Aspen Insurance Holdings Limited

Financial Statements for the period
23 May 2002 to 31 December 2002

Aspen

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building a global force in specialty insurance and reinsurance, offering domestic solutions with an international perspective

Group Overview

Established in June 2002, Aspen Insurance Holdings Limited (Aspen), domiciled in Bermuda, is a global provider of specialty insurance and reinsurance products through its three operating subsidiaries. Aspen's total shareholder equity is some US$990 million and our principal shareholders are Blackstone, Candover, CSFB and Wellington Underwriting plc.

Aspen Insurance UK Limited (Aspen Re), formerly Wellington Re, was established in London in June 2002 to service the growing needs of the London and wider UK broking communities and our clients and their agents globally. The company, which trades under the names of Aspen Insurance and Aspen Re, is the major business in the Aspen Group writing a range of specialty insurance and reinsurance lines across eight key business lines with a strong focus on UK commercial insurance and property and casualty reinsurance. We offer strong technical rating and risk management practices, significant line size and service standards that help set us apart from other providers.

Aspen Insurance Limited (Aspen) was established in Bermuda in December 2002 to access this increasingly important market and to allow the expansion of business in London by way of a quota share agreement with Aspen Re. In addition, Aspen writes a limited book of property reinsurance and retrocession contracts.

Aspen Specialty Insurance Company (Aspen Specialty) was established in Boston, Massachusetts in September 2003 and writes a focused book of property and casualty surplus lines business, predominantly through the US wholesale surplus lines broker network.

Aspen is committed to building a strongly capitalised, diversified business, positioned to meet our clients' risk transfer needs and has been awarded the following ratings from the major agencies:

Aspen Insurance UK Limited

Standard & Poor's	A (Strong)
AM Best	A (Excellent)
Moody's	A2 (Good)

Aspen Insurance Limited

Standard & Poor's	A (Strong)
AM Best	A- (Excellent)

Aspen Specialty Insurance Company

AM Best	A- (Excellent)

Operational Review

Consolidated overview

Aspen Insurance Holdings Limited (Aspen) was incorporated under the name of Exali Reinsurance Holdings Limited ('Exali') on 23 May 2002. Exali subsequently changed its name to Aspen on 20 November 2002. On 21 June 2002 Aspen acquired the entire issued share capital of The City Fire Insurance Company Limited ('City Fire'). City Fire was renamed Wellington Reinsurance Limited (Wellington Re) and re-capitalised with an ordinary share capital of £410 million. Wellington Re commenced underwriting on 23 June 2002. On 4 March 2003 Wellington Re was renamed Aspen Insurance UK Limited (Aspen Re).

On 6 November 2002 Aspen established a wholly owned Bermudian subsidiary, Exali Insurance Limited. The company changed its name to Aspen Insurance Limited (Aspen) on 22 November 2002. Aspen has been capitalised with an issued share capital of US$200 million.

The activities of each of the Group companies is as follows:

Aspen Insurance Holdings Limited

Bermudian registered holding company of the Aspen operations with paid up capital of £552 million (US$837 million).

Aspen Insurance UK Limited

UK registered and FSA authorised reinsurance and insurance company with issued share capital of £410 million.

Aspen Insurance UK Services Limited

Provider of services to Aspen Insurance UK Limited in its capacity as the employer of the directors and staff of Aspen Insurance UK Limited.

Aspen Insurance Limited

Bermudian registered Class 4 authorised reinsurance operation with paid up capital of US$200 million.

Sources of business

The Group's operations are currently managed as two segments, reinsurance and insurance.

The reinsurance segment has three primary elements, property reinsurance, casualty reinsurance and specialty lines. The first two of these, property reinsurance and casualty reinsurance are all directly underwritten by employees of the Group. Specialty lines comprises classes of business not directly underwritten by the Group but sourced through quota share arrangements. This element will continue to be sourced through a quota share arrangement in 2003 whereas all other lines will be written directly by the Group.

The insurance operations are underwritten directly by employees of the Group and include both public and employers' liability business together with a UK commercial property account.

Operational Review

An analysis of the technical account for the period 23 May 2002 to 31 December 2002 by segment is set out below.

	Reinsurance operations US$m	Insurance operations US$m	Total US$m
Gross written premiums	288.2	86.6	374.8
Gross earned premiums	135.8	28.0	163.8
Net earned premiums	96.9	23.4	120.3
Net incurred claims	(60.9)	(16.0)	(76.9)
Expenses	(22.9)	(5.3)	(28.2)
Underwriting profit before investment income	13.1	2.1	15.2
Investment return			8.4
Other net income			11.5
Income from continuing operations before tax			**35.1**
Net claims ratio	63%	68%	64%
Expense ratio	24%	23%	23%
Combined ratio	87%	91%	87%

Operational Review

Overall analysis

This being the first period of operation of the Group impacts the results of all classes of business. First, losses occurring during ('LOD') reinsurance is wholly expensed in the period whereas only a portion of the written premiums are earned. This produces a proportionately higher reinsurance cost in the first year of operation compared to subsequent years. Second, the expense costs are proportionately higher in the first year of operation as the volume of premium against which they are offset is lower. Of the total business written US$158.6m was written by the Group and US$216.2m was written by Syndicates 2020 and 3030 as described in greater detail below.

Reinsurance operations

The majority of the reinsurance business written arises from two quota share contracts under which the Group reinsured part of a portfolio of risks written by Syndicates 2020 and 3030 which are managed by Wellington Underwriting Agencies Limited, a subsidiary of Wellington Underwriting plc which is one of our principal shareholders.

Property reinsurance

The property reinsurance operations comprise catastrophe, risk excess and pro-rata treaty reinsurance. The year has developed well with relatively few major losses. The catastrophe account was impacted by the European floods which have produced in excess of US$3 million of gross and net claims to the Group. The only material loss on the risk excess account was a US$1.8 million gross and net loss at a United States grain store.

Casualty reinsurance

The casualty reinsurance account consists of international casualty business including motor excess, international liability and professional indemnity proportional reinsurance written throughout the world including the United States of America. No material claims have been reported in the period reflecting the long tail nature of the business written.

Specialty reinsurance

The business written includes all classes of marine and aviation risks as well as US property binders and property facultative business. This business is written by Syndicate 2020 at Lloyd's and the Group will continue to underwrite a quota share of that syndicate in 2003. For 2003 the Group has entered into a 7.5% quota share with Syndicate 2020.

Insurance operations

The majority of the insurance business was written directly by Aspen Insurance UK Limited.

Operational Review

Commercial liability insurance

The commercial liability account consists of UK employers' and public liability insurance. This business was primarily written in the second half of the year and accordingly a relatively small proportion of the written premiums are earned in the period under review. No material claims have been notified in respect of this business.

Commercial property insurance

The commercial property account was also primarily written in the second half of the year and accordingly only a small amount of premiums were earned before the year end. No major claims have been notified in respect of this business.

Investment strategy

The Group maintains its investments primarily in UK and US high quality fixed interest bonds. It holds no equities. These investments, including liquidity funds, are currently managed by the following fund managers:

Aim Global Investment company Limited

Citigroup Asset Management

Barclays Global Investors (Ireland) Limited

Wellington Management company LLP

Weiss, Peck & Greer LLC

Other net income

Other income comprises a realised foreign exchange gain of US$12.7 million for the Group. This arose from a contract taken out to avoid any adverse currency movement between the date of establishment of Aspen and the date that the second tranche of share capital was paid to the company on 29 November 2002. This gain is partly offset by the central costs of the Group of US$1.0 million.

Consolidated balance sheet

The consolidated balance sheet of the Group as at 31 December 2002 shows total assets of US$1,211.8 million and total common shareholders' equity of US$878.1 million. Of the total assets US$922.4 million is represented by financial investments. Debtors amount to US$215.3 million and relate to amounts due under the insurance contracts entered into. The largest portion of this relates to the quota share arrangements which operate on a cash-withheld basis for a 36 month period. The cash withheld will be utilised to meet any associated claims on the business written with the balance plus investment income being paid over to the company at the end of the 36 month period.

Chris O'Kane
Chief Executive
19 May 2003

Consolidated Statement of Operations

	Notes	2002 US$m
For the period from incorporation on 23 May 2002 to 31 December 2002		
Revenues		
Net premiums earned (includes US$74.3m from related parties)	15	120.3
Net investment income	5	8.5
Realised investment losses	5	(0.1)
Realised foreign exchange gain	6	12.7
Other		0.4
Total revenues		**141.8**
Expenses		
Insurance losses and loss adjustment expenses (includes US$51.7m from related parties)	7, 15	(76.9)
Policy acquisition expenses (includes US$14.1m from related parties)		(21.1)
Operating and administration expenses (includes US$2.6m from related parties)		(8.7)
Total expenses		**(106.7)**
Income from operations before income tax		35.1
Income tax expense	8	(6.5)
Net income		**28.6**

	Notes	US$
Basic earnings per common share	3	**0.89**
Diluted earnings per common share	3	**0.89**

See notes to consolidated financial statements

Consolidated Balance Sheet

As at 31 December 2002

Assets	Notes	2002 US$m
Investments		
Fixed maturities		87.3
Short term investments		835.1
Total investments	4	**922.4**
Cash and cash equivalents		9.6
Reinsurance recoverables (includes US$10.4m from related parties)	7	12.5
Ceded unearned premiums (includes US$12.8m from related parties)		18.9
Receivables		
Underwriting premiums (includes US$151.4m from related parties)		214.5
Other		0.8
Deferred policy acquisition costs (includes US$13.9m from related parties)		31.0
Office properties and equipment		0.1
Intangible assets	13	2.0
Total assets		**1,211.8**
Liabilities		
Insurance reserves		
Losses and loss adjustment expenses (includes US$62.2m from related parties)	7	93.9
Unearned premiums (includes US$104.6m from related parties)		215.7
Total insurance reserves		309.6
Deferred income taxes	8	4.6
Payables		
Reinsurance premiums		2.1
Accrued expenses and other (includes US$1.5m from related parties)		17.4
Total liabilities		**333.7**
Shareholders' equity		
Common Stock: 56,876,360 ordinary shares of 0.1544558¢ each	9	836.9
Retained earnings		28.6
Accumulated other comprehensive income, net of taxes		
Unrealised appreciation on investments	17	0.6
Unrealised gains on foreign currency	17	12.0
Total accumulated other comprehensive income		12.6
Total shareholders' equity		878.1
Total liabilities and shareholders' equity		**1,211.8**

See notes to consolidated financial statements

Consolidated Statement of Shareholders' Equity

Shareholders' equity	Notes	2002 US$m
Common Stock:		
On 23 May 2002		0.0
Stock Issued:		
New shares issued		836.9
End of period	9	**836.9**
Retained earnings:		
On 23 May 2002		0.0
Net income for the period		28.6
End of period		**28.6**
Unrealised appreciation on investments, net of taxes:		
On 23 May 2002		0.0
Change for the period		0.6
End of period	17	**0.6**
Unrealised gain on foreign currency translation, net of taxes:		
On 23 May 2002		0.0
Change for the period		12.0
End of period	17	**12.0**
Total shareholders' equity		**878.1**

Consolidated statement of comprehensive Income

Aspen Insurance Holdings Limited	2002 US$m
Net income	28.6
Other comprehensive income, net of taxes	
Change in unrealised appreciation on investments	0.6
Change in unrealised gain on foreign currency translation	12.0
Other comprehensive income	12.6
Comprehensive income	**41.2**

See notes to consolidated financial statements

Statement of Consolidated Cash Flows

Operating activities	2002 US$m
Net income (includes US$6.1m from related parties)	28.6
Adjustments	
Change in assets and liabilities net of effects of purchase of City Fire Insurance Company Limited	
Change in property-liability insurance reserves	
■ Losses and loss adjustment expenses (includes US$62.2m from related parties)	86.0
■ Unearned premiums (includes US$104.6m from related parties)	210.6
Change in reinsurance balances	
■ Reinsurance recoverables (includes US$10.4m from related parties)	(10.5)
■ Ceded unearned premiums (includes US$12.8m from related parties)	(18.4)
Change in deferred policy acquisition costs (includes US$13.9m from related parties)	(30.0)
Change in insurance premiums receivable (includes US$151.4m from related parties)	(209.7)
Change in reinsurance premiums payable	2.1
Change in deferred income taxes	3.8
Change in accounts receivable	(0.8)
Change in accrued expenses and other (includes US$1.5m from related parties)	16.4
Net cash from operating activities	**78.1**

Investing activities	
Purchase of investments	(963.2)
Proceeds from the sales and maturities of investments	63.5
Payment for purchase of City Fire Insurance Company Limited net of cash acquired	(17.7)
Net cash used for investing activities	**(917.4)**

Financing activities	
Proceeds from the issuance of common shares, net of issuance costs	836.9
Net cash from financing activities	836.9
Effect of exchange rate movements on cash and cash equivalents	12.0
Increase in cash and cash equivalents	9.6
Cash at beginning of the period	0.0
Cash at end of the period	**9.6**

See notes to consolidated financial statements

committed to building a strongly capitalised, diversified business, positioned to meet our clients’ risk transfer needs

Notes to the Consolidated Financial Statements

1 Basis of presentation and summary of significant accounting policies

Basis of presentation and consolidation

Aspen Insurance Holdings Limited ('The Holding Company') was incorporated under the name of Exali Reinsurance Holdings Limited ('Exali') on 23 May 2002 to hold the subsidiaries that provide insurance and reinsurance on a world-wide basis. Exali subsequently changed its name to Aspen Insurance Holdings Limited on 20 November 2002. On 21 June 2002 The Holding Company acquired the entire issued share capital of The City Fire Insurance Company Limited ('City Fire'). City Fire was renamed Wellington Reinsurance Limited (Wellington Re) and commenced underwriting on 23 June 2002. On 4 March 2003, Wellington Re was renamed Aspen Insurance UK Limited (Aspen Re). Aspen Insurance Limited was established on 6 November 2002 as Exali Insurance Limited and changed its name to Aspen Insurance Limited on 22 November 2002. Aspen Insurance UK Services Limited provides services to Group companies in its capacity as the employer of the directors and staff of Aspen Insurance UK Limited.

The Consolidated Financial Statements of Aspen Insurance Holdings Limited ('The Holding Company') are prepared in accordance with United States Generally Accepted Accounting Principles ('GAAP'). The financial statements are presented on a consolidated basis including the transactions of all operating subsidiaries. Transactions between Group companies are eliminated within the consolidated financial statements.

Use of Estimates

Estimates and assumptions are made by the directors that have an effect on the amounts reported within these consolidated financial statements. The most significant estimates relate to the reserves for property and liability losses. These estimates are continually reviewed and adjustments made as necessary, but actual results could turn out significantly different from those expected when the estimates were made.

Accounting for underwriting operations

Premiums earned

Assumed premiums are recognised as revenues proportionately over the coverage period. Premiums earned are recorded in the statement of operations, net of the cost of purchased reinsurance. Premiums not yet recognised as revenue are recorded in the consolidated balance sheet as unearned premiums, gross of any ceded unearned premiums. Written and earned premiums, and the related costs, which have not yet been reported to the Group are estimated and accrued. Due to the time lag inherent in reporting of premiums by cedants, such estimated premiums written and earned, as well as related costs, may be significant. Differences between such estimates and actual amounts will be recorded in the period in which the actual

Notes to the Consolidated Financial Statements

Premiums on proportional treaty type contracts are generally not reported to the Group until after the reinsurance coverage is in force and the reinsurer is at risk. As a result an estimate of these 'pipeline' premiums is recorded. The company estimates pipeline premiums based on estimates of ultimate premium, calculated unearned premium and premiums reported from ceding companies. The Group estimates commissions, losses and loss adjustment expenses on these premiums.

Reinstatement premiums and additional premiums are accrued as provided for in the provisions of assumed reinsurance contracts, based on experience under such contracts. Reinstatement premiums are the premiums charged for the restoration of the reinsurance limit of a catastrophe contract to its full amount after payment by the reinsurer of losses as a result of an occurrence. These premiums relate to the future coverage obtained during the remainder of the initial policy term and are earned over the remaining policy term. Additional premiums are premiums charged after coverage has expired, related to experience during the policy term, which are earned immediately. An allowance for uncollectable premiums is established for possible non-payment of such amounts due, as deemed necessary.

Outward reinsurance premiums are accounted for in the same accounting period as the premiums for the related direct insurance or inwards reinsurance business. Reinsurance contracts that operate on a 'losses occurring during' basis are accounted for in full over the period of coverage whilst 'risk attaching during' policies are expensed using the same ratio as the underlying premiums on a daily pro-rata basis.

Insurance losses and loss adjustment expenses

Losses represent the amount paid or expected to be paid to claimants in respect of events that have occurred on or before the balance sheet date. The costs of investigating, resolving and processing these claims are known as loss adjustment expenses ('LAE'). The statement of operations records these losses net of reinsurance, meaning that gross losses and loss adjustment expenses incurred are reduced by the amounts recovered or expected to be recovered under reinsurance contracts.

Reinsurance

Written premiums, earned premiums and incurred claims and LAE all reflect the net effect of assumed and ceded reinsurance transactions. Assumed reinsurance refers to the Group's acceptance of certain insurance risks that other insurance companies have underwritten. Ceded reinsurance means other insurance companies have agreed to share certain risks with this Group. Reinsurance accounting is followed when risk transfer requirements have been met.

The Group regularly evaluates the financial condition of its reinsurers and monitors the concentration of credit risk to minimise its exposure to financial loss from reinsurers' insolvency. Where it is considered required, appropriate provision is made for balances deemed irrecoverable from reinsurers.

Notes to the Consolidated Financial Statements

Insurance reserves

Insurance reserves are established for the total unpaid cost of claims and LAE, which cover events that have occurred by the balance sheet date. These reserves reflect the Group's estimates of the total cost of claims incurred but not yet reported to it ('IBNR'). Claim reserves are reduced for estimated amounts of salvage and subrogation recoveries. Estimated amounts recoverable from reinsurers on unpaid losses and LAE are reflected as assets.

For reported claims, reserves are established on a case by case basis within the parameters of coverage provided in the insurance policy or reinsurance agreement. For IBNR claims, reserves are estimated using established actuarial methods. Both case and IBNR reserve estimates consider such variables as past loss experience, changes in legislative conditions, changes in judicial interpretation of legal liability policy coverages, and inflation.

Because many of the coverages underwritten involve claims that may not ultimately be settled for many years after they are incurred, subjective judgements as to the ultimate exposure to losses are an integral and necessary component of the loss reserving process. Reserves are established by the selection of a 'best estimate' from within a range of estimates. The Group continually reviews its reserves, using a variety of statistical and actuarial techniques to analyse current claims costs, frequency and severity data, and prevailing economic, social and legal factors. Reserves established in prior periods are adjusted as claim experience develops and new information becomes available. Adjustments to previously estimated reserves are reflected in the financial results of the period in which the adjustments are made.

Whilst the reported reserves make a reasonable provision for unpaid claim and LAE obligations, it should be noted that the process of estimating required reserves does, by its very nature, involve uncertainty. The level of uncertainty can be influenced by factors such as the existence of coverage with long duration payment patterns and changes in claims handling practices, as well as the factors noted above. Ultimate actual payments for claims and LAE could turn out to be significantly different from our estimates.

Policy acquisition expenses

The costs directly related to writing an insurance policy are referred to as policy acquisition expenses and consist of commissions, premium taxes and other direct underwriting expenses. Although these expenses are incurred when a policy is issued they are deferred and amortised over the same period as the corresponding premiums are recorded as revenues.

On a regular basis a recoverability analysis is performed of the deferred policy acquisition costs in relation to the expected recognition of revenues, including anticipated investment income, and reflect adjustments, if any, as period costs. Should the analysis indicate that the acquisition costs are unrecoverable, further analyses are performed to determine if a reserve is required to provide for losses which may exceed the related unearned premium.

Notes to the Consolidated Financial Statements

Accounting for investments

Fixed maturities

The fixed maturity portfolio is composed primarily of high-quality, US and UK government securities. The entire fixed maturity investment portfolio is classified as available for sale. Accordingly that portfolio is carried on the consolidated balance sheet at estimated fair value. Fair values are based on quoted market prices from a third party pricing service.

Short term investments

Short term investments include highly liquid debt instruments and commercial paper and is held as part of the investment portfolio of the Group.

Realised investment gains and losses

The cost of each individual investment is recorded so that when an investment is sold the resulting gain or loss can be identified and recorded in the statement of operations.

The difference between the cost and the estimated fair market value of all investments is monitored. If we determine that any investment has experienced a decline in value that is believed to be other than temporary, we consider the current facts and circumstances, including the financial position and future prospects of the entity that issued the investment security, and make a decision to either record a write-down in the carrying value of the security or sell the security; in either case a realised loss is recorded in the statement of operations.

Unrealised appreciation or depreciation on investments

For investments carried at estimated fair value the difference between amortised cost and fair value, net of deferred taxes, is recorded as part of shareholders' equity. This difference is referred to as unrealised appreciation or depreciation on investments. The change in unrealised appreciation or depreciation, net of taxes, during the year is a component of other comprehensive income.

Cash and cash equivalents

Cash and cash equivalents include cash on hand and at bank.

Derivative financial instruments

In accordance with Statement of Financial Accounting Standards ('SFAS') No. 133, 'Accounting for Derivative Instruments and Hedging Activities', all derivatives are recorded on the consolidated balance sheet at fair value. The accounting for the gain or loss due to the changes in the fair value of these instruments is dependent on whether the derivative qualifies as a hedge. If the derivative does not qualify as a hedge, the gains or losses are reported in earnings when they occur. If the derivative does qualify as a hedge, the accounting varies based on the type of risk being hedged. The Group has not entered into any derivative contracts qualifying as hedges during the reporting period.

Intangible assets

Acquired insurance licences are held in the consolidated balance sheet at cost. This intangible

Notes to the Consolidated Financial Statements

asset is not currently being amortised as the directors believe that these will have an indefinite life. The directors test for impairment annually or when events or changes in circumstances indicate that the asset might be impaired.

Office properties and equipment

Office equipment is carried at depreciated cost. These assets are depreciated on a straight line basis over the estimated useful lives of the assets of four years.

Foreign currency translation

The functional currencies of the Group's operations are US dollars for the reinsurance operations segment and British Pounds for the UK insurance operations segment. Transactions in currencies other than the functional currency of an operations segment are measured in the functional currency of that operations segment at the exchange rate prevailing at the date of the transaction. Monetary assets and liabilities denominated in non-functional currencies are remeasured at the exchange rate prevailing at the balance sheet date. Any resulting foreign exchange gains or losses are reflected in the statement of operations.

Assets and liabilities of the Group's British Pound functional currency operations segment are then translated into US dollars at the exchange rate prevailing at the balance sheet date. Income and expenses of this operations segment are translated at the average exchange rate for the period. The unrealised gain or loss from this translation, net of tax, is recorded as part of shareholders' equity. The change in unrealised foreign currency translation gain or loss during the year, net of tax, is a component of other comprehensive income.

Earnings per share

Basic earnings per share is determined by dividing income / loss available to shareholders by the weighted average number of shares outstanding during the period. Diluted earnings per share reflects the effect on earnings and average number of shares outstanding associated with dilutive securities.

Income tax

Income taxes are accounted for under the asset and liability method. Deferred tax assets and liabilities are recognised for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases and operating loss and tax credit carryforwards. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognised in income in the period that includes the enactment date.

Notes to the Consolidated Financial Statements

Related party transactions

The following summarises the related party transactions of the Group.

Wellington Underwriting plc

Wellington Underwriting plc ('WU') holds 21.2% of the common shares of The Holding Company and is represented on the Board of Directors of The Holding Company. Details of the shareholding of WU are disclosed in note 9. In addition, WU holds 3,781,120 options to subscribe for ordinary shares of The Holding Company, as noted below and in note 12.

The principal operating subsidiary of the Group, Aspen Insurance UK Limited (Aspen Re), has a number of arrangements with WU. These arrangements can be summarised as follows:

Quota share arrangements

For 2002, WU's managed Syndicate 2020 ('Syndicate 2020') has placed a qualifying quota share contract with a Berkshire Hathaway group company, National Indemnity Corporation of Omaha ('NICO') and established a consortium Syndicate 3030 with another Berkshire Hathaway subsidiary. Aspen Re has accessed certain of its business through these arrangements.

On 9 July 2002 Aspen Re wrote two quota share contracts. Under the first, Aspen Re assumed a 34% share of NICO's qualifying quota share reinsurance of syndicate 2020, subject to an overall premium limit of £63.8 million. Under the second, Aspen Re assumed a 70% reinsurance quota share of Syndicate 3030. Of the gross written premiums of US$374.8 million for the period ended 31 December 2002, US$98.2 million related to the Syndicate 2020 qualifying quota share and US$118.0 million to the quota share of Syndicate 3030.

These arrangements were undertaken on a funds withheld basis whereby the premiums due to Aspen Re will be paid net of claims and expenses, along with interest due on the funds withheld, calculated at rates specified in the quota share agreements.

For 2003, the Group has entered into a 7.5% quota share agreement directly with Syndicate 2020. The Group has an option, but no contractual obligation, to assume up to a 20% quota share of Syndicate 2020's business for subsequent years, while Syndicate 2020 has an option, but no contractual obligation, to assume up to a 20% quota share of Aspen Re's business for subsequent years. These options will terminate for years after 2005 if The Holding Company completes an initial public offering prior to 21 December 2005.

At 31 December 2002 the net amounts receivable from NICO and Syndicate 3030 under these contracts were US$7.4m and US$0.4m respectively, analysed as follows:

Assets	NICO US$m	3030 US$m	Total US$m
Reinsurance recoverable	6.3	4.1	10.4
Ceded unearned premiums	2.4	10.4	12.8
Underwriting premium receivables	98.2	118.0	216.2
Other receivables	0.0	0.1	0.1
	106.9	**132.6**	**239.5**
Liabilities			
Losses and loss adjustment expenses	(37.4)	(24.8)	(62.2)
Unearned premiums	(30.0)	(74.6)	(104.6)
Reinsurance premiums payables	(24.4)	(25.5)	(49.9)
Accrued expenses and other payables	(7.7)	(7.3)	(15.0)
	(99.5)	**(132.2)**	**(231.7)**
	7.4	**0.4**	**7.8**

Notes to the Consolidated Financial Statements

Option to purchase retrocession agreement

The quota share arrangements for 2002 described above were entered into pursuant to an option agreement entered into on 28 May 2002, whereby WU and The Holding Company agreed to pay NICO US$2.5 million and US$2.0 million, respectively, to procure (i) the retrocession to a subsidiary of The Holding Company of the NICO qualifying quota share of Syndicate 2020 and (ii) the reinsurance of Syndicate 3030. On 21 June 2002 Aspen Re reimbursed WU US$2.5 million for the amount that WU paid to NICO for the option, together with a fee of US$275,000 for the risk borne by WU during the period 28 May 2002 to 21 June 2002. Subsequently The Holding Company recharged the cost of the option to Aspen Re. The cost of these option agreements has been treated as a policy acquisition cost and is charged to the income statement in proportion to the premiums recognised under the contracts.

Provision of services

The Group has entered into a contract for the provision of services by a subsidiary company of WU to the Group. These services include accounting, actuarial, operations and technical support. This agreement is for an indefinite period but may be terminated by either party upon the occurrence of certain specified circumstances, such as the inability to pay debts, on an Initial Public Offering, and, after an initial period of 3 years, may be terminated by either party on 18 months' prior notice. The Group may also terminate specific services if it undertakes those services itself and does not contract those services to a third party. The provision of these services is covered by a detailed service level agreement and is priced on an actual cost basis. The cost of these services in 2002 was US$2.6 million, and the amount due to WU at 31 December 2002 was US$1.5m.

Stock options

As disclosed in note 12, the company granted options to subscribe to its shares to WU and to a trust established for the benefit of the unaligned members of Syndicate 2020 in consideration for the transfer of an underwriting team from WU, the right to seek to renew certain business written by Syndicate 2020, an agreement in which WU agrees not to compete with Aspen until April 2004, the use of the Wellington name and logo and the provision of certain outsourced services to the Group. These options have been recorded at a value of nil, equal to the transferor's historical cost basis of the assets transferred to the Group.

Shares issued to the directors

Shares in The Holding Company have been issued to the directors of Group companies in the period. These amounts and the consideration received by the company are disclosed in note 9.

2 Acquisition of City Fire Insurance Company Limited

In June 2002 the Group completed the acquisition of City Fire Insurance Company Limited for a total consideration of US$24.2 million (including acquisition costs and stamp duty of US$1.1 million). That company, at the date of acquisition, was not writing any new or renewal business and its only employees were responsible for managing its effective run-off. The name of the company was subsequently changed to Wellington Reinsurance Limited and then to Aspen Re and the company became the principal trading entity of the Group. The directors have assessed the fair value of the net tangible and financial assets acquired at US$22.8 million. An amount of US$2.0 million, gross of US$0.6m deferred tax, is the estimated fair value of that company's insurance licences that are treated as an intangible asset.

Notes to the Consolidated Financial Statements

3 Earnings per common share

Earnings	US$m
Basic	
Net income as reported and available to common shareholders	28.6
Diluted	
Net income as reported and available to common shareholders	28.6
Effect of dilutive securities	0.0
Net diluted income as reported and available to common shareholders	**28.6**

Common shares	
Basic	32.0
Weighted average common shares	32.0
Diluted	
Weighted average common shares	32.0
Weighted average effect of dilutive securities	0.0
Total	**32.0**

Earnings per common share	US$
Basic	0.89
Diluted	**0.89**

Notes to the Consolidated Financial Statements

4 Investments

The following presents the cost, gross unrealised appreciation and depreciation, and estimated fair value of investments in fixed maturities and other investments.

As at 31 December 2002 **Investments**	US$m Cost or amortised cost	US$m Gross unrealised appreciation	US$m Gross unrealised depreciation	US$m Estimated fair value
Fixed maturities				
Foreign governments	56.9	1.1	1.4	56.6
Corporate securities	30.6	0.2	0.1	30.7
Total fixed maturities	87.5	1.3	1.5	87.3
Short term investments	834.1	1.7	0.7	835.1
Total	921.6	3.0	2.2	922.4

The following table presents the breakdown of fixed maturities by year to stated maturity. Actual maturities may differ from those stated as a result of calls and prepayments.

Fixed maturities by maturity date	US$m Amortised cost	US$m Estimated fair value
One year or less	30.6	30.7
Over one year through five years	56.9	56.6
Total	87.5	87.3

Notes to the Consolidated Financial Statements

5 Investment transactions

The following table sets out an analysis of investment purchases, sales and maturities.

Purchases	US$m
Fixed maturities	129.1
Short term investments	834.1
Total purchases	**963.2**
Proceeds from sales and maturities	
Fixed maturities	
■ Sales	14.4
■ Maturities and redemptions	49.1
Total sales and maturities	63.5
Net purchases	**899.7**

The following is a summary of investment income.

	US$m
Fixed maturities	1.5
Short term investments	7.0
Net investment income	**8.5**

The following table summarises the pretax realised investment gains and losses, and the change in unrealised appreciation of investments recorded in shareholders' equity and in comprehensive income.

Pretax realised investment gains and losses	US$m
Short term investments	
■ Gross realised gains	0.1
■ Gross realised losses	(0.2)
Total fixed maturities	(0.1)
Total pretax realised investment gains (losses)	**(0.1)**

Change in unrealised appreciation	US$m
Fixed maturities	(0.2)
Short term investments	1.0
Total change in pretax unrealised appreciation	0.8
Change in taxes	(0.2)
Total change in unrealised appreciation, net of taxes	**0.6**

Notes to the Consolidated Financial Statements

6 Derivative financial instruments

Derivative financial instruments include futures, forward, swap and option contracts and other financial instruments with similar characteristics. The Group has very limited involvement with these instruments, primarily for the purpose of protecting against fluctuations in foreign currency exchange rates. The Group has not had any instruments that qualify as hedges under SFAS 133 during the reporting period.

Non-Hedge Derivatives - during the period the Group sold forward, under a contract which matured before the period end, £230 million at a fixed exchange rate. A gain of US$12.7 million was realised under the contract. This contract was taken out to protect the Group from exchange rate fluctuations between the period of establishment of the Group and its receipt of the proceeds from its second tranche of capital. There were no derivatives outstanding at the end of the period.

7 Reserves for losses and loss adjustment expenses

The following table represents a reconciliation of beginning and ending consolidated property-liability insurance loss and loss adjustment expenses ('LAE') reserves.

As at 31 December 2002

Reserves for losses and loss adjustment expenses	US$m
Provision for losses and LAE at date of incorporation	0.0
Less reinsurance recoverable	0.0
Net loss and LAE reserves at date of incorporation	0.0
Loss and LAE reserves of subsidiary at date of acquisition	6.1
Less reinsurance recoverables	(1.6)
Net loss and LAE reserves of subsidiary at date of acquisition	4.5
Provision for losses and LAE for claims incurred	
■ Current year	76.2
■ Prior years	0.7
Total incurred	76.9
Losses and LAE payments for claims incurred	
■ Current year	(0.7)
■ Prior years	(3.0)
Total paid	(3.7)
Foreign exchange gains / (losses)	3.7
Net loss and LAE reserves at year end	81.4
Plus reinsurance recoverables on unpaid losses at end of year	12.5
Loss and LAE reserves at end of year	93.9

Notes to the Consolidated Financial Statements

8 Income taxes

Total income tax for the year ended 31 December 2002 is allocated as follows:

	US$m
Income from operations	6.5
Shareholders' equity, for unrealised change in appreciation on investments	0.2
Total income tax	**6.7**

Income from continuing operations before tax and income tax expense attributable to that income consists of:

	Income before tax	Current income taxes	Deferred income taxes	Total income taxes
United Kingdom	33.9	2.5	4.0	6.5
Bermuda	1.2	0.0	0.0	0.0
Total	**35.1**	**2.5**	**4.0**	**6.5**

Income tax reconciliation	US$m
Income tax at the statutory rate applicable in the United Kingdom (30%)	10.5
Effect of exchange gains exempt from UK taxation	(3.6)
Effect of lower rate applicable to operations in Bermuda (Bermudian operations taxed at 0%)	(0.4)
Total income tax expense	**6.5**

The tax effects of temporary differences that give rise to deferred tax liabilities are presented in the following table.

Deferred tax liabilities	US$m
Insurance reserves	4.0
Intangible assets	0.6
Deferred tax liabilities	**4.6**

Notes to the Consolidated Financial Statements

9 Capital structure

The Holding Company was formed on 23 May 2002 with the issue of 12,000 nil paid shares with a par value of US$0.1 to members of management of the Group. On 18 June 2002 the denomination of the share capital was changed to British pounds and the par value of the shares changed to £0.001. On August 20, 2003, the denomination of the share capital was changed from British pounds to US dollars and the par value of the shares changed to 0.15144558¢. Following the funding of Aspen Holdings by the accredited investors on June 21, 2002 the nil paid shares were purchased by Aspen Holdings and made available for reissue, extinguishing the liability of the original shareholders for the amounts unpaid on those shares. The following summarises the capital structure.

	No.	US$000
Authorised share capital		
Ordinary shares of 0.15144558¢ each	76,416,910	116
Issued share capital of 0.15144558¢ per share	56,876,360	86
Share premium account		836,772
Issued common shares	**56,876,360**	**836,858**

The proceeds from the issue of equities are shown net of related issuance costs of US$28.1 million. The shares in The Holding Company were issued to the investors as follows:

	No.	£000	US$000
21 June 2002			
Accredited investors	24,729,470	247,327	370,991
Members of management of the Group	130,120	1,269	1,904
16 October 2002			
Wellington Underwriting plc	4,625,070	47,000	73,052
19 November 2002			
Wellington Underwriting plc	4,874,930	49,763	79,044
29 November 2002			
Wellington Underwriting plc	2,555,230	26,089	40,498
Accredited investors	19,910,690	199,093	298,640
Members of management of the Group	40,630	420	629

The remaining issued shares, numbering 10,220, were issued to staff of Aspen Group companies at various times during the period to 31 December 2002 for a total consideration of US$165,000.

Notes to the Consolidated Financial Statements

10 Statutory requirements and dividend restrictions

As a holding company, Aspen Insurance Holdings Limited relies on dividends from its insurance subsidiaries to provide cash flow to meet ongoing cash requirements, including any future debt service payments and other expenses, and to pay dividends, if any, to our shareholders. The company's insurance subsidiaries are subject to insurance laws and regulations in the jurisdictions in which they operate, including Bermuda, the United Kingdom and the United States, and are subject to significant regulatory restrictions limiting their ability to declare and pay dividends.

Aspen Insurance Limited's ability to pay dividends and make capital distributions is subject to certain regulatory restrictions based principally on the amount of Aspen Insurance Limited's premiums written and net reserves for losses and loss expenses.

Under the jurisdiction of the Financial Services Authority ('FSA'), Aspen Insurance UK Limited must maintain a margin of solvency at all times, which is determined based on the type and amount of insurance business written. The UK regulatory requirements impose no explicit restrictions on Aspen Insurance UK Limited's ability to pay a dividend, but the company would have to notify the FSA 28 days prior to any proposed dividend payment.

Aspen Specialty Insurance Limited will be subject to regulation by the State of North Dakota Insurance Department regarding payment of dividends and capital distributions in 2003.

Statutory capital and surplus as reported to the relevant regulatory authorities for the principal operating subsidiaries of the company as of December 31, 2002 is as follows:

	Bermuda US$m	UK US$m
Required statutory capital and surplus	100.0	53.8
Actual statutory capital and surplus	199.3	649.0

As at December 31, 2002, there are no statutory restrictions on the payment of dividends from retained earnings by the company as the minimum statutory capital and surplus requirements are satisfied by the share capital and additional paid-in capital of the company in all jurisdictions.

As well, the minimum levels of solvency and liquidity have been met and all applicable regulatory requirements and licensing rules complied with.

11 Retirement plans

The Group operates a defined contribution retirement plan for the majority of its employees at varying rates of their salaries, up to a maximum of 20%. During the period total contributions by the Group to the retirement plan were US$0.3 million.

12 Share options

The Holding Company issued options to subscribe for up to 6,787,880 ordinary shares of 0.15144558¢ each in Aspen Insurance Holdings Limited to Wellington and the members of Syndicate 2020 who are not corporate members of Wellington.

The subscription price payable under the options is initially £10 and increases by 5% per annum, less any dividends paid. Option holders are not entitled to participate in any dividends prior to exercise and would not rank as a creditor in the event of liquidation. The options are exercisable on the first registered public offering of the ordinary shares in the United States of America or the first listing of the ordinary shares on a stock exchange (a 'listing') or a sale of all or substantially all of the business, assets or undertakings of The Holding Company and its subsidiaries or a sale of 50% or more of the shares of The Holding Company (a 'sale') or, if no listing or sale has occurred prior to June 21, 2007, at any time within the five business days following June 21, 2007. If not exercised, the options will expire after five years, but if a listing occurs within those five years, the term is automatically extended prior to a period of ten years.

Notes to the Consolidated Financial Statements

13 Intangible assets

As at 31 December 2002

Intangible assets	Insurance licences US$m
As at 23 May 2002	0.0
Cost in period	2.0
End of period	**2.0**
Impairments	
As at 23 May 2002	0.0
Charge in period	0.0
End of period	**0.0**
Net book value	
As at 23 May 2002	**0.0**
As at 31 December 2002	**2.0**

14 Commitments and contingencies

In the normal course of business letters of credit are issued as collateral on behalf of the business, as required within our reinsurance operations. As of 31 December 2002 letters of credit with an aggregate amount of £47.4 million were outstanding. No amounts have been drawn down on these letters of credit.

15 Reinsurance ceded

The primary purpose of the ceded reinsurance program is to protect the Group from potential losses in excess of what the Group is prepared to accept. It is expected that the companies to which reinsurance has been ceded will honour their obligations. In the event that these companies are unable to honour their obligations to the group, the group will pay these amounts. Appropriate provision is made for possible non-payment of amounts due to the Group.

Balances pertaining to reinsurance transactions are reported 'gross' on the consolidated balance sheet, meaning that reinsurance recoverable on unpaid losses and ceded unearned premiums are not deducted from insurance reserves but are recorded as assets.

The largest concentration of reinsurance recoverables as at 31 December 2002, excluding related party quota share arrangements, was with XL Re Limited (Bermuda), which is rated A+ by AM Best and AA by Standard & Poor's for its financial strength. The largest concentration of ceded unearned premiums as at 31 December 2002, excluding related party quota share arrangements, was with Everest Re (Bermuda) Limited, which is rated A+ by AM Best and AA- by Standard & Poor's for its financial strength. Balances with XL Re represented 29.3% of reinsurance recoverables and balances with Everest Re represent 23.6% of ceded unearned premiums.

Notes to the Consolidated Financial Statements

15 Reinsurance ceded continued

The effect of assumed and ceded reinsurance on premiums written, premiums earned and insurance losses and loss adjustment expenses is as follows.

For the period from incorporation on 23 May 2002 to 31 December 2002

Premiums written	US$m
Direct	86.6
Assumed	288.2
Ceded	(62.2)
Net premiums written	**312.6**

Premiums earned	
Direct	28.0
Assumed	135.8
Ceded	(43.5)
Net premiums earned	**120.3**

Insurance losses and loss adjustment expenses	
Direct	17.2
Assumed	69.8
Ceded	(10.1)
Total net insurance losses and loss adjustment expenses	**76.9**

16 Segment information

The Group has two reportable segments, reinsurance operations and insurance operations. The directors have determined these segments with reference to the organisation structure of the business, and the different services provided by the segments. The accounting policies of both segments are the same as those described in the summary of significant accounting policies. Results are analysed separately for each of our property-liability segments. Property-liability underwriting assets are reviewed in total by the directors for the purpose of decision making.

Geographical areas - the following summary presents financial data of the Group's operations based on their location.

Revenues	US$m
UK	32.2
US	77.0
Non US or UK	11.1
Net premiums earned	**120.3**

Notes to the Consolidated Financial Statements

Segment information - the summary below presents revenues and pre-tax income from operations for the reportable segments.

Revenues	US$m
Underwriting	
Total primary insurance operations	23.4
Total reinsurance operations	96.9
Total underwriting	120.3
Investment operations	
Net investment income	8.5
Realised investment gains / (losses)	(0.1)
Total investment operations	8.4
Other	13.1
Total revenues	**141.8**

Expenses	US$m
Underwriting - claims and expenses	
Total primary insurance operations	21.3
Total reinsurance operations	83.8
Total underwriting	105.1
Investment operations	
Net investment income	-
Realised investment gains / (losses)	-
Total investment operations	-
Other	1.6
Total expenses	**106.7**

Income from operations before income taxes	US$m
Underwriting	
Total primary insurance operations	2.0
Total reinsurance operations	11.6
Total underwriting	13.6
Investment operations	
Net investment income	8.5
Realised investment gains / (losses)	(0.1)
Total investment operations	8.4
Other	13.1
Total income before income taxes	**35.1**

Notes to the Consolidated Financial Statements

17 Other comprehensive income

Other comprehensive income is defined as any change in the Group's equity from transactions and other events originating from non-owner sources. These changes are comprised of our reported net income, changes in unrealised appreciation and depreciation on investments and changes in unrealised foreign currency adjustments, net of taxes.

The following table sets out the components of the Group's other comprehensive income, other than net income.

Other comprehensive income	US$m Pre-tax	US$m Income tax effect	US$m After tax
Unrealised appreciation on investments	3.0	(1.0)	2.0
Unrealised depreciation on investments	(2.2)	0.8	(1.4)
Net change in foreign currency translation	12.0	-	12.0
Total other comprehensive income	**12.8**	**(0.2)**	**12.6**

18 Supplemental disclosure of cash flow information

Cash paid during the year for:	$m
Income taxes	3.2

Non-cash investing and financing activities:

The company purchased all of the capital stock of City Fire Insurance Company Ltd for $24.2m. In conjunction with the acquisition, liabilities were assumed as follows:

Fair value of assets acquired, including cash of US$6.5m	33.0
Cash paid for the capital stock	(24.2)
Liabilities assumed	8.8

19 Subsequent events

On August 20, 2003, the shareholders of Aspen Insurance Holdings Limited approved the establishment of the 2003 Share Incentive Plan under which options for 3,884,020 ordinary shares will be issued to directors and employees of the company. The options are subject to certain restrictions on vesting but, when vested, can be exercised at a price of £10.70 per share. The company will follow the provisions of SFAS No. 123, 'Accounting for Stock-Based Compensation' for any of the company's plans.

On August 26, 2003, the company entered into a credit facility with a syndicate of commercial banks under which it may, subject to the terms of the credit agreements, borrow up to US$150 million for periods of up to three years and a further US$50 million for periods of up to one year. Credit Suisse First Boston, an affiliate of Credit Suisse First Boston Private Equity, which is a shareholder of the company, is a member of the syndicate on terms and conditions similar to other syndicate members.

On September 5, 2003, Aspen US Holdings acquired Dakota Specialty Insurance Company for cash consideration of US$20.9 million. Dakota Specialty was renamed Aspen Specialty Insurance Company and is eligible to operate as an insurer in the excess and surplus lines markets of many states of the United States.

Management's Responsibility for Financial Statements

Scope of responsibility

Management prepare the accompanying consolidated financial statements and related information and are responsible for their integrity and objectivity. The statements were prepared in conformity with United States generally accepted accounting principles. These consolidated financial statements include amounts that are based on management's estimates and judgements, particularly our reserves for losses and loss adjustment expenses. We believe that these statements present fairly the Group's financial position and results of operations and that other information contained within the annual report is consistent with the consolidated financial statements.

Internal controls

We maintain and rely on systems of internal accounting controls designed to provide reasonable assurance that assets are safeguarded and transactions are properly authorised and recorded. We continually monitor these internal accounting controls, modifying and improving them as business conditions and operations change. We recognise the inherent limitations in all internal control systems and believe that our systems provide an appropriate balance between the costs and benefits desired. We believe our systems of internal accounting controls provide reasonable assurance that errors or irregularities that would be material to the consolidated financial statements are prevented or detected in the normal course of business.

Independent auditors

Our independent auditors, KPMG Audit plc, have audited the consolidated financial statements. Their audit was conducted in accordance with auditing standards generally accepted in the United States of America, which includes the consideration of our internal controls to the extent necessary to form an independent opinion on the consolidated financial statements prepared by the directors.

Audit committee

The audit committee of the Board of Directors, composed entirely of non-executive directors, assists the Board of Directors in overseeing their discharge of their financial reporting responsibilities. The committee meets with management and representatives of KPMG Audit plc to discuss significant changes to financial reporting principles and policies and internal controls and procedures proposed or contemplated by management or KPMG Audit plc. Additionally the committee assists the Board of Directors in the selection, evaluation of, and if applicable, replacement of our independent auditors; and in the evaluation of the independence of the independent auditors. KPMG Audit plc have access to the audit committee without management's presence.

Chris O'Kane
Chief Executive

Julian Cusack
Finance Director

19 May 2003

Independent Auditors' Report

To the Shareholders and Board of Directors of Aspen Insurance Holdings Limited

We have audited the accompanying consolidated balance sheet of Aspen Insurance Holdings Limited and its subsidiaries as of 31 December 2002, and the related consolidated statements of operations, shareholders' equity, comprehensive income and cash flows for the period from incorporation on 23 May 2002 to 31 December 2002. These consolidated financial statements are the responsibility of the company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated 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 consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of Aspen Insurance Holdings Limited and its subsidiaries as of 31 December 2002, and the results of their operations and their cash flows for the period from incorporation on 23 May 2002 to 31 December 2002, in conformity with accounting principles generally accepted in the United States of America.

KPMG Audit plc

KPMG Audit plc
19 May 2003
London

Designed by **pws**

Contact us

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