MIDDLESEA INSURANCE p.l.c.

Annual Report and Consolidated Financial Statements
31 December 2007

Company Registration Number: C 5553

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# Directors' report

The directors present their report and the audited financial statements for the year ended 31 December 2007.

## Principal activities

The principal activities of the Group consist of the business of insurance, including long term business.

## Review of the business

Middlesea Insurance p.l.c. registered a profit before tax of Lm4 million for the year ended 31 December 2007, compared to the profit of Lm3.66 million generated last year.

Gross premium written increased by 24% to Lm45 million. Whilst all companies within the Group registered an increase in business, the main contributor is Progress Assicurazioni S.p.A.

Total income from insurance activities increased from Lm4.07 million to Lm4.11 million. Profits generated from General Business improved significantly from Lm2.30 million last year to Lm2.82 million this year with the improvement coming through on technical results before the allocation of investment income. The Combined Ratio in fact improved from 98.89% last year to 97.48% this year. Profits generated on long term business, on the other hand fell from Lm1.77 million last year to Lm1.29 million, with the main decrease coming through on the associated undertaking's profit after taxation. In total, the Group's investment return (excluding the share of associated undertaking's profit, net of tax) has remained consistent at Lm2.5million.

The Group's profit after tax and after deducting minority interest amounted to Lm2.89 million compared to last year's Lm3.17 million.

The Group's total assets increased from Lm118 million to Lm129 million. At the year end investments under management totalled Lm96 million and the Group had net technical reserves of Lm62 million. Group equity increased from Lm35 million in 2006 to Lm36.8 million at the end of 2007 whilst the net asset value per share attributable to shareholders increased from Lm1.35 to Lm1.42 per share.

The Group has a positive outlook on its position in the general business insurance market in Malta. The Group aims to continue to deliver a broad and superior range of products that meet the needs of its customers.

## Results and dividends

The consolidated profit and loss account is set out on page 7. The directors recommend the payment of a dividend of 5.5 cents per share totalling Lm1,375,000 (2006 – Lm1,125,000).

# **Directors' report** - continued

## Directors

The directors of the Company who held office during the year were:

M.C. Grech – Executive Chairman
R.E.D. Chalmers M.A.Div (Edin), F.C.A., A.T.I.I., F.C.P.A., MIA – Deputy Chairman
G. Bonnici
E. Caruana Demajo LL.D.
A. Corsi (Degree in Statistics and Actuarial Services, Associate of the Italian Society of Actuaries "Ordine Nazionale degli Attuari")
G. Debono Grech L.P., FISMM, B.A. (Leg) , Mag. Jur. (Int. Law), Dip. Trib. Eccl. Melita
T. Depasquale
V. Galea Salomone B.A. (Luther), M.B.A. (Henley-Brunel)
J.C. Grech M.A.(Econ.), Dip. ICEI (A'dam), PhD (Geneva), F.C.I.B., M.B.I.M., F.M.I.M.
A. Jimenez Herradon
M. Sparberg Dr Jur
L. Spiteri M.A. (Oxon)
D. Sugranyes Bickel ("Licence en Sciences Economiques et Sociales") (resigned – 11 February 2008)
J.F.X. Zahra B.A. (Hons.) Econ., M.A. (Econ.), M.C.I.M., M.M.R.S.

In accordance with the Articles of Association of the Company, all directors retire from office at the Annual General Meeting and are eligible for re-election or re-appointment. Those members who either separately or in aggregate hold not less than 7% of the total voting rights have the right to appoint a director, by letter addressed to the Company, for each and every complete 7% shareholding, so however that those members who hold that percentage separately are required to exercise this right. The remaining directors are elected at the Annual General Meeting.

## Auditors

The auditors, PricewaterhouseCoopers, have indicated their willingness to continue in office and a resolution for their re-appointment will be proposed at the Annual General Meeting.

By order of the Board

| | |
|---|---|
| M.C. Grech | R.E.D. Chalmers |
| Executive Chairman | Deputy Chairman |

Middle Sea House
Floriana, Malta

25 April 2008

## Statement of directors' responsibilities

The directors are required by the Insurance Business Act, 1998 and the Companies Act, 1995 to prepare financial statements which give a true and fair view of the state of affairs of the Company and Group as at the end of each financial period and of the profit or loss for that period.

In preparing the financial statements, the directors are responsible for:

- ensuring that the financial statements have been drawn up in accordance with International Financial Reporting Standards as adopted by the European Union;
- selecting and applying appropriate accounting policies;
- making accounting estimates that are reasonable in the circumstances;
- ensuring that the financial statements are prepared on the going concern basis unless it is inappropriate to presume that the Company and Group will continue in business as a going concern.

The directors are also responsible for designing, implementing and maintaining internal control relevant to the preparation and the fair presentation of the financial statements that are free from material misstatement, whether due to fraud or error, and that comply with the Insurance Business Act, 1998 and the Companies Act, 1995. They are also responsible for safeguarding the assets of the Company and the Group and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

The directors are responsible for the maintenance and integrity of the Annual Report on the Company's website. Access to information published on the website is available in other countries and jurisdictions, where legislation governing the preparation and dissemination of financial statements may differ from requirements or practice in Malta.

## Statement of the Directors pursuant to Listing Rule 9.40.5

We confirm that to the best of our knowledge:

1. the consolidated financial statements give a true and fair view of the financial position of the Company, and its subsidiaries included in the consolidation taken as a whole, as at 31 December 2007, and of their financial performance and their cash flows for the year then ended in accordance with International Financial Reporting Standards as adopted by the EU.

2. the Annual Report and Consolidated Financial Statements includes a fair review of the information required in terms of Listing Rule 9.40.5 together with a description of the principal risks and uncertainties that they face.

Approved by the Board of Directors on 25 April 2008 and signed on its behalf by:

| | |
|---|---|
| M.C. Grech<br>Executive Chairman | R.E.D. Chalmers<br>Deputy Chairman |

# Independent auditor's report

To the Shareholders of Middlesea Insurance p.l.c.

We have audited the consolidated financial statements of Middlesea Insurance p.l.c. and its subsidiaries (the "Group") and of Middlesea Insurance p.l.c. (the "Company") set out on pages 6 to 78 which comprise the balance sheets as at 31 December 2007 and the profit and loss accounts, statements of changes in equity and cash flow statements for the year then ended and a summary of significant accounting policies and other explanatory notes.

**Directors' Responsibility for the Financial Statements**

The directors are responsible for the preparation and fair presentation of these financial statements in accordance with International Financial Reporting Standards as adopted by the European Union and the requirements of the Insurance Business Act, 1998 and the Companies Act, 1995. As described in the statement of directors' responsibilities on page 3, this responsibility includes designing, implementing and maintaining internal control relevant to the preparation and fair presentation of financial statements that are free of material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.

**Auditor's Responsibility**

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with International Standards on Auditing. Those Standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance whether the financial statements are free of material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by the directors, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

**Opinion**

In our opinion, the financial statements give a true and fair view of the financial position of the Group and the Company as at 31 December 2007, and of their financial performance and their cash flows for the year then ended in accordance with International Financial Reporting Standards as adopted by the European Union and have been properly prepared in accordance with the requirements of the Insurance Business Act, 1998 and the Companies Act, 1995.

PRICEWATERHOUSECOOPERS
167 Merchants Street
Valletta
Malta

25 April 2008

# Profit and loss account
# Technical account – general business

| | | Year ended 31 December | | | |
|---|---|---|---|---|---|
| | | **Group** | | **Company** | |
| | Notes | **2007 Lm** | 2006 Lm | **2007 Lm** | 2006 Lm |
| **Earned premiums, net of reinsurance** | | | | | |
| Gross premiums written | 3 | **44,102,441** | 35,397,807 | **13,452,183** | 12,731,883 |
| Outward reinsurance premiums | | **(7,127,499)** | (6,409,397) | **(5,678,658)** | (5,012,028) |
| Net premiums written | | **36,974,942** | 28,988,410 | **7,773,525** | 7,719,855 |
| Change in the gross provision for unearned premiums | | **(4,253,944)** | (1,794,708) | **(184,884)** | (102,434) |
| Change in the provision for unearned premiums reinsurers' share | | **487,861** | 438,691 | **231,360** | 188,530 |
| | | **(3,766,083)** | (1,356,017) | **46,476** | 86,096 |
| **Earned premiums, net of reinsurance** | | **33,208,859** | 27,632,393 | **7,820,001** | 7,805,951 |
| **Allocated investment return transferred from the non-technical account** | 5 | **1,984,642** | 1,997,775 | **576,958** | 763,232 |
| **Total technical income** | | **35,193,501** | 29,630,168 | **8,396,959** | 8,569,183 |
| **Claims incurred, net of reinsurance** | | | | | |
| Claims paid | | | | | |
| - gross amount | | **22,325,819** | 21,063,186 | **6,517,973** | 6,446,869 |
| - reinsurers' share | | **(2,462,909)** | (2,508,838) | **(2,037,185)** | (1,825,046) |
| | | **19,862,910** | 18,554,348 | **4,480,788** | 4,621,823 |
| Change in the provision for claims | | | | | |
| - gross amount | | **4,789,115** | 3,305,767 | **(489,028)** | 635,633 |
| - reinsurers' share | | **569,935** | (417,425) | **874,325** | 72,759 |
| | | **5,359,050** | 2,888,342 | **385,297** | 708,392 |
| **Claims incurred, net of reinsurance** | | **25,221,960** | 21,442,690 | **4,866,085** | 5,330,215 |
| **Net operating expenses** | 4 | **7,149,997** | 5,884,051 | **1,922,253** | 1,957,728 |
| **Total technical charges** | | **32,371,957** | 27,326,741 | **6,788,338** | 7,287,943 |
| **Balance on the technical account for general business** (page 8) | | **2,821,544** | 2,303,427 | **1,608,621** | 1,281,240 |

# Profit and loss account
# Technical account – long term business

| | Notes | Year ended 31 December | |
|---|---|---|---|
| | | Group and Company | |
| | | **2007** | 2006 |
| | | **Lm** | Lm |
| **Earned premiums, net of reinsurance** | | | |
| Gross premiums written | 3 | **631,175** | 597,956 |
| Outward reinsurance premiums | | **(262,758)** | (258,913) |
| **Earned premiums, net of reinsurance** | | **368,417** | 339,043 |
| **Investment income** | | | |
| Income from other investments | 5 | **38,810** | 56,904 |
| **Total technical income** | | **407,227** | 395,947 |
| **Claims incurred, net of reinsurance** | | | |
| Claims paid | | | |
| - gross amount | | **163,846** | 140,979 |
| - reinsurers' share | | **(113,273)** | (50,198) |
| | | **50,573** | 90,781 |
| Change in the provision for claims | | | |
| - gross amount | | **188,207** | (21,579) |
| - reinsurers' share | | **(121,332)** | 5,395 |
| | | **66,875** | (16,184) |
| **Claims incurred, net of reinsurance** | | **117,448** | 74,597 |
| **Change in other technical provisions, net of reinsurance** | | | |
| Long term business provision, net of reinsurance | | | |
| - gross amount | | **26,556** | 16,006 |
| - reinsurers' share | | **(6,546)** | (10,511) |
| | | **20,010** | 5,495 |
| **Net operating expenses** | 4 | **105,216** | 34,508 |
| **Total technical charges** | | **242,674** | 114,600 |
| **Balance on the technical account for long term business** (page 8) | | **164,553** | 281,347 |

# Profit and loss account
# Non-technical account

| | | Year ended 31 December | | | |
|---|---|---|---|---|---|
| | | **Group** | | **Company** | |
| | Notes | **2007** | 2006 | **2007** | 2006 |
| | | **Lm** | Lm | **Lm** | Lm |
| **Balances on technical accounts** | | | | | |
| General business (page 6) | | **2,821,544** | 2,303,427 | **1,608,621** | 1,281,240 |
| Long term business (page 7) | | **164,553** | 281,347 | **164,553** | 281,347 |
| | | **2,986,097** | 2,584,774 | **1,773,174** | 1,562,587 |
| Share of profit of associated undertaking involved in long term business | 5 | **1,127,593** | 1,487,930 | **-** | - |
| Total income from insurance activities | | **4,113,690** | 4,072,704 | **1,773,174** | 1,562,587 |
| Other investment income | 5 | **3,548,337** | 3,131,072 | **2,934,855** | 2,784,874 |
| Investment expenses and charges | 5 | **(1,078,399)** | (688,478) | **(699,558)** | (335,647) |
| Allocated investment return transferred to the general business technical account | 5 | **(1,984,642)** | (1,997,775) | **(576,958)** | (763,232) |
| Other income | 6 | **625,629** | 593,834 | **-** | - |
| Administration expenses | 4 | **(1,224,393)** | (1,454,537) | **(441,355)** | (475,734) |
| **Profit before tax** | | **4,000,222** | 3,656,820 | **2,990,158** | 2,772,848 |
| Income tax expense | 9 | **(1,033,794)** | (434,086) | **(732,480)** | (526,052) |
| **Profit for the financial year** | | **2,966,428** | 3,222,734 | **2,257,678** | 2,246,796 |
| **Attributable to:** | | | | | |
| - shareholders | | **2,898,020** | 3,176,482 | **2,257,678** | 2,246,796 |
| - minority interests | | **68,408** | 46,252 | **-** | - |
| | | **2,966,428** | 3,222,734 | **2,257,678** | 2,246,796 |
| **Earnings per share attributable to shareholders** | 11 | **11c6** | 12c7 | | |

## Balance sheet

| | | As at 31 December | | | |
|---|---|---|---|---|---|
| | | Group | | Company | |
| | Notes | **2007** | 2006 | **2007** | 2006 |
| | | **Lm** | Lm | **Lm** | Lm |
| **ASSETS** | | | | | |
| Intangible assets | 13 | **457,330** | 430,097 | **281,770** | 342,841 |
| Property, plant and equipment | 14 | **2,555,079** | 1,274,114 | **481,940** | 511,055 |
| Investment property | 15 | **4,689,901** | 4,364,335 | **3,314,250** | 3,143,980 |
| Investment in group undertakings | 16 | **-** | - | **10,935,996** | 9,907,363 |
| Investment in associated undertaking | 17 | **18,493,442** | 17,364,598 | **5,117,196** | 4,117,196 |
| Other investments | 18 | **73,047,458** | 69,024,665 | **21,021,848** | 22,283,858 |
| Deferred income tax | 19 | **1,416,913** | 1,128,795 | **-** | - |
| Reinsurers' share of technical provisions | 20 | **12,406,454** | 12,360,650 | **5,874,888** | 6,389,975 |
| Deferred acquisition costs | 21 | **2,995,350** | 2,204,198 | **1,106,254** | 1,053,245 |
| Insurance and other receivables | 22 | **8,839,861** | 7,788,125 | **3,869,235** | 4,488,841 |
| Income tax receivable | | **16,067** | 294,775 | **-** | - |
| Cash and cash equivalents | 23 | **4,249,853** | 1,939,735 | **1,320,723** | 906,215 |
| **Total assets** | | **129,167,708** | 118,174,087 | **53,324,100** | 53,144,569 |
| **EQUITY** | | | | | |
| **Capital and reserves attributable to Shareholders** | | | | | |
| Share capital | 24 | **6,250,000** | 6,250,000 | **6,250,000** | 6,250,000 |
| Share premium account | | **1,192,500** | 1,192,500 | **1,192,500** | 1,192,500 |
| Other reserves | 25 | **9,252,201** | 9,313,631 | **14,769** | 76,199 |
| Profit and loss account | | **18,761,143** | 16,988,123 | **10,954,588** | 9,821,910 |
| | | **35,455,844** | 33,744,254 | **18,411,857** | 17,340,609 |
| **Minority interests** | | **1,392,053** | 1,258,923 | **-** | - |
| **Total equity** | | **36,847,897** | 35,003,177 | **18,411,857** | 17,340,609 |
| **LIABILITIES** | | | | | |
| Deferred income tax | 19 | **515,371** | 481,982 | **515,371** | 481,982 |
| Provisions for other liabilities and charges | 26 | **379,427** | 347,499 | **-** | - |
| Technical provisions | 20 | **74,646,453** | 65,388,631 | **20,948,120** | 21,037,501 |
| Borrowings | 27 | **7,032,311** | 7,765,899 | **7,032,311** | 7,765,899 |
| Insurance and other payables | 28 | **9,535,173** | 8,833,236 | **6,333,801** | 6,164,917 |
| Income tax payable | | **211,076** | 353,663 | **82,640** | 353,661 |
| **Total liabilities** | | **92,319,811** | 83,170,910 | **34,912,243** | 35,803,960 |
| **Total equity and liabilities** | | **129,167,708** | 118,174,087 | **53,324,100** | 53,144,569 |

The financial statements on pages 6 to 79 were authorised for issue by the Board on 25 April 2008 and were signed on its behalf by:

M.C. Grech
Executive Chairman

R.E.D. Chalmers
Deputy Chairman

# Statement of changes in equity

## Group

| | Notes | Attributable to shareholders | | | | | |
|---|---|---|---|---|---|---|---|
| | | Share capital Lm | Share premium account Lm | Other reserves Lm | Profit & loss account Lm | Minority interests Lm | Total Lm |
| Balance at 1 January 2006 | | 6,250,000 | 1,192,500 | 8,448,685 | 15,061,641 | 1,036,604 | 31,989,430 |
| Fair value losses on available-for-sale investments, net of tax | 25 | - | - | (67,486) | - | - | (67,486) |
| Revaluation surplus on property plant and equipment, net of tax | 25 | - | - | 57,432 | - | 6,395 | 63,827 |
| Share of increase in value of in-force business of associated undertaking | 25 | - | - | 875,000 | - | - | 875,000 |
| Net gains recognised directly in equity | | - | - | 864,946 | - | 6,395 | 871,341 |
| Profit for the financial year | | - | - | - | 3,176,482 | 46,252 | 3,222,734 |
| Total recognised income for the financial year | | - | - | 864,946 | 3,176,482 | 52,647 | 4,094,075 |
| Dividends for 2005 | 12 | - | - | - | (1,250,000) | (49,626) | (1,299,626) |
| Increase in share capital of subsidiary | 30 | - | - | - | - | 219,298 | 219,298 |
| **Balance at 31 December 2006** | | 6,250,000 | 1,192,500 | 9,313,631 | 16,988,123 | 1,258,923 | 35,003,177 |
| | | | | | | | |
| Balance at 1 January 2007 | | 6,250,000 | 1,192,500 | 9,313,631 | 16,988,123 | 1,258,923 | 35,003,177 |
| Fair value losses on available-for-sale investments, net of tax | 25 | - | - | (56,030) | - | - | (56,030) |
| Release on sale of subsidiary undertaking | 25 | - | - | (5,400) | - | - | (5,400) |
| Net losses recognised directly in equity | | - | - | (61,430) | - | - | (61,430) |
| Profit for the financial year | | - | - | - | 2,898,020 | 68,408 | 2,966,428 |
| Total recognised (expense)/income for the financial year | | - | - | (61,430) | 2,898,020 | 68,408 | 2,904,998 |
| Dividends for 2006 | 12 | - | - | - | (1,125,000) | (26,339) | (1,151,339) |
| Increase in share capital of subsidiary | | - | - | - | - | 118,447 | 118,447 |
| Disposal of subsidiary | | - | - | - | - | (27,386) | (27,386) |
| **Balance at 31 December 2007** | | 6,250,000 | 1,192,500 | 9,252,201 | 18,761,143 | 1,392,053 | 36,847,897 |

# Statement of changes in equity

## Company

| | Notes | Share capital Lm | Share premium account Lm | Other reserves Lm | Profit & loss account Lm | Total Lm |
|---|---|---|---|---|---|---|
| Balance at 1 January 2006 | | 6,250,000 | 1,192,500 | 143,685 | 8,825,114 | 16,411,299 |
| Fair value losses on available-for-sale investments, net of tax | 25 | - | - | (67,486) | - | (67,486) |
| Net losses recognised directly in equity | | - | - | (67,486) | - | (67,486) |
| Profit for the financial year | | - | - | - | 2,246,796 | 2,246,796 |
| Total recognised (expense)/income for the financial year | | - | - | (67,486) | 2,246,796 | 2,179,310 |
| Dividends for 2005 | 12 | - | - | - | (1,250,000) | (1,250,000) |
| **Balance at 31 December 2006** | | 6,250,000 | 1,192,500 | 76,199 | 9,821,910 | 17,340,609 |
| Balance at 1 January 2007 | | 6,250,000 | 1,192,500 | 76,199 | 9,821,910 | 17,340,609 |
| Fair value losses on available-for-sale investments, net of tax | 25 | - | - | (56,030) | - | (56,030) |
| Release on sale of subsidiary undertaking | | - | - | (5,400) | - | (5,400) |
| Net losses recognised directly in equity | | - | - | (61,430) | - | (61,430) |
| Profit for the financial year | | - | - | - | 2,257,678 | 2,257,678 |
| Total recognised (expense)/income for the financial year | | - | - | (61,430) | 2,257,678 | 2,196,248 |
| Dividends for 2006 | 12 | - | - | - | (1,125,000) | (1,125,000) |
| **Balance at 31 December 2007** | | 6,250,000 | 1,192,500 | 14,769 | 10,954,588 | 18,411,857 |

As at 31 December 2007, unrealised fair value gains, net of taxation, amounting at Lm2,631,928 (2006: Lm2,480,842), have been credited to the profit and loss account and are not distributable in terms of the Companies Act, 1995.

# Cash flow statement

| | | Year ended 31 December | | | |
|---|---|---|---|---|---|
| | | Group | | Company | |
| | Notes | **2007** | 2006 | **2007** | 2006 |
| | | **Lm** | Lm | **Lm** | Lm |
| **Operating activities** | | | | | |
| Cash generated from operations | 29 | **8,851,400** | 4,706,663 | **2,071,837** | 1,217,747 |
| Dividends received | | **513,485** | 576,400 | **517,708** | 603,273 |
| Interest received | | **2,600,965** | 2,286,604 | **789,904** | 678,186 |
| Interest paid | | **(483,144)** | (269,362) | **(465,290)** | (262,301) |
| Tax paid | | **(1,123,083)** | (648,676) | **(772,101)** | (324,502) |
| Net cash generated from operating activities | | **10,359,623** | 6,651,629 | **2,142,058** | 1,912,403 |
| **Investing activities** | | | | | |
| Purchase of investment property | 15 | **(39,301)** | - | **(39,301)** | - |
| Disposal of investment property | 15 | **-** | 105,700 | **-** | 105,700 |
| Increase in investment in group undertaking | 16 | **-** | - | **(855,440)** | (1,568,993) |
| Disposal of group undertaking, net of cash acquired | 16 | **(41,544)** | - | **36,900** | - |
| Increase in investment in associated undertaking | 17 | **-** | (1,500,000) | **-** | (1,500,000) |
| Purchase of financial investments | 18 | **(89,132,359)** | (29,025,096) | **(8,163,660)** | (7,808,457) |
| Redemption of financial investments on maturity | 18 | **76,894,737** | 17,487,002 | **1,694,562** | 4,489,690 |
| Disposal of financial investments | 18 | **7,683,818** | 5,634,569 | **7,530,495** | 4,259,138 |
| Purchase of property, plant and equipment and intangible assets | 13,14 | **(1,668,461)** | (338,798) | **(91,613)** | (232,334) |
| Disposal of property, plant and equipment | 13,14 | **20,085** | - | **19,095** | - |
| Net cash (used in)/generated from investing activities | | **(6,283,025)** | (7,636,623) | **131,038** | (2,255,256) |
| **Financing activities** | | | | | |
| Bank loans | 27 | **(733,588)** | 1,380,973 | **(733,588)** | 1,380,973 |
| Proceeds from minority interest on issue of shares | | **118,447** | 219,298 | **-** | - |
| Dividends paid to group shareholders | 12 | **(1,125,000)** | (1,250,000) | **(1,125,000)** | (1,250,000) |
| Dividends paid to minority interests | | **(26,339)** | (49,626) | **-** | - |
| Net cash (used in)/generated from financing activities | | **(1,766,480)** | 300,645 | **(1,858,588)** | 130,973 |
| **Increase/(decrease) in cash and cash equivalents** | | **2,310,118** | (684,349) | **414,508** | (211,880) |
| **Movement in cash and cash equivalents** | | | | | |
| At beginning of year | | **1,939,735** | 2,624,084 | **906,215** | 1,118,095 |
| Net cash inflow/(outflow) | | **2,310,118** | (684,349) | **414,508** | (211,880) |
| At end of year | 23 | **4,249,853** | 1,939,735 | **1,320,723** | 906,215 |

## Accounting policies

The principal accounting policies adopted in the preparation of these financial statements are set out below. These policies have been consistently applied to all the years presented, unless otherwise stated.

### 1. Basis of preparation

These financial statements are prepared in accordance with International Financial Reporting Standards as adopted for use in the European Union, the Insurance Business Act, 1998 and the Companies Act, 1995.

The financial statements are prepared under the historical cost convention as modified by the revaluation of property, plant and equipment, investment property, financial assets at fair value through profit or loss, and the share of associated undertaking's value of in-force business.

The preparation of financial statements in conformity with the above reporting framework requires the use of certain critical accounting estimates. It also requires management to exercise its judgement in the process of applying the Group's accounting policies. The areas involving a higher degree of judgement or complexity, or areas where assumptions and estimates are significant to the consolidated financial statements, are disclosed in Note 1.

The balance sheet is organised in increasing order of liquidity, with additional disclosures on the current or non-current nature of the Group's assets and liabilities provided within the notes to the financial statements.

*Standards, interpretations and amendments to published standards effective in 2007*

In 2007 the Group adopted new standards, amendments and interpretations to existing Standards that are mandatory for the Group's accounting period beginning on 1 January 2007. The adoption of these revisions to the requirements of IFRSs did not result in substantial changes to the Group's accounting policies. IFRS 7, Financial Instruments: Disclosures, and the complementary Amendment to IAS 1, Presentation of Financial Statements – Capital Disclosures, introduce new disclosures relating to financial instruments and capital, but do not have any impact on the classification and measurement of the Group's financial instruments and capital.

*Standards, interpretations and amendments to published standards that are not yet effective*

Certain new standards, amendments and interpretations to existing standards have been published by the date of authorisation for issue of these financial statements, which are mandatory for the Group's accounting periods beginning after 1 January 2007. The Group has not early adopted these revisions to the requirements of IFRSs, and the Group's directors are of the opinion that there are no requirements that will have a possible impact on the Group's financial statements in the period of initial application.

## 2. Consolidation

*(a) Group undertakings*

The consolidated financial statements incorporate the assets, liabilities and results of the Company and its group (or subsidiary) undertakings drawn up to 31 December each year. Subsidiary undertakings are those companies in which the Group, directly or indirectly, has an interest of more than one half of the voting rights or otherwise has power to exercise control over the operations. Subsidiaries are consolidated from the date on which effective control is transferred to the Group and are no longer consolidated from the date of disposal. On acquisition of a subsidiary undertaking, all of its assets and liabilities that exist at the date of acquisition are recorded at their fair values reflecting their condition at that date. All intercompany transactions between group companies are eliminated. Accounting policies for subsidiaries are changed where necessary to ensure consistency with the policies adopted by the Group. Separate disclosure is made of minority interests. A list of the Group's subsidiaries is set out in note 16.

*(b) Associated undertakings*

Interests in associated undertakings are accounted for by the equity method of accounting and are initially recognised at cost. The Group's investment in associates includes goodwill (net of any accumulated impairment loss) identified on acquisition. These are undertakings over which the Group has significant influence, but which it does not control. Equity accounting involves recognising in the profit and loss the share of the associated undertaking's post-acquisition profits or losses and recognising in reserves its share of post-acquisition movements in reserves. The interest in the associated undertaking is carried in the balance sheet at an amount that reflects the share of the net assets of the associated undertaking. When the Group's share of losses in an associate equals or exceeds its interest in the associate, including any other unsecured receivables, the Group does not recognise further losses, unless it has incurred obligations or made payments on behalf of the associate.

Unrealised gains on transactions between the Group and its associates are eliminated to the extent of the Group's interest in the associates. Unrealised losses are also eliminated unless the transaction provides evidence of an impairment of the asset transferred. Accounting policies for associated undertakings are changed where necessary to ensure consistency with the policies adopted by the Group. A list of the Group's associated undertakings is set out in note 17.

*(c) Goodwill*

Goodwill represents the excess of the cost of an acquisition over the fair value of the Group's share of the net identifiable assets of the acquired subsidiary/associate at the date of the acquisition. Any excess of the acquiree's identifiable assets, liabilities and contingent liabilities and the measurement of the cost of the acquisition is recognised immediately in the profit and loss account.

## 3. Segment reporting

A business segment is a group of assets and operations engaged in providing products or services that are subject to risks and returns that are different from those of other business segments. In identifying the Group's business segments, the directors are also guided by the Regulations under the Insurance Business Act, 1998 on the disclosure requirements relevant to specified insurance classes of business. A geographical segment is engaged in providing products and services within a particular economic environment that is subject to risks and returns that are different from those of segments operating in other economic environments.

## 4. Foreign currency translation

*Functional and presentation currency*

Items included in the financial statements of each of the Group's entities are measured using the currency of the primary economic environment in which the entity operates (the 'functional currency'). The consolidated financial statements are presented in Maltese Lira, which is the Group's presentation currency.

*Transactions and balances*

Transactions in foreign currencies have been converted into the functional currency at the rates of exchange ruling on the date of the transaction. Foreign exchange gains and losses resulting from the settlement of such transactions and from the translation at year-end exchange rates of monetary assets and liabilities denominated in foreign currencies are recognised in the profit and loss account. Translation differences on non-monetary items mainly arising on equities held at fair value through profit or loss, are reported as part of the fair value gain or loss.

*Group companies*

The results and financial position of all Group entities that have a functional currency different from the presentation currency are translated into the presentation currency as follows:

(i) assets and liabilities for each balance sheet presented are translated at the closing rate at the date of that balance sheet; and
(ii) income and expenses for each profit and loss account are translated at average exchange rates.

Following the fixing of the Central Parity Rate of the Maltese Lira to the Euro, no currency translation difference arises upon translation into the presentation currency.

Goodwill and fair value adjustments arising on the acquisition of a foreign entity are treated as the foreign entity's assets and liabilities and are translated at the closing rate.

## 5. Property, plant and equipment

Property, plant and equipment are stated at historical cost less depreciation. Historical cost includes expenditure that is directly attributable to the acquisition of the items.

Subsequent costs are included in the asset's carrying amount or recognised as a separate asset, as appropriate, only when it is probable that future economic benefits associated with the item will flow to the Group and the cost of the item can be measured reliably. All other repairs and maintenance costs are charged to the profit and loss account during the financial period in which they are incurred.

Land is not depreciated. Depreciation on other assets is calculated using the straight-line method to allocate their cost to their residual values over their estimated useful lives as follows:

| | |
|---|---|
| Buildings | 100 years |
| Leasehold improvements | 40 years |
| Motor vehicles | 5 years |
| Furniture, fittings and equipment | 3 - 10 years |

The assets' residual values and useful lives are reviewed at each balance sheet date and adjusted if appropriate.

An asset's carrying amount is written down immediately to its recoverable amount if the asset's carrying amount is greater than its estimated recoverable amount.

Gains and losses on disposals are determined by comparing proceeds with carrying amounts and are included in the profit and loss account.

On transfer of an owner-occupied property to investment property that will be carried at fair value the difference between the carrying amount and the fair value at that date is credited directly to other reserves in shareholders' equity. On subsequent disposal of the investment property, the revaluation surplus included in equity is transferred directly to retained earnings.

## 6. Investment property

Freehold and leasehold properties treated as investments principally comprise office and other commercial buildings that are held for long-term rental yields and that are not occupied by the Group. Investment property is carried at fair value, representing the open market value determined annually by external valuers. Changes in fair values are reported in the profit and loss account.

## 7. Intangible assets

*Computer software*

Acquired computer software licences are capitalised on the basis of the costs incurred to acquire and bring to use the specific software. These costs are amortised using the straight-line method over their useful lives, not exceeding a period of five years.

All costs associated with maintaining computer software programmes are recognised as an expense as incurred.

## 8. Share of associated undertaking's value of in-force business

The value of in-force business is determined by the directors of the associate, based on the advice of the company's approved actuary. The valuation represents the discounted value of projected future transfers to shareholders from policies in force at the year end, after making provision for taxation. In determining this valuation, assumptions relating to future mortality, persistence and levels of expenses are based on experience of the type of business concerned. Gross investment returns assumed vary depending upon the mix of investments held by the company and expected market conditions. Annual movements in the share of the in-force business valuation are credited or debited to reserves and are included in the balance sheet of the Group as part of the investments in associated undertaking.

## 9. Investments in group and associated undertakings

In the Company's financial statements, investments in group and associated undertakings are accounted for by the cost method of accounting less impairment. The dividend income from such investments is included in the profit and loss account in the accounting year in which the Company's rights to receive payment of any dividend is established. On disposal of an investment, the difference between the net disposal proceeds and the carrying amount is charged or credited to the profit and loss account.

## 10. Financial assets

The Group classifies its financial assets into the following categories: financial assets at fair value through profit or loss, available-for-sale investments and loans and receivables. The classification is dependant on the purpose for which the investments were acquired. The directors determine the appropriate classification of investments at the time of purchase and re-evaluate such designation at every reporting date.

- Financial assets at fair value through profit or loss are part of a group of investments that is managed on a portfolio basis and whose performance is evaluated and reported internally on a fair value basis to the Group's Board in accordance with a documented investment strategy. Derivatives are also classified as fair value through profit or loss.

**10. Financial assets** - continued

- Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market, other than those that the Group has designated as fair value through profit or loss. They include, inter alia, insurance and other receivables, income tax receivable, cash and cash equivalents in the balance sheet as well as other financial investments (comprising deposits with credit institutions, unlisted fixed income debt securities and treasury bills) classified as loans and receivables within note 18.

- Available-for-sale investments are those non-derivative financial assets that are designated as available-for-sale or are not classified as (a) loans and receivables, (b) held-to-maturity or (c) financial assets at fair value through profit or loss. They include inter alia unlisted equities.

All purchases and sales of investments are recognised on the trade date, which is the date that the Group commits to purchase or sell the assets. All investments are initially recognised at fair value plus, in the case of all financial assets not carried at fair value through profit or loss, transaction costs that are directly attributable to their acquisition. Investments are derecognised when the rights to receive cash flows from the investments have expired or where they have been transferred and the Group has also transferred substantially all risks and rewards of ownership.

Financial assets at fair value through profit or loss and available-for-sale investments are subsequently re-measured at fair value. Loans and receivables are carried at amortised cost using the effective interest method, less any provision for impairment. Realised and unrealised gains and losses arising from changes in the fair value of the 'financial assets at fair value through profit or loss' category are included in the profit and loss account in the period in which they arise. Any unrealised gain or loss on an available-for-sale financial asset is recognised directly in equity, through the statement of changes in equity, except for impairment losses and foreign exchange gains and losses arising on monetary securities, until the financial asset is derecognised, at which time the cumulative gain or loss previously recognised in equity is recognised in the profit and loss.

The fair value of investments is based on quoted market prices at the balance sheet date. If the market for a financial asset is not active, the Group establishes fair value by using valuation techniques. These include the use of recent arm's length transactions, reference to other instruments that are substantially the same and discounted cash flow analysis.

Derivatives are recognised at fair value on the date on which a derivative contract is entered into and are subsequently re-measured at their fair value. Fair values are obtained from quoted market prices in active markets, and other valuation techniques, as appropriate. Subsequent changes in the fair value of any derivative instruments are recognised immediately in the profit and loss account. All derivatives are carried as assets when fair value is positive, and as liabilities when fair value is negative.

The Group enters into currency forward contracts to hedge the foreign exchange risk arising on its investments denominated in a foreign currency. These transactions provide effective economic hedges under the Company's risk management policies. However hedge accounting under the specific rules in IAS 39 is not required, because the change in the value of the hedged financial instrument is recognised in the profit and loss account.

## 11. Impairment of assets

*(a) Impairment of financial assets at amortised cost*

The Group assesses at each balance sheet date whether there is objective evidence that a financial asset or group of financial assets is impaired. A financial asset or group of financial assets is impaired and impairment losses are incurred only if there is objective evidence of impairment as a result of one or more events that have occurred after the initial recognition of the asset (“a loss event”) and that loss event (or events) has an impact on the estimated future cash flows of the financial asset or group of financial assets that can be reliably estimated.

Objective evidence that a financial asset or group of assets is impaired includes observable data that comes to the attention of the Group about the following events:

(i) significant financial difficulty of the issuer or debtors;
(ii) a breach of contract, such as a default or delinquency in payments;
(iii) it becoming probable that the issuer or debtor will enter bankruptcy or other financial reorganisation; and
(iv) observable data indicating that there is a measurable decrease in the estimated future cash flow from a group of financial assets since the initial recognition of those assets, although the decrease cannot yet be identified with the individual financial assets in the Group.

The Group first assesses whether objective evidence of impairment exists individually for financial assets that are individually significant. If the Group determines that no objective evidence of impairment exists for an individually assessed financial asset, whether significant or not, it includes the asset in a group of financial assets with similar credit risk characteristics and collectively assesses them for impairment. Assets that are individually assessed for impairment and for which an impairment loss is or continues to be recognised are not included in a collective assessment of impairment.

If there is objective evidence that an impairment loss has been incurred on loans and receivables carried at amortised cost, the amount of the loss is measured as the difference between the asset’s carrying amount and the present value of estimated future cash flows discounted at the financial asset’s original effective interest rate. The carrying amount of the asset is reduced through the use of an allowance account and the amount of the loss is recognised in the profit and loss account.

If in a subsequent period, the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognised (such as improved credit rating), the previously recognised impairment loss is reversed by adjusting the allowance account. The amount of the reversal is recognised in the profit and loss account.

**11. Impairment of assets** - continued

*(b) Impairment of financial assets carried at fair value*

The Group assesses at each balance sheet date whether there is objective evidence that an available-for-sale financial asset is impaired, including in the case of equity investments classified as available-for-sale, a significant or prolonged decline in the fair value of the security below its cost. If any such evidence exists for available-for-sale financial assets, the cumulative loss – measured as the difference between the acquisition cost and current fair value, less any impairment loss on the financial asset previously recognised in the profit or loss – is removed from equity and recognised in the profit and loss account. Impairment losses recognised in the profit and loss account on equity instruments are not subsequently reversed.

*(c) Impairment of other non-financial assets*

Assets that have an indefinite useful life and are not subject to amortisation are tested annually for impairment. Assets that are subject to amortisation or depreciation are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. An impairment loss is recognised for the amount by which the asset's carrying amount exceeds its recoverable amount. The recoverable amount is the higher of an asset's fair value less costs to sell and value in use. For the purposes of assessing impairment, assets are grouped at the lowest levels for which there are separately identifiable cash flows (cash-generating units).

**12. Offsetting financial instruments**

Financial assets and liabilities are offset and the net amount reported in the balance sheet only when there is a legally enforceable right to offset the recognised amounts and there is an intention to settle on a net basis, or to realise the asset and settle the liability simultaneously.

**13. Cash and cash equivalents**

Cash and cash equivalents include cash in hand and deposits held at call with banks, which are held for operational purposes, and bank overdrafts.

**14. Share capital**

Shares are classified as equity when there is no obligation to transfer cash or other assets.

## 15. Insurance contracts

The Group issues contracts that transfer significant insurance risk and that are classified as insurance contracts.

As a general guideline, the Group defines as significant insurance risk the possibility of having to compensate the policyholder if a specified uncertain future event (the insured event) adversely affects the policyholder.

*Insurance contracts - General business*

The results for general business are determined on an annual basis whereby the incurred cost of claims, commission and related expenses are charged against the earned proportion of premiums, net of reinsurance as follows:

(i) Premiums written relate to business incepted during the year together with any differences between the booked premiums for prior years and those previously accrued, less cancellations.

(ii) Unearned premiums represent the proportion of premiums written in the year that relate to unexpired terms of policies in force at the balance sheet date, calculated on a time apportionment basis.

(iii) Commissions and other acquisition costs that vary with and are related to securing new contracts and renewing existing contracts are deferred over the period in which the related premiums are earned. These are capitalised and shown as deferred acquisition costs ("DAC") in the balance sheet. DAC is amortised over the term of the policies as the premium is earned. All other costs are recognised as expenses when incurred.

(iv) Claims incurred comprise claims and related expenses paid in the year and changes in the provisions for outstanding claims, including provisions for claims incurred but not reported (IBNR) or not enough reported (IBNER) and related expenses, together with any other adjustments to claims from previous years. Where applicable, deductions are made for salvage and other recoveries.

(v) Provision is made at the year-end for the estimated cost of claims incurred but not settled at the balance sheet date, including the cost of claims incurred but not yet reported to the Group. The estimated cost of claims includes expenses to be incurred in settling claims. The Group takes all reasonable steps to ensure that it has appropriate information regarding its claims exposures. The Group does not discount its liabilities for unpaid claims. Liabilities for unpaid claims are estimated using the input of assessments for individual cases reported to the Group and statistical analysis for the claims incurred but not reported, and to estimate the expected ultimate cost of more complex claims that may be affected by external factors (such as court decisions).

**15. Insurance contracts** - continued

(vi) Provision in the form of an unexpired risk provision, is made on the basis of claims and administrative expenses likely to arise after the end of the financial year from contracts concluded before the balance sheet date, in so far as their estimated value exceeds the provision for unearned premiums and any premiums receivable under those contracts.

*Long term business – Group Life*

Group life business consists of annual policies that cover the lives of a group of customers' employees for the year under cover. Premiums, including reinsurance premiums, and claims are accounted for when due for payment. Reinsurance recoveries are accounted for in the same period as the related claim. The long-term business provision is based on the net "unearned premiums" method as adjusted to take into account the premium written. The valuation is carried out in conjunction with the Company's appointed independent actuary. Profits, which accrue as a result of actuarial valuations, are released to the non-technical profit and loss account. Any shortfall between actuarial valuations and the balance on the long-term business provision is appropriated from the non-technical profit and loss account.

*Reinsurance contracts held*

Contracts entered into by the Group with reinsurers under which the Group is compensated for losses on one or more contracts issued by the Group and that meet the classification requirements for insurance contracts are classified as reinsurance contracts held. Insurance contracts entered into by the Group under which the contract holder is another insurer (inwards reinsurance) are included with insurance contracts.

The benefits to which the Group is entitled under its reinsurance contracts held are recognised as reinsurance assets. These assets consist of short-term balances due from reinsurers (classified within debtors), as well as longer term receivables (classified within reinsurers' share of technical provisions) that are dependent on the expected claims and benefits arising under the related reinsured insurance contracts. Amounts recoverable from or due to reinsurers are measured consistently with the amounts associated with the reinsured insurance contracts and in accordance with the terms of each reinsurance contract. Reinsurance liabilities are primarily premiums payable for reinsurance contracts and are recognised as an expense when due.

The Group assesses its reinsurance assets for impairment on a regular basis. If there is objective evidence that the reinsurance asset is impaired, the Group reduces the carrying amount of the reinsurance asset to its recoverable amount and recognises that impairment loss in the profit and loss account. The Group gathers the objective evidence that a reinsurance asset is impaired using the same process adopted for financial assets held at amortised cost. The impairment loss is also calculated following the same method used for these financial assets. These processes are described in accounting policy 11.

**15. Insurance contracts** - continued

*Receivables and payables related to insurance contracts*

Receivables and payables are recognised when due. These include amounts due to and from agents, brokers and insurance contract holders.

If there is objective evidence that an insurance receivable is impaired, the Group reduces the carrying amount of the insurance receivable accordingly and recognises that impairment loss in the profit and loss account. The Group gathers the objective evidence that an insurance receivable is impaired using the same process adopted for financial assets held at amortised cost.

The impairment loss is calculated following the same method used for these financial assets. These processes are described in accounting policy 11.

*Liability adequacy test*

At each balance sheet date, liability adequacy tests are performed to ensure the adequacy of the contract liabilities net of related DAC assets. In performing these tests, current best estimates of future contractual cash flows and claims handling and administration expenses, as well as investment income from the assets backing such liabilities, are used. Any deficiency is immediately charged to profit or loss initially by writing off DAC and by subsequently establishing a provision for losses arising from liability adequacy tests (the unexpired risk provision as described above). Any DAC written off as a result of this test cannot subsequently be reinstated.

**16. Borrowings**

Borrowings are recognised initially at fair value, net of transaction costs incurred. Borrowings are subsequently stated at amortised cost.

No borrowing costs have been capitalised. Interest costs are charged against income without restriction.

**17. Deferred income tax**

Deferred income tax is provided using the liability method for all temporary differences arising between the tax bases of assets and liabilities and their carrying values for financial reporting purposes. However, if the deferred income tax arises from initial recognition of an asset or liability in a transaction other than a business combination that at the time of the transaction affects neither accounting nor taxable profit or loss, it is not accounted for. Currently enacted tax rates are used in the determination of deferred income tax.

Deferred tax assets are recognised only to the extent that future taxable profit will be available such that realisation of the related tax benefit is probable.

## 18. Provisions

Provisions are recognised when the Group has a present legal or constructive obligation as a result of past events, it is probable that an outflow of resources will be required to settle the obligation, and a reliable estimate of the amount can be made.

## 19. Revenue recognition

Revenue comprises the fair value for services and is recognised as follows:

(a) Rendering of services

Premium recognition is described in accounting policy 15 dealing with insurance contracts.

(b) Dividend income

Dividend income is recognised when the right to receive payment is established.

(c) Other net fair value gains/(losses) from financial assets at fair value through income

Other gains or losses arising from changes in the fair value of the 'financial assets at fair value through income' category are presented in the income statement within 'Net fair value gains (or losses) on financial assets at fair value through income' in the period in which they arise.

(d) Interest income

Interest income from financial assets not classified as fair value through profit or loss is recognised using the effective interest method. When a receivable is impaired, the Group reduces the carrying amount to its recoverable amount, being the estimated future cash flow discounted at the original effective interest rate of the instrument and continues unwinding the discount as interest income.

(e) Rent receivable

Rent receivable from investment property is accounted for on an accruals basis in accordance with the substance of the relevant lease agreements.

## 20. Investment return

Investment return includes dividend income, other net fair value movements on financial assets at fair value through income (including interest income from financial assets classified as fair value through profit or loss), interest income from financial assets not classified as fair value through profit or loss, rental receivable, share of associated undertaking's result, and is net of investment expenses, charges, and interest.

**20. Investment return** - continued

Investment return is initially recorded in the non-technical account, except for income attributed to long term business which is recognised immediately in the long term business technical account. A transfer is made from the non-technical account to the general business technical account of the actual investment return on investments supporting the insurance technical provisions.

**21. Leases**

Assets leased out under operating leases are included in investment property. Rental income is recognised in the profit and loss account over the period of the lease to which it relates.

**22. Dividends**

Dividend distribution to the Company's shareholders is recognised as a liability in the period in which the dividends are approved by the Company's shareholders.

# Notes to the financial statements

## 1. Critical accounting estimates and judgments in applying accounting policies

Estimates and judgments are continually evaluated and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances. The estimates and assumptions that have a significant risk of affecting the reported amount of assets and liabilities within the next financial year are discussed below.

*(a) Ultimate liability arising from claims made under insurance contracts*

There are several sources of uncertainty that need to be considered in the estimate of the liability that the Group will ultimately pay for such claims. In particular, insurance risks including exposure to liability can span over more than one accounting year, and this increases the uncertainty surrounding the estimate for final settlement.

The Group applies conventional statistical or actuarial models in order to determine the ultimate liability of claims. As disclosed in note 2.1, the Bornhuetter-Ferguson Paid model uses a combination of a benchmark or market-based estimate and an estimate based on claims experience. The initial loss ratio estimate is an important assumption in the estimation technique and is based on previous years' experience, adjusted for factors such as premium rate changes, anticipated market experience and historical claims inflation. Details of sensitivity to any potential change in this initial loss ratio is disclosed in note 20 to these financial statements. The Group believes that the liability arising from claims under insurance contracts is adequately reserved as at the financial year end as evidenced by the development table included in note 20.

*(b) Estimate of in-force business of the associated company*

The value of in-force business is a projection of future shareholders' profit expected from contracts in force at the year end, appropriately discounted and adjusted for the effect of taxation. This valuation requires the use of assumptions relating to future mortality, persistence, levels of expenses and investment returns over the longer term (see accounting policy 8).

The after tax value of in-force business is determined by the directors on an annual basis, based on the advice of the approved actuary. The value of in-force business depends upon assumptions made regarding future economic and demographic experience. The economic assumptions are internally consistent and reflect the directors' view of economic conditions in the longer term.

The valuation assumes a margin of 2% (2006: 2%) between the weighted average projected investment return and the discount factor applied. The calculation also assumes lapse rates varying from 2% to 10% (2006: 3% to 5%), and an expense inflation rate of 3.6% (2006: 3.6%). Changes in current year assumptions, as compared to the 2006 valuation process, did not have a significant impact on the Group's net assets. If the assumed margin between weighted average projected investment return and discount rate were reduced by 1%, the after tax value of in-force business would increase to Lm9.79 million (2006: Lm9.78 million). If the assumed spread between weighted average projected investment return and discount rate were increased by 1%, the after tax value of in-force business would decrease to Lm8.64 million (2006: Lm8.64 million).

## 2. Management of insurance and financial risk

The Group is a party to contracts that transfer insurance risk or financial risk or both. This section summarises these risks and the way that the Group manages them.

### 2.1 Insurance risk

The risk under any one insurance contract is the possibility that the insured event occurs and the uncertainty of the amount of the resulting claim. By the very nature of an insurance contract, this risk is fortuitous.

The terms and conditions of the contracts set out the bases for the determination of the Group's liability should the insured event occur. The risks underwritten include accident and health, motor (including third party liability), marine and transport, fire and other damage to property, liability and group life. Details of gross premiums written as well as the insurance liabilities analysed by class are provided in the "Segmental Analysis".

For a portfolio of insurance contracts where the theory of probability is applied to pricing and provisioning, the principal risk that the Group faces under its insurance contracts is that the actual claims and benefit payments are significantly different to the amounts included within technical provisions. This could occur because the frequency or severity of claims and benefits are greater or lower than estimated. Insurance events are fortuitous and the actual number and amount of claims and benefits may vary from year to year from the estimate established using statistical techniques.

Factors that aggravate insurance risk include lack of risk diversification in terms of type and amount of risk and geographical location.

Experience shows that the larger the portfolio of similar insurance contracts, the smaller the relative variability about the expected outcome will be. In addition, a more diversified portfolio is less likely to be affected across the board by a change in any subset of the portfolio. The Group has developed its insurance underwriting strategy to diversify the type of insurance risk accepted and within each of these categories to achieve a sufficiently large population of risks to reduce the potential variability of the expected outcome.

*a) Frequency and severity of claims*

The frequency and severity of claims can be affected by several factors. The following are considered by the Group to be the most significant:

- The increasing levels of court awards in cases where damages are suffered as a result of injuries; the divergence of awards that is dependant on the territory of the claim and the jurisdiction of the court; the effect of inflation due to the prolonged period typically required to settle such cases.

- The risk of a single event that can extensively affect a multiple of individual risks to which the Group is exposed.

## 2. Management of insurance and financial risk - continued

### 2.1 Insurance risk - continued

The Group manages these risks through its underwriting strategy, adequate reinsurance arrangements and proactive claims handling. In addition, on the acquisition of Progress Assicurazioni S.p.A., the Group had entered into a reinsurance arrangement with Corporacion Mapfre Compania Internacional De Reaseguros S.A., the previous shareholders of the Italian company. In terms of this agreement, Corporacion Mapfre Compania Internacional De Reaseguros S.A. agreed to reimburse the company for the net adverse run-off cost of all risks incepted prior to the date of original acquisition. Recoveries in terms of this arrangement are further disclosed in note 20 to the financial statements.

Underwriting

The underwriting strategy ensures that the risks underwritten are well diversified in terms of type and amount of risk and geography.

The Group follows strict underwriting guidelines and sets limits on the overall retention of risk that it carries. Any risk in excess of this limit is either reinsured under a facultative cover note or is declined. Underwriting limits are in place to enforce appropriate risk selection criteria. In certain circumstances, certain exclusions to risks are included within these guidelines. For example, the Group does not insure US risks unless they are incidental. The Group can impose deductibles to help manage its costs. It also uses its experience and expertise to mitigate the risk of fraudulent claims. Insurance contracts also entitle the Group to pursue third parties for payment of some or all of the costs (ie subrogation). A significant portion of the Group’s business is underwritten through an agency distribution network. Underwriting authority limits are set for individual agencies or branches, and any contracts through which the Group is committed to cover risks in excess of these authority limits require head office approval.

Reinsurance arrangements

The Group has reinsurance protection in place for all classes of business. The type of reinsurance cover, and the level of retention, is based on the Group’s internal risk management assessment which takes into account the risk being covered, the sums assured and the geographical location of the risk. The Boards of the individual insurance companies within the Group approve each reinsurance program on an annual basis. The reinsurance arrangements include a mix of proportional, facultative and non-proportional covers, which limit the liability of the Group to any one individual claim or event. It is generally the Group’s policy for reinsurance to be placed with listed multinational reinsurance companies whose credit rating is not less than A.

As referred to earlier, the Group has in place further agreements to cover the net adverse run-off costs of all risks of the Italian subsidiary incepted prior to the date of original acquisition.

**2. Management of insurance and financial risk** - continued

**2.1 Insurance risk** - continued

Claims handling

The Group has specialised claims units dealing with the mitigation of risks surrounding known claims. These units investigate and adjust all claims. Claims are reviewed individually on a regular basis. Those claims that take more than one year to settle are reviewed regularly, and are adjusted to reflect the latest information on the underlying facts, current law, jurisdiction, contractual terms and conditions and other factors. The Group actively manages and pursues early settlement of claims to reduce its exposure to unpredictable developments.

In the case of the Company, authority limits are set for the settlement of claims through the individual agents. Any claims incurred above these limits are referred to head office for handling. In addition, all claims involving bodily injury are referred to head office irrespective of their amount. In the case of the Italian subsidiary, all claims are managed and settled directly by the company. Agents do not have authority to settle claims.

Concentration of insurance risk

The Group's risks are concentrated across the Euro-Med region. 69% of premium is written in Italy and Sicily, 28% is written in Malta and 3% is written in Gibraltar. The Group further diversifies business underwritten in Italy through a distribution network comprising 114 agencies operating on the Italian mainland, 44 agencies operating in Sicily and a further 8 agencies operating in Sardegna.

The entry into the Italian and Gibraltarian markets was a result of a strategic decision by the Group to diversify risk away from the Maltese Islands, and to increase the potential for growth.

From a Group perspective, compulsory motor liability remains the largest class of business written at 55% of total premium. Other significant insurance business classes include motor comprehensive insurance at 20% and accident and health at 11%. The remaining 14% of premium written is generated across a spread of classes including property, marine, other non-motor liability business and long term business. Further information on premiums written, and claims incurred and insurance liabilities by insurance business class is provided in note 3 to these financial statements.

The concentration of motor third party liability is mainly located within the Italian operation where this class (RCA) accounts for 72% of the total business written in Italy. The emphasis of RCA business is consistent with general market trends in Southern Italy and Sicily where RCA is traditionally the predominant type of insurance cover taken out by a policyholder. The subsidiary is continuously adopting various measures to improve the mix of non-RCA business, including:

## 2. Management of insurance and financial risk - continued

### 2.1 Insurance risk - continued

- setting performance targets for agents driven by an increase in the content of non-RCA business;
- terminating agency agreements that underperform;
- Negotiating contracts with new intermediaries where portfolios are predominantly non-RCA business.
- Launching new products which cover both commercial and personal lines of business

The above measures are further complemented by strong underwriting disciplines, including realignment of the Italian operation's pricing strategy commensurate with the level of risk.

The spread of business underwritten by the local company (including the Gibraltar branch) is more diversified. Comprehensive motor business accounts for 30% of premium written, followed by property and accident and health both at 19%, and motor liability at 18%. The remaining 14% of the portfolio is spread across marine, non-motor liability business and long term business. The current portfolio mix is consistent with local market statistics.

*b) Sources of uncertainty in the estimation of future claim payments*

Claims on contracts are accounted for on a claims-occurrence basis. The Group is liable for all insured events that occurred during the term of the contract, even if the loss is discovered after the end of the contract term. As a result, the estimation of claims incurred but not reported ('IBNR') is generally subject to a greater degree of uncertainty than the estimation of the cost of settling claims already notified to the company, where information about the claim event is generally available. Certain classes of business, most notably those exposed to liability, can take several years to develop and are therefore subject to a greater degree of uncertainty than other classes of business which are typically settled in a shorter period of time.

The estimated cost of claims includes direct expenses to be incurred in settling claims, net of the expected subrogation value and recoveries. The Group takes all reasonable steps to ensure that it has appropriate information regarding its claims exposures. However, given the uncertainty in establishing claims provisions, it is possible that the final outcome will prove to be different from the original liability established. The liability for these contracts comprises a provision for IBNR and a provision for reported claims not yet paid at the balance sheet date.

In calculating the estimated cost of unpaid claims, the Group uses a combination of estimation techniques, based partly on known information at year end, partly on statistical analysis of historical experience and partly on actuarial valuations carried out by an independent external actuary (in so far as is relevant to the Italian operation).

## 2. Management of insurance and financial risk - continued

### 2.1 Insurance risk - continued

The reserve takes into account the estimated cost of the settlement of the claim, based on the information available at each period end. The statistical techniques are based on the statistical analysis of historical experience, which assumes that the development pattern of the current claims will be consistent with past experience.

The Company has constructed 'chain ladders' that triangulate the settlement of claims by accounting year or underwriting year, depending on the class of business (i.e. covering risks underwritten in Malta or Gibraltar). The 'chain ladders' include the known claims incurred (i.e. the claims paid and claims outstanding in any given year) by underwriting/accounting year, and they demonstrate how each year has progressed in the subsequent years of development. The 'chain ladder' is then projected forward giving greater weighting to recent years. Allowance is made, however, for changes or uncertainties which may create distortions in the underlying statistics or which might cause the cost of unsettled claims to increase or reduce when compared with the cost of previously settled claims. In fact, large claims impacting each relevant business class are generally assessed separately, being measured on a case by case basis or projected separately in order to allow for the possible distortive effect of the development and incidence of these large claims.

The Italian subsidiary applies multiple actuarial techniques to estimate the ultimate cost of claims for material classes of insurance business (essentially RCA). In addition, an external actuarial assessment on the adequacy of claims reserving is commissioned on an annual basis, in accordance with Italian Regulatory requirements. The choice of selected results depends on an assessment of the technique that is considered to be most appropriate in relation to observed historical developments. The methods used in reserving as at 31 December were the following:

- Loss Development Method Paid (LDM)
- Loss Development Method Paid Inflated Adjusted
- Bornhuetter-Ferguson Paid

The basic LDM involves the analysis of historical claims paid development factors and the selection of estimated development factors based on this historical pattern. The selected development factors are then applied to cumulative claims paid data for each accident year that is not fully developed to produce an estimated ultimate claims cost of each accident year. The second method follows through from the basic framework but is adjusted to cater for inflation.

## 2. Management of insurance and financial risk - continued

### 2.1 Insurance risk - continued

Bornhuetter-Ferguson method uses a combination of a benchmark or market-based estimate and an estimate based on claims experience. The former is based on a measure of exposure such as premiums, using an initial loss ratio estimate; the latter is based on the paid claims to date. The initial loss ratio estimate is an important assumption in the estimation technique and is based on previous years' experience, adjusted for factors such as premium rate changes, anticipated market experience and historical claims inflation. The two estimates are combined using a formula that gives more weight to the experience-based estimates as time passes.

The projections given by the various methodologies assist in estimating the range of possible outcomes. The results achieved by the different methodologies are appropriately weighted by the actuary for the purposes of reserving applied in the financial statements.

Note 20 presents the development of the estimate of ultimate claim cost for claims notified in a given year. This gives an indication of the accuracy of the Group's estimation technique for claims reserving.

### 2.2 Financial risk

The Group is exposed to a range of financial risks through its financial assets, financial liabilities, and insurance and reinsurance assets and liabilities. The most important components of these financial risks for the Group are: interest rate risk, equity price risk, currency risk, credit risk and liquidity risk. These risks arise from open positions in interest rate, currency and equity products, all of which are exposed to general and specific market movements. The risks that the Group primarily faces due to the nature of its investments and liabilities are interest rate risk and equity price risk.

**Market risk**

*a) Cash flow and fair value interest rate risk*

The Group matches its insurance liabilities with a portfolio of equity, property, and debt securities and short term deposits. The non-equity portion of the financial assets in this portfolio is characterised by interest rate risk.

In general, the Group is exposed to risk associated with the effects of fluctuations in the prevailing levels of market interest rates. Several line items on the balance sheet are based on fixed interest rates, and are therefore subject to changes in fair value resulting from changes in market rates. This risk is managed through investment in debt securities and deposits having a wide range of maturity dates. Group investment parameters exist to limit exposure to any one particular issuer and any one particular security (with the exception of investment in Government paper). The Group also has assets as well as loan facilities issued at variable rates which expose it to cash flow interest rate risk. Periodic reports are prepared at portfolio, legal entity and asset and liability class level that are circulated to the Group's key management personnel.

## 2. Management of insurance and financial risk - continued

### 2.2 Financial risk: market risk - continued

Assets and liabilities exposed to interest rate risk and their maturities are analysed below:

**Group**

| | Within 1 year 2007 | Between 1 - 2 years 2007 | Between 2 - 5 years 2007 | Over 5 years 2007 | Total 2007 |
|---|---|---|---|---|---|
| **Assets** | | | | | |
| Debt securities – listed fixed interest rate | 20,093,216 | 5,861,435 | 9,963,865 | 7,365,244 | 43,283,760 |
| Treasury bills | 149,550 | - | - | - | 149,550 |
| Loans and receivables | | | | | |
| Deposits with banks and credit institutions | 13,138,585 | - | - | - | 13,138,585 |
| Treasury bills | 2,145,115 | - | - | - | 2,145,115 |
| Unlisted fixed income debt securities | 100,000 | - | - | - | 100,000 |
| Cash and cash equivalents | 4,249,853 | - | - | - | 4,249,853 |
| Total interest bearing liabilities | 39,876,319 | 5,861,435 | 9,963,865 | 7,365,244 | 63,066,863 |
| **Liabilities** | | | | | |
| Borrowings | - | - | 2,038,560 | 4,993,751 | 7,032,311 |
| Deposits received from reinsurers | 2,027,181 | - | - | - | 2,027,181 |
| Total interest bearing liabilities | 2,027,181 | - | 2,038,560 | 4,993,751 | 9,059,492 |

**Group**

| | Within 1 year 2006 | Between 1 - 2 years 2006 | Between 2 - 5 years 2006 | Over 5 years 2006 | Total 2006 |
|---|---|---|---|---|---|
| **Assets** | | | | | |
| Debt securities – listed fixed interest rate | 9,831,740 | 8,410,256 | 12,133,994 | 10,312,536 | 40,688,526 |
| Loans and receivables | | | | | |
| Deposits with banks and credit institutions | 8,395,248 | - | - | - | 8,395,248 |
| Treasury bills | 7,338,066 | - | - | - | 7,338,066 |
| Unlisted fixed income debt securities | - | 100,000 | - | - | 100,000 |
| Cash and cash equivalents | 1,848,190 | - | - | - | 1,848,190 |
| Total interest bearing assets | 27,413,244 | 8,510,256 | 12,133,994 | 10,312,536 | 58,370,030 |
| **Liabilities** | | | | | |
| Borrowings | 164,207 | 164,207 | 3,339,551 | 4,097,934 | 7,765,899 |
| Deposits received from reinsurers | 1,816,502 | - | - | - | 1,816,502 |
| Total interest bearing liabilities | 1,980,709 | 164,207 | 3,339,551 | 4,097,934 | 9,582,401 |

## 2. **Management of insurance and financial risk** - continued

## 2.2 **Financial risk: market risk** - continued

**Company**

| | Within 1 year 2007 | Between 1 - 2 years 2007 | Between 2 - 5 years 2007 | Over 5 years 2007 | Total 2007 |
|---|---|---|---|---|---|
| Debt securities – listed fixed interest rate | 629,419 | 312,663 | 4,402,553 | 4,786,876 | 10,131,511 |
| Treasury bills | 149,550 | - | - | - | 149,550 |
| Loans and receivables | | | | | |
| Deposits with banks and credit institutions | 3,391,698 | - | - | - | 3,391,698 |
| Unlisted fixed income debt securities | 100,000 | - | - | - | 100,000 |
| Cash and cash equivalents | 1,320,723 | - | - | - | 1,320,723 |
| Loan to related party | - | 351,742 | - | - | 351,742 |
| Total interest bearing assets | 5,591,390 | 664,405 | 4,402,553 | 4,786,876 | 15,445,224 |
| **Liabilities** | | | | | |
| Borrowings | - | - | 2,038,560 | 4,993,751 | 7,032,311 |
| Deposits received from reinsurers | 1,649,816 | - | - | - | 1,649,816 |
| Total interest bearing liabilities | 1,649,816 | - | 2,038,560 | 4,993,751 | 8,682,127 |

**Company**

| | Within 1 year 2006 | Between 1 - 2 years 2006 | Between 2 - 5 years 2006 | Over 5 years 2006 | Total 2006 |
|---|---|---|---|---|---|
| Debt securities – listed fixed interest rate | 249,663 | 630,430 | 3,683,585 | 5,748,219 | 10,311,897 |
| Loans and receivables | | | | | |
| Deposits with banks and credit institutions | 4,114,754 | - | - | - | 4,114,754 |
| Unlisted fixed income debt securities | 100,000 | - | - | - | 100,000 |
| Cash and cash equivalents | 873,509 | - | - | - | 873,509 |
| Loan to related party | - | - | 365,102 | - | 365,102 |
| Total interest bearing assets | 5,337,926 | 630,430 | 4,048,687 | 5,748,219 | 15,765,262 |
| **Liabilities** | | | | | |
| Borrowings | 164,207 | 164,207 | 3,339,551 | 4,097,934 | 7,765,899 |
| Deposits received from reinsurers | 1,462,253 | - | - | - | 1,462,253 |
| Total interest bearing liabilities | 1,626,460 | 164,207 | 3,339,551 | 4,097,934 | 9,228,152 |

## 2. Management of insurance and financial risk - continued

### 2.2 Financial risk: market risk - continued

Assets and liabilities issued at variable rates expose the Group to cash flow interest rate risk whilst assets and liabilities issued at fixed rates expose the Group to fair value interest rate risk. The overall exposure to these two risks are as follows:

| | Group | | Company | |
|---|---|---|---|---|
| | **2007** | 2006 | **2007** | 2006 |
| | **Lm** | Lm | **Lm** | Lm |
| **Assets held at variable rates** | | | | |
| Deposits with banks or credit institutions | **13,138,585** | 8,395,248 | **3,391,698** | 4,114,754 |
| Treasury bills | **2,145,115** | 7,338,066 | **-** | - |
| Cash and cash equivalents | **4,249,853** | 1,823,088 | **1,320,723** | 873,509 |
| | **19,533,553** | 17,556,402 | **4,712,421** | 4,988,263 |
| **Liabilities issued at variable rates** | | | | |
| Borrowings | **7,032,311** | 7,765,899 | **7,032,311** | 7,765,899 |
| Deposits received from reinsurers | **2,027,181** | 1,816,502 | **1,649,816** | 1,462,253 |
| | **9,059,492** | 9,582,401 | **8,682,127** | 9,228,152 |

| | Group | | Company | |
|---|---|---|---|---|
| | **2007** | 2006 | **2007** | 2006 |
| | **Lm** | Lm | **Lm** | Lm |
| **Assets held at fixed rates** | | | | |
| Debt securities | **43,433,310** | 40,688,526 | **10,281,061** | 10,311,897 |
| Loans and receivables | **100,000** | 100,000 | **100,000** | 100,000 |
| Loan to related parties | **-** | - | **351,742** | 365,102 |
| Cash and cash equivalents | **-** | 25,102 | **-** | - |
| | **43,533,310** | 40,813,628 | **10,732,803** | 10,776,999 |

Insurance and other liabilities are not directly sensitive to the level of market interest rates, as they are not discounted and with the exception of deposits received from reinsurers are contractually non-interest bearing. In those instances where interest is payable (e.g. in the case of damages awarded by the Courts), interest is included in the claims cost whilst the investment income earned until the claim is settled is credited to the profit and loss account as it accrues.

Up to the balance sheet date the Group did not have any hedging policy with respect to interest rate risk as exposure to such risks was not deemed to be significant by the directors.

## 2. Management of insurance and financial risk - continued

### 2.2 Financial risk: market risk - continued

*i) Sensitivity Analysis – interest rate risk*

The sensitivity analysis for interest rate risk illustrates how changes in the fair value or future cash flows of a financial instrument will fluctuate because of changes in market interest rates at the reporting date.

The interest rate sensitivity, which considers the impact of changes in interest rates on financial assets and financial liabilities, has been based on a model of Euro Swap rates, being the Group's and Company's largest exposure. The sensitivity chosen aims to reflect a 1 in 10 year events.

At 31 December 2007, if interest rates at that date would have been 1.35 basis points lower with all other variables held constant, the Group pre-tax profit for the year would have been Lm1.3 million (2006 - Lm 1.2 million) higher. The Company pre-tax profit for the year would have been Lm0.9 million (2006 – Lm0.9 million) higher. An increase of 1.35 basis points, with all other variables held constant, would have resulted in Group pre-tax profits being Lm1.2 million (Lm1.4) lower. The Company pre-tax profit for the year would have been Lm0.8 million (2006 – Lm0.8) lower.

*b) Equity price risks*

The Group's financial assets are susceptible to the risk of decreases in value due to changes in the prices of equities because of investments held and classified on the balance sheet as fair value through profit or loss or as available-for-sale. The directors manage this risk of price volatility by entering into a diverse range of investments including equities and collective investment schemes. In addition, the Group's investments are spread geographically in a diverse number of different Zone of approved countries in terms of Insurance Directive 16. The Group has an active Investment Committee that has established a set of investment guidelines that is also approved by the Board of Directors. Investments over prescribed limits are directly approved by the Board. These guidelines provide parameters for investment management, including contracts with external portfolio managers. They include, inter alia, reference to an optimal spread of the investment portfolio, minimum security ratings assessment of equity issuers and maximum exposures by the Group to any one issuer and its connected parties (with the exception of investments in Government paper). These parameters also consider solvency restrictions imposed by the relevant Regulations.

Management structures are in place to monitor all the Group's overall market positions on a frequent basis. Reports are prepared at portfolio, legal entity and asset and liability class level that are circulated to the Group's key management personnel. These are also reviewed on a monthly basis by the Investment Committee and on a quarterly basis by the Board.

**2. Management of insurance and financial risk** - continued

**2.2 Financial risk: market risk** - continued

*i) Sensitivity analysis – equity price risk*

The sensitivity for equity price risk illustrates how changes in the fair value of equity securities will fluctuate because of changes in market prices, whether those changes are caused by factors specific to the individual equity issuer, or factors affecting all similar equity traded in the market.

The sensitivity for equity price risk is derived based on global equity returns, assuming that currency exposures are hedged. The sensitivities chosen aim to reflect a 1 in 10 year event. Given the investment strategy of the Group and Company the global equity markets are considered to be the more appropriate benchmark for sensitivity purposes.

An increase and a decrease of 10% in equity prices, with all other variables held constant, would result in an impact of Lm1.4 million (2006: Lm1.2 million) on the Group's pre-tax profit.

An increase and a decrease in 10% in equity prices, with all other variables held constant, would result in an impact of Lm0.7 million (2006: Lm0.8 million) on the Company's pre-tax profit.

*c) Currency risk*

The Company has assets and liabilities denominated in currencies other than Maltese Lira, the functional currency, principally including Euro, Sterling and US Dollar. The Company is therefore exposed to currency risk, as the value of assets and liabilities denominated in other currencies will fluctuate due to changes in exchange rates.

The Company's exposure to exchange risk is limited as follows:

a) No exposure exists to the Euro due to the fixing of the Central Parity Rate at Lm1 = Euro 0.4293.
b) Through the establishment of guidelines for investing in foreign currency (other than Euro) and hedging currency risk through forward exchange contracts where considered necessary. These guidelines are approved by the Board and a manageable exposure to currency risk is thereby permitted.

The Company also operates in Gibraltar creating an additional source of foreign currency risk – GBP.

- The operating results of the Group's foreign branches are translated at average exchange rates prevailing during the period in the financial statements; and
- The investment in foreign branches is translated into Maltese Lira using the foreign currency exchange rate at the financial statement period-end date.

At 31 December 2007, foreign currency exposure (other than Euro) amounted to Lm1.8 million (2006: Lm3.2 million). Lm0.2 was hedged as at the financial year end (2006: Lm0.7 million) leaving an unhedged exposure of Lm1.6 million (2006: Lm2.5 million).

**2. Management of insurance and financial risk** - continued

**2.2 Financial risk: market risk** - continued

*c) Currency risk - continued*

The subsidiaries of the Group are not exposed to currency risk as both the assets and liabilities of the subsidiaries are mainly denominated in their functional currency.

The Group's and the Company's net exposure to foreign currencies (other than Euro) is not considered to be material and accordingly a sensitivity analysis for foreign exchange risk disclosing how profit or loss and equity would have been affected by changes in foreign exchange rates that were reasonably possible at the balance sheet date is not deemed necessary.

**Credit risk**

Credit risk is the risk of decreases in value when counterparties are not capable of fulfilling their obligations or when a change in their credit status takes place. Key areas where the Group is exposed to credit risk are:

- Investments and cash and cash equivalents
- Reinsurers' share of insurance liabilities
- Amounts due from reinsurers in respect of claims already paid
- Amounts due from insurance contract holders
- Amounts due from insurance intermediaries
- Counterparty risk with respect to derivative transactions

The Group places limits on the level of credit risk undertaken from the main categories of financial instruments. These limits also take due consideration of the solvency restrictions imposed by the relevant Regulations. The investment strategy of the Group considers the credit standing of the counterparty and control structures are in place to assess and monitor these risk thresholds.

The Group structures the levels of credit risk it accepts by limiting as far as possible its exposure to a single counterparty or groups of counterparty. The Group has in place internal control structures to assess and monitor credit exposures and risk thresholds.

The Group's cash is placed with a number of quality financial institutions, thereby reducing the concentration of counterparty credit risk to an acceptable level.

**2. Management of insurance and financial risk** - continued

**Credit risk** - continued

Reinsurance is used to manage insurance risk. This does not, however, discharge the Group's liability as primary insurer. If a reinsurer fails to pay a claim for any reason, the Group remains liable for the payment to the policyholder. The creditworthiness of reinsurers is monitored on a quarterly basis by reviewing credit grades provided by rating agencies and other publicly available financial information, thereby ensuring the continuous financial strength of the reinsurer. At the same time that the Board approves the overall reinsurance protection of the Group, it ensures that the reinsurers' credit rating (either Standard & Poors or equivalent) is within the parameters set by it.

The Group is exposed to contract holders and intermediaries for insurance premium. Credit agreements are in place in all cases where credit is granted, and in the case of larger risks, premium payment warranties are in place. This limits the liability of the Group towards the insured or any third party if the premium remains unsettled after the credit period granted and allows the Group to cancel the policy *ab initio*, if considered necessary. Records are kept of the payment history for significant contract holders and intermediaries with whom regular business is conducted. Credit is not granted to contract holders or intermediaries whose payment history is not satisfactory. Credit risk with respect to debtors is further limited due to the large number of customers comprising the Group's debtor base.

The exposure to individual counterparties is also managed by other mechanisms, such as the right to offset where counterparties are both debtors and creditors of the Group. Management information reported to the Group includes details of provisions for impairment on loans and receivables and subsequent write-offs. Internal audit performs regular reviews to assess the degree of compliance with the Group's procedures on credit.

The Group does not enter into derivative contracts, with the exception of forward contracts that are transacted for the purpose of hedging foreign currency exposure as described earlier. All forward contracts are placed with quality financial institutions within the parameters of a hedging policy approved by the Board.

## 2. Management of insurance and financial risk - continued

### Credit risk - continued

The total assets bearing credit risk are the following:

| | Group | | Company | |
|---|---|---|---|---|
| | **2007** | 2006 | **2007** | 2006 |
| | **Lm** | Lm | **Lm** | Lm |
| Debt securities | **43,283,760** | 40,688,526 | **10,131,511** | 10,311,897 |
| Other financial assets (including deposits with banks, treasury bills and debt securities) | **15,533,250** | 15,833,314 | **3,641,248** | 4,214,754 |
| Reinsurers share of technical provisions | **9,530,855** | 9,979,458 | **3,913,671** | 4,666,664 |
| Insurance and other receivables | **8,347,002** | 7,180,322 | **3,441,656** | 3,937,363 |
| Income tax receivable | **16,067** | 294,775 | **-** | - |
| Cash and cash equivalents | **4,249,853** | 1,939,735 | **1,320,723** | 906,215 |
| Total | **80,960,787** | 75,916,130 | **22,448,809** | 24,036,893 |

The carrying amounts disclosed above represent the maximum exposure to credit risk.

These assets are analysed in the table below using Standard and Poors rating (or equivalent).

| Company | Group | | Company | |
|---|---|---|---|---|
| | **2007** | 2006 | **2007** | 2006 |
| | **Lm** | Lm | **Lm** | Lm |
| AAA | **31,958,314** | 39,127,564 | **155,942** | 4,685,228 |
| AA | **18,941,823** | 14,661,949 | **5,838,084** | 6,290,687 |
| A | **20,398,333** | 13,686,489 | **12,490,652** | 8,275,987 |
| BBB | **260,145** | 39,483 | **716** | 10,856 |
| Not rated | **9,402,172** | 8,400,645 | **3,963,415** | 4,774,135 |
| | **80,960,787** | 75,916,130 | **22,448,809** | 24,036,893 |

## 2. Management of insurance and financial risk - continued

**Credit risk** - continued

Financial assets that are past due but not impaired

Within insurance and other receivables are the following debtors that are classified as past due but not impaired.

| | Group | | Company | |
|---|---|---|---|---|
| | **2007** | 2006 | **2007** | 2006 |
| | **Lm** | Lm | **Lm** | Lm |
| Within credit terms | **483,325** | 692,578 | **477,019** | 589,390 |
| Not more than three months | **464,567** | 494,928 | **307,902** | 283,606 |
| Within three to twelve months | **319,757** | 72,259 | **107,289** | 28,790 |
| Over twelve months | **384,888** | 599,821 | **149,601** | 143,633 |
| | **1,652,537** | 1,859,586 | **1,041,811** | 1,045,419 |

IFRS 7 defines a financial asset as being past due when the counterparty has failed to make a payment when contractually due. It goes further to stipulate that full disclosure must be made of all balances due from this particular counterparty, including those which are still within credit terms and therefore not contractually due.

The overall exposure of the Group in terms of IFRS 7 is Lm1,652,537, of which Lm483,325 are not contractually due. With respect to the remaining balance, it is the view that no impairment charge is necessary, due to the following reasons:

1. The amount due was settled after year end.
2. In cases where the amount has not been settled, agreement for settlement has been reached or is being negotiated.
3. Collateral of Lm55,429 is in place and which can be called upon in negotiations fails. The collateral is in the form of a hypothec on property taken out against one particular agent.

## 2. Management of insurance and financial risk - continued

**Credit risk** - continued

Financial assets that are impaired

Within insurance and other receivables are the following debtors that are classified as impaired:

| | Group | | Company | |
|---|---|---|---|---|
| | **2007** | 2006 | **2007** | 2006 |
| | **Lm** | Lm | **Lm** | Lm |
| Over twenty four months | **802,587** | 762,238 | **289,925** | 271,134 |

These balances are covered by the following:

| | Group | | Company | |
|---|---|---|---|---|
| | **2007** | 2006 | **2007** | 2006 |
| | **Lm** | Lm | **Lm** | Lm |
| Impairment loss (note 22) | **750,081** | 709,732 | **237,419** | 218,628 |
| Other insurance payables | **52,506** | 52,506 | **52,506** | 52,506 |
| | **802,587** | 762,238 | **289,925** | 271,134 |

A decision to impair an asset is based on the following information that comes to the attention of the Group:

1. significant financial difficulty of the debtor
2. it becoming probable that the debtor will enter bankruptcy or other financial reorganisation.

**Liquidity risk**

Liquidity risk is the risk of not being able to meet unexpected or unexpectedly high payments in the short term, hence incurring a financial loss through the disposal of assets at an unfavourable price.

The Group is exposed to daily calls on its available cash resources mainly from claims arising from insurance contracts. Liquidity risk is the risk that cash may not be available to pay obligations when due at a reasonable cost. The Group manages its funds in such a manner as to ensure an adequate portion of available funds to meet such calls, principally through limits set by the Board on the minimum proportion of maturing funds available to meet such calls. Further, the Group invests a majority of its assets in listed investments that can be readily disposed of.

## 2. Management of insurance and financial risk - continued

### Liquidity risk - continued

The following table indicates the expected timing of cash flows arising from the Group's liabilities:

| | Expected cash flows (undiscounted) (Lm millions) | | | | | | |
|---|---|---|---|---|---|---|---|
| | 0-1 yr | 1-2 yrs | 2-3 yrs | 3-4 yrs | 4-5 yrs | 5yrs | Total |
| Technical provisions – claims outstanding | 23.9 | 9.6 | 6.3 | 3.9 | 3.2 | 9.5 | 56.4 |
| Borrowings | 0.3 | 0.4 | 0.4 | 1.5 | 1.3 | 5.6 | 9.5 |
| Insurance and other payables | 9.5 | - | - | - | - | - | 9.5 |
| Income tax payable | 0.2 | - | - | - | - | - | 0.2 |

## 3. Segment information

### *Primary reporting format – geographical segments*

The Group is organised on a worldwide basis into four geographical segments that are all principally involved in the business of general insurance: Malta, Italy, Gibraltar and London (discontinued):

- Malta – The holding Company is incorporated in Malta and is licensed under the Insurance Business Act, 1998, as a composite insurer, to carry on both general and long term business of insurance.
- Italy – The Italian subsidiary carries on general business of insurance in Sicily and on the Italian mainland.
- Gibraltar – The holding Company also operates through a branch in Gibraltar carrying on general business of insurance.
- London – Up to November 2000, the holding Company operated in the UK, as a general business reinsurer, through a branch in London. This branch has since been closed and the Group's International reinsurance acceptance business is close to being fully run-off.

The segment results for the year ended 31 December are as follows:

| | Group | | | |
|---|---|---|---|---|
| | **Gross premiums written** | | **Profit/(loss) before tax** | |
| | **2007** | 2006 | **2007** | 2006 |
| | **Lm** | Lm | **Lm** | Lm |
| Malta | **12,710,405** | 11,942,329 | **2,548,683** | 2,771,327 |
| Italy | **30,650,258** | 22,665,924 | **1,329,120** | 765,238 |
| Gibraltar | **1,364,918** | 1,380,158 | **140,806** | 134,640 |
| London – discontinued | **8,035** | 7,352 | **(18,387)** | (14,385) |
| **Total for the year** | **44,733,616** | 35,995,763 | **4,000,222** | 3,656,820 |

**3. Segment information** - continued

There is no business transacted between the segments other than as disclosed in note 32.

**Segment assets and liabilities**

Segment assets include all operating assets used by a segment and consist principally of investments, reinsurers' share of technical provisions and debtors, net of provisions. Segment liabilities comprise operating liabilities mainly including technical provisions. Segment liabilities for the London and Gibraltar branch are principally backed by investments and other assets managed from Malta (the home country of the parent company).

The Group's assets and liabilities for segments operating for the year then ended are as follows:

| | Assets | | Liabilities | |
|---|---|---|---|---|
| | **2007** | 2006 | **2007** | 2006 |
| | **Lm** | Lm | **Lm** | Lm |
| Malta | **54,165,377** | 53,885,430 | **31,192,670** | 32,362,230 |
| Italy | **71,243,900** | 59,316,434 | **57,368,710** | 47,013,268 |
| Gibraltar | **3,040,419** | 2,987,806 | **3,040,419** | 2,987,806 |
| London - discontinued | **718,012** | 1,984,417 | **718,012** | 807,606 |
| | **129,167,708** | 118,174,087 | **92,319,811** | 83,170,910 |

The assets allocated to the Malta operation include the aggregate investment in the associated undertaking of Lm18,493,442 (2006: Lm17,364,598). This undertaking is involved in underwriting life assurance in Malta.

**Other information**

| | Group 2007 | | | |
|---|---|---|---|---|
| | Malta | Italy | London | Total |
| | Lm | Lm | Lm | Lm |
| Share of profit of associated undertaking | 1,127,593 | - | - | 1,127,593 |
| Capital expenditure | 267,758 | 1,400,703 | - | 1,668,461 |
| Depreciation and amortisation - tangible and intangible assets | 198,486 | 136,288 | - | 334,774 |
| Impairment loss on receivables | 62,079 | 91,025 | - | 153,088 |
| Write back of impairment loss on receivables | (43,288) | (69,451) | - | (112,739) |
| Other non-cash movements | - | 35,658 | - | 35,658 |

## 3. Segment information - continue

| | Group 2006 | | | |
|---|---|---|---|---|
| | Malta Lm | Italy Lm | London Lm | Total Lm |
| Share of profit of associated undertaking | 1,487,930 | - | - | 1,487,930 |
| Capital expenditure | 293,156 | 45,642 | - | 338,798 |
| Depreciation and amortisation - tangible and intangible assets | 180,826 | 113,095 | 589 | 294,510 |
| Impairment loss on receivables | - | 21,185 | - | 21,185 |
| Other non-cash movements | - | 27,429 | 24,505 | 51,934 |

Capital expenditure comprises additions to tangible and intangible assets.

***Secondary reporting format – business segments***

### General business

The Group's four geographic segments operate in two main business segments, general business, that is further sub-divided into various insurance business classes, and long-term business as follows:

**Gross premiums written and gross premiums earned by class of business**

| | Group | | | |
|---|---|---|---|---|
| | Gross premiums written | | Gross premiums earned | |
| | **2007 Lm** | 2006 Lm | **2007 Lm** | 2006 Lm |
| **Direct insurance** | | | | |
| Motor (third party liability) | **24,603,585** | 18,446,839 | **22,100,607** | 17,735,316 |
| Motor (other classes) | **8,819,828** | 7,554,871 | **7,967,272** | 7,288,606 |
| Fire and other damage to property | **3,998,755** | 3,799,735 | **3,400,673** | 3,262,904 |
| Accident & health | **4,737,171** | 3,724,690 | **4,359,706** | 3,594,363 |
| Other classes | **1,943,102** | 1,871,672 | **2,020,239** | 1,721,910 |
| | **44,102,441** | 35,397,807 | **39,848,497** | 33,603,099 |

28% (2006: 32%) of gross premiums written for direct general insurance business emanate from contracts concluded in or from Malta, 69% (2006: 64%) emanate from contracts concluded in or from Italy and 3% (2006: 4%) emanate from contracts concluded in or from Gibraltar.

## 3. Segment information - continued

***Secondary reporting format – business segments*** - continued

**Gross claims incurred, gross operating expenses and reinsurance balance by class of business**

| | Group | | | | | |
|---|---|---|---|---|---|---|
| | **Gross claims incurred** | | **Gross operating expenses** | | **Reinsurance balance** | |
| | **2007** | 2006 | **2007** | 2006 | **2007** | 2006 |
| | **Lm** | Lm | **Lm** | Lm | **Lm** | Lm |
| **Direct insurance** | | | | | | |
| Motor (third party liability) | **19,717,829** | 16,433,794 | **3,858,994** | 3,100,538 | **133,930** | (221,966) |
| Motor (other classes) | **4,606,376** | 3,781,737 | **2,254,673** | 1,883,975 | **486,127** | 271,590 |
| Fire and other damage to property | **1,172,227** | 741,418 | **1,080,066** | 1,016,952 | **1,240,242** | 1,357,860 |
| Accident & health | **1,611,737** | 1,619,304 | **1,236,221** | 1,044,899 | **205,021** | 92,519 |
| Other classes | **6,765** | 1,792,700 | **520,080** | 485,355 | **881,307** | (103,228) |
| | **27,114,934** | 24,368,953 | **8,950,034** | 7,531,719 | **2,946,627** | 1,396,775 |

**Gross premiums written and gross premiums earned by class of business**

| | Company | | | |
|---|---|---|---|---|
| | **Gross premiums written** | | **Gross premiums earned** | |
| | **2007** | 2006 | **2007** | 2006 |
| | **Lm** | Lm | **Lm** | Lm |
| **Direct insurance** | | | | |
| Motor (third party liability) | **2,511,576** | 2,573,347 | **2,517,607** | 2,632,544 |
| Motor (other classes) | **4,198,020** | 4,208,870 | **4,208,100** | 4,305,690 |
| Fire and other damage to property | **2,744,937** | 2,569,930 | **2,618,545** | 2,528,381 |
| Accident and health | **2,721,671** | 2,127,472 | **2,534,665** | 2,043,310 |
| Other classes | **1,275,979** | 1,252,264 | **1,388,382** | 1,119,524 |
| | **13,452,183** | 12,731,883 | **13,267,299** | 12,629,449 |

90% (2006: 89%) of gross premiums written for direct general insurance business emanate from contracts concluded in or from Malta. The balance emanates from contracts concluded in or from Gibraltar.

## 3. Segment information - continued

### *Secondary reporting format – business segments* - continued

**Gross claims incurred, gross operating expenses and reinsurance balance by class of business**

| | Company | | | | | |
|---|---|---|---|---|---|---|
| | **Gross claims incurred** | | **Gross operating expenses** | | **Reinsurance balance** | |
| | **2007** | 2006 | **2007** | 2006 | **2007** | 2006 |
| | **Lm** | Lm | **Lm** | Lm | **Lm** | Lm |
| **Direct insurance** | | | | | | |
| Motor (third party liability) | **1,455,667** | 1,441,705 | **632,746** | 650,313 | **195,367** | 100,021 |
| Motor (other classes) | **2,701,561** | 2,844,794 | **1,053,349** | 1,052,508 | **341,301** | 168,103 |
| Fire and other damage to property | **752,708** | 433,014 | **812,351** | 732,259 | **1,171,337** | 1,251,761 |
| Accident & health | **1,511,155** | 1,316,816 | **623,138** | 558,934 | **187,925** | 93,045 |
| Other classes | **(392,146)** | 1,046,173 | **321,348** | 330,440 | **867,829** | 91,555 |
| | **6,028,945** | 7,082,502 | **3,442,932** | 3,324,454 | **2,763,759** | 1,704,485 |

The reinsurance balance represents the charge/(credit) to the technical account arising from the aggregate of all items relating to reinsurance outwards.

### Long term business

| | Group and Company | |
|---|---|---|
| | **2007** | 2006 |
| | **Lm** | Lm |
| **Gross premiums written** | | |
| Direct insurance | **626,260** | 592,795 |
| Reinsurance inwards | **4,915** | 5,161 |
| | **631,175** | 597,956 |

Gross premiums written by way of direct business of insurance relate to periodic premiums under group contracts. All long term business contracts of insurance are concluded in or from Malta.

## 3. Segment information - continued

### *Secondary reporting format – business segments* - continued

### Group segment assets and liabilities

| | Motor third party Lm | Motor other Lm | Fire and other damage to property Lm | Accident and Health Lm | Other classes Lm | Long-term business Lm | Unallocated Lm | Total Lm |
|---|---|---|---|---|---|---|---|---|
| **At 31 December 2007** | | | | | | | | |
| Assets allocated to business segments | 48,994,034 | 11,505,158 | 7,555,066 | 3,507,244 | 5,668,072 | 477,231 | 6,986,502 | 84,693,307 |
| Assets allocated to shareholders | - | - | - | - | - | - | 44,474,401 | 44,474,401 |
| Total assets | 48,994,034 | 11,505,158 | 7,555,066 | 3,507,244 | 5,668,072 | 477,231 | 51,460,903 | 129,167,708 |
| Liabilities allocated to business segments | 48,011,630 | 10,643,726 | 7,857,854 | 3,976,606 | 5,706,586 | 477,231 | 2,804,565 | 79,478,198 |
| Liabilities allocated to shareholders | - | - | - | - | - | - | 12,841,613 | 12,841,613 |
| Total liabilities | 48,011,630 | 10,643,726 | 7,857,854 | 3,976,606 | 5,706,586 | 477,231 | 15,646,178 | 92,319,811 |
| **At 31 December 2006** | | | | | | | | |
| Assets allocated to business segments | 41,960,087 | 7,708,299 | 5,547,691 | 3,133,042 | 9,048,199 | 262,469 | 5,914,142 | 73,573,929 |
| Assets allocated to shareholders | - | - | - | - | - | - | 44,600,158 | 44,600,158 |
| Total assets | 41,960,087 | 7,708,299 | 5,547,691 | 3,133,042 | 9,048,199 | 262,469 | 50,514,300 | 118,174,087 |
| Liabilities allocated to business segments | 41,300,458 | 7,065,718 | 5,974,250 | 3,514,975 | 9,087,260 | 262,469 | 2,146,391 | 69,351,521 |
| Liabilities allocated to shareholders | - | - | - | - | - | - | 13,819,389 | 13,819,389 |
| Total liabilities | 41,300,458 | 7,065,718 | 5,974,250 | 3,514,975 | 9,087,260 | 262,469 | 15,965,780 | 83,170,910 |

## 4. Net operating expenses

| | Group | | Company | |
|---|---|---|---|---|
| | **2007** | 2006 | **2007** | 2006 |
| | **Lm** | Lm | **Lm** | Lm |
| Acquisition costs | **7,298,025** | 5,739,253 | **2,898,043** | 2,608,743 |
| Change in deferred acquisition costs, net of reinsurance | **(586,411)** | (71,230) | **51,275** | 102,207 |
| Administrative expenses | **3,776,192** | 3,600,390 | **1,147,892** | 1,270,080 |
| Reinsurance commissions and profit participation | **(2,008,200)** | (1,895,317) | **(1,628,386)** | (1,513,060) |
| | **8,479,606** | 7,373,096 | **2,468,824** | 2,467,970 |
| **Allocated to:** | | | | |
| General business technical account | **7,149,997** | 5,884,051 | **1,922,253** | 1,957,728 |
| Long term business technical account | **105,216** | 34,508 | **105,216** | 34,508 |
| Non-technical account (administrative expenses) | **1,224,393** | 1,454,537 | **441,355** | 475,734 |
| | **8,479,606** | 7,373,096 | **2,468,824** | 2,467,970 |

Total commissions for direct business accounted for in the financial year amounted to Lm5,956,024 (2006: Lm5,261,017) in the Group's technical result and Lm2,507,373 (2006: Lm2,424,595) in the Company's technical result. Administrative expenses mainly comprise staff costs which are analysed in note 8.

Non-technical account

Administrative expenses in the non-technical profit and loss account represent expenditure after appropriate apportionments are made to the general and long term business technical accounts. They include staff costs, premises costs, depreciation charge, directors' fees, auditors' remuneration, professional fees, marketing and promotional costs, and other general office expenditure.

## 5. Investment return

| | Group | | Company | |
|---|---|---|---|---|
| | **2007** | 2006 | **2007** | 2006 |
| | **Lm** | Lm | **Lm** | Lm |
| **Investment income** | | | | |
| Share of associated undertaking's profit, net of tax | **1,127,593** | 1,487,930 | **-** | - |
| Dividend income from group undertakings | **-** | - | **1,936,141** | 2,008,675 |
| Gain on sale of shares in subsidiary company | **1,221** | - | **6,900** | - |
| Rental receivable from investment property | **243,049** | 208,891 | **188,095** | 154,590 |
| Interest receivable from loans and receivables | | | | |
| - group undertakings | **-** | - | **15,670** | 19,706 |
| - other financial assets not at fair value through profit or loss | **948,379** | 395,051 | **265,186** | 212,621 |
| Income from financial assets at fair value through profit or loss | | | | |
| - dividend income | **555,483** | 576,400 | **-** | - |
| - net gains | **1,582,139** | 1,907,220 | **462,465** | 461,526 |
| Net fair value gains on investment property | **288,618** | 156,336 | **130,969** | 41,522 |
| Exchange differences | **-** | 56,416 | **-** | 56,416 |
| | **4,746,482** | 4,788,244 | **3,005,426** | 2,955,056 |

## 5. Investment return - continued

| | Group | | Company | |
|---|---|---|---|---|
| | **2007** | 2006 | **2007** | 2006 |
| | **Lm** | Lm | **Lm** | Lm |
| **Investment expenses and charges** | | | | |
| Direct operating expenses arising from investment property that generated rental income | **27,444** | 23,844 | **27,444** | 23,844 |
| Interest expense for financial liabilities that are not at fair value through profit or loss | **410,349** | 316,497 | **392,491** | 309,436 |
| Net fair value losses on financial assets at fair value through profit or loss | **461,226** | 321,169 | **140,441** | 6,269 |
| Net fair value loss on investment property | **2,357** | 9,629 | **-** | - |
| Exchange differences | **142,035** | 2,018 | **141,577** | - |
| Other investment expenses | **66,730** | 69,634 | **29,366** | 51,351 |
| | **1,110,141** | 742,791 | **731,319** | 390,900 |
| **Total investment return** | **3,636,341** | 4,045,453 | **2,274,107** | 2,564,156 |
| **Analysed between:** | | | | |
| Allocated investment return transferred to the general business technical account | **1,984,642** | 1,997,775 | **576,958** | 763,232 |
| Investment return included in the non-technical account | **1,612,889** | 1,932,749 | **1,658,339** | 1,685,995 |
| Investment return included in the long term business technical account | **38,810** | 56,904 | **38,810** | 56,904 |
| Allocated investment return against provision for discontinued operations | **-** | 58,025 | **-** | 58,025 |
| | **3,636,341** | 4,045,453 | **2,274,107** | 2,564,156 |

## 6. Other income

| | Group | | Company | |
|---|---|---|---|---|
| | **2007** | 2006 | **2007** | 2006 |
| | **Lm** | Lm | **Lm** | Lm |
| Management fees | **562,785** | 516,610 | **-** | - |
| Other income | **62,844** | 77,224 | **-** | - |
| | **625,629** | 593,834 | **-** | - |

## 7. Profit before tax

Profit before tax is stated after charging/(crediting):

| | Group | | Company | |
|---|---|---|---|---|
| | **2007** | 2006 | **2007** | 2006 |
| | **Lm** | Lm | **Lm** | Lm |
| Staff costs (note 8) | **2,458,738** | 2,140,074 | **732,604** | 586,304 |
| Auditors' remuneration | **74,850** | 42,700 | **20,475** | 18,200 |
| Depreciation/amortisation: | | | | |
| - intangible assets (note 13) | **142,790** | 135,135 | **92,665** | 83,533 |
| - tangible assets (note 14) | **191,984** | 159,375 | **70,039** | 64,857 |
| Impairment loss on receivables | **153,088** | 21,185 | **62,079** | - |
| Write back of impairment loss on receivables | **(112,739)** | - | **(43,288)** | - |

## 8. Staff costs

| | Group | | Company | |
|---|---|---|---|---|
| | **2007** | 2006 | **2007** | 2006 |
| | **Lm** | Lm | **Lm** | Lm |
| Salaries | **2,050,813** | 1,757,712 | **672,829** | 530,121 |
| Social security costs | **383,903** | 340,323 | **35,753** | 32,161 |
| Provision for contracted pension obligations (note 10) | **24,022** | 42,039 | **24,022** | 24,022 |
| | **2,458,738** | 2,140,074 | **732,604** | 586,304 |

The average number of persons employed during the year was:

| | Group | | Company | |
|---|---|---|---|---|
| | **2007** | 2006 | **2007** | 2006 |
| Key management personnel | **10** | 3 | **4** | 2 |
| Managerial | **25** | 32 | **10** | 12 |
| Technical | **106** | 93 | **37** | 34 |
| Administrative | **21** | 19 | **2** | 3 |
| | **162** | 147 | **53** | 51 |

## 9. Income tax expense

| | Group | | Company | |
|---|---|---|---|---|
| | **2007** | 2006 | **2007** | 2006 |
| | **Lm** | Lm | **Lm** | Lm |
| Current tax expense | **1,259,203** | 857,823 | **668,920** | 749,736 |
| Deferred tax charge (note 19) | **(225,409)** | (423,737) | **63,560** | (223,684) |
| Income tax expense | **1,033,794** | 434,086 | **732,480** | 526,052 |

## 9. **Income tax expense** - continued

The tax on the Group's and Company's profit before tax differs from the theoretical amount that would arise using the basic tax rate as follows:-

| | Group | | Company | |
|---|---|---|---|---|
| | **2007** | 2006 | **2006** | 2006 |
| | **Lm** | Lm | **Lm** | Lm |
| Profit before tax | **4,000,222** | 3,656,820 | **2,990,158** | 2,772,848 |
| Tax at 35% | **1,400,078** | 1,279,887 | **1,046,555** | 970,497 |
| Adjusted for tax effect of: | | | | |
| Dividends received from untaxed income | **-** | - | **(382,627)** | (271,425) |
| Exempt income | **(375,429)** | (883,505) | **-** | (363,916) |
| Differences arising from Section 15 of the Income Tax Act | **(245,232)** | (211,543) | **-** | - |
| Temporary differences attributable to unrecognised deferred tax | **-** | (6,033) | **-** | - |
| Non-deductible expenditure | **199,517** | 103,459 | **72,579** | 6,579 |
| Foreign tax payable | **53,245** | 70,354 | **92,219** | 127,319 |
| Effect of withholding tax regime on investment property | **(25,406)** | 143,774 | **(25,406)** | 143,774 |
| Other | **27,021** | (62,307) | **(70,840)** | (86,776) |
| Income tax expense | **1,033,794** | 434,086 | **732,480** | 526,052 |

## 10. **Directors' emoluments**

| | **2007** | 2006 |
|---|---|---|
| | **Lm** | Lm |
| Contracted emoluments paid to management | **48,938** | 48,416 |
| Directors' fees | **47,629** | 49,672 |
| | **96,567** | 98,088 |

The executive director is entitled to the use of a company car.

The Company paid insurance premiums of Lm6,163 during the year (2006: Lm5,613) in respect of insurance cover in favour of its directors. Furthermore, provisions have been made (Group: 2007 – Lm24,022 and 2006 – Lm42,039, Company: 2007 – Lm24,022 and 2006 – Lm24,022) in respect of contracted pension obligations.

## 11. Earnings per share

Earnings per share is based on the net profit for the year divided by the weighted average number of ordinary shares in issue during the year.

| | Group | |
|---|---|---|
| | **2007** | 2006 |
| | **Lm** | Lm |
| Net profit attributable to shareholders | **2,898,020** | 3,176,482 |
| Weighted average number of ordinary shares in issue (note 24) | **25,000,000** | 25,000,000 |
| Earnings per share | **11c6** | 12c7 |

## 12. Dividends

At the forthcoming Annual General Meeting, a dividend in respect of 2007 of 5.5 cents per share with a nominal value of 25 cents amounting to Lm1,375,000 is to be proposed. The dividend for the year is being declared from the Company's untaxed account. These financial statements do not reflect this dividend payable, which will be accounted for in shareholders' equity as an appropriation of retained earnings in the year ending 31 December 2007. The dividends declared after the financial year end in respect of 2006 were Lm1,125,000 (4.5 cents per share with a nominal value of 25 cents) and in respect of 2005 were Lm1,250,000 (10 cents, including a special dividend of 3 cents per share with a nominal value of 50 cents). The special dividend was declared on the occasion of the Company's 25th Anniversary.

## 13. Intangible assets

| **Computer software** | **Group** Lm | **Company** Lm |
|---|---|---|
| **At 1 January 2006** | | |
| Cost | 1,254,222 | 715,618 |
| Accumulated amortisation | (834,837) | (417,734) |
| **Net book amount** | 419,385 | 297,884 |
| **Year ended 31 December 2006** | | |
| Opening net book amount | 419,385 | 297,884 |
| Additions | 145,847 | 128,490 |
| Amortisation charge | (135,135) | (83,533) |
| Closing net book amount | 430,097 | 342,841 |
| **At 31 December 2006** | | |
| Cost | 1,400,069 | 844,108 |
| Accumulated amortisation | (969,972) | (501,267) |
| Net book value | 430,097 | 342,841 |
| **Year ended 31 December 2007** | | |
| Opening net book amount | 430,097 | 342,841 |
| Additions | 170,586 | 31,594 |
| Disposal (disposal of subsidiary) | (1,414) | - |
| Amortisation charge | (142,790) | (92,665) |
| Amortisation released on disposal | 851 | - |
| Closing net book amount | 457,330 | 281,770 |
| **At 31 December 2007** | | |
| Cost | 1,569,241 | 875,702 |
| Accumulated amortisation | (1,111,911) | (593,932) |
| Net book value | 457,330 | 281,770 |

Amortisation expense has been charged in administrative expenses.

## 14. Property, plant and equipment

### Group

| | Freehold land and buildings Lm | Leasehold improvements Lm | Motor vehicles Lm | Furniture, fittings and equipment Lm | Total Lm |
|---|---|---|---|---|---|
| **1 January 2006** | | | | | |
| Cost | 641,015 | 501,382 | 50,124 | 1,426,363 | 2,618,884 |
| Accumulated depreciation | (35,917) | (176,228) | (44,599) | (1,046,630) | (1,303,374) |
| Net book amount | 605,098 | 325,154 | 5,525 | 379,733 | 1,315,510 |
| **Year ended 31 December 2006** | | | | | |
| Opening net book amount | 605,098 | 325,154 | 5,525 | 379,733 | 1,315,510 |
| Additions | 445 | 84,110 | 18,900 | 89,496 | 192,951 |
| Revaluation surplus | 103,364 | - | - | - | 103,364 |
| Transfers to investment property (note 15) | (178,336) | - | - | - | (178,336) |
| Depreciation charge | (4,212) | (14,254) | (6,595) | (134,314) | (159,375) |
| Closing net book amount | 526,359 | 395,010 | 17,830 | 334,915 | 1,274,114 |
| **At 31 December 2006** | | | | | |
| Cost | 551,087 | 585,492 | 69,024 | 1,515,859 | 2,721,462 |
| Accumulated depreciation | (24,728) | (190,482) | (51,194) | (1,180,944) | (1,447,348) |
| Net book amount | 526,359 | 395,010 | 17,830 | 334,915 | 1,274,114 |
| **Year ended 31 December 2007** | | | | | |
| Opening net book amount | 526,359 | 395,010 | 17,830 | 334,915 | 1,274,114 |
| Additions | 1,321,253 | 20,671 | 745 | 155,206 | 1,497,875 |
| Disposals | - | (19,095) | (10,595) | (66,272) | (95,962) |
| Depreciation charge | (32,595) | (15,245) | (4,639) | (139,505) | (191,984) |
| Depreciation released on disposals | - | - | 9,601 | 61,435 | 71,036 |
| Closing net book amount | 1,815,017 | 381,341 | 12,942 | 345,779 | 2,555,079 |
| **At 31 December 2007** | | | | | |
| Cost | 1,872,340 | 587,068 | 59,174 | 1,604,793 | 4,123,375 |
| Accumulated depreciation | (57,323) | (205,727) | (46,232) | (1,259,014) | (1,568,296) |
| Net book amount | 1,815,017 | 381,341 | 12,942 | 345,779 | 2,555,079 |

Depreciation expense has been charged in administrative expenses.

## 14. Property, plant and equipment - continued

### Company

| | Freehold land and buildings Lm | Leasehold improvements Lm | Motor vehicles Lm | Furniture, fittings and equipment Lm | Total Lm |
|---|---|---|---|---|---|
| **At 1 Janaury 2006** | | | | | |
| Cost | 29,148 | 468,228 | 30,678 | 898,244 | 1,426,298 |
| Accumulated depreciation | (284) | (174,357) | (30,678) | (748,911) | (954,230) |
| Net book amount | 28,864 | 293,871 | - | 149,333 | 472,068 |
| **Year ended 31 December 2006** | | | | | |
| Opening net book amount | 28,864 | 293,871 | - | 149,333 | 472,068 |
| Additions | 445 | 57,315 | 18,500 | 27,584 | 103,844 |
| Depreciation charge | (292) | (12,027) | (3,392) | (49,146) | (64,857) |
| Closing net book amount | 29,017 | 339,159 | 15,108 | 127,771 | 511,055 |
| **At 31 December 2006** | | | | | |
| Cost | 29,593 | 525,543 | 49,178 | 925,828 | 1,530,142 |
| Accumulated depreciation | (576) | (186,384) | (34,070) | (798,057) | (1,019,087) |
| Net book amount | 29,017 | 339,159 | 15,108 | 127,771 | 511,055 |
| **Year ended 31 December 2007** | | | | | |
| Opening net book amount | 29,017 | 339,159 | 15,108 | 127,771 | 511,055 |
| Additions | - | 756 | - | 59,263 | 60,019 |
| Disposals | - | (19,095) | - | - | (19,095) |
| Depreciation charge | (295) | (12,458) | (3,700) | (53,586) | (70,039) |
| Closing net book amount | 28,722 | 308,362 | 11,408 | 133,448 | 481,940 |
| **At 31 December 2007** | | | | | |
| Cost | 29,593 | 507,204 | 49,178 | 985,091 | 1,571,066 |
| Accumulated depreciation | (871) | (198,842) | (37,770) | (851,643) | (1,089,126) |
| Net book amount | 28,722 | 308,362 | 11,408 | 133,448 | 481,940 |

Depreciation expense has been charged in administrative expenses.

## 15. Investment property

| | Group Lm | Company Lm |
|---|---|---|
| **At 1 January 2006** | | |
| Cost | 3,524,631 | 2,610,147 |
| Accumulated fair value gains | 620,361 | 598,011 |
| Net book amount | 4,144,992 | 3,208,158 |
| **Year ended 31 December 2006** | | |
| Opening net book amount | 4,144,992 | 3,208,158 |
| Transfer from property, plant and equipment at fair value (note 14) | 178,336 | - |
| Disposals | (105,302) | (105,302) |
| Net fair value gains | 146,309 | 41,124 |
| Closing net book amount | 4,364,335 | 3,143,980 |
| **At 31 December 2006** | | |
| Cost | 3,605,065 | 2,512,245 |
| Accumulated fair value gains | 759,270 | 631,735 |
| Net book amount | 4,364,335 | 3,143,980 |
| **Year ended 31 December 2007** | | |
| Opening net book amount | 4,364,335 | 3,143,980 |
| Additions | 39,301 | 39,301 |
| Net fair value gains | 286,265 | 130,969 |
| Closing net book amount | 4,689,901 | 3,314,250 |
| **At 31 December 2007** | | |
| Cost | 3,644,366 | 2,551,546 |
| Accumulated fair value gains | 1,045,535 | 762,704 |
| Net book amount | 4,689,901 | 3,314,250 |

## 15. **Investment property** - continued

The investment properties are valued annually on 31 December at fair value comprising open market value by an independent professionally qualified valuers.

If the investment property was stated on the historical cost basis, the amounts would be as follows:

| | **Group** | | **Company** | |
|---|---|---|---|---|
| | **2007** | 2006 | **2007** | 2006 |
| | **Lm** | Lm | **Lm** | Lm |
| Cost | **3,540,388** | 3,501,701 | **2,551,546** | 2,512,245 |
| Accumulated depreciation | **(197,881)** | (167,800) | **(161,879)** | (136,957) |
| Net book amount | **3,342,507** | 3,333,901 | **2,389,667** | 2,375,288 |

## 16. Investments in group undertakings

| | **Company** |
|---|---|
| | Lm |
| **Year ended 31 December 2006** | |
| Opening net book amount and cost | 7,936,824 |
| Additions | 1,970,539 |
| Closing net book amount and cost | 9,907,363 |
| **Year ended 31 December 2007** | |
| Opening net book amount and cost | 9,907,363 |
| Additions | 1,064,033 |
| Disposals | (35,400) |
| Closing net book amount and cost | 10,935,996 |

The group undertakings at 31 December are shown below:

| **Group undertakings** | **Registered office** | **Class of shares held** | **Percentage of shares held 2007** | **Percentage of shares held 2006** |
|---|---|---|---|---|
| Church Wharf Properties Limited | Middle Sea House Floriana | Ordinary shares | 75% | 75% |
| Euro Globe Holdings Limited | Middle Sea House Floriana | Ordinary shares | 100% | 100% |
| International Insurance Management Services Limited | Middle Sea House Floriana | Ordinary shares | 100% | 100% |
| Malta International Training Centre Limited | Europa Centre Floriana | Ordinary shares | - | 60% |
| Progress Assicurazioni S.p.A. | Piazza A. Gentile Palermo | Ordinary shares | 90% | 90% |

## 16. Investments in group undertakings - continued

The amount of dividends that can be distributed in cash by the insurance subsidiary, Progress Assicurazioni S.p.A., is dependent on the solvency restrictions imposed by the Italian Regulations.

## 17. Investment in associated undertaking

| | Group Lm | Company Lm |
|---|---|---|
| **At 1 January 2006** | | |
| Cost | 1,917,196 | 1,917,196 |
| Accumulated share of associated undertaking's profit and reserves | 11,579,472 | - |
| Net book amount | 13,496,668 | 1,917,196 |
| **Year ended 31 December 2006** | | |
| Opening net book amount | 13,496,668 | 1,917,196 |
| Additions | 2,200,000 | 2,200,000 |
| Share of associated undertaking's profits and reserves | 1,667,930 | - |
| Closing net book amount | 17,364,598 | 4,117,196 |
| **At 31 December 2006** | | |
| Cost | 4,117,196 | 4,117,196 |
| Accumulated share of associated undertaking's profits and reserves | 13,247,402 | - |
| Net book amount | 17,364,598 | 4,117,196 |
| **Year ended 31 December 2007** | | |
| Opening net book amount | 17,364,598 | 4,117,196 |
| Additions | 1,000,000 | 1,000,000 |
| Share of associated undertaking's profits and reserves | 128,844 | - |
| Closing net book amount | 18,493,442 | 5,117,196 |
| **At 31 December 2007** | | |
| Cost | 5,117,196 | 5,117,196 |
| Accumulated share of associated undertaking's profits and reserves | 13,376,246 | - |
| Net book amount | 18,493,442 | 5,117,196 |

## 17. Investment in associated undertaking - continued

The associated undertaking at 31 December which is unlisted is shown below:

| Associated undertaking | Registered office | Class of shares held | Percentage of shares held 2007 | Percentage of shares held 2006 |
|---|---|---|---|---|
| Middlesea Valletta Life Assurance Company Limited | Middle Sea House Floriana | Ordinary shares | **50%** | 50% |

A summary of the audited balance sheet at 31 December of Middlesea Valletta Life Assurance Company Limited, which represents a significant investment to the Group, is set out below:

| | **2007 Lm** | 2006 Lm |
|---|---|---|
| Investments | **326,715,926** | 279,501,649 |
| Net current assets | **5,697,464** | 4,175,142 |
| Intangible assets | **19,706,881** | 19,459,424 |
| Property, plant and equipment | **288,227** | 255,062 |
| Technical provisions and financial liabilities | **(312,929,792)** | (266,967,173) |
| Deferred taxation | **(365,543)** | 431,374 |
| **Shareholders' funds** | **39,113,163** | 36,855,478 |
| 50% (2006: 50%) thereof relating to Group | **19,556,581** | 18,427,739 |
| Less: Group's share of the profit arising on the sale of investment property to Middlesea Valletta Life Assurance Company Limited | **(1,057,804)** | (1,057,804) |
| **Amount at which the Group's investment is carried in the balance sheet** | **18,498,777** | 17,369,935 |

The profit after tax earned by Middlesea Valletta Life Assurance Company Limited for the year ended 31 December 2007 was Lm2,257,685 (2006: Lm2,985,860). Total revenue for the year ended 31 December 2007 amounted to Lm58,345,502 (2006: Lm50,364,783).

The amount of dividends that can be distributed in cash by the insurance associate is restricted by the solvency requirements imposed by the MFSA Regulations.

## 18. Other investments

The investments are summarised by measurement category in the table below.

| | Group | | Company | |
|---|---|---|---|---|
| | **2007** | 2006 | **2007** | 2006 |
| | **Lm** | Lm | **Lm** | Lm |
| Fair value through profit or loss | **57,399,558** | 52,850,349 | **17,436,443** | 17,898,595 |
| Available-for-sale | **264,200** | 341,002 | **93,707** | 170,509 |
| Loans and receivables | **15,383,700** | 15,833,314 | **3,491,698** | 4,214,754 |
| | **73,047,458** | 69,024,665 | **21,021,848** | 22,283,858 |

*(a) Investments at fair value through profit or loss*

Analysed by type of investment as follows:

| | Group | | Company | |
|---|---|---|---|---|
| | **2007** | 2006 | **2007** | 2006 |
| | **Lm** | Lm | **Lm** | Lm |
| Equity securities, other variable yield securities and units in unit trusts | **13,966,248** | 12,161,823 | **7,155,382** | 7,586,698 |
| Debt securities – listed fixed interest rate | **43,433,310** | 40,688,526 | **10,281,061** | 10,311,897 |
| Total investments at fair value through profit or loss | **57,399,558** | 52,850,349 | **17,436,443** | 17,898,595 |

Equity securities, other variable yield securities and units in unit trusts are classified as non-current.

The movements for the year are summarised as follows:

| | **Group** | **Company** |
|---|---|---|
| | Lm | Lm |
| **Year ended 31 December 2006** | | |
| Opening net book amount | 56,259,304 | 17,957,999 |
| Additions | 10,724,322 | 5,058,457 |
| Disposals – sales | (5,536,638) | (4,265,743) |
| Disposals – redemptions | (8,143,499) | (775,862) |
| Net fair value gains (excluding net realised movements) | (453,140) | (76,256) |
| Closing net book amount | 52,850,349 | 17,898,595 |
| **Year ended 31 December 2007** | | |
| Opening net book amount | 52,850,349 | 17,898,595 |
| Additions | 22,238,350 | 7,182,755 |
| Disposals – sales | (7,811,061) | (7,654,294) |
| Disposals – redemptions | (9,582,078) | - |
| Disposals – on disposal of subsidiary | (11,529) | - |
| Net fair value losses (excluding net realised movements) | (284,473) | 9,387 |
| Closing net book amount | 57,399,558 | 17,436,443 |

## 18. **Other investments** - continued

### *(b) Available-for-sale financial assets*

| | Group | | Company | |
|---|---|---|---|---|
| | **2007** | 2006 | **2007** | 2006 |
| | **Lm** | Lm | **Lm** | Lm |
| Unlisted shares | **264,200** | 341,002 | **93,707** | 170,509 |

Unlisted shares are classified as non-current. The movements for the year are summarised as follows:

| | Group | | Company | |
|---|---|---|---|---|
| | **2007** | 2006 | **2007** | 2006 |
| | **Lm** | Lm | **Lm** | Lm |
| **Year ended 31 December** | | | | |
| Opening net book amount | **341,002** | 360,451 | **170,509** | 274,333 |
| Additions | **9,399** | 84,375 | **9,399** | - |
| Net fair value losses (note 25) | **(86,201)** | (103,824) | **(86,201)** | (103,824) |
| Closing net book amount | **264,200** | 341,002 | **93,707** | 170,509 |

### *(c) Loans and receivables*

Analysed by type of investment as follows:

| | Group | | Company | |
|---|---|---|---|---|
| | **2007** | 2006 | **2007** | 2006 |
| | **Lm** | Lm | **Lm** | Lm |
| Deposits with banks or credit institutions | **13,138,585** | 8,395,248 | **3,391,698** | 4,114,754 |
| Treasury bills | **2,145,115** | 7,338,066 | **-** | - |
| Unlisted fixed income debt securities | **100,000** | 100,000 | **100,000** | 100,000 |
| | **15,383,700** | 15,833,314 | **3,491,698** | 4,214,754 |

## 18. Other investments - continued

### *(c) Loans and receivables - continued*

The movements for the year for treasury bills and unlisted fixed income debt securities are summarised as follows:

| | Group | | |
|---|---|---|---|
| | Unlisted fixed income debt securities Lm | Treasury bills Lm | Total Lm |
| **Year ended 31 December 2006** | | | |
| Opening net book amount | 100,000 | 596,830 | 696,830 |
| Additions | - | 16,137,799 | 16,137,799 |
| Disposals – redemptions | - | (9,396,563) | (9,396,563) |
| Closing net book amount | 100,000 | 7,338,066 | 7,438,066 |
| **Year ended 31 December 2007** | | | |
| Opening net book amount | 100,000 | 7,338,066 | 7,438,066 |
| Additions | - | 60,446,713 | 60,446,713 |
| Disposals – redemptions | - | (65,639,664) | (65,639,664) |
| Closing net book amount | 100,000 | 2,145,115 | 2,245,115 |

| | Company | | |
|---|---|---|---|
| | Unlisted fixed income debt securities Lm | Treasury bills Lm | Total Lm |
| **Year ended 31 December 2006** | | | |
| Opening net book amount | 100,000 | 596,830 | 696,830 |
| Additions | - | 2,750,000 | 2,750,000 |
| Disposals – redemptions | - | (3,346,830) | (3,346,830) |
| Closing net book amount | 100,000 | - | 100,000 |
| **Year ended 31 December 2007** | | | |
| Opening and closing net book amount | 100,000 | - | 100,000 |

## 19. Deferred income tax

| | Group | | Company | |
|---|---|---|---|---|
| | **2007** | 2006 | **2007** | 2006 |
| | **Lm** | Lm | **Lm** | Lm |
| Balance at 1 January | **(646,813)** | (226,275) | **481,982** | 742,004 |
| Movements during the year: | | | | |
| Profit and loss account (note 9) | **(225,409)** | (423,737) | **63,560** | (223,684) |
| Fair value reserve | **(30,171)** | 3,199 | **(30,171)** | (36,338) |
| Release on disposal of subsidiary | **851** | - | **-** | - |
| **Balance at 31 December (net)** | **(901,542)** | (646,813) | **515,371** | 481,982 |

Deferred taxation is calculated on temporary differences under the liability method using the principal tax rate within the relevant jurisdiction. The year end balance comprises:

| | Group | | Company | |
|---|---|---|---|---|
| | **2007** | 2006 | **2007** | 2006 |
| | **Lm** | Lm | **Lm** | Lm |
| Temporary differences on property, plant and equipment | **82,043** | 62,228 | **62,224** | 56,120 |
| Temporary differences attributable to unrealised capital losses and exchange gains | **934,159** | 924,148 | **615,694** | 660,492 |
| Temporary differences attributable to unabsorbed tax losses and allowances carried forward | **(1,053,003)** | (902,590) | **(134,550)** | (198,513) |
| Temporary differences attributable to insurance technical provisions | **(740,594)** | (561,339) | **-** | - |
| Temporary differences attributable to other provisions | **(168,989)** | (194,933) | **(69,886)** | (78,001) |
| Other temporary differences, including impact of non-deductible expenses and different tax rates | **44,842** | 25,673 | **41,889** | 41,884 |
| **Balance at 31 December (net)** | **(901,542)** | (646,813) | **515,371** | 481,982 |

Deferred income tax assets and liabilities are offset when there is a legally enforceable right to set off a current tax asset against a current tax liability. The following amounts determined after appropriate offsetting are shown in the balance sheet:

| | Group | | Company | |
|---|---|---|---|---|
| | **2007** | 2006 | **2007** | 2006 |
| | **Lm** | Lm | **Lm** | Lm |
| Deferred tax asset | **(1,416,913)** | (1,128,795) | **-** | - |
| Deferred tax liability | **515,371** | 481,982 | **515,371** | 481,982 |
| | **(901,542)** | (646,813) | **515,371** | 481,982 |

The deferred income tax assets and liabilities are, principally, recoverable after more than 12 months.

## 20. Insurance liabilities and reinsurance assets

| | Group | | Company | |
|---|---|---|---|---|
| | **2007** | 2006 | **2007** | 2006 |
| | **Lm** | Lm | **Lm** | Lm |
| **Gross** | | | | |
| Short-term insurance contracts | | | | |
| - claims outstanding | **56,394,178** | 51,416,856 | **15,042,526** | 15,343,347 |
| - provision for unearned premiums and unexpired risks | **17,987,289** | 13,733,345 | **5,640,608** | 5,455,724 |
| Long term business provision – Group Life | **264,986** | 238,430 | **264,986** | 238,430 |
| **Total technical provisions, gross** | **74,646,453** | 65,388,631 | **20,948,120** | 21,037,501 |
| **Recoverable from reinsurers** | | | | |
| Short-term insurance contracts | | | | |
| - claims outstanding | **9,530,855** | 9,979,458 | **3,913,671** | 4,666,664 |
| - provision for unearned premiums and unexpired risks | **2,781,871** | 2,294,010 | **1,867,489** | 1,636,129 |
| Long term business provision – Group Life | **93,728** | 87,182 | **93,728** | 87,182 |
| **Total reinsurers' share of insurance liabilities** | **12,406,454** | 12,360,650 | **5,874,888** | 6,389,975 |
| **Net** | | | | |
| Short-term insurance contracts | | | | |
| - claims outstanding | **46,863,323** | 41,437,398 | **11,128,855** | 10,676,683 |
| - provision for unearned premiums and unexpired risks | **15,205,418** | 11,439,335 | **3,773,119** | 3,819,595 |
| Long term business provision – Group Life | **171,258** | 151,248 | **171,258** | 151,248 |
| **Total technical provisions, net** | **62,239,999** | 53,027,981 | **15,073,232** | 14,647,526 |

Technical provisions are classified as current liabilities.

The gross claims reported are net of expected recoveries from salvage and subrogation. The amounts for salvage and subrogation at the end of 2007 and 2006 are not material.

The technical provisions are largely based on case-by-case estimates supplemented with additional provisions for IBNR, IBNER and unexpired risks in those instances where the ultimate cost determined by estimation techniques is higher. IBNR and IBNER included in claims outstanding for the Group amounted to Lm6,912,534 (2006: Lm5,707,603).

As described in note 2.1, the Bornhuetter-Ferguson Paid model is applied when calculating the ultimate cost of claims reserves for the Italian subsidiary. A key variable used in applying this model is the initial loss ratio estimate. This estimate is determined by an external actuary and is based on previous years' experience, adjusted for factors such as premium rate changes, anticipated market experience and historical claim inflation. A change of 2.5% in this ratio, would affect the technical provisions by approximately Lm493,695 (2006: Lm214,650).

The development tables below give an indication of the time it takes to settle certain claims. This is attributable to certain classes of business taking several years to develop (as mentioned in note 2.1) and also to the length of time it takes certain classes to be resolved in court.

## 20. Insurance liabilities and reinsurance assets - continued

The development of insurance liabilities provides a measure of the Group's ability to estimate the ultimate value of claims. The top half of the table below illustrates how the Group's estimate of total claims incurred for each accident year has changed at successive year-ends. The bottom half of the table reconciles the cumulative claims to the amount appearing in the balance sheet. The accident-year basis is considered to be the most appropriate for the business written by the Group. The Company and its Italian subsidiary operate in different markets and separate consideration was made for the development of their respective insurance liabilities. Development trends are reported in aggregate below, on a net basis:

| | 2001 | 2002 | 2003 | 2004 | 2005 | 2006 | 2007 | Total |
|---|---|---|---|---|---|---|---|---|
| | Lm | Lm | Lm | Lm | Lm | Lm | Lm | Lm |
| Estimate of the ultimate claims costs: | | | | | | | | |
| - at end of accident year | 11,923,035 | 19,165,751 | 20,706,962 | 22,792,483 | 20,638,392 | 20,953,659 | 26,437,497 | |
| - one year later | 11,826,101 | 20,172,077 | 20,765,684 | 22,828,334 | 21,530,395 | 21,017,312 | - | |
| - two years later | 11,518,670 | 18,886,037 | 19,729,707 | 22,178,195 | 20,840,874 | - | - | |
| - three years later | 11,045,271 | 19,067,431 | 19,237,483 | 21,822,292 | - | - | - | |
| - four years later | 10,768,688 | 18,849,643 | 19,058,851 | - | - | - | - | |
| - five years later | 10,930,494 | 18,678,594 | - | - | - | - | - | |
| - six years later | 10,853,094 | - | - | - | - | - | - | |
| Current estimates of cumulative claims | 10,853,094 | 18,678,594 | 19,058,851 | 21,822,292 | 20,840,874 | 21,017,312 | 26,437,497 | 138,708,514 |
| Cumulative payments to date | (9,584,614) | (16,929,385) | (16,313,585) | (17,311,150) | (14,810,009) | (12,582,827) | (7,994,862) | (95,526,432) |
| Liability recognised in the balance sheet | 1,268,480 | 1,749,209 | 2,745,266 | 4,511,142 | 6,030,865 | 8,434,485 | 18,442,635 | 43,182,082 |
| Liability in respect of prior years | | | | | | | | 3,681,241 |
| Total reserve included in the balance sheet | | | | | | | | 46,863,323 |

The Group continues to benefit from reinsurance programmes that were purchased in prior years and includes proportional cover supplemented by excess of loss reinsurance cover. The reinsurers's share of claims liabilities is estimated net of the provision for known and expected incidents of insolvency of reinsurers.

## 20. Insurance liabilities and reinsurance assets - continued

Amounts due from reinsurers in respect of claims already paid by the Group on the contracts that are reinsured are offset against the amounts due to the same reinsurers for premium ceded under the respective treaties. The balances due from/to reinsurers are disclosed within receivables and payables in notes 22 and 28.

Recoveries on claims outstanding from reinsurers include an amount of Lm1,828,493 (2006: Lm2,009,780) that is recoverable from Corporacion Mapfre Compania Internacional De Reaseguros S.A. under arrangements entered into upon the acquisition of Progress Assicurazioni S.p.A. on 29 September 2000. In terms of these arrangements, Corporacion Mapfre Compania Internacional De Reaseguros S.A. agreed to meet the run-off cost of all risks incepted prior to the date of acquisition.

### Long term business provision

The balance on the long term business provision has been certified by the company's appointed actuary as being sufficient to meet liabilities at 31 December 2007. The net assets representing this long term business provision, which are included under the respective headings in the Group's overall balance sheet, are as follows:

| | **2007** | 2006 |
|---|---|---|
| | **Lm** | Lm |
| Investments | **1,853,354** | 1,673,235 |
| Insurance and other receivables | **242,164** | 402,541 |
| Cash at bank and in hand | **50,441** | 11,783 |
| Claims outstanding | **(83,154)** | (16,279) |
| Insurance and other payables | **(1,891,547)** | (1,920,032) |
| **Long term business provision, net of reinsurance** | **171,258** | 151,248 |

### Movements in insurance liabilities and reinsurance assets

(a) Claims and loss adjustments expenses

| | **Group** | | |
|---|---|---|---|
| | **Year ended 2007** | | |
| | Gross | Reinsurance | Net |
| | Lm | Lm | Lm |
| Total at beginning of year | 51,416,856 | (9,979,458) | 41,437,398 |
| Claims settled during the year | (22,489,665) | 2,576,182 | (19,913,483) |
| Increase/(decrease) in liabilities | | | |
| - arising from current year claims | 29,445,887 | (2,779,307) | 26,666,580 |
| - arising from prior year claims | (1,978,900) | 651,728 | (1,327,172) |
| **Total at year end** | 56,394,178 | (9,530,855) | 46,863,323 |

## 20. **Insurance liabilities and reinsurance assets** - continued

(a) Claims and loss adjustments expenses - continued

| | Group Year ended 2006 | | |
|---|---|---|---|
| | Gross Lm | Reinsurance Lm | Net Lm |
| Total at beginning of year | 48,132,668 | (9,567,428) | 38,565,240 |
| Claims settled during the year | (21,204,165) | 2,559,036 | (18,645,129) |
| Increase/(decrease) in liabilities | | | |
| - arising from current year claims | 23,865,953 | (1,981,908) | 21,884,045 |
| - arising from prior year claims | 622,400 | (989,158) | (366,758) |
| **Total at year end** | 51,416,856 | (9,979,458) | 41,437,398 |

| | Company Year ended 2007 | | |
|---|---|---|---|
| | Gross Lm | Reinsurance Lm | Net Lm |
| Total at beginning of year | 15,343,347 | (4,666,664) | 10,676,683 |
| Claims settled during the year | (6,681,819) | 2,150,458 | (4,531,361) |
| Increase/(decrease) in liabilities | | | |
| - arising from current year claims | 8,901,035 | (2,520,209) | 6,380,826 |
| - arising from prior year claims | (2,520,037) | 1,122,744 | (1,397,293) |
| **Total at year end** | 15,042,526 | (3,913,671) | 11,128,855 |

| | Company Year ended 2006 | | |
|---|---|---|---|
| | Gross Lm | Reinsurance Lm | Net Lm |
| Total at beginning of year | 14,729,293 | (4,744,818) | 9,984,475 |
| Claims settled during the year | (6,587,848) | 1,875,244 | (4,712,604) |
| Increase/(decrease) in liabilities | | | |
| - arising from current year claims | 7,898,428 | (1,772,296) | 6,126,132 |
| - arising from prior year claims | (696,526) | (24,794) | (721,320) |
| **Total at year end** | 15,343,347 | (4,666,664) | 10,676,683 |

## 20. Insurance liabilities and reinsurance assets - continued

(a) Claims and loss adjustments expenses - continued

The Group continuously monitors closely the development in insurance liabilities in order to ascertain the adequacy of its claims reserves. Movements in reserves in respect of claims occurring in previous years arise when these claims are actually settled and/or when reserves are revised to reflect new information that emerges.

(b) Provision for unearned premiums and unexpired risks

The movements for the year are summarised as follows:

| | **Group Year ended 2007** | | |
|---|---|---|---|
| | Gross Lm | Reinsurance Lm | Net Lm |
| At beginning of year | 13,733,345 | (2,294,010) | 11,439,335 |
| Net charge to profit and loss | 4,253,944 | (487,861) | 3,766,083 |
| At end of year | 17,987,289 | (2,781,871) | 15,205,418 |

| | **Group Year ended 2006** | | |
|---|---|---|---|
| | Gross Lm | Reinsurance Lm | Net Lm |
| At beginning of year | 11,938,637 | (1,855,319) | 10,083,318 |
| Net charge to profit and loss | 1,794,708 | (438,691) | 1,356,017 |
| At end of year | 13,733,345 | (2,294,010) | 11,439,335 |

| | **Company Year ended 2007** | | |
|---|---|---|---|
| | Gross Lm | Reinsurance Lm | Net Lm |
| At beginning of year | 5,455,724 | (1,636,129) | 3,819,595 |
| Net credit to profit and loss | 184,884 | (231,360) | (46,476) |
| At end of year | 5,640,608 | (1,867,489) | 3,773,119 |

## 20. Insurance liabilities and reinsurance assets - continued

(b) Provision for unearned premiums - continued

| | Company Year ended 2006 | | |
|---|---|---|---|
| | Gross Lm | Reinsurance Lm | Net Lm |
| At beginning of year | 5,353,290 | (1,447,599) | 3,905,691 |
| Net credit to profit and loss | 102,434 | (188,530) | (86,096) |
| At end of year | 5,455,724 | (1,636,129) | 3,819,595 |

## 21. Deferred acquisition costs

| | Group | | Company | |
|---|---|---|---|---|
| | **2007 Lm** | 2006 Lm | **2007 Lm** | 2006 Lm |
| **Year ended 31 December** | | | | |
| Opening net book amount | **2,204,198** | 1,970,344 | **1,053,245** | 1,094,142 |
| Net amount credited/(charged) to the profit and loss | **791,152** | 233,854 | **53,009** | (40,897) |
| Closing net book amount | **2,995,350** | 2,204,198 | **1,106,254** | 1,053,245 |

Deferred acquisition costs are all classified as current assets.

## 22. Insurance and other receivables

| | Group | | Company | |
|---|---|---|---|---|
| | **2007 Lm** | 2006 Lm | **2007 Lm** | 2006 Lm |
| *Receivables arising from direct insurance operations:* | | | | |
| - due from policyholders | **49,507** | 33,674 | **49,507** | 33,674 |
| - due from agents, brokers and intermediaries | **5,415,016** | 5,237,488 | **2,576,709** | 2,944,459 |
| - due from reinsurers | **2,236,344** | 1,284,554 | **272,259** | 263,048 |
| *Receivables arising from reinsurance operations:* | | | | |
| - due from reinsurers | **35,715** | 67,941 | **35,715** | 67,941 |
| *Deposits with ceding undertakings* | **64,933** | 66,960 | **64,933** | 66,960 |
| *Other loans and receivables:* | | | | |
| - prepayments | **492,859** | 607,803 | **427,579** | 551,478 |
| - accrued interest and rent | **1,115,402** | 1,035,565 | **258,646** | 281,388 |
| - loan to third parties | **-** | 90,297 | **-** | - |
| - other debtors | **180,166** | 73,575 | **-** | - |
| - receivables from group undertakings | **-** | - | **69,564** | 133,419 |
| - loans to related parties | **-** | - | **351,742** | 365,102 |
| *Provision for impairment of receivables* | **(750,081)** | (709,732) | **(237,419)** | (218,628) |
| | **8,839,861** | 7,788,125 | **3,869,235** | 4,488,841 |
| Current portion | **8,839,861** | 7,769,828 | **3,869,235** | 4,488,841 |
| Non-current portion | **-** | 18,297 | **-** | - |

## 22. Insurance and other receivables - continued

Loans to related parties are unsecured, interest bearing, and have no fixed date of repayment.

Movements on the provision for impairment of receivables are as follows:

| | Group | | Company | |
|---|---|---|---|---|
| | **2007 Lm** | 2006 Lm | **2007 Lm** | 2006 Lm |
| Balance as at 1 January | **709,732** | 688,547 | **218,628** | 218,628 |
| Provision for impairment for the year | **153,088** | 21,185 | **62,079** | - |
| Release of provision for impairment during the year | **(112,739)** | - | **(43,288)** | - |
| Balance as at 31 December | **750,081** | 709,732 | **237,419** | 218,628 |

## 23. Cash and cash equivalents

For the purpose of the cash flow statement, the year end cash and cash equivalents comprise the following:

| | Group | | Company | |
|---|---|---|---|---|
| | **2007 Lm** | 2006 Lm | **2007 Lm** | 2006 Lm |
| Cash at bank and in hand | **4,249,853** | 1,939,735 | **1,320,723** | 906,215 |

## 24. Share capital

| | Group and Company | |
|---|---|---|
| | **2007 Lm** | 2006 Lm |
| **Authorised** | | |
| 60,000,000 ordinary shares of 25 cents each | **15,000,000** | 15,000,000 |
| **Issued and fully paid** | | |
| 25,000,000 ordinary shares of 25 cents each | **6,250,000** | 6,250,000 |

By virtue of an ordinary resolution approved during the Annual General Meeting held on 16 June 2006, it was resolved to split the 50c shares into shares of 25c each. Accordingly, the authorised share capital was increased to 60,000,000 ordinary shares of 25c each and the issued and fully paid share capital was increased to 25,000,000 ordinary shares of 25c each.

**24. Share capital** - continued

The Group's objectives when managing capital are:

- To comply with the obligations to maintain positive solvency position based on the regulatory requirements of the insurance markets where the Group operates;
- To provide for the capital requirements of the companies within the Group;
- To safeguard the Group's ability to continue as a going concern so that it can continue to provide returns for shareholders and benefits for other stakeholders; and
- To provide an adequate return to shareholders by pricing insurance contracts commensurately with the level of risk.

The capital requirements of the companies within the Group are maintained in accordance with regulatory solvency and capital requirements of the insurance markets in which they operate. The financing of the Group's subsidiaries and associate companies is provided by the Company in the form of share capital in the respective company. The Company is financed by shareholders' total equity together with borrowings from banks.

The Company's total equity and borrowings as at 31 December 2007 was Lm25,444,168 (2006: Lm25,106,508). The equity component within these amounts was 72% (2006: 69%). Investments in subsidiaries and associate companies were Lm16,053,192 as at 31 December 2007 (Lm14,024,559 – 31 December 2006). The Company's own solvency requirements were adequately covered by net admissible assets throughout the financial period.

All companies within the Group were compliant with the respective regulatory solvency requirements throughout the financial period.

## 25. Other reserves

### Group

| | Value of in-force business Lm | Available-for-sale investments Lm | Land and buildings revaluation Lm | Total Lm |
|---|---|---|---|---|
| Balance at 1 January 2006 | 8,305,000 | 143,685 | - | 8,448,685 |
| Revaluation – gross (note 14) | - | (103,824) | 93,008 | (10,816) |
| Revaluation – tax (note 19) | - | 36,338 | (35,576) | 762 |
| Share of increase in value of in-force business of associated undertaking | 875,000 | - | - | 875,000 |
| Balance at 31 December 2006 | 9,180,000 | 76,199 | 57,432 | 9,313,631 |
| Balance at 1 January 2007 | 9,180,000 | 76,199 | 57,432 | 9,313,631 |
| Revaluation – gross (note 18) | - | (86,201) | - | (86,201) |
| Revaluation – tax (note 19) | - | 30,171 | - | 30,171 |
| Release on sale of subsidiary undertaking | - | (5,400) | - | (5,400) |
| Balance at 31 December 2007 | 9,180,000 | 14,769 | 57,432 | 9,252,201 |

The above reserves are not distributable reserves.

### Company

| | Available-for-sale investments Lm |
|---|---|
| Balance at 1 January 2006 | 143,685 |
| Revaluation – gross (note 18) | (103,824) |
| Revaluation – tax (note 19) | 36,338 |
| Balance at 31 December 2006 | 76,199 |
| Balance at 1 January 2007 | 76,199 |
| Revaluation – gross (note 18) | (86,201) |
| Revaluation – tax (note 19) | 30,171 |
| Release on sale of subsidiary undertaking | (5,400) |
| Balance at 31 December 2007 | 14,769 |

The above reserves are not distributable reserves.

## 26. Provisions for other liabilities and charges

| | Group | |
|---|---|---|
| | **2007** | 2006 |
| | **Lm** | Lm |
| Provision for severance indemnity | **379,427** | 347,499 |

### Provision for severance indemnity

| | Group | |
|---|---|---|
| | **2007** | 2006 |
| | **Lm** | Lm |
| At 1 January | **347,499** | 332,500 |
| Profit and loss account | **35,658** | 27,429 |
| Payments | **(3,730)** | (12,430) |
| **Balance at 31 December** | **379,427** | 347,499 |

The above represents a provision for the legal obligation to pay a severance indemnity to personnel upon termination of their contract of employment. The obligation arises under Italian legislation and the provision is determined on the basis of length of service and remuneration for each employee whose contract of service is governed by Italian law. These liabilities are all non-current in nature.

## 27. Borrowings

| | Group and Company | |
|---|---|---|
| | **2007** | 2006 |
| | **Lm** | Lm |
| Bank loans | **7,032,311** | 7,765,899 |

The borrowings are secured by a special hypothec on investments. The carrying amounts of borrowings approximate their fair value.

## 28. Insurance and other payables

| | Group | | Company | |
|---|---|---|---|---|
| | **2007** | 2006 | **2007** | 2006 |
| | **Lm** | Lm | **Lm** | Lm |
| Deposits received from reinsurers | **2,027,181** | 1,816,502 | **1,649,816** | 1,462,253 |
| Creditors arising out of direct insurance operations | **2,513,098** | 1,669,876 | **866,729** | 810,371 |
| Creditors arising out of reinsurance operations | **291,467** | 476,515 | **291,467** | 476,515 |
| Amounts owed to associated undertaking | **1,264,711** | 1,361,093 | **929,336** | 1,089,275 |
| Amounts owed to group undertaking | **-** | - | **495,412** | - |
| Social security and other tax payables | **190,981** | 211,492 | **150,560** | 159,138 |
| Accruals and deferred income | **3,247,735** | 3,297,758 | **1,950,481** | 2,167,365 |
| | **9,535,173** | 8,833,236 | **6,333,801** | 6,164,917 |

All trade and other payables are classified as current.

## 29. Cash generated from operations

Reconciliation of profit before tax to cash generated from operations:

| | Group | | Company | |
|---|---|---|---|---|
| | **2007** | 2006 | **2007** | 2006 |
| | **Lm** | Lm | **Lm** | Lm |
| Profit before tax | **4,000,222** | 3,656,820 | **2,990,158** | 2,772,848 |
| Adjusted for: | | | | |
| Depreciation (note 14) | **191,984** | 159,375 | **70,039** | 64,857 |
| Bad and doubtful debts | **40,349** | - | **18,791** | - |
| Provision for severance indemnity (note 26) | **35,658** | 27,429 | **-** | - |
| Amortisation (note 13) | **142,790** | 135,135 | **92,665** | 83,533 |
| Adjustments relating to investment return | **(3,614,964)** | (3,793,542) | **(2,268,428)** | (2,341,245) |
| Movements in: | | | | |
| Insurance and other receivables | **(1,177,784)** | 204,468 | **554,232** | 278,905 |
| Deferred acquisition costs | **(791,152)** | (233,854) | **(53,009)** | 40,897 |
| Reinsurers' share of technical provisions | **(45,804)** | (861,232) | **515,087** | (120,887) |
| Technical provisions | **9,257,822** | 5,094,902 | **(89,381)** | 732,494 |
| Insurance and other payables | **812,279** | 317,162 | **241,683** | (293,655) |
| **Cash generated from operations** | **8,851,400** | 4,706,663 | **2,071,837** | 1,217,747 |

## 30. Commitments

### Capital commitments

| | Group | | Company | |
|---|---|---|---|---|
| | **2007** | 2006 | **2007** | 2006 |
| | **Lm** | Lm | **Lm** | Lm |
| Authorised and not contracted for<br>- property, plant and equipment | **82,017** | 219,255 | **19,983** | 113,250 |
| Authorised and not contracted for<br>- intangible assets | **79,080** | 200,925 | **47,784** | 72,200 |

### Operating lease commitments – where the company is a lessor

The future minimum lease payments receivable under non-cancellable operating leases are as follows:

| | Group | | Company | |
|---|---|---|---|---|
| | **2007** | 2006 | **2007** | 2006 |
| | **Lm** | Lm | **Lm** | Lm |
| Not later than 1 year | **115,157** | 154,044 | **115,157** | 118,044 |
| Later than 1 year and not later than 5 years | **361,810** | 370,207 | **361,810** | 327,107 |
| Later than 5 years | **95,857** | 95,857 | **95,857** | 95,857 |
| | **572,824** | 620,108 | **572,824** | 541,008 |

Investment property includes properties valued at Lm1,441,768 (2006: Lm1,444,124) on which the lessees have an option to buy these properties at a pre-determined price and within a pre-determined time. The fair value of these properties does not exceed the pre-determined option price.

## 31. Contingencies

The Company has given guarantees to third parties amounting to Lm75,460 (2006: Lm57,343) not arising under contracts of insurance.

## 32. Related party transactions

In the normal course of business, the Group enters into various transactions with related parties. Related parties are defined as those that have an ability to control or exercise significant influence over the other party in making financial and operational decisions. These include directors and shareholders who hold a substantial amount of the votes able to cast at general meetings.

## 32. **Related party transactions** - continued

Relevant particulars of related party transactions, all of which have been carried out on an arms length basis, are as follows:

| | **2007** | 2006 |
|---|---|---|
| | **Lm** | Lm |
| *(a) Sales of insurance contracts and other services* | | |
| Sale of insurance contracts | | |
| - subsidiaries | **18,202** | 15,159 |
| - associate | **41,621** | 38,664 |
| - shareholders represented on the Board | **425,148** | 164,554 |
| Recoveries on claims outstanding from Corporacion Mapfre Compania Internacional De Reaseguros S.A. under reinsurance arrangements entered into upon the acquisition of Progress Assicurazioni S.p.A. | **181,287** | (16,304) |
| Reimbursement of expenses for back-office services provided | | |
| - associate | **462,500** | 406,000 |
| Investment income | | |
| - subsidiaries (dividends/interest receivable) | **546,637** | 845,993 |
| - associate (dividends) | **1,000,000** | 700,000 |
| - shareholders represented on the Board (dividends/interest receivable) | **114,015** | 94,306 |
| *(b) Purchases of products and services* | | |
| Reinsurance premium ceded to shareholders (represented on the Board) | **4,353,826** | 4,038,108 |
| Acquisition costs payable to intermediaries where directors of the company are shareholders in companies that act as insurance agents | **535,121** | 366,733 |
| Reimbursement of expenses payable for back-office services | | |
| - subsidiaries | **360,000** | 328,000 |
| Interest payable on borrowings | | |
| - shareholder represented on the Board (acting as banker) | **305,424** | 201,010 |
| Rental income payable to associate | **10,073** | 9,806 |

The Group restructured the composition of the senior management during 2007. Following this restructuring, key management personnel now comprises the Chief Executive Officers, General Manager, Assistant General Managers, Chief Officers and Chief Underwriters. Total remuneration paid by the Group to key management personnel during the year amounted to Lm242,906 (Company: Lm89,041). The key management personnel up to 2006 comprised the Chief Executive Office and the General Managers of the companies with the Group. Total remuneration paid by the Group during 2006 to key management personnel were Lm147,559 (Company: Lm74,295).

## 32. Related party transactions - continued

Year end balances arising from the above transactions:

| | Group | | Company | |
|---|---|---|---|---|
| | **2007** | 2006 | **2007** | 2006 |
| | **Lm** | Lm | **Lm** | Lm |
| Debtors arising out of direct insurance operations: | | | | |
| - intermediaries | **631,562** | 546,236 | **424,832** | 358,054 |
| Creditors arising out of direct insurance operations | **668,653** | 499,270 | **399,301** | 300,164 |
| Amounts owed by subsidiary undertakings | **-** | - | **421,306** | 498,521 |
| Amounts owed to subsidiary undertaking | **-** | - | **495,412** | - |
| Amounts owed to participating undertaking | **1,264,711** | 1,361,093 | **929,336** | 1,089,275 |
| Reinsurers share of technical provisions | **4,615,761** | 4,534,566 | **2,115,932** | 2,110,997 |
| Investments in related parties | **4,143,871** | 1,693,756 | **4,143,131** | 1,533,916 |
| Accruals and deferred income (key management personnel) | **285,131** | 192,091 | **285,131** | 109,766 |

All balances above have arisen in the course of the Group’s normal operations. All the amounts receivable are unsecured, interest free and are due within 12 months from the balance sheet date.

## 33. Fair values

The fair value of publicly traded investments classified as financial assets through profit or loss is based on quoted market prices at the balance sheet date. The fair value of unquoted equities, with the exception of investments in group undertakings and associates, is established using valuation techniques.

Equity accounting in the holding Company’s accounts is no longer permitted under IAS 27 and IAS 28 (both revised 2003). Consequently, as from 1 January 2005, the investments in unlisted group undertakings and associates are valued at cost in the Company’s accounts. Had equity accounting been applied, the carrying amount of these investments would have increased by Lm17 million (2005: Lm16.4 million). This has no impact on the Group’s balance sheet.

At 31 December 2007 and 2006, the carrying amount of the Group’s and Company’s other financial assets and liabilities approximated their fair values.

## 34. Statutory information

Middlesea Insurance p.l.c. is a public limited company and is incorporated in Malta.

# Supplementary information – primary statements at Euro equivalent amounts


| | **Pages** |
|---|---|
| Profit and loss account – Technical account – general business | i |
| Profit and loss account – Technical account – long term business | ii |
| Profit and loss account – Non technical account | iii |
| Balance sheet | iv |
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| Cash Flow Statement | vii |


All figures have been translated using the irrevocably fixed conversion rate of €1 = Lm0.4293.

# Profit and loss account
# Technical account – general business

| | Year ended 31 December | | | |
|---|---|---|---|---|
| | Group | | Company | |
| | **2007** | 2006 | **2007** | 2006 |
| | **€** | € | **€** | € |
| **Earned premiums, net of reinsurance** | | | | |
| Gross premiums written | **102,731,052** | 82,454,711 | **31,335,157** | 29,657,310 |
| Outward reinsurance premiums | **(16,602,607)** | (14,929,879) | **(13,227,715)** | (11,674,885) |
| Net premiums written | **86,128,445** | 67,524,832 | **18,107,442** | 17,982,425 |
| Change in the gross provision for unearned premiums | **(9,909,024)** | (4,180,545) | **(430,664)** | (238,607) |
| Change in the provision for unearned premiums reinsurers' share | **1,136,412** | 1,021,875 | **538,924** | 439,157 |
| | **(8,772,612)** | (3,158,670) | **108,260** | 200,550 |
| **Earned premiums, net of reinsurance** | **77,355,833** | 64,366,162 | **18,215,702** | 18,182,975 |
| **Allocated investment return transferred from the non-technical account** | **4,622,972** | 4,653,564 | **1,343,951** | 1,777,852 |
| **Total technical income** | **81,978,805** | 69,019,726 | **19,559,653** | 19,960,827 |
| **Claims incurred, net of reinsurance** | | | | |
| Claims paid | | | | |
| - gross amount | **52,005,169** | 49,064,025 | **15,182,793** | 15,017,166 |
| - reinsurers' share | **(5,737,035)** | (5,844,020) | **(4,745,365)** | (4,251,214) |
| | **46,268,134** | 43,220,005 | **10,437,428** | 10,765,952 |
| Change in the provision for claims | | | | |
| - gross amount | **11,155,637** | 7,700,366 | **(1,139,128)** | 1,480,627 |
| - reinsurers' share | **1,327,592** | (972,339) | **2,036,629** | 169,482 |
| | **12,483,229** | 6,728,027 | **897,501** | 1,650,109 |
| **Claims incurred, net of reinsurance** | **58,751,363** | 49,948,032 | **11,334,929** | 12,416,061 |
| **Net operating expenses** | **16,655,012** | 13,706,152 | **4,477,645** | 4,560,280 |
| **Total technical charges** | **75,406,375** | 63,654,184 | **15,812,574** | 16,976,341 |
| **Balance on the technical account for general business** (page iii) | **6,572,430** | 5,365,542 | **3,747,079** | 2,984,486 |

# Profit and loss account
# Technical account – long term business

| | Year ended 31 December | |
|---|---|---|
| | Group and Company | |
| | **2007** | 2006 |
| | **€** | € |
| **Earned premiums, net of reinsurance** | | |
| Gross premiums written | **1,470,242** | 1,392,863 |
| Outward reinsurance premiums | **(612,062)** | (603,106) |
| **Earned premiums, net of reinsurance** | **858,180** | 789,757 |
| **Investment income** | | |
| Income from other investments | **90,403** | 132,551 |
| **Total technical income** | **948,583** | 922,308 |
| **Claims incurred, net of reinsurance** | | |
| Claims paid | | |
| - gross amount | **381,658** | 328,392 |
| - reinsurers' share | **(263,855)** | (116,929) |
| | **117,803** | 211,463 |
| Change in the provision for claims | | |
| - gross amount | **438,404** | (50,266) |
| - reinsurers' share | **(282,627)** | 12,566 |
| | **155,777** | (37,700) |
| **Claims incurred, net of reinsurance** | **273,580** | 173,763 |
| **Change in other technical provisions, net of reinsurance** | | |
| Long term business provision, net of reinsurance | | |
| - gross amount | **61,859** | 37,285 |
| - reinsurers' share | **(15,248)** | (24,484) |
| | **46,611** | 12,801 |
| **Net operating expenses** | **245,087** | 80,382 |
| **Total technical charges** | **565,278** | 266,946 |
| **Balance on the technical account for long term business** (page iii) | **383,305** | 655,362 |

# Profit and loss account
# Non-technical account

| | Year ended 31 December | | | |
|---|---|---|---|---|
| | **Group** | | **Company** | |
| | **2007** | 2006 | **2007** | 2006 |
| | **€** | € | **€** | € |
| **Balances on technical accounts** | | | | |
| General business (page i) | **6,572,430** | 5,365,542 | **3,747,079** | 2,984,486 |
| Long term business (page ii) | **383,305** | 655,362 | **383,305** | 655,362 |
| | **6,955,735** | 6,020,904 | **4,130,384** | 3,639,848 |
| Share of profit of associated undertaking involved in long term business | **2,626,585** | 3,465,944 | **-** | - |
| Total income from insurance activities | **9,582,320** | 9,486,848 | **4,130,384** | 3,639,848 |
| Other investment income | **8,265,402** | 7,293,436 | **6,836,373** | 6,487,011 |
| Investment expenses and charges | **(2,511,994)** | (1,603,722) | **(1,629,532)** | (781,847) |
| Allocated investment return transferred to the general business technical account | **(4,622,972)** | (4,653,564) | **(1,343,951)** | (1,777,852) |
| Other income | **1,457,324** | 1,383,261 | **-** | - |
| Administration expenses | **(2,852,069)** | (3,388,160) | **(1,028,080)** | (1,108,162) |
| **Profit before tax** | **9,318,011** | 8,518,099 | **6,965,194** | 6,458,998 |
| Income tax expense | **(2,408,093)** | (1,011,148) | **(1,706,219)** | (1,225,371) |
| **Profit for the financial year** | **6,909,918** | 7,506,951 | **5,258,975** | 5,233,627 |
| **Attributable to:** | | | | |
| - shareholders | **6,750,570** | 7,399,213 | **5,258,975** | 5,233,627 |
| - minority interests | **159,348** | 107,738 | **-** | - |
| | **6,909,918** | 7,506,951 | **5,258,975** | 5,233,627 |
| **Earnings per share attributable to shareholders** | **27c0** | 29c6 | | |

# Balance sheet

| | As at 31 December | | | |
|---|---|---|---|---|
| | Group | | Company | |
| | **2007** | 2006 | **2007** | 2006 |
| | **€** | € | **€** | € |
| **ASSETS** | | | | |
| Intangible assets | **1,065,292** | 1,001,857 | **656,348** | 798,605 |
| Property, plant and equipment | **5,951,733** | 2,967,887 | **1,122,618** | 1,190,438 |
| Investment property | **10,924,531** | 10,166,166 | **7,720,126** | 7,323,503 |
| Investment in group undertakings | **-** | - | **25,474,018** | 23,077,948 |
| Investment in associated undertaking | **43,078,132** | 40,448,633 | **11,919,860** | 9,590,487 |
| Other investments | **170,154,805** | 160,784,219 | **48,967,733** | 51,907,426 |
| Deferred income tax | **3,300,519** | 2,629,385 | **-** | - |
| Reinsurers' share of technical provisions | **28,899,264** | 28,792,569 | **13,684,808** | 14,884,637 |
| Deferred acquisition costs | **6,977,289** | 5,134,400 | **2,576,879** | 2,453,401 |
| Insurance and other receivables | **20,591,337** | 18,141,451 | **9,012,893** | 10,456,187 |
| Income tax receivable | **37,426** | 686,641 | **-** | - |
| Cash and cash equivalents | **9,899,495** | 4,518,367 | **3,076,457** | 2,110,913 |
| **Total assets** | **300,879,823** | 275,271,575 | **124,211,740** | 123,793,545 |
| **EQUITY** | | | | |
| **Capital and reserves attributable to Shareholders** | | | | |
| Share capital | **14,558,584** | 14,558,584 | **14,558,584** | 14,558,584 |
| Share premium account | **2,777,778** | 2,777,778 | **2,777,778** | 2,777,778 |
| Other reserves | **21,551,830** | 21,694,923 | **34,402** | 177,495 |
| Profit and loss account | **43,701,708** | 39,571,682 | **25,517,326** | 22,878,896 |
| | **82,589,900** | 78,602,967 | **42,888,090** | 40,392,753 |
| **Minority interests** | **3,242,611** | 2,932,502 | **-** | - |
| **Total equity** | **85,832,511** | 81,535,469 | **42,888,090** | 40,392,753 |
| **LIABILITIES** | | | | |
| Deferred income tax | **1,200,492** | 1,122,716 | **1,200,492** | 1,122,716 |
| Provisions for other liabilities and charges | **883,827** | 809,455 | **-** | - |
| Technical provisions | **173,879,462** | 152,314,538 | **48,795,993** | 49,004,195 |
| Borrowings | **16,380,878** | 18,089,679 | **16,380,878** | 18,089,679 |
| Insurance and other payables | **22,210,978** | 20,575,905 | **14,753,788** | 14,360,394 |
| Income tax payable | **491,675** | 823,813 | **192,499** | 823,808 |
| **Total liabilities** | **215,047,312** | 193,736,106 | **81,323,650** | 83,400,792 |
| **Total equity and liabilities** | **30,0879,823** | 275,271,575 | **124,211,740** | 123,793,545 |

# Statement of changes in equity

## Group

| | Attributable to shareholders | | | | | |
|---|---|---|---|---|---|---|
| | **Share capital €** | **Share premium account €** | **Other reserves €** | **Profit & loss account €** | **Minority interests €** | **Total €** |
| Balance at 1 January 2006 | 14,558,584 | 2,777,778 | 19,680,142 | 35,084,186 | 2,414,637 | 74,515,327 |
| Fair value losses on available-for-sale investments, net of tax | - | - | (157,200) | - | - | (157,200) |
| Revaluation surplus on property plant and equipment, net of tax | - | - | 133,780 | - | 14,897 | 148,677 |
| Share of increase in value of in-force business of associated undertaking | - | - | 2,038,201 | - | - | 2,038,201 |
| Net gains recognised directly in equity | - | - | 2,014,781 | - | 14,897 | 2,029,678 |
| Profit for the financial year | - | - | - | 7,399,213 | 107,738 | 7,506,951 |
| Total recognised income for the financial year | - | - | 2,014,781 | 7,399,213 | 122,635 | 9,536,629 |
| Dividends for 2005 | - | - | - | (2,911,717) | (115,597) | (3,027,314) |
| Increase in share capital of subsidiary | - | - | - | - | 510,827 | 510,827 |
| **Balance at 31 December 2006** | 14,558,584 | 2,777,778 | 21,694,923 | 39,571,682 | 2,932,502 | 81,535,469 |
| Balance at 1 January 2007 | 14,558,584 | 2,777,778 | 21,694,923 | 39,571,682 | 2,932,502 | 81,535,469 |
| Fair value losses on available-for-sale investments, net of tax | - | - | (130,514) | - | - | (130,514) |
| Release on sale of subsidiary undertaking | - | - | (12,579) | - | - | (12,579) |
| Net losses recognised directly in equity | - | - | (143,093) | - | - | (143,093) |
| Profit for the financial year | - | - | - | 6,750,570 | 159,348 | 6,909,918 |
| Total recognised (expense)/income for the financial year | - | - | (143,093) | 6,750,570 | 159,348 | 6,766,825 |
| Dividends for 2006 | - | - | - | (2,620,544) | (61,353) | (2,681,897) |
| Increase in share capital of subsidiary | - | - | - | - | 275,906 | 275,906 |
| Disposal of subsidiary | - | - | - | - | (63,792) | (63,792) |
| **Balance at 31 December 2007** | 14,558,584 | 2,777,778 | 21,551,830 | 43,701,708 | 3,242,611 | 85,832,511 |

# Statement of changes in equity

## Company

| | Share capital € | Share premium account € | Other reserves € | Profit & loss account € | Total € |
|---|---|---|---|---|---|
| Balance at 1 January 2006 | 14,558,584 | 2,777,778 | 334,695 | 20,556,986 | 38,228,043 |
| Fair value losses on available-for-sale investments, net of tax | - | - | (157,200) | - | (157,200) |
| Net losses recognised directly in equity | - | - | (157,200) | - | (157,200) |
| Profit for the financial year | - | - | - | 5,233,627 | 5,233,627 |
| Total recognised (expense)/income for the financial year | - | - | (157,200) | 5,233,627 | 5,076,427 |
| Dividends for 2005 | - | - | - | (2,911,717) | (2,911,717) |
| **Balance at 31 December 2006** | 14,558,584 | 2,777,778 | 177,495 | 22,878,896 | 40,392,753 |
| Balance at 1 January 2007 | 14,558,584 | 2,777,778 | 177,495 | 22,878,896 | 40,392,753 |
| Fair value losses on available-for-sale investments, net of tax | - | - | (130,514) | - | (130,514) |
| Release on sale of subsidiary undertaking | - | - | (12,579) | - | (12,579) |
| Net losses recognised directly in equity | - | - | (143,093) | - | (143,093) |
| Profit for the financial year | - | - | - | 5,258,975 | 5,258,975 |
| Total recognised (expense)/income for the financial year | - | - | (143,093) | 5,258,975 | 5,115,882 |
| Dividends for 2006 | - | - | - | (2,620,545) | (2,620,545) |
| **Balance at 31 December 2007** | 14,558,584 | 2,777,778 | 34,402 | 25,517,326 | 42,888,090 |

As at 31 December 2007, unrealised fair value gains, net of taxation, amounting at €6,130,743 (2006: €5,778,807), have been credited to the profit and loss account and are not distributable in terms of the Companies Act, 1995.

## Cash flow statement

| | Year ended 31 December | | | |
|---|---|---|---|---|
| | Group | | Company | |
| | **2007** | 2006 | **2007** | 2006 |
| | **€** | € | **€** | € |
| **Operating activities** | | | | |
| Cash generated from operations | **20,618,216** | 10,963,576 | **4,826,082** | 2,836,587 |
| Dividends received | **1,196,098** | 1,342,651 | **1,205,935** | 1,405,248 |
| Interest received | **6,058,619** | 5,326,355 | **1,839,981** | 1,579,748 |
| Interest paid | **(1,125,423)** | (627,445) | **(1,083,834)** | (610,997) |
| Tax paid | **(2,616,080)** | (1,511,009) | **(1,798,511)** | (755,886) |
| Net cash generated from operating activities | **24,131,430** | 15,494,128 | **4,989,653** | 4,454,700 |
| **Investing activities** | | | | |
| Purchase of investment property | **(91,547)** | - | **(91,547)** | - |
| Disposal of investment property | **-** | 246,215 | **-** | 246,215 |
| Increase in investment in group undertaking | **-** | - | **(1,992,639)** | (3,654,771) |
| Disposal of group undertaking, net of cash acquired | **(96,771)** | - | **85,954** | - |
| Increase in investment in associated undertaking | **-** | (3,494,060) | **-** | (3,494,060) |
| Purchase of financial investments | **(207,622,545)** | (67,610,286) | **(19,016,212)** | (18,188,812) |
| Redemption of financial investments on maturity | **179,116,555** | 40,733,757 | **3,947,268** | 10,458,164 |
| Disposal of financial investments | **17,898,481** | 13,125,015 | **17,541,334** | 9,921,124 |
| Purchase of property, plant and equipment and intangible assets | **(3,886,469)** | (789,187) | **(213,401)** | (541,193) |
| Disposal of property, plant and equipment | **46,785** | - | **44,479** | - |
| Net cash (used in)/generated from investing activities | **(14,635,511)** | (17,788,546) | **305,236** | (5,253,333) |
| **Financing activities** | | | | |
| Bank loans | **(1,708,800)** | 3,216,801 | **(1,708,800)** | 3,216,802 |
| Proceeds from minority interest on issue of shares | **275,907** | 510,827 | **-** | - |
| Dividends paid to group shareholders | **(2,620,545)** | (2,911,717) | **(2,620,545)** | (2,911,717) |
| Dividends paid to minority interests | **(61,353)** | (115,597) | **-** | - |
| Net cash (used in)/generated from financing activities | **(4,114,791)** | 700,314 | **(4,329,345)** | 305,085 |
| **Increase/(decrease) in cash and cash equivalents** | **5,381,128** | (1,594,104) | **965,544** | (493,548) |
| **Movement in cash and cash equivalents** | | | | |
| At beginning of year | **4,518,367** | 6,112,471 | **2,110,913** | 2,604,461 |
| Net cash inflow/(outflow) | **5,381,128** | (1,594,104) | **965,544** | (493,548) |
| At end of year | **9,899,495** | 4,518,367 | **3,076,457** | 2,110,913 |