
Debt securities and other fixed income securities	208,807	212,340
Deposits with credit institutions	<u>55,134</u>	<u>55,156</u>
	<u>269,686</u>	<u>272,771</u>

At 31 December 2004, £ 224,182,000 (2003: £213,974,054) of the above amounts were listed on the London Stock Exchange.

Company	2004	2003
	£000	£000
Cost or valuation		
Investment in Group undertakings		
At 1 January	-	-
Additions (see Note 1)	4,228	-
At 31 December	<u>4,228</u>	<u>-</u>

19 Assets held to cover linked liabilities

	31 December 2004		31 December 2003	
	Cost	Market Value	Cost	Market Value
	£000	£000	£000	£000
Investments included under assets held to cover linked liabilities	<u>468,641</u>	<u>502,128</u>	<u>472,268</u>	<u>474,280</u>

20 Debtors arising out of direct insurance operations

	31 December	31 December
	2004	2003
	£000	£000
Amounts owed by policyholders	<u>5,007</u>	<u>4,691</u>

21 Other debtors

Group	31 December	31 December
	2004	2003
	£000	£000
Other debtors	3,052	5,156
Tax recoverable	103	58
Amount due from Countrywide Assured Group plc undertakings	-	8,188
	<u>3,155</u>	<u>13,402</u>

Company	31 December	31 December
	2004	2003
	£000	£000
Other debtors	1	-
Owed by Group undertakings	420	-
	<u>421</u>	<u>-</u>

22 Tangible assets

	Motor Vehicles £000	Computer Equipment £000	Fixtures, fittings and office equipment £000	Total £000
Cost				
At 1 January 2004	12	5,753	637	6,402
Additions	-	122	23	145
Disposals	-	(4,336)	(515)	(4,851)
Transferred on sale of discontinued operation	-	(451)	(32)	(483)
At 31 December 2004	12	1,088	113	1,213
Depreciation				
At 1 January 2004	12	4,924	562	5,498
Charge for the year	-	277	24	301
Disposals	-	(4,332)	(515)	(4,847)
Transferred on sale of discontinued operation	-	(128)	(14)	(142)
At 31 December 2004	12	741	57	810
Net book value at 31 December 2004	-	347	56	403
Net book value at 31 December 2003	-	829	75	904

23 Present value of acquired in-force business

	2004 £000	2003 £000
Value at 1 January	1,963	2,374
Amortisation	(341)	(411)
Value at 31 December	<u>1,622</u>	<u>1,963</u>

The acquired value of in-force business relates to the acquisition of Premium Life Assurance Company Limited in 1996.

24 Called up share capital

Authorised	31 December 2004 £	On incorporation 29 October 2003 £
Ordinary shares of £1 each	-	50,000
Ordinary shares of 5p each	10,050,000	-
	<u>10,050,000</u>	<u>50,000</u>
Issued		
Ordinary shares of £1 each	-	2
Ordinary shares of 5p each	4,228,208	-
	<u>4,228,208</u>	<u>2</u>

Under the merger accounting convention referred to in Note 2 above, the issued and called up share capital of the Group at 31 December 2004 and 31 December 2003 is stated at £4,228,208, being the allotment of ordinary shares on 25 May 2004 pursuant to demerger.

The following note sets out changes in the authorised and issued share capital of Chesnara plc from 29 October 2003, the date of incorporation, to 31 December 2004.

(a) Ordinary shares of £1 each

	Authorised		Issued	
	Number	£	Number	£
On incorporation on 29 October 2003	50,000	50,000	2	2
Reorganisation on 9 March 2004	(50,000)	(50,000)	(2)	(2)
Balance at 31 December 2004	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>

(b) Ordinary shares of 2.5p each

	Authorised		Issued		
	Number	£	Number	£	p
Reorganisation on 9 March 2004					
(i) Sub-division of existing £1 shares	2,000,000	50,000	80		2.00
(ii) Creation of further shares	398,000,000	9,950,000	-		-
Cancellation of shares on 17 May 2004	-	-	(78)		(1.95)
Allotment on 25 May 2004 pursuant to demerger	-	-	169,128,338	4,228,208.45	
Consolidation on 25 May 2004 of existing shares of 2.5p each into ordinary shares of 5p each	(400,000,000)	(10,000,000)	(169,128,340)	(4,228,208.50)	
Balance at 31 December 2004	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>

(c) Ordinary shares of 5p each

	Authorised		Issued		
	Number	£	Number	£	p
Consolidation on 25 May 2004 of existing ordinary shares of 2.5p each into ordinary shares of 5p each	200,000,000	10,000,000	84,564,170	4,228,208.50	
Cancellation of shares on 22 June 2004	-	-	(2)		(.10)
Sub-division and conversion on 22 June 2004 of £50,000 authorised share capital represented by a Redeemable Preference Share	1,000,000	50,000	-		-
Balance at 31 December 2004	<u>201,000,000</u>	<u>10,050,000</u>	<u>84,564,168</u>	<u>4,228,208.40</u>	

(d) Redeemable Preference Share of £50,000

	Authorised		Issued	
	Number	£	Number	£
Reorganisation on 9 March 2004	1	50,000	1	50,000
Redemption on 22 June 2004	-	-	(1)	(50,000)
Sub-division and conversion on 22 June 2004 into ordinary shares of 5p each	(1)	(50,000)	-	-
Balance at 31 December 2004	-	-	-	-

On 29 October 2003, on incorporation, the Company had an authorised share capital of £50,000, divided into 50,000 ordinary shares of £1 each, of which two ordinary shares were allotted, called up and fully paid on incorporation.

On 1 March 2004, the two issued ordinary shares of £1 each were transferred to two partners of Pinsent Masons, solicitors to Chesnara plc (the "subscriber shareholders").

On 9 March 2004, the share capital of the Company was reorganised as follows:

- (i) the 49,998 authorised but unissued ordinary shares were sub-divided into 1,999,920 ordinary shares of 2.5p each;
- (ii) the authorised share capital was increased to £10,050,000 by the creation of a further 398,000,000 ordinary shares of 2.5p each and a new redeemable preference share of £50,000;
- (iii) each of the two issued ordinary shares of £1 each was sub-divided into 40 ordinary shares of 2.5p each; and
- (iv) in order to satisfy the requirements of section 117 of the Companies Act 1985 as to the minimum paid up share capital for a public company, the redeemable preference share was issued (paid up as to one quarter) to one of the subscriber shareholders.

On 17 May 2004, 78 ordinary shares of 2.5p each held by the subscriber shareholders were gifted back to the Company and cancelled. On cancellation an amount representing the nominal value of those shares was transferred to a capital redemption reserve.

On 25 May 2004, in accordance with the demerger referred to in Note 1, three additional shares were allotted to the subscriber shareholders and 169,128,335 shares were allotted to the shareholders of Countrywide plc ("Countrywide") as recorded on the shareholder register on 25 May 2004 such that they received one ordinary share in Chesnara plc for every one ordinary share in Countrywide. Following this allotment, the existing ordinary shares of 2.5p were consolidated into ordinary shares of 5p each on the basis of one new share for every two old shares. Fractions arising on this consolidation were transferred to a nominee and sold in the market for the benefit of the Company.

On 22 June 2004:

- (i) the remaining two ordinary shares of 5p each held by the subscriber shareholders were gifted back to the Company and cancelled. On cancellation an amount representing the nominal value of these shares was transferred to a capital redemption reserve; and
- (ii) the redeemable preference share of £50,000 was paid up in full and then redeemed. The nominal amount of the redeemable preference share, being £50,000, was sub-divided and converted into ordinary shares of 5p each and an amount of £50,000, being equal to the par value of the redeemable preference share, was transferred to a capital redemption reserve.

Pursuant to an agreement dated 18 March 2004 between Chesnara plc and Numis Securities Limited ("Numis"), Numis received, on the admission of Chesnara plc to the Official List of the UK Listing Authority, an option to subscribe for Chesnara plc shares equivalent in number to 2% of the issued share capital of

Chesnara plc at the date of admission. The period in which Numis was entitled to exercise the option to acquire shares began 6 months after the admission date and would have ended 36 months after the admission date. The exercise price for the option was calculated on the basis of a theoretical market capitalisation for Chesnara plc of £76,666,667. The option arrangement was entered into as part of the arrangements for the engagement of Numis as brokers to Chesnara plc further to a letter of engagement dated 18 March 2004 between the two parties. The issued share capital of Chesnara plc at the date of admission was 84,564,170 ordinary shares of 5p each. Accordingly, Numis had an option to subscribe for 1,691,284 ordinary shares at an option price of 90.66 pence per share.

On 10 February 2005, pursuant to a notice of exercise of such option by Numis, the Board approved the issue and allotment of 1,691,284 new ordinary shares of 5p each to rank pari passu with the existing ordinary share capital of 5p each. The consideration received from Numis in respect of the allotment of shares was £1,533,318, of which £84,565 was credited to the called up share capital account and £1,448,753 was credited to share premium account. As a result the called up share capital of the Company totalled £4,312,773, represented by 86,255,452 ordinary shares of 5p each. On 16 February 2005 the newly issued shares were admitted to trading on the London Stock Exchange.

25 Reconciliation of movements in shareholder funds

Group	Share Capital	Demerger Reserve	Capital Redemption Reserve	Profit and Loss Account	Total Shareholder Funds	Total Shareholder Funds
	£000	£000	£000	£000	2004 £000	2003 £000
At 1 January	4,228	36,272	-	38,239	78,739	89,508
Profit/(loss) for the year	-	-	-	5,364	5,364	(10,769)
Dividends	-	-	-	(10,151)	(10,151)	-
Transfer from profit and loss account to redeem preference share	-	-	50	(50)	-	-
At 31 December	<u>4,228</u>	<u>36,272</u>	<u>50</u>	<u>33,402</u>	<u>73,952</u>	<u>78,739</u>
Company						
At 1 January	-	-	-	-	-	-
Profit for the year	-	-	-	10,191	10,191	-
Dividends	-	-	-	(10,141)	(10,141)	-
Issue of redeemable preference share on re-organisation - 9 March 2004	50	-	-	-	50	-
Redemption of preference share - 25 June 2004	(50)	-	-	-	(50)	-
Transfer from profit and loss account to redeem preference share	-	-	50	(50)	-	-
Allotment on 25 May 2004 pursuant to the Demerger (refer to Note 1 to these Accounts)	4,228	-	-	-	4,228	-
At 31 December	<u>4,228</u>	<u>-</u>	<u>50</u>	<u>-</u>	<u>4,278</u>	<u>-</u>

The amounts available for distribution are restricted by the rules made by the Financial Services Authority under the Financial Services and Markets Act 2000 in respect of long-term business. Of Countrywide Assured plc's total reserves of £32,534,000 (2003: £36,815,000), the amount not regarded as available to pay dividends is £19,365,000 (2003: £29,917,000).

The Company share capital at 1 January 2004 was £2 which has been rounded to nil in the above table.

26 Technical provisions

	2004	2003
	£000	£000
(i) Long-term business provision		
Gross amount		
At 1 January	284,417	322,412
Movement in the long-term business technical account excluding bonuses	10,614	(37,995)
At 31 December	295,031	284,417
Reinsurers' share		
At 1 January	49,274	57,743
Movement in the long-term business technical account	2,010	(8,468)
At 31 December	51,284	49,275
Net technical provisions		
At 1 January	235,143	264,669
Net movement in the long-term business technical account excluding bonuses	8,604	(29,527)
At 31 December	243,747	235,142

The principal assumptions underlying the calculation of the long-term business provision are:

	31 December	31 December
	2004	2003
(a) Rates of interest	%	%
Assurances		
With profit (non-linked business)	3.50	3.25
Without profit (non-linked business)	3.75	3.50
Without profit (annual premium)	3.90	4.00
Without profit (guaranteed income bonds)	4.50	4.20
Annuities		
With profit (non-linked business)		
- deferred	4.40	4.25
Without profit (linked)		
-deferred	3.90	4.00
-vested	4.40	4.70
(b) Mortality and morbidity tables		
Assurances and deferred annuities	80%A67/70 ultimate	80%A67/70 ultimate
Term assurance	80%A67/70 ultimate	80%A67/70 ultimate
Vested annuities	81.5% PM/FA80 ultimate – 5	84% PM/FA80 ultimate – 5
Critical illness	105% of reinsurer critical illness rates	105% of reinsurer critical illness rates
	31 December	31 December
	2004	2003
	£000	£000
(c) Bonuses	£000	£000
The total bonuses attributable are as follows:		
Gross period end declared bonuses, included in movement in long-term business provision	1,243	1,325
Reinsurance	(1,243)	(1,325)
	<u>-</u>	<u>-</u>

(d) Future bonuses

Explicit provision has only been made for vested bonuses and no allowance for future bonuses has been made in the gross long-term business provisions. All of the with-profit liability is reinsured.

(e) Changes in assumptions

There have been no significant changes in the method used to derive the above assumptions in 2004.

(f) Sensitivity

The value of retained liabilities would increase if the assumed rates of interest were reduced. This is especially the case with the guaranteed bond liabilities and the annuities. The effect of a 10% reduction in interest rates will be to increase liabilities in these products by 1.2%. However, under the corporate asset / liability matching policy, these two product lines are closely matched by appropriate assets, which would largely mitigate the effect of a reduction in interest rates.

The annuity liabilities would be increased if further significant improvements in mortality were assumed, whereas the assurance liabilities would decrease.

(ii) Technical provision for linked liabilities	2004	2003
Gross amount	£000	£000
At 1 January	591,125	498,678
Movement in the long-term business technical account excluding bonuses	31,465	92,447
At 31 December	622,590	591,125
Reinsurers' share		
At 1 January	120,515	105,991
Movement in the long-term business technical account	4,482	14,524
At 31 December	124,997	120,515
Net technical provisions		
At 1 January	470,610	392,687
Net movement in the long-term business technical account excluding bonuses	26,983	77,923
At 31 December	497,593	470,610

(iii) Claims outstanding	2004	2003
Gross amount	£000	£000
At 1 January	10,498	6,101
Movement in the long-term business technical account excluding bonuses	337	4,397
At 31 December	10,835	10,498
Reinsurers' share		
At 1 January	5,645	2,476
Movement in the long-term business technical account	(582)	3,169
At 31 December	5,063	5,645
Net technical provisions		
At 1 January	4,853	3,625
Net movement in the long-term business technical account excluding bonuses	919	1,228
At 31 December	5,772	4,853

27 Compensation in respect of pension transfers and opt-outs and in respect of endowment mis-selling complaints

Pension Transfers and Opt-Outs

The long-term business provision includes an amount of £450,000 (2003: £531,000) in respect of potential compensation payments and associated costs arising from a review of advice provided to customers who were sold personal pension policies by Group representatives between 25 May 1988 and 30 June 1994. This review, which was conducted in accordance with guidelines issued by the FSA and which was

completed by 31 December 2002, related to transfers, opt-outs and non-joiners from occupational schemes. The amount for future compensation provided at 31 December 2004 and 31 December 2003 relates to a small number of unsettled cases where the Group does not have primary responsibility for compensation under the regulatory rules. The Directors are of the opinion that suitable provision has been made for these cases as at 31 December 2004.

Endowment Mis-selling Complaints

The long-term business provision includes an amount of £14,760,000 (2003: £12,250,000) in respect of potential compensation payments arising from endowment mis-selling complaints. The corresponding charge to the long-term business technical account in respect of movements on these amounts was £16,610,000 (2003: £13,950,000). The provision for the costs of redress has been estimated on the basis of the Group's experience in respect of policyholders' propensity to complain, complaint uphold rates and average cost of settlement. It is also based on estimation of the in-force endowment policy population exposed to complaint, taking account of estimated future policy cessation, and of the rate at which policies are expected to become time-barred in accordance with FSA rules.

As the setting of the provision for the rate of redress of endowment mis-selling complaints relies on estimates of factors which may be materially affected by unanticipated or unforeseen events, it is not possible to determine precisely the level of future redress. The directors are of the opinion that suitable provision has been made taking account of known circumstances.

The assumptions were significantly strengthened during 2004 to take into account emerging experience, the effect of the FSA's revised guidance on time-barring, together with an expected worsening of experience due to changes in the way policyholders are notified of shortfalls, following guidance from the ABI.

The liability for mortgage endowment mis-selling claims would increase if there were an increase in the number of complaints received, a decrease in the number of policies time-barred, an increase in the complaint uphold rate or an increase in the average complaint amount per policy compared with current assumptions. A decrease in the assumed unit growth rate would tend to increase the average redress amount per policy.

28 Provision for other risks and charges

	2004	2003
	£000	£000
(i) Deferred taxation		
At 1 January	4,689	9,826
Movement in the year	(2,851)	(5,137)
Transferred on disposal of discontinued operation	(12)	-
At 31 December	<u>1,826</u>	<u>4,689</u>

The components of the deferred tax liabilities are as follows. The balances have not been discounted.

	31 December	31 December
	2004	2003
	£000	£000
Deferred acquisition costs	1,536	4,840
Long-term business technical provision	375	(88)
Capital allowances	(85)	(63)
	<u>1,826</u>	<u>4,689</u>

At 31 December 2004, Countrywide Assured plc had excess and deferred management expenses of £124.8m (2003: £133.9m) and Case VI losses of £ 56.3m (2003: £57.0m) in respect of which a deferred tax asset is not recognised.

	2004	2003
	£000	£000
(ii) Other provisions		
At 1 January	1,466	1,817
Movement in the year	(540)	(351)
At 31 December	<u>926</u>	<u>1,466</u>

Other provisions include property related provisions made on the Group's former head office and sales offices as follows:

	2004	2003
	£000	£000
Property provision		
At 1 January	755	1,268
Additional provisions in the year	197	173
Charged in the year	(80)	(87)
Unused amounts reversed	(374)	(599)
At 31 December	<u>498</u>	<u>755</u>

29 Other creditors including taxation and social security

Group	31 December	31 December
	2004	2003
	£000	£000
UK corporation tax	1,208	117
Other	4,646	10,026
Dividend proposed	6,124	-
Amounts due to Countrywide Assured Group plc companies	-	642
	<u>11,978</u>	<u>10,785</u>

All creditors are payable within one year.

Company	31 December	31 December
	2004	2003
	£000	£000
UK corporation tax	1	-
Dividend proposed	6,124	-
Other	536	-
	<u>6,661</u>	<u>-</u>

30 Reconciliation of operating profit/(loss) to net cash inflow/(outflow) from operating activities

	Year ended 31 December	
	2004	2003
	£000	£ 000
Operating profit/(loss) before tax	2,645	(15,359)
Adjustment for non-cash items:		
Depreciation on tangible fixed assets	301	659
Profit/(loss) relating to long term business	(4,287)	9,414
Shareholder investment returns allocated to technical account	2,426	2,373
Cash transferred from/(to) long term business fund	5,500	(9,000)
Unrealised (gains)/losses on investments	(738)	28
Decrease in amounts owing to long-term business	3,194	3,960
Other items	3	455
Net cash inflow/(outflow) from operating activities	9,044	(7,470)

31 Movement in opening and closing portfolio investments, net of financing

	Year ended 31 December	
	2004	2003
	£000	£000
Increase / (decrease) in cash and short term deposits, net of overdrafts	6,171	(2,016)
Net purchases/(sales) of portfolio investments	841	(5,151)
Unrealised gains/(losses) on investments	738	(28)
Portfolio investments, net of financing at start of year	37,851	45,046
Portfolio investments, net of financing at end of year	45,601	37,851
Represented by:		
Shares in unit trusts	15,518	5,167
Fixed income securities	-	7,561
Deposits with credit institutions	21,046	22,167
Investment properties	360	450
Cash at bank and in hand	8,677	2,506
	45,601	37,851

32 Reconciliation of cash and investments to balance sheet

	1 January	Cashflow	Shareholder unrealised gains/(losses)	Changes in	31 December
	2004			long-term	
	£000	£000	£000	business	£000
Cash					
Shareholder					
Cash at bank and in hand	2,686	6,024	-	-	8,710
Overdrafts	(180)	147	-	-	(33)
Net shareholder cash	2,506	6,171	-	-	8,677
Long-term business					
Cash at bank and in hand	21,194	-	-	9,353	30,547
Overdrafts	-	-	-	(3)	(3)
Net long-term business cash	21,194	-	-	9,350	30,544
Total net cash	23,700	6,171	-	9,350	39,221

	1 January 2004 £000	Cashflow £000	Shareholder unrealised gains/(losses) £000	Changes in long-term business investments £000	31 December 2004 £000
Investments					
Shareholder					
Land and buildings	450	-	(90)	-	360
Investments	34,895	841	828	-	36,564
Total Shareholder investments	35,345	841	738	-	36,924
Long-term business					
Investments	709,359	-	-	34,235	743,594
Total investments	744,704	841	738	34,235	780,518

33 Contingent liabilities

In the opinion of the directors, there were no material contingent liabilities that require disclosure or provision as at 31 December 2004.

34 Capital commitments

There were no material capital commitments as at 31 December 2004.

35 Pension arrangements

The Chesnara plc group offers membership of the Countrywide Assured Group plc pension scheme to eligible employees. The scheme has two sections of membership, defined benefit and defined contribution. At 31 December 2004, there were five deferred members of the defined benefit section (31 December 2003: two active members and three deferred members).

The amount of the deficit in the Countrywide Assured Group pension scheme attributable to the Chesnara plc group at 31 December 2003 was £398,000, for which full provision was made. On that date, the defined benefit section of the scheme was closed in respect of future service and all current active members became deferred members and were given the option of joining the defined contribution section of the scheme.

The contributions payable by Chesnara plc and Countrywide Assured Services Limited ("CASL") to the defined benefit section of the pension scheme for the year ended 31 December 2004 were £nil (2003: £21,421).

Since Chesnara plc and its subsidiary company, CASL, are members of a pension scheme providing benefits based on final pensionable pay and are unable to identify their share of the scheme assets and liabilities on a consistent and reasonable basis, as permitted by FRS 17 "Retirement benefits", the scheme has been accounted for in these Accounts as if the scheme were a defined contribution scheme.

Under a deed of settlement, dated 18 March 2004, between Countrywide Assured Group plc, Chesnara plc, CASL and the scheme Trustees, the parties agreed that Chesnara plc and CASL should have no further liability to the Trustees and the scheme under section 75 of the Pensions Act 1995 by virtue of their participation in the scheme in respect of the accrued pension rights of deferred members in respect of past service and that such liabilities would be borne by Countrywide Assured Group plc. This agreement was subject, in the case of CASL, to payment of £398,000 in respect of the deficit referred to above. On 18 March 2004, the scheme Trustees included Mike Nower who was, at that date, a director of Countrywide Assured Group plc and of Countrywide Assured Life Holdings Limited and Colin Finch, who was, at that date, a director of Countrywide Assured Group plc.

Under FRS 17, certain disclosures are required in respect of the defined benefit section of the Countrywide Assured Group plc pension scheme. As the Group is unable to identify its share of scheme assets and

liabilities on a consistent and reasonable basis, as stated, and, as no further liabilities will arise, the directors believe that the lack of disclosure under FRS 17 is not misleading.

Under the deed of settlement referred to above, Countrywide Assured Group plc and the scheme Trustees also gave permission for Chesnara plc and CASL to participate in the Countrywide Assured Group pension scheme for a period of up to 12 months following the demerger described in Note 1 above. It is the intention of the Group to allow eligible employees to enter the Chesnara plc Stakeholder Scheme on a basis where employer contributions are made to the scheme at the same rate as would be payable had their membership of the Countrywide Assured Group pension scheme continued, provided that employee contributions also continue to be made at the same rate, unless the employee opts to request the Company to pay employer contributions into a personal pension plan, in which instance, employer contributions will be made on the same terms as for the Chesnara plc Stakeholder Scheme.

The pension cost charge for the Group's defined contribution pension arrangements represents contributions payable by the Group and amounted to £260,435 for the year ended 31 December 2004 (2003: £ 316,324).

36 Related party transactions

As set out in Note 1 above, on 24 May 2004 Chesnara plc acquired the whole of the issued ordinary share capital of Countrywide Assured Life Holdings Limited ("CALH") from Countrywide plc ("Countrywide"), which had itself, on 22 May 2004, acquired the whole of the issued share capital of CALH from Countrywide Assured Group plc ("CAG"). The ultimate holding companies of CALH over the period covered by these Accounts up to the date of the effective demerger of the CALH group from the CAG group by way of its transfer into the ownership of Chesnara plc were, from 1 January 2003 to 22 May 2004, CAG and, from 22 May 2004 to 24 May 2004, Countrywide. Accordingly, the transactions between the stated dates which are disclosed in this Note in accordance with the requirements of FRS 8, include those between, on the one part, members of the CALH group and directors of CALH and, on the other part, other members of the CAG group or other members of the Countrywide group. They also include the material contractual arrangements set in place between Chesnara plc, CAG, and Countrywide in connection with the effective demerger of the CALH group from the CAG group.

(a) Transactions involving key management

Directors emoluments in respect of the CALH directors paid by members of the CAG group or by members of the Countrywide group amounted to £297,294 in the period 1 January 2004 to 24 May 2004 (year ended 31 December 2003: £780,000).

Pension contributions in respect of CALH directors paid by members of CAG Group or by members of the Countrywide group amounted to £10,685 in the period 1 January 2004 to 24 May 2004 (year ended 31 December 2003: £33,000).

(b) Transactions with CAG group and Countrywide group companies

Aggregate transactions with members of the CAG group and with members of the Countrywide group included within consolidated profit and loss account captions are set out below:

	Period 1 January 2004 to 24 May 2004 £000	Year ended 31 December 2003 £000
Investment Income	-	346
Other charges		
- Group management charges	(150)	(360)
- Write-off of amounts due from CAG	-	(3,792)
- Other	-	(1,050)

(c) Material contractual arrangements

The following material contractual arrangements, not being arrangements entered into in the ordinary course of business, were set in place in connection with the effective demerger of the CALH group from the CAG group on 24 May 2004 ("the Demerger"). To the extent that these arrangements include

representations, warranties and indemnities, such provisions are considered standard in an agreement of that nature save to the extent identified below:

i) Separation and Transitional Services Agreement

Chesnara plc and Countrywide plc entered into a Separation and Transitional Services Agreement which took effect from 24 May 2004. The agreement deals with a number of administrative arrangements between the Chesnara plc group and Countrywide plc, following the Demerger, in relation to property, tax, information technology, intellectual property (including trade names), access to information for audit and other purposes, share schemes, pensions and various other matters.

The agreement contains an indemnity from Chesnara plc in favour of Countrywide plc in respect of guarantees entered into by CAG relating to Harbour House, Portway, Preston, occupied by members of the Chesnara plc group and reciprocal tax indemnities in respect of certain past and future liabilities of the Countrywide plc group and the Chesnara plc group which may arise following the Demerger in respect of which the liabilities of each party are unlimited.

As soon as reasonably practical after the Demerger, the Countrywide plc group undertook to cease using the word "Assured" in the name of any Countrywide plc group company or any trading name of any Countrywide plc group company. In addition, Countrywide was allowed a period of up to 12 months in which to revise literature and other items which contain the word "Assured".

The agreement provided that neither party would, for a period of three years following 24 May 2004, engage in any campaign, systematically induce, solicit or entice any customer to surrender, terminate, rescind or suspend payment into any policy where it had been arranged or introduced by the other party.

ii) Demerger Agreement

Under the Demerger Agreement, Countrywide plc agreed, subject to the satisfaction of certain conditions, to the transfer on 24 May 2004 of CALH to Chesnara plc, in consideration of which, Chesnara plc would allot and issue, as fully paid, ordinary shares in Chesnara plc to Countrywide plc shareholders. Each Countrywide plc shareholder on the register of members at the Demerger record date would receive 1 ordinary share in Chesnara plc for every 1 ordinary share in Countrywide plc it held at that time and would not be required to make any payment for such shares.

Under the agreement, Countrywide plc gave no warranties, save as to the ownership of CALH and of the shares in the companies to be transferred. Apart from an interim dividend payment paid to Countrywide plc, as set out in Note 13 above, and certain pension scheme arrangements, as set out in Note 35 above, there are no other material related party transactions.

37 Post balance sheet events

(i) Insurance Administration Services Agreement

On 28 January 2005 the Company's principal subsidiary company, Countrywide Assured plc ("CA"), entered into an Insurance Administration Services Agreement with Liberata Financial Services Limited ("Liberata") which took effect from 1 February 2005. Under the terms of the agreement, staff engaged on the maintenance and run-off of the CA life and pensions book were transferred to Liberata under arrangements which comply with the Transfer of Undertakings (Protection of Employment) Regulations 1981 and Liberata undertook to provide policy administration and accountancy services for a period of 10 years. In connection with these arrangements, governance and oversight functions are performed by a small team of staff employed by Chesnara plc and the cost of these services is charged to CA by way of a management services fee.

In accordance with these arrangements a significant proportion of the cost of the resources required to provide policy administration and accountancy services is, from 1 February 2005, no longer incurred directly within net operating expenses in the long-term business technical account, but is incurred indirectly by way of charges from Liberata and Chesnara plc. The longer-term expense assumptions underlying the establishment of the long-term business provision at 31 December 2004 materially anticipated the salient terms of these arrangements.

Following a decision delivered in the European Court of Justice in March 2005 in the case of *Staatssecretaris van Financiën v Arthur Andersen and Co, Accountants*, there is uncertainty whether charges made under such arrangements will be exempt from VAT at all times in the future. No provision has been made in these financial statements for any effect which this may have on the results or financial position of the Group.

(ii) Issue and Allotment of Ordinary Shares

On 10 February 2005, pursuant to a notice of exercise of option by Numis Securities Limited ("Numis"), the Board approved the issue and allotment to Numis of 1,691,284 new ordinary shares of 5p each. Further details are given in Note 24 above

38 Subsidiary and associated holdings

Name	Country of Incorporation or registration	Principal Activity	Class and percentage of shares held
Countrywide Assured plc	England & Wales	Long-term insurance business	100% of all share capital (4)
Countrywide Assured Life Holdings Limited	England & Wales	Holding company	100% of all share capital
Countrywide Assured Services Limited	England & Wales	Management services	100% of all share capital (4)
Countrywide Assured Trustee Company Limited	England & Wales	Corporate trustee	100% of all share capital (4)
Premium Life Assurance Holdings Limited	England & Wales	Intermediate holding company	100% of all share capital (1)
Reefwise Limited	England & Wales	Intermediate holding company	100% of all share capital (2)
Premium Life International Limited	Guernsey	Long-term insurance business	100% of all share capital (3)
Countrywide Assured Commission Services Limited	England & Wales	Commission financing	100% of all share capital (3)
The Greenways Management Company (Deepcar) Limited	England & Wales	Management services	100% of all share capital (3)
Countrywide Assured Consultancy Limited	England & Wales	Dormant – in the process of winding up	100% of all share capital (4)
Countrywide Assured Care Limited	England & Wales	Dormant – in the process of winding up	100% of all share capital (1)
Premium Life Assurance Company Limited	England & Wales	Dormant– in the process of winding up	100% of all share capital (3)
Premium Life Finance Limited	England & Wales	Dormant– in the process of winding up	100% of all share capital (3)
Premium Life Investment Management Services Limited	England & Wales	Dormant– in the process of winding up	100% of all share capital (3)
Premium Life Unit Trust Managers Limited	England & Wales	Dormant– in the process of winding up	100% of all share capital (3)

(1) Held indirectly through Countrywide Assured plc

(2) Held indirectly through Premium Life Assurance Holdings Limited

(3) Held indirectly through Reefwise Limited

(4) Held directly

The companies in which Chesnara's interest is more than 20% are as above. Application has been made to strike off 6 Group companies, which have been dormant or not traded for at least 6 years. The companies are Premium Life Finance Limited, Premium Life Investment Management Services Limited, Premium Life Unit Trust Managers Limited, Premium Life Assurance Company Limited, Countrywide Assured Care Limited and Countrywide Assured Consultancy Limited.

This is the last page of the audited financial statements.

Supplementary Information on an Achieved Profit Basis

Summarised Group Profit and Loss Account – Achieved Profit Basis

	Note	Discontinued Operation 2004 £000	Continuing Operations 2004 £000	Total 2004 £000	Discontinued Operation 2003 £000	Continuing Operations 2003 £000	Total 2003 £000
Operating loss before tax and exceptional items	5	-	(5,882)	(5,882)	-	(44,745)	(44,745)
Investment variances							
- profit on sale of a discontinued operation	5	1,948	-	1,948	-	-	-
- other	5	109	1,665	1,774	151	(1,212)	(1,061)
Economic assumption changes		-	(826)	(826)	-	1,322	1,322
Achieved profit/(loss) on ordinary activities before taxation	5	<u>2,057</u>	<u>(5,043)</u>	<u>(2,986)</u>	<u>151</u>	<u>(44,635)</u>	<u>(44,484)</u>
Tax on achieved profit/(loss) on ordinary activities				3,455			(1,899)
Achieved profit/(loss) on ordinary activities after taxation	5			469			(46,383)
Dividends				(10,151)			-
Retained achieved loss for the financial year				<u>(9,682)</u>			<u>(46,383)</u>

The notes on pages 75 to 79 form part of this supplementary information.

Reconciliation of movements in shareholders' funds – Achieved Profit Basis

	2004	2003
	£000	£000
Shareholder funds at 1 January	152,745	199,128
Achieved profit/(loss) for the financial period	469	(46,383)
Dividends paid and proposed	(10,151)	-
Shareholder funds at 31 December	<u>143,063</u>	<u>152,745</u>

The notes on pages 75 to 79 form part of this supplementary information.

Statement of encumbered capital and reconciliation to net asset value

	2004	2003
	£000	£000
Encumbered capital		
- long-term insurance capital requirement	27,932	27,621
- resilience capital requirement	<u>2,552</u>	<u>-</u>
	30,484	27,621
Unencumbered capital	<u>27,985</u>	<u>26,603</u>
Net asset value at 31 December	58,469	54,224
Value of policies in-force	<u>84,594</u>	<u>98,521</u>
Embedded value at 31 December	<u>143,063</u>	<u>152,745</u>

Note:

The long-term insurance capital requirement at 31 December 2003 is taken as the required minimum margin as reflected in the Insurance Returns to the FSA for the year ended 31 December 2003.

Summarised Group Balance Sheet – Achieved Profit Basis

ASSETS	Note	31 December 2004 £000	31 December 2003 £000
Investments			
Land and buildings		360	450
Other financial investments		278,030	269,974
		<u>278,390</u>	<u>270,424</u>
Value of in-force business			
Long-term insurance	8/9	84,594	98,521
Assets held to cover linked liabilities		<u>502,128</u>	<u>474,280</u>
		865,112	843,225
Reinsurers' share of technical provisions		181,344	175,435
Debtors		8,162	18,093
Other assets		39,660	24,784
Prepayments and accrued income		6,942	6,466
Total assets		<u>1,101,220</u>	<u>1,068,003</u>
 LIABILITIES			
Capital and reserves			
Called up share capital		4,228	4,228
Capital redemption reserve		50	-
Demerger reserve		36,272	36,272
Profit and loss account		102,513	112,245
Shareholders' funds attributable to equity interests	8/9	<u>143,063</u>	<u>152,745</u>
Technical provisions		316,518	306,084
Technical provisions for linked liabilities		622,590	591,125
Provision for other risks and charges		841	1,403
Creditors		18,208	16,646
Total liabilities		<u>1,101,220</u>	<u>1,068,003</u>

The notes on pages 75 to 79 form part of this supplementary information.

Notes to the Achieved Profit Result

1. Directors' Responsibilities

The Directors are responsible for preparing the consolidated supplementary information on pages 72 to 79. In preparing the supplementary information, it is the Directors' responsibility to ensure that suitable accounting policies are adopted and applied consistently and that judgements and standards are reasonable and prudent.

2 Basis of Presentation

Supplementary information on pages 72 to 79 is presented which presents summary data relating to the results and financial position of the Group on the Achieved Profits basis, the objective of which is to provide shareholders with alternative information on the financial position and results of the Group to that presented under the Modified Statutory Solvency Basis ("MSSB"). The information includes the result of the Group's Life Assurance long-term business on a basis determined in accordance with the ABI Guidance "Supplementary reporting for long-term assurance business" (the "Achieved Profit method") (ABI AP Guidance) issued in December 2001. All other transactions and balances have been determined in accordance with the MSSB accounting policies noted on pages 47 to 50. The comparative figures for the year ended 31 December 2003 have been presented to provide consistent treatment and disclosure between periods.

The revision of the economic and demographic assumptions at December 2004 from those adopted at December 2003 would result in a change to opening and closing 2003 Shareholder Funds and components of 2003 Achieved Profit Earnings. The effect of these is shown in Note 6 following.

3 Methodology

The Achieved Profit methodology recognises as an element of "Shareholder Funds" the discounted value of the expected future statutory surpluses arising from the contracts in force at the period end. These future surpluses are calculated by projecting future cash flows using realistic assumptions for each component of cash flow.

Residual assets, comprising the excess assets within the long-term fund over and above mathematical reserves, together with the excess of segregated shareholder net assets on a statutory solvency basis over the Capital Resources Requirement ("CRR"), which is regarded as encumbered capital, represent further components of Shareholder Funds.

Recognition, within Shareholder Funds, of the cost of maintaining the CRR at a reporting date is offset within Achieved Profit methodology by the recognition of the discounted value of expected future anticipated net interest and releases of the CRR over the period to expiry of the policies in force.

The annual result is impacted by the movement in this cost from year to year which comprises a charge against new business profit with a partial offset for the release of capital requirements for business in force.

The Achieved Profit methodology recognises as profit the movement in Shareholder Funds over a period. Operating profit has been determined upon the principles embodied in paragraph 58, 'Components of Achieved Profits', of the ABI AP Guidance.

Demographic actuarial assumptions adopted for the determination of discounted value are generally reviewed annually although more frequent reviews are carried out if there is evidence of material changes. Future economic and investment assumptions are based on period end conditions. Experience variances shown in Note 5 below have been determined using closing assumptions.

In the derivation of discounted future surplus no recognition is given to future premiums under non-contractual increments or for future Department of Work and Pensions rebate premiums.

4 Key Assumptions

Economic and Investment Assumptions

The principal economic and investment assumptions used within the cash flows for projecting the business in force are set out below:

	Year Ended 31 December	
	2004	2003
	%	%
Economic assumptions		
Risk discount rate	9.00	9.25
Future expenses inflation rate	3.10	3.50
Future expense charge inflation rate	3.10	3.50
Future RPI	2.50	2.50
Unit linked funds		
- Income (pre tax)	3.30	3.39
- Capital growth (pre tax)	3.52	3.73
- Total	<u>6.82</u>	<u>7.12</u>

Investment returns (pre tax)

Government fixed interest	4.70	5.00
Other fixed interest	5.20	5.50
Equity	7.30	7.60
Property	7.30	7.60

The risk discount rate is used to discount projected future cash flows from the business in force to a present value and is set within the context of assumptions for future investment returns.

The principal economic assumptions have been determined by reference to underlying medium term government fixed interest yields at the respective valuation dates. Other fixed interest yield assumptions reflect the yield curve for different asset outstanding terms and credit and liquidity risk adjustments. The equity return assumes, over the longer term, a risk premium adjustment over medium term Government Fixed Interest yields.

Other material business assumptions

Future persistency experience assumptions are determined, in the main, by reference to the Life Business's own emerging experience of individual products but with some allowance recognised for external industry experience and trends. Explicit allowance for anticipated short-term adverse persistency risk has been reflected by the inclusion, within the core annualised product line lapse assumption rates, of additional temporary decrement rates, being 8% pa for Endowment business and 3.5% pa for Protection business, with the additional decrement rates assumed operable from 31 December 2004 for temporary periods of twelve months (Endowment business) and six months (Protection business).

The contribution of both persistency assumption charges and persistency experience to operating loss before tax and exceptional items for the twelve months ended 31 December 2004 was a charge of £6,251,000 (year ended 31 December 2003: a charge of £38,982,000).

Mortality and morbidity decrement assumptions are determined by reference to emerging underlying experience, published industry data and reinsurer rates. Due regard is paid in setting the experience assumptions to policyholder reasonable expectations as mortality and morbidity costs are met by charges against unit accounts.

The renewal expense assumptions at 31 December 2004 reflect the charges under the Insurance Administration Services Agreement with Liberata Financial Services Limited, which took effect from 1 February 2005 and which is more fully described in Note 37 to the MSSB Accounts on page 70, together with the residual governance expenses attributable to the Company.

The renewal expense assumptions at 31 December 2003 are based on an analysis of recent experience. Per policy expenses were assumed to inflate at a rate consistent with assumptions regarding future economic conditions and investment earnings rates.

During 2003, the life business substantially closed to new business and the allowance for future expenses in the calculation of the embedded value at 31 December 2003 and 31 December 2004 has been based on the Board's view of total company expenses chargeable to the long-term business. In addition, the Board

has decided, on the grounds of prudence, that, in view of the uncertain outlook for expenses over the longer term, cash flows arising beyond a 14-year time horizon should be excluded from the value of policies in-force.

The expense inflation and indexation of capital gains assumptions are set within the context of rates of price inflation implicit within the yields of 15 year indexed linked gilt edged securities, and consistent earnings inflation assumptions.

Future fund management expenses are based on current fees charged to the life business.

Tax has been provided at the rates applicable to investment income and expenses relief provided under relevant life company taxation, which is assumed to continue unaltered. A projection of future tax charges, based upon an assumption of continuation of current tax rules, is made and is discounted at the risk discount rate to produce a deferred tax charge at the period end. The effective rate of tax applicable to the change in discounted value of future surpluses over the year is 28% (2003 2.4%). The net result is grossed up by the deferred tax charge movement and current tax to derive the gross result.

The provision established to cover redress on endowment complaints is based on recent experience of complaints cases, assuming the life business continues to deal with complaints in accordance with the FSA's procedural requirements, including the application of time-barring.

The portion of a reinsurer default reserve that relates to unit-linked business is assumed to be released within 12 months. However, the portion of this reserve that relates to with-profits business is assumed to be released over the expected lifetime of that business.

5 Components of achieved profit

The pre-tax components of the Achieved Profit result are shown below. The basic operating Achieved Profit result is determined by using the assumptions set out above in Note 4. This result is adjusted to take into account items considered to be short-term variations to these longer-term assumptions to determine the total achieved pre and post-tax result for the respective year.

	Year Ended 31 December	
	2004	2003
	£000	£000
New business contribution	664	(703)
Existing business contribution		
Expected return	10,708	13,925
Experience variances		
- Persistency	2,854	(12,185)
- Mortality/morbidity	(1,030)	3,969
- Pensions redress and complaints	(17,556)	(14,110)
- Other	3,541	3,212
Operating assumption changes		
- Persistency	(9,105)	(26,797)
- Expenses and deductions, including outsource expenses	3,110	(12,227)
- Other	(220)	(801)
Expected return on unencumbered capital	1,152	972
Operating achieved loss before tax and exceptional items	(5,882)	(44,745)
Investment return variances		
- Profit on sale of discontinued operation	1,948	-
- Other	1,774	(1,061)
Effect of economic assumption changes		
- Investment return	(2,146)	3,855
- Risk discount rate	1,320	(2,533)
Achieved loss before tax	(2,986)	(44,484)
Tax	3,455	(1,899)
Achieved profit /(loss) after tax	469	(46,383)

6 Life Assurance reported information at 31 December 2003 restated based on assumptions used at 31 December 2004

The following table restates information on new business contribution and expected return for the year ended 31 December 2003, and on Shareholder Funds as at that date, using the same economic assumptions adopted at 31 December 2004 to enable comparison. Under achieved profit methodology an active approach to assumption setting is generally required.

	31 December 2003
	£m
New business contribution: (reported 2003 economic assumptions)	(0.7)
New business contribution: (revalued on 2004 economic assumptions)	(0.7)
Expected return : (reported 2003 economic assumptions)	13.9
Expected return: (revalued on 2004 economic assumptions)	13.4
Shareholder funds: (reported 2003 economic assumptions)	152.7
Shareholder funds: (revalued on 2004 economic assumptions)	151.7

7. Sensitivities

(i) Impact of financial assumption changes for the year ended 31 December 2004 or as at 31 December 2004

	New Business Contribution (£ m)	Shareholder Funds (£ m)
Reported at 31 December 2004	0.7	143.1
Risk Discount Rate +1%	(0.0)	(4.1)
Risk Discount Rate -1%	0.0	4.3
Investment Return (pre tax) +1%	0.0	4.6 *
Investment Return (pre tax) -1%	(0.0)	(4.6)*

* For the current range of term assurance products the investment return assumption (net of tax charge) is capped at the effective net of tax investment rate used in the premium review process.

(ii) Impact of a 10% increase in persistency assumptions at 31 December 2004

The table below shows the impact of adopting persistency assumptions at a level of 110% of the actual assumptions adopted at December 2004.

	New Business Contribution (£ m)	Shareholder Funds (£ m)
Reported at 31 December 2004	0.7	143.1
Persistency Assumptions +10%	0.0	(4.9)

The impact of adopting lower persistency assumptions at a level of 90% of the actual assumptions adopted at 31 December 2004 would have resulted in increases in New Business Contribution and Shareholder Funds by amounts of similar magnitude to the movements shown above.

8. Value of policies in-force and embedded value of the life assurance business

	2004	2003
	£000	£000
Value of policies in force:		
At 1 January (net of tax)	98,521	135,956
Gross decrease in value of policies in-force	(19,452)	(36,205)
Taxation	5,525	(1,230)
At 31 December (net of tax)	<u>84,594</u>	<u>98,521</u>
Net asset value at 31 December	58,469	54,224
Shareholder funds at 31 December	<u><u>143,063</u></u>	<u><u>152,745</u></u>

9. Reconciliation of MSSB shareholder equity to embedded value

	31 December	31 December
	2004	2003
	£000	£000
MSSB shareholders' equity	73,952	78,739
MSSB adjustments		
- deferred acquisition costs	(5,120)	(16,135)
- purchased in-force value	(1,622)	(1,963)
- actuarial reserves	62	(169)
- deferred taxation	1,911	4,752
Sub-total	<u>69,183</u>	<u>65,224</u>
Reinsurer default reserve	(9,000)	(11,000)
Reserve for additional costs	<u>(1,714)</u>	<u>-</u>
	58,469	54,224
Value of in-force book	<u>84,594</u>	<u>98,521</u>
Embedded value	<u><u>143,063</u></u>	<u><u>152,745</u></u>

The reinsurer default reserve and the reserve for additional costs relate to reserves which have been established for FSA prudential reporting. Neither of these reserves is recognised for reporting under the Modified Statutory Solvency Basis or under the Achieved Profit Basis as the events to which they relate are, in the opinion of the Directors, considered to be remote or uncertain. However, for the purpose of reporting under the Achieved Profit basis, the reserves are charged to the Shareholder net assets component of embedded value, but are released within the value-in-force calculations. This method is used so that the cost of capital of maintaining the relevant reserves is recognised within the overall embedded value calculation.

The reassurer default reserve relates to the reserve which is maintained against the effect of possible default by a major reinsurer, Guardian Assurance plc, which is a subsidiary of Aegon NV.

The reserve for additional costs relates to VAT which may become assessable on charges made under an Insurance Administration Services Agreement with Liberata Financial Services Limited. Following a decision delivered in the European Court of Justice in March 2005 in the case of *Staatssecretaris von Financiën v Arthur Andersen and Co, Accountants*, there is uncertainty whether charges made under such arrangements will be exempt from VAT.

External Review

The preparation of the supplementary information has been reviewed by KPMG Audit Plc, who have reported to the Board that, in accordance with their terms of reference, the supplementary information has been properly prepared on the basis of the methodology and assumptions adopted.

Five Year Financial Record

Profit and Loss Account Summary

	Year ended 31 December				
	2004 £000	2003 £000 (restated)	2002 £000 (Note 2)	2001 £000 (Note 2)	2000 £000 (Note 2)
Earned premiums, net of reinsurance	171,037	142,325	229,602	185,562	223,553
Pre-tax profit/(loss) arising on long-term business	4,287	(9,414)	4,379	15,469	11,624
Other income and charges	(1,751)	(6,096)	(500)	(73)	(309)
Operating profit/(loss)	2,536	(15,510)	3,879	15,396	11,315
Profit/(loss) on ordinary activities before tax	2,536	(15,510)	3,879	15,396	11,315
Continuing operations	2,536	(15,510)	3,879	15,396	11,315
Discontinued operations					
- operating profit/(loss)	109	151	(145)	(1,162)	(2,083)
- profit on disposal	1,948	-	-	-	-
Tax on profit/(loss) on ordinary activities	771	4,590	(149)	(1,375)	752
Profit/(loss) on ordinary activities after tax	5,364	(10,769)	3,585	12,859	9,984
Dividends paid and proposed	(10,151)	-	-	(6,000)	(7,000)
Retained (loss)/profit for the period transferred to reserves	(4,787)	(10,769)	3,585	6,859	2,984
Basic earnings/(loss) per share	6.34p	(12.73)p	4.24p	15.21p	11.81p
Diluted earnings/(loss) per share	6.33p	(12.73)p	4.23p	15.18p	11.79p
Dividend per share	11.85p	n/a	n/a	n/a	n/a

Dividend per share has only been calculated for 2004, the year in which the Company was first listed on the London Stock Exchange.

Operating Statistics

	Year ended 31 December				
	2004 £000	2003 £000	2002 £000	2001 £000	2000 £000
New policies issued in period	2,339	36,941	52,132	43,243	37,312
Life annual premium income (API)	£123.3m	£146.9m	£158.3m	£160.6m	£164.3m
Life single premium income (SPI)	£78.9m	£27.7m	£96.6m	£51.1m	£51.1m
Life annualised premium income (API + 1/10 SPI)	£131.2m	£149.0m	£168.0	£165.7m	£169.4m

Five Year Financial Record

Balance Sheet

	Year ended 31 December				
	2004 £000	2003 £000	2002 £000	2001 £000	2000 £000
ASSETS					
Investments	278,390	270,424	283,531	272,614	272,262
Assets held to cover linked liabilities	502,128	474,280	395,063	433,341	434,549
Reinsurers' share of technical provisions	181,344	175,435	166,210	189,301	148,324
Debtors	8,162	18,093	19,624	18,753	24,761
Other assets	41,282	26,747	33,190	21,374	22,613
Prepayments and accrued income	12,062	22,601	42,373	38,828	34,792
Total Assets	1,023,368	987,580	939,991	974,211	937,301
LIABILITIES					
Shareholders' funds attributable to equity interests	73,952	78,739	89,507	85,922	79,065
Technical provisions	305,866	294,915	328,513	293,676	251,297
Technical provisions for linked liabilities	622,590	591,125	498,677	561,498	568,017
Provision for other risks and charges	4,752	6,155	11,591	11,248	10,304
Creditors	16,208	16,646	11,703	21,867	28,618
Total Liabilities	1,023,368	987,580	939,991	974,211	937,301

Five Year Financial Record

Cash flow statement

	Year ended 31 December				
	2004 £000	2003 £000	2002 £000	2001 £000	2000 £000
Net cash inflow from operating activities	9,044	(7,470)	13,367	4,646	13,320
Taxation	(201)	349	124	217	(418)
Capital expenditure	(146)	(46)	(406)	(637)	(1,024)
Disposal of subsidiary	2,750	-	-	-	-
Cash balances transferred on disposal	(408)	-	-	-	-
Equity dividends paid	(4,027)	-	(6,000)	(7,000)	(5,000)
Net cash inflow/(outflow) of the Group excluding long-term business	7,012	(7,167)	(7,085)	(2,774)	6,878

The cash flows were invested as follows:

Portfolio investments					
Purchases:					
Equities	11,256	10,234	9,595	9,225	8,429
Fixed income securities	1,228	11,058	35,438	24,617	-
Deposits	41,500	129,551	9,869	12,832	6,200
	<u>53,984</u>	<u>150,843</u>	<u>54,902</u>	<u>46,674</u>	<u>14,629</u>

Sales:					
Equities	(1,397)	(11,369)	(8,248)	(12,211)	(480)
Fixed income securities	(9,072)	(12,932)	(32,342)	(26,887)	(9,418)
Deposits	(42,674)	(131,693)	(8,078)	(8,873)	-
	<u>(53,143)</u>	<u>(155,994)</u>	<u>(48,668)</u>	<u>(47,971)</u>	<u>(9,898)</u>

Net purchase/(sales) of portfolio investments	841	(5,151)	6,234	(1,297)	4,731
Increase/(decrease) in cash and short-term deposits, net of overdrafts	6,171	(2,016)	851	(1,477)	2,147
Net investment of cash flows	7,012	(7,167)	7,085	(2,774)	6,878

In accordance with FRS 1, this statement excludes the cashflows of the long-term business fund.

Notes to the Five Year Financial Record

- (1) The results and cashflow for the year ended 31 December 2004 and the financial position as at that date are the results, cashflow and financial position of the Chesnara plc group applying the merger accounting convention. In accordance with that convention, the consolidated results, cashflow and financial position of Chesnara plc are based on the consolidated results, cashflow and financial position of Countrywide Assured Life Holdings Limited ("CALH") (refer to Note 2 to the financial statements): The results, cashflows and financial positions in respect of all prior periods are based on the results, cashflow and financial positions of CALH for those periods or at those period ends. Information in respect of periods beginning on or after 1 January 2001 was included in the Listing Particulars referred to in Note 1 to the financial statements.
- (2) As stated in Note 2 to the financial statements, in order to comply with Statement of Recommended Practice on Accounting for Insurance Business issued by the Association of British Insurers, as revised in November 2004, the Directors decided to report using smoothed investment assumptions. This represented a change in accounting policy and the results arising on the long-term business technical account and the non-technical account were, accordingly, restated in respect of the year ended 31 December 2003. As stated in Note 8 to the financial statements, a full 5-year comparison of longer-term rates of investment return with the actual return will be built up to 5 years by 31 December 2007. It is considered impractical to restate all periods prior to 2003 in accordance with this change in accounting policy, which does not involve a change in the financial positions already reported.

Notice of Annual General Meeting

Chesnara plc

Notice is hereby given that the Annual General Meeting of the Company will be held at the offices of Pinsent Masons, 1 Gresham Street, London, EC2V 7BU on 26 April 2005 at 11.00am for the following purposes:-

Ordinary Business

Resolution 1

To receive and adopt the accounts for the year ended 31 December 2004 together with the Reports of the Directors and Auditors thereon.

Resolution 2

To declare a final dividend

Resolution 3

To approve the Directors' Remuneration Report set out in the Annual Report.

Resolutions 4 and 5

To re-elect the following Directors who retire by rotation:-

Mike Gordon

Terry Marris

To consider and, if thought fit, pass Resolution 6 and 7 as Ordinary Resolutions.

Resolution 6

That KPMG Audit Plc be and are hereby appointed as Auditors of the Company to hold office from the conclusion of this meeting until the conclusion of the next general meeting at which the accounts are laid before the Company at a remuneration to be fixed by the Directors.

Resolution 7

That the Directors be and are hereby generally and unconditionally authorised, pursuant to Section 80 of the Companies Act 1985 (the Act) to exercise all the powers of the Company to allot relevant securities (as defined in Section 80 of the Act) provided that:-

- (i) the nominal value of relevant securities allotted pursuant to this authority shall not exceed £1,437,447 representing 33.33% of the issued ordinary shares of 5p each.
- (ii) this authority shall expire on the date of the Annual General Meeting to be held in 2006 or fifteen months after the passing of this resolution whichever occurs first; and
- (iii) the company may make an offer or agreement before the expiry of this authority which would or might require relevant securities to be allotted after this authority has expired and the Directors may allot relevant securities in pursuance of any such offer or agreements as if this authority has not expired; this authority is to replace the existing like authority which is hereby revoked with immediate effect.

To consider and, if thought fit, pass Resolution 8 and 9 as Special Resolutions.

Resolution 8

That the Directors be and they are hereby empowered, pursuant to Section 95 of the Companies Act 1985 (the Act), to allot equity securities (as defined in Section 94 of the Act) pursuant to the authority contained in the foregoing Resolution numbered 7 as if Section 89(1) of the Act did not apply to such allotment, save that this power shall be limited to:

- (i) the allotment of equity securities in connection with a rights issue or other pre-emptive offer in favour of Ordinary Shareholders where the equity securities respectively attributable to the interests of all Ordinary Shareholders are proportionate (as nearly as may be) to the respective numbers of Ordinary Shares held by them subject to such exclusions or arrangements as the Directors may deem necessary or desirable to deal with fractional entitlements otherwise arising or legal or practical problems under the laws or regulations of any regulatory authority in any territory;

- (ii) the allotment of equity securities pursuant to the terms of any share scheme for employees approved by the members in General Meetings; and
- (iii) the allotment of equity securities for cash (otherwise than as mentioned in sub-paragraphs (i) and (ii) above) provided that the maximum nominal value of equity securities allotted does not exceed £215,638 representing approximately 5% of the issued share capital of the Company; and shall expire on the date of the Annual General Meeting of the Company to be held in 2006 or fifteen months after the passing of this resolution whichever occurs first except to the extent that the same is renewed or extended prior to or at such Meeting save that the Company may make an offer or agreement before the expiry of this power which would or might require securities to be allotted after it has expired and the Directors may allot equity securities in pursuance of any such offer or agreement as if the power conferred hereby had not expired.

Resolution 9

That the Company be and is hereby authorised to make market purchases (within the meaning of Section 163(3) of the Companies Act 1985) of Ordinary Shares of 5p each in the capital of the Company provided that:

- (i) the maximum aggregate number of Ordinary Shares hereby authorised to be purchased is 8,625,545;
- (ii) the minimum price which may be paid for such Ordinary Shares is 5p per share;
- (iii) the maximum price (exclusive of expenses) which may be paid for such Ordinary Shares is not more than 5% above the average of the middle market quotations for the Ordinary Shares derived from the Daily Official List of the London Stock Exchange for the five business days before the purchase is made;
- (iv) the authority hereby conferred shall expire at the conclusion of the next Annual General Meeting of the Company held in 2006 or, if earlier, the date 15 months after the date on which the resolution is passed ; and
- (v) the Company may make a contract or contracts to purchase Ordinary Shares under the authority hereby conferred prior to the expiry of such authority which will or may be executed wholly or partly after the expiry of such authority, and may make a purchase of Ordinary Shares in pursuance of any such contract or contracts.

Notes

1. Any Member entitled to attend and vote at this Meeting may appoint a proxy or proxies to attend and on a poll, vote instead of him. A proxy need not be a Member of the Company. A form of proxy for this Meeting is enclosed, and if used should be lodged with the Company's Registrars, Capita Registrars at The Registry, P.O. Box 25, 34 Beckenham Road, Beckenham, Kent, BR3 3BR not less than 48 hours before the time appointed for the holding of the meeting. The appointment of a proxy will not preclude a shareholder from attending and voting at the meeting.
2. There is no Directors' service contract of more than one year's duration with any Director.
3. The Register of Directors' shareholdings and transactions and copies of Directors' service contracts will be available for inspection at the registered office of the Company during normal business hours each business day and at the place of the Annual General Meeting for at least 15 minutes prior to and during the Meeting.
4. Pursuant to Regulation 41 of the Uncertificated Securities Regulations 2001, the time by which a person must be entered on the register of members in order to have the right to attend and vote at the Annual General Meeting is 11.00am on 24 April 2005 or, if the Meeting is adjourned, such time being not more than 48 hours prior to the time fixed for the adjourned meeting. Changes to entries on the register of members after that time will be disregarded in determining the right of any person to attend or vote at the meeting.

Additional Information

Approval of the Directors Remuneration Report set out in the Annual Report (Resolution 3)

The Directors' Remuneration Report Regulation 2002, which came into force on 1 August 2002, stipulates the form of the Report. The Report is set out on pages 28 to 34 of the Annual Report. Shareholders will be asked to approve this Remuneration Report under Resolution 3.

Authority to Allot Relevant Securities (Resolution 7)

The Company will be asking shareholders to renew the existing authority which the Directors have to allot shares in respect of the authorised but unissued ordinary share capital. Resolution 9 seeks to renew this

authority to issue shares up to an aggregate nominal amount of £1,437,447 representing approximately 33.33% of the issued share capital of the Company.

Disapplication of Pre-emption Rights (Resolution 8)

Resolution 8 will be proposed as a Special Resolution, renewing the Directors' authority to allot shares for cash other than to existing shareholders in proportion to their shareholding up to an aggregate nominal value of £215,638, representing 5% of the Company's issued share capital. Both these authorities, if given, will expire at the conclusion of the next Annual General Meeting or 15 months after the passing of the resolution, whichever occurs first.

Power to purchase own shares (Resolution 9)

The Companies Act 1985 permits a public company to purchase its own shares in accordance with powers contained in its Articles of Association with the authority of a resolution of shareholders. Such a power would expire at the conclusion of the next Annual General Meeting. With effect from 1 December 2003, listed companies are able to buy their own shares and, instead of cancelling them, hold them in treasury and either sell them for cash or use them for cash or use them for an employee share scheme under the Companies (Acquisition of Own Shares) (Treasury Shares) Regulations 2003. The aggregate nominal value of shares of any class held as treasury shares must not be at any time exceed 10% of the nominal value of the issued share capital of the shares in that class at that time. Your Directors believe that the Company should continue to have the authority to purchase its own shares. However, this authority will only be exercised when the result would be an increase in earnings per share and in the best interests of the Company. Your Directors have no present intention to make use of this authority. Resolution 9 will be proposed as a Special Resolution at the Annual General Meeting to give the necessary authority.

By Order of the Board

DATE 21 March 2005

Ken Romney
Company Secretary

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Preston
PR2 2PR

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EC2V 7BU