

CAPCO REINSURANCE COMPANY LTD.

FINANCIAL STATEMENTS

DECEMBER 31, 2001

CAPCO REINSURANCE COMPANY LTD.

Financial statements

December 31, 2001

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CAPCO REINSURANCE COMPANY LTD.

Corporate information

December 31, 2001

Directors

John L Marion
Trevor A Carmichael
Martin R Hole

Officers

John L Marion - President
Martin R Hole - General Manager
Trevor A Carmichael - Secretary
Ella M Hoyos - Assistant Secretary

Registered office

Chancery House
High Street
Bridgetown
Barbados

Insurance managers

Mims International (Barbados) Ltd.
Building No. 2, Chelston Park
Collymore Rock
St. Michael
Barbados

Bankers

Royal Bank of Canada
Building No. 1, Chelston Park
Collymore Rock
St. Michael
Barbados

Attorneys-at-law

Chancery Chambers
High Street
Bridgetown
Barbados

Auditors

Pannell Kerr Forster
1st Floor, Building No. 2
Chelston Park
Collymore Rock
St. Michael
Barbados

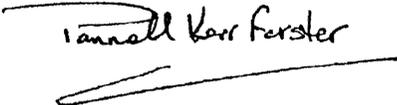
Auditors' report

To the shareholders of Capco Reinsurance Company Ltd.

We have audited the accompanying balance sheet of Capco Reinsurance Company Ltd. as of December 31, 2001 and the related statements of income, changes in shareholders' equity and cash flows for the year then ended. The financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on the financial statements based on our audit.

We conducted our audit in accordance with International Standards on Auditing. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements present fairly, in all material respects, the financial position of the Company as of December 31, 2001 and the results of its operations and cash flows for the year then ended in accordance with accounting principles generally accepted in Canada.


Pannell Kerr Forster

28 February, 2002

CAPCO REINSURANCE COMPANY LTD.

Balance sheet

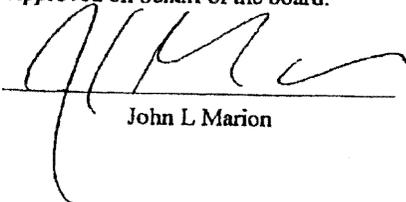
As of December 31, 2001

(expressed in United States dollars)

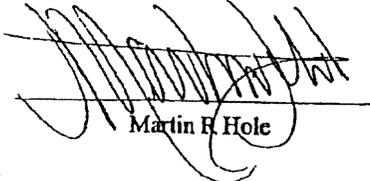
	Notes	2001	2000
Assets			
Cash and deposits	3	10,894,267	5,566,332
Marketable securities	4	135,127,202	206,154,655
Accrued investment income		2,620,653	1,814,873
Prepaid expenses		-	5,000
Total assets		\$ 148,642,122	\$ 213,540,860
Liabilities			
Accounts payable		24,047	57,581
Unearned premium reserve		9,000,000	14,000,000
Losses and loss expenses	5	55,432,000	73,184,000
Total liabilities		64,456,047	87,241,581
Shareholders' equity			
Stated capital	6	158,000,000	190,000,000
(Accumulated deficit)		(73,813,925)	(63,700,721)
Total shareholders' equity		84,186,075	126,299,279
Total liabilities and shareholders' equity		\$ 148,642,122	\$ 213,540,860

The accompanying notes form an integral part of these financial statements.

Approved on behalf of the board.



 John L. Marion
 Director



 Martin R. Hole
 Director

CAPCO REINSURANCE COMPANY LTD.

Statement of income

For the year ended December 31, 2001

(expressed in United States dollars)

	Notes	2001	2000
Underwriting income			
Premiums assumed		-	(69,826,033)
Decrease (increase) in unearned premium reserve		<u>5,000,000</u>	<u>(14,000,000)</u>
Net premiums earned		<u>5,000,000</u>	<u>(83,826,033)</u>
Underwriting expenses			
Losses and loss expenses		55,432,000	(16,939,679)
Other expenses		<u>-</u>	<u>3,000</u>
		<u>55,432,000</u>	<u>(16,936,679)</u>
Net underwriting (loss)		(50,432,000)	(66,889,354)
Net investment income	7	10,465,461	3,526,521
Administrative expenses		<u>(136,665)</u>	<u>(153,444)</u>
Net (loss)		\$ <u>(40,103,204)</u>	\$ <u>(63,516,277)</u>

The accompanying notes form an integral part of these financial statements.

CAPCO REINSURANCE COMPANY LTD.

Statement of changes in shareholders' equity

For the year ended December 31, 2001

(expressed in United States dollars)

	2001	2000
Common shares		
Balance at beginning of year	20,000,000	4,000,000
Repurchase of shares	-	(3,800,000)
Issue of shares	-	19,800,000
Balance at end of year	<u>20,000,000</u>	<u>20,000,000</u>
Preference shares		
Balance at beginning of year	170,000,000	-
Repurchase of shares	(32,000,000)	-
Issue of shares	-	170,000,000
Balance at end of year	<u>138,000,000</u>	<u>170,000,000</u>
(Accumulated deficit)		
Balance at beginning of year	(63,700,721)	695,556
Repurchase of shares	29,990,000	-
Net (loss) for the year	(40,103,204)	(63,516,277)
Dividend paid	-	(880,000)
Balance at end of year	<u>(73,813,925)</u>	<u>(63,700,721)</u>
Total shareholders' equity at end of year	\$ <u>84,186,075</u>	\$ <u>126,299,279</u>

The accompanying notes form an integral part of these financial statements.

CAPCO REINSURANCE COMPANY LTD.

Statement of cash flows

For the year ended December 31, 2001

(expressed in United States dollars)

	2001	2000
Operating activities		
Net (loss)	(40,103,204)	(63,516,277)
Adjustments for:		
Amortised cost adjustments	(218,426)	(608,159)
(Gain) loss on sale of securities	<u>(785,092)</u>	<u>278,014</u>
(Loss) before changes in non-operating balances	(41,106,722)	(63,846,422)
Accrued investment income	(805,780)	(359,322)
Prepaid expenses	5,000	(5,000)
Outstanding losses and loss expenses	(17,752,000)	(15,178,568)
Unearned premium reserve	(5,000,000)	14,000,000
Accounts payable	<u>(33,534)</u>	<u>30,505</u>
<i>Cash (used in) operating activities</i>	<u>(64,693,036)</u>	<u>(65,358,807)</u>
Investing activities		
Proceeds from sale of marketable securities	202,499,219	103,184,522
Purchase of marketable securities	(130,468,248)	(304,397,063)
Marketable securities transferred on novation	<u>-</u>	<u>86,554,838</u>
<i>Cash provided by (used in) investing activities</i>	<u>72,030,971</u>	<u>(114,657,703)</u>
Financing activities		
Issue of preference shares	-	170,000,000
Repurchase of preference shares	(2,010,000)	-
Issue of common shares	-	19,800,000
Repurchase of common shares	-	(3,800,000)
Dividend paid – common shares	<u>-</u>	<u>(880,000)</u>
<i>Cash (used in) provided by financing activities</i>	<u>(2,010,000)</u>	<u>185,120,000</u>
Net increase in cash and deposits	5,327,935	5,103,490
Cash and deposits – beginning of year	<u>5,566,332</u>	<u>462,842</u>
Cash and deposits – end of year	<u>\$ 10,894,267</u>	<u>\$ 5,566,332</u>

The accompanying notes form an integral part of these financial statements.

CAPCO REINSURANCE COMPANY LTD.

Notes to financial statements

December 31, 2001

1. Incorporation and operations

Capco Reinsurance Company Ltd. ("the Company") was incorporated in 1994 under the laws of Barbados. The Company is licensed to conduct general insurance business from Barbados under the provisions of the Exempt Insurance Act of Barbados and engages in reinsurance business.

The reinsurance business arises from reinsurance agreements, which limit the loss exposure of certain insurance companies belonging to one group. The underlying risks reinsured by the Company arise from the United States property and casualty market.

The Company was reorganised during the year ended December 31, 2000 so that it ceased being a subsidiary of Western General Insurance Ltd. as of August 18, 2000 on the issue of 19,000,000 common shares to other independent shareholders. Additionally, the reinsurance business previously carried on was transferred to its parent company effective April 28, 2000 by way of a novation agreement.

2. Significant accounting policies

These financial statements have been prepared in accordance with accounting principles generally accepted in Canada. The preparation of financial statements in accordance with generally accepted accounting principles requires management to make estimates and assumptions that affect reported amounts of assets and liabilities and disclosure of contingent assets and liabilities as of the date of the financial statements. Estimates also affect the reported amounts of income and expenses for the reporting period in the statement of income. Actual results could differ from these estimates.

Outlined below are the significant accounting policies of the Company.

(a) Cash and deposits

Cash and deposits consist of cash at banks, money market funds, short term deposits and securities purchased with maturities, generally three months or less. Management considers these highly liquid investments to be the equivalents of cash.

(b) Premiums and acquisition costs

Reinsurance premiums are earned on a pro-rata basis over the terms of the underlying policies.

Acquisition costs are deferred and amortised over the period that the related premiums are recognised.

CAPCO REINSURANCE COMPANY LTD.

Notes to financial statements

December 31, 2001

(expressed in United States dollars)

2. Significant accounting policies (continued)

(c) Marketable securities

Marketable securities are comprised of fixed coupon instruments, which are carried at amortised cost, based on expected maturity dates.

Investment income is recorded on the accrual basis and includes realised gains and losses on sales of securities calculated on a specific identification cost basis and amortisation of discounts or premiums on securities acquired at less or more than the par value. Amortisation is calculated on a straight line basis. When a loss of value on any security occurs which is considered to be a permanent decline, a write down is made and is included in the determination of net investment income.

(d) Losses and loss expenses

Outstanding losses and loss expenses represent the Company's estimated liabilities to third parties and consist of a provision for outstanding losses and loss expense, a provision for losses incurred but not reported ("IBNR"). Reported losses are valued based on reports from the ceding companies, with additional provisions made where management considers these necessary.

Management believes that the IBNR assumptions made are reasonable and that the resultant provisions should prove to be adequate in respect of the reinsurance agreement by which the Company is bound. However, the provisions are necessarily based on estimates and ultimate settlement of these liabilities may be greater or lesser than those estimated. Any difference between the estimated amounts and the actual settlements will be reflected in the results of the year in which they are determined.

(e) Underwriting income recognition

Underwriting income is only recognised when a programme has developed further and the ultimate losses can be determined with a higher degree of certainty. All programmes where discounting applies were terminated prior to August 18, 2000. Premiums earned are recognised in income over the terms of the underlying contracts. Prior to August 18, 2000 for accounts where discounting applies, investment income earned on the specific investments purchased from the fundings was credited to the underwriting accounts in the statement of income. In the early stage of development of these programmes, the provision for losses was carried at the total of the premium funding and the investment income earned to the date on the premium. This approach is maintained provided the discount factor upon which the provision for losses and loss expenses is carried is not greater than the current investment rate of return being realised by the Company.

CAPCO REINSURANCE COMPANY LTD.

Notes to financial statements

December 31, 2001

(expressed in United States dollars)

2. Significant accounting policies (continued)

(f) **Foreign currency translation**

Foreign currency assets and liabilities are translated at rates in effect at the balance sheet date. Income and expenditure transactions are translated quarterly, at rates which reflect the average exchange rate for the three month period. Gains and losses arising on the translation are recognised in the statement of income.

(g) **Taxation**

Under the Exempt Insurance Act, the Company's taxable income is subject to tax at 0% during the first thirty years of operations and thereafter at 2% on the first \$125,000 of taxable income, and at 0% in respect of all amounts in excess of \$125,000. Accordingly, no taxation is chargeable in Barbados on income earned by the Company for periods up to 31 December, 2024.

3. Cash and deposits

Cash and deposits include \$2,692,199 (2000 - \$5,000,000) which represent balances held in trust under various agreements established as security under the terms of various reinsurance agreements. These balances are in addition to marketable securities held in trust (see Note 4).

CAPCO REINSURANCE COMPANY LTD.

Notes to financial statements

December 31, 2001

(expressed in United States dollars)

4. Marketable securities

	2001	2000
Classification of portfolio		
Corporate and bank securities	128,127,317	100,764,398
Asset backed securities	6,999,885	-
Government and government guaranteed	-	4,865,492
Private investment trust	-	<u>100,524,764</u>
	<u>\$ 135,127,202</u>	<u>\$ 206,154,654</u>
Maturity profile		
Amortised cost		
From one to five years	128,127,317	105,629,890
From five to ten years	-	100,524,764
After more than ten years	<u>6,999,885</u>	<u>-</u>
	<u>\$ 135,127,202</u>	<u>\$ 206,154,654</u>
Fair value		
From one to five years	131,183,620	106,172,945
From five to ten years	-	100,876,301
After more than ten years	<u>7,196,273</u>	<u>-</u>
	<u>\$ 138,379,893</u>	<u>\$ 207,049,246</u>

The amortised cost and fair value amounts are shown by contractual maturity. Actual maturity may differ from contractual maturity because certain borrowers have the right to call or prepay certain obligations with or without call or prepayment penalties.

Marketable securities with an amortised cost of \$135,127,202 (2000 - \$206,154,654) are held as collateral under the terms of security trusts established under various agreements with other reinsurers in support of certain provisions for losses and loss expenses, for which full provision has been made.

CAPCO REINSURANCE COMPANY LTD.

Notes to financial statements

December 31, 2001

(expressed in United States dollars)

5. Losses and loss expenses

The provisions for outstanding losses and loss expenses are estimates subject to variability, and the variability, as with any insurance company, could be material in the near term.

The variability arises because all events affecting the ultimate settlement of claims have not taken place and may not take place for some time. Variability can be caused by receipt of additional claim information, changes in judicial interpretation of contracts, or significant changes in severity or frequency of claims from historical trends. The estimates are principally based on historical experience of the programmes concerned. Methods of estimation have been used which management believes produce reasonable results given current information.

6. Stated capital

The Company is authorised to issue an unlimited number of common shares of no par value and ten thousand (10,000) Series A redeemable preferred shares of no par value.

The Series A preferred shares have a preferential right to the receipt of dividends over that of the common shares at a rate of 6% per annum based on an amount of \$20,000 per share. Dividends are payable on July 1 each year and in the event of non-payment, dividends due but unpaid will be added to the original amount for the purpose of calculating future dividends.

	2001	2000
Issued capital		
Common shares		
20,000,000 common shares – stated value	\$ <u>20,000,000</u>	\$ <u>20,000,000</u>
Preferred shares		
6,900 Series A shares (2000 – 8,500)	\$ <u>138,000,000</u>	\$ <u>170,000,000</u>
Summary		
Common shares	20,000,000	20,000,000
Preferred shares	<u>138,000,000</u>	<u>170,000,000</u>
Total	\$ <u>158,000,000</u>	\$ <u>190,000,000</u>

CAPCO REINSURANCE COMPANY LTD.

Notes to financial statements

December 31, 2001

(expressed in United States dollars)

6. Stated capital (continued)

Dividends accrued on preferred shares as of December 31, 2001 amounts to \$11,419,060 (2000 - \$3,604,932). The Company has no distributable earnings and consequently, the dividends accrued will not be payable as of December 31, 2001.

In March, 2001, the share capital was reduced by the repurchase and cancellation of 1,600 preferred shares for the sum of \$2,010,000. The difference between the purchase price and the stated value of the shares has been deducted from the retained earnings.

In December, 2001 the directors approved a further reduction of the share capital by the repurchase and cancellation of 3,400 preferred shares. As at December 31, 2001 this transaction had not taken place.

7. Net investment income

Net investment income comprises:

	2001	2000
Interest income	9,642,849	5,086,626
Realised gains (losses) on sale of securities	785,092	(278,014)
Amortised cost adjustments	<u>218,427</u>	<u>608,159</u>
Total investment income	10,646,368	5,416,771
Custodian and investment manager fees	(180,907)	(129,139)
Allocated to losses and loss expenses (Note 2(e))	<u>-</u>	<u>(1,761,111)</u>
	\$ <u>10,465,461</u>	\$ <u>3,526,521</u>

8. Financial instruments

Fair value

The estimates of fair values presented herein are subjective in nature and are not necessarily indicative of the amounts that the Company could realise in a current market exchange. Any differences would not be expected to be material. All non-financial instruments are excluded from fair value disclosure. Thus, the total fair value amounts cannot be aggregated to determine the underlying economic value of the Company.

The following methods and assumptions were used by the Company in estimating fair value disclosures for financial instruments.

CAPCO REINSURANCE COMPANY LTD.

Notes to financial statements

December 31, 2001

(expressed in United States dollars)

8. Financial instruments (continued)

Cash

The carrying amount reported in the balance sheet for this instrument approximates its fair value.

Fair value for fixed interest securities are based on quoted market prices, where available. For fixed interest securities not actively traded, fair values are estimated using values obtained from independent pricing services. For further information see Note 4.

Other assets and liabilities

The fair value of accrued investment income and accounts payable approximate their carrying values.

Concentration of credit risk

The investment portfolio is managed following prudent standards of diversification. Investment guidelines limit the holdings of a single issue or issuer. Additionally, all securities must have a minimum rating of AA-/AA3 or better. The Company believes that there are no significant concentrations of credit risk associated with its investments.