

Report  
and Accounts  
2002

*Alea*

## Who we are

- Global, multi-line solutions oriented reinsurer/insurer.
- 370 talented professionals in 14 offices and 11 countries worldwide.
- Established global infrastructure using state of the art underwriting systems.
- USD 661 million of total operating capital and rated A– by both Standard and Poor’s and A.M. Best.
- Total assets of USD 2,743 million.
- Minimal asbestos and environmental exposure with a well-protected balance sheet.
- Expertise in a wide range of property and casualty reinsurance, insurance, alternative risk and finite products.
- Significant presence in major insurance and reinsurance markets worldwide including fully licensed operating companies in:
  - London (including excess and surplus lines approvals in 43 jurisdictions)
  - United States (48 States)
  - Bermuda
  - Switzerland
  - Jersey
- Particular focus on developing long-term sustainable relationships with clients and brokers based on consistent solutions and customer service focused approach.

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## Directors and officers

### Alea Group Holdings (Bermuda) Ltd

#### Directors

Mr Dennis W Purkiss (Chairman)\*  
Mr Richard T Delaney#  
Mr Timothy C Faries  
Mr James R Fisher#  
Mr Todd A Fisher\*#  
Mr Perry Golkin\*#  
Mr Scott C Nuttall#

\*Member of the remuneration committee

#Member of the audit committee

All Directors were reappointed on  
26 April 2002

#### Secretary

Mr George P Judd

#### Registered office

Cedar House  
41 Cedar Avenue  
Hamilton HM12  
Bermuda

#### Bankers

Bank of NT Butterfield  
P.O. Box HM195  
Hamilton HMAX  
Bermuda

#### Solicitors

Appleby Spurling & Kempe  
Cedar House  
41 Cedar Avenue  
Hamilton HM12  
Bermuda

#### Auditors

Deloitte & Touche Ltd  
Klausstrasse 4  
Postfach  
8034 Zurich  
Switzerland

### Alea Group Holdings Ltd

#### Directors

Mr Dennis W Purkiss (Chairman)\*  
Mr James R Fisher#<sup>1</sup>  
Mr Todd A Fisher\*#<sup>2</sup>  
Mr Max F Furrer#<sup>3</sup>  
Mr Perry Golkin\*<sup>1</sup>  
Mr Gilles Meyer<sup>A</sup>  
Dr Rudolf Tschaeni#<sup>2</sup>

\*Member of the remuneration committee

#Member of the audit committee

<sup>1</sup>Resigned 27 March 2002

<sup>2</sup>Resigned 28 March 2002

<sup>3</sup>Resigned 30 March 2002

<sup>A</sup>Appointed 5 April 2002

#### Secretary

Ms Andrea Roethlisberger

#### Registered office

Lindenstrasse 16  
6340 Baar  
Zug  
Switzerland

#### Bankers

UBS AG  
Aeschenplatz 6  
4002 Basel  
Switzerland

#### Solicitors

Lenz & Staehelin  
Bleicherweg 58  
8002 Zurich  
Switzerland

#### Auditors

Deloitte & Touche Ltd  
Klausstrasse 4  
Postfach  
8034 Zurich  
Switzerland

I am pleased to report that in 2002 Alea has been able to demonstrate the faith that all of our employees, shareholders, customers and brokers have placed in us by delivering our primary goal – profitability. 2002 was a year during which we have been able to capitalise on the efforts put into place in previous periods to create a profitable group with an excellent future.

Following the completion of our Capital Enhancement Program, we have been able to grow our premiums by 89% gross and 118% net of reinsurance and achieve a total Group profit after tax of USD 56.2 million including realised and unrealised gains.

The Group has seven licensed insurance companies, all covered by Group guarantees and inter-company arrangements. Each has a Group rating of A– from A.M. Best and Standard & Poor's. During 2002 Standard & Poor's changed the Group's rating outlook from negative to stable, a position which has continued despite rating downgrades for many of our competitors and negative rating outlooks for many more. I am pleased to report that each of these licensed insurance entities was profitable in 2002.

- **Alea London Ltd** achieved a profit after tax of USD 27.9 million. It was able to substantially reduce its estimate of gross losses in respect of the 11 September 2001 terrorist attacks and also settled the Piper Alpha losses within its previously recorded loss reserves.
- **Alea Jersey Ltd** achieved a profit of USD 0.1 million after tax and **Alea Global Risk Ltd** achieved a profit of USD 4.6 million and commuted its involvement in a reinsurance pool at no further loss to the Group.
- **Alea (Bermuda) Ltd** achieved a profit after tax of USD 21.0 million primarily from its participation in the results of other entities through quota share arrangements. We also commenced the development of our Bermuda underwriting presence.
- **Alea Europe Ltd** recorded a profit of USD 3.3 million after application of the aggregate excess contracts and the inter-company reinsurance arrangements. Work has continued in restructuring our European operations. In particular the Group is pleased to have reached a conclusion on both of its largest outstanding disputes. Overall the settlement of these disputes removes a potential source of future uncertainty and reasonable provision has been made in these financial statements for the net impact of both disputes. Alea Europe Ltd also suffered a loss of USD 21.7 million gross and USD 14.9 million net in respect of the European floods. Whilst 2002 was a disappointing year for Alea Europe Ltd financially, due to the flood losses and the developments outlined above, its operating results for the 2002 underwriting year were a very significant improvement on prior years and the underwriting actions taken, particularly in 2001, have certainly prevented the company from suffering some of the dire proportional treaty results reported by European competitors in 2002. Most European treaty reinsurance business is underwritten in January and this year Alea Europe had an extremely successful renewal season when it was able to take advantage of the dislocation in the European Markets to obtain increases in shares in our target markets. Overall we now believe that Alea Europe has a significant opportunity to contribute to the Group results in 2003.
- **Alea North America Insurance Company** achieved a profit after tax of USD 2.1 million and wrote USD 332.1 million of gross premiums during its first year of operation. This is growth of 34% in its North American treaty business and 591% in Alea Alternative Risk business compared to the business previously introduced by these management teams and underwritten in Alea (Bermuda) Ltd through the fronting arrangement with Lumbermens, which came to its natural conclusion as of 31 December 2001.

Our US operations have a close working relationship with Lumbermens Mutual Casualty Company, stemming from our purchase of the Equus Re underwriting operations from Lumbermens in December 1999. This relationship includes continuing management responsibilities with regard to a portfolio transfer to Alea (Bermuda) Ltd of Lumbermens business written by Equus Re up to 30 September 1999 (prior to our acquisition of the Equus Re operations). This business is protected by a stop loss cover excess of a 75% loss ratio from Lumbermens (the Protected Business). There are similar

responsibilities with regard to business written on behalf of Lumbermens via the reinsurance intermediary relationship established after the acquisition (the Fronted Business). These management responsibilities include collection of premium, adjustment and payment of claims and reporting to Lumbermens.

Lumbermens financial strength ratings have been downgraded by A.M. Best to B and by Standard & Poor's to BB+. On 3 March 2003 Kemper (including Lumbermens) announced it had remaining capital of approximately \$1 billion and planned to cease writing new business. Due to the fact that the amounts Alea currently owes Lumbermens significantly exceed the amounts Lumbermens owes Alea, and these obligations are the subject of contractual mutual offset provisions as permitted by Illinois law, we are confident that we are not exposed to credit risk resulting from these developments. However, because of the change in circumstance, we are working actively to reduce the extent of our relationship with Lumbermens with a view to commuting the Protected Business and novating the Fronted Business onto our contracts. This is in order to obtain a release of the collateral that we have established to secure our claims payment obligations to Lumbermens.

- **Alea North America Specialty Insurance Company** (formerly named Alea North American Reinsurance Company) has commenced the process of applying for surplus lines eligibility to enhance options available to the Group's US clients. It achieved a profit after tax of USD 1.5 million and its capital is utilised to support Alea North America Insurance Company's business.

Overall we continued to develop our professional infrastructure increasing staff numbers from 317 to 370 as at 31 December 2002. We increased our underwriting presence and product capability in London, the United States, Europe and Bermuda with recruitment of seasoned professional staff. Having re-domiciled our holding company to Bermuda we also have developed certain administrative functions in Bermuda to support the new structure.

The focus of our Information Technology effort was in finance where we successfully introduced a global underwriting earnings model driven off the quarterly reserving studies; implemented a Group financial consolidation system with data being uploaded directly into the system from local units; and implemented a "Flash" reporting system designed to communicate key metrics monthly. These developments have enabled us to significantly speed up our reporting to management, board and shareholders.

The Group reported a good underwriting result and excellent investment result. The combined ratio was 100.4 % inclusive and 97.5% exclusive of the European floods (net USD 14.9 million).

The investment performance was excellent. The Alea Group followed a deliberately risk averse strategy after May 2000 when it sold its equity portfolio. When the new capital was raised this was used to invest in high quality bonds and treasury stocks with the result that in 2002 the Group achieved a total return on its asset portfolio of 7.4%, including unrealised gains of USD 25.4 million. There has been no need to make asset write-downs due to the high credit quality of our portfolio. As at 31 December 2002 98% of the total investment portfolio is invested in AA or higher rated securities.

**Capital Enhancement Program**

Following the events of 11 September, the Group accelerated its CEP to provide additional operating capital in order to take advantage of improving market conditions. With the support of our main shareholder KKR 1996 Fund (Overseas) Limited Partnership, the Group raised an additional USD 247.2 million of equity capital supplemented by bank borrowings of USD 25 million under its existing revolving credit facility in December 2001 and USD 75 million under a supplemental term loan component to the facility. The Group still has access to a further USD 35.7 million in available funds under its revolving credit facility if it so requires. Incremental capital of USD 347.2 million was raised as follows:

	USD m
KKR Overseas & affiliates	<b>108.8</b>
New York State Retirement Co-Investment Fund L.P.	<b>15.0</b>
CalPERS/PCG Corporate Partners, LLC	<b>30.0</b>
State of Wisconsin Investment Board	<b>60.0</b>
BACP Europe Fund II L.P.	<b>30.0</b>
Granite Private Equity III, LLC	<b>3.4</b>
Equity	<b>247.2</b>
Loan revolver	<b>25.0</b>
Term loan (2007)	<b>75.0</b>
<b>Total operating capital raised as a result of CEP</b>	<b>347.2</b>

As part of the CEP, the Alea Group perceived certain strategic opportunities in forming Alea Group Holdings (Bermuda) Ltd as the new parent company of the Group. Accordingly our majority shareholder, KKR Overseas increased capital in the Group by purchasing shares of Alea Group Holdings (Bermuda) Ltd and exchanging its shares in Alea Group Holdings Ltd for shares of the new parent company. All new capital injections were made directly into Alea Group Holdings (Bermuda) Ltd.

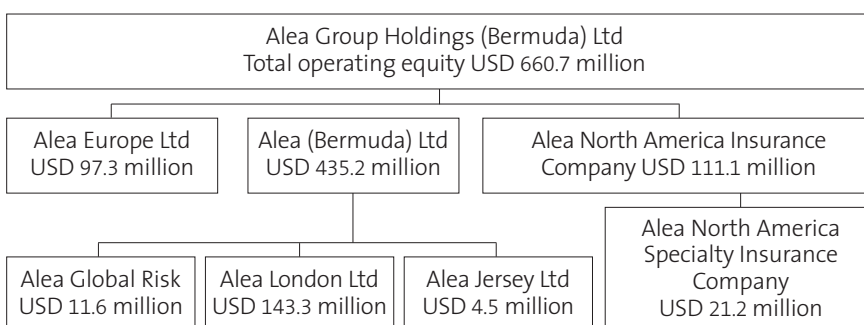
The investments made by Alea Group Holdings (Bermuda) Ltd were made by way of warrants pending regulatory approvals of the transaction. Following the receipt of all necessary regulatory approvals in February 2002 and the exchange of stock in April 2002, Alea Group Holdings (Bermuda) Ltd became the new ultimate holding company. Further details of the CEP are included in note 16 to the financial statements.

As at 31 December 2002 total operating equity available to the insurance subsidiaries was as follows:

	USD m
Shareholders' equity	<b>442.2</b>
Subordinated preferred equity	<b>50.0</b>
Loans	<b>168.5</b>
<b>Total operating equity</b>	<b>660.7</b>

Details of the loans are provided in note 23 to the financial statements and a reconciliation of the movements in shareholders' funds is provided in note 18.

The UK GAAP equity structure as at 31 December 2002 for each insurance subsidiary was as follows:



Of the USD 660.7 million total capitalisation, USD 16.2 million remains in holding companies and USD 3.9 million was invested in the non-insurance subsidiaries. In addition the capitalisation of Alea North American Insurance Company includes USD 20.0 million arising from a loan provided by Alea London Ltd. Furthermore, the statutory capital of Alea North America Insurance Company was enhanced by the issue of a USD 17 million Surplus Loan Note.

### **Rating agencies**

In July 2002, Standard & Poor's and A.M. Best affirmed our insurance operating subsidiaries' A- Financial Strength Ratings. We are particularly pleased that following the announcement of the first stage of our Capital Enhancement Program of USD 100 million by KKR Overseas, S&P moved our outlook to stable reflecting the significantly improved business conditions and our positioning in the market place, thus paving the way for a rating upgrade in due course. Management is conscious of the importance of these ratings and is committed to achieving an enhancement as soon as possible.

Each of the insurance operating companies below carries an "A minus (Strong) – Outlook Stable" financial strength rating from Standard & Poor's and an "A minus (Excellent)" financial strength rating from A.M. Best.

Alea (Bermuda) Ltd  
Alea Europe Ltd  
Alea London Limited  
Alea North America Insurance Company  
Alea North America Specialty Insurance Company  
(formerly named Alea North America Reinsurance Company)  
Alea Jersey Limited  
Alea Global Risk Limited

### **Intra-Group arrangements**

Whilst recognising the separate legal status of each entity, business processes are standardised and managed consistently. The Group continues to view each of its insurance operating entities as core to the whole. Mindful of local market conditions, regulatory requirements and the capital adequacy requirements of the rating agencies, the Group ensures that each balance sheet retains risk commensurate with its capital base.

The primary means of achieving this is by arranging capacity through internal quota shares primarily with Alea (Bermuda) Ltd which now has the majority of the Group's operating capital of USD 435.2 million. For 2002 we have put into effect a 70% quota share to Alea (Bermuda) Ltd of Alea North America's insurance and reinsurance business. This will be particularly important for Alea North America during its growth phase.

In addition the Alea Group makes public its view of the interdependence of each subsidiary with the issue of intra-group cross guarantees that, whilst inevitably affected by local regulatory requirements, make clear that it is management's intention to view each subsidiary as part of the whole. Through consultation with A.M. Best and Standard & Poor's, a form of wording for the guarantees has been developed that is acceptable to both agencies. Group guarantors may only terminate these guarantees after giving one month's notice to these agencies. Any contract written whilst the guarantees are in force remains guaranteed should the guarantee be cancelled subsequently.

In the third quarter of 2002, in recognition of its new status as the ultimate holding company of the Group, Alea Group Holdings (Bermuda) Ltd entered into a top down guarantee with each of the seven rated insurance operating entities: Alea (Bermuda) Ltd, Alea North America Insurance Co, Alea North America Specialty Insurance Company, Alea London Ltd, Alea Europe Ltd, Alea Jersey Ltd and Alea Global Risk Ltd. These guarantees are in addition to the pre-existing cross company guarantees already in place between the various subsidiaries of the Group. Details of these guarantees have been made available to the rating agencies and broker security committees.

Finally in the fourth quarter Alea (Bermuda) Ltd entered into an aggregate stop loss arrangement designed to protect the balance sheet of Alea Europe Ltd.

## Group systems

During 2002 the Group continued the development of its core control processes through the Group Information Technology Strategy. The functionality of the main underwriting systems continues to be enhanced. Version 4 of our Underwriting System incorporates improved aggregation control, improved recording of proportional treaty details, and a re-engineering to the quicker, more flexible XML technology. This has been rolled out to Alea London, Alea North America treaty and Alea Europe. Management information has increased with real-time reporting of underwriting information through the underwriting data warehouse.

The Group's financial reporting timetable has been streamlined with the introduction of the new earnings models and global consolidation system. Management control has been enhanced with the introduction of the monthly flash reporting system measuring inter alia, premium, cash flow, pricing data and significant broker metrics. During 2002 the Group also made significant progress in the development and implementation of additional support systems in particular with the purchase of an insurance accounting system and a reinsurance accounting and statutory reporting system in Alea Alternative Risk.

## Corporate Governance

The Remuneration Committee of the Board met on a regular basis to discuss remuneration and incentive policies.

The Audit Committee of the Board met on a regular basis to discuss control issues facing the Group with input from the Group's external auditors and independent actuaries Deloitte & Touche. In addition another independent actuarial firm reviewed our underwriting pricing processes, providing confirmation of our approach in particular regarding our processes for selecting initially expected loss ratios and recommending further improvements which are in the process of being implemented. Deloitte & Touche carried out their second annual independent actuarial study as of 30 September 2002, the purpose of which was to test the reasonableness of the reserves established by the Directors. The gross and net loss reserves recorded by the Directors remain within the range of expectations from that study.

The risk management function was extended with the commencement of a Group internal audit function. As each entity is now reaching a more mature stage, emphasis was placed on documentation and process control identification to provide the base for future internal audit procedures. All risk management and internal audit recommendations are placed in front of the Audit Committee of the Board.

The Group Executive Committee (comprising representatives from functional heads of each specialisation and the Chief Executive Officers of each business unit) met frequently to agree strategic development and share growth opportunities.

The Investment Committee (comprising representatives from Corporate Centre, the local Chief Financial Officers of each business unit and members of the Board) met frequently to agree the investment strategy focusing on high quality bonds, AAA rated mortgage backed securities and treasury stock. During much of the year the Group managed its own European portfolio with BlackRock Inc. acting as principal investment manager for the other portfolios. In the third quarter Bank One were appointed investment managers to a USD 100 million investment sub-portfolio with oversight from Blackrock. Returns on all invested asset portfolios have been excellent. In the final quarter management of the European portfolio was also placed with BlackRock.

The Reinsurance Security Committee (comprising representatives from Corporate Centre and representatives of each business unit) was extended to recognise the increasing importance of the purchase of reinsurance for the Alea Alternative Risk business in North America. Additional guidelines were agreed to encompass the new characteristics of this business.

The Special Transaction Committee (comprising representatives from Corporate Centre, the Board and local CEOs) reviewed and confirmed a significant contract for Alea London which gave rise to approximately USD 65 million of premium in 2002 with significantly more in 2003 and 2004. Approval of this contract required input from 22 people in four countries working in four business units and three corporate centre locations and is a great example of the global culture we have built.

The Underwriting Committee (comprising representatives from Corporate Centre, the Board, and local underwriting management) considered health check reports on each of London, Basel, Rocky Hill (Alternative Risk) and Wilton (North American treaty business) and assisted in developing underwriting guidelines. Health checks (underwriting audit reviews) were carried out under the guidance of our risk management team. In each instance the findings were used to enhance future control processes within the enterprise and transfer best practise around the Group. The health checks did not identify material instances of control lapses in any location.

The second annual financial conference was held in March 2003 to enable the senior financial team to review progress in 2002 and set priorities for 2003. The conference was attended by key financial, risk management and internal audit personnel from all locations.

All of the above initiatives are designed to create a truly global corporate culture bringing together worldwide expertise to consider the issues facing the Group.

### **Conclusion**

2002 was an excellent year for Alea. We have developed our business profitably during a period when many of our competitors have faced considerable problems. These problems which focused on casualty business written in the late 1990's, equity market overvaluation, bond asset write downs, and asbestos development were not avoided by chance. In each instance Alea developed its own strategy designed to avoid the worst excesses of the cyclical market place and in 2002 the strategy has borne fruit. During the last few months we have looked at a number of external growth opportunities and in each instance the benefit of such growth has been more than offset by our perception of the inadequacies of the underwriting approach previously adopted. Thus our growth strategy will continue to be driven from internal growth and cautious expansion of our opportunities in lines of business we understand. The unexpectedly severe problems which have hit the market place, with an unprecedented collapse in the availability and quality of reinsurance capacity following the well documented demise of a number of major players in the industry creates an excellent opportunity for Alea in 2003.

Alea now has total operating capital of USD 660.7 million available to underwrite insurance and reinsurance business and the beginnings of a track record, which we believe will enable us to take advantage of the improvements in market conditions in each of the places in which we do business. As events of the last few months have shown it is not size per se which creates a secure environment in which to place reinsurance. We believe instead that it is an unrelenting attention to detail in ensuring that each decision, wherever taken around the world, is in the best interests of the Group as a whole and where the final premium volume and the size of the Group is important but not overwhelmingly so.

Market conditions began to improve in 2001, the events of that year, the 11 September terrorist attacks being followed shortly by the build up of new capital in Bermuda, were hugely important in changing the reinsurance landscape. If anything the events of 2002, the continuing severe downturn in equities, the credit quality crisis in the bond markets and the reduction in interest rates are even more important in setting the stage for 2003.

As we said last year Alea faced an extremely tough three years in getting to where we are today, the sheer number and size of catastrophe losses in 1999, the restructuring of the portfolio in 2000, and the unprecedented market losses of 2001. During this period we substantially restructured our European business and we built significant new businesses in the United States, Bermuda and in London. In 2002 all of these initiatives came together to create a profitable enterprise with a great future.

In 2002 the Group made a total return on equity of 13%. We would like to thank our employees, customers, brokers, and shareholders for staying with us through this turbulent period. The stage is now set to create further profits in 2003 and beyond.

## Executive committee



**Dennis Purkiss**  
**Group Chairman and**  
**Group Chief Executive Officer**

Dennis is the Group Chairman and Group Chief Executive Officer and a member of the Board of Directors of Alea Group Holdings (Bermuda) Ltd.

**Amanda Atkins**  
**Group Chief Financial Officer and**  
**EVP, Operations**

After securing her degree at Manchester University, Amanda began her career at Coopers & Lybrand and has since been Chief Financial Officer for a number of international insurance and reinsurance companies, most recently Zurich Reinsurance London Limited between 1994 and 1998. Amanda has 24 years industry experience.

**Stewart Laderman**  
**Group Chief Underwriting Officer**

Stewart is an Associate of the Chartered Institute of Insurers. He was a member of the Zurich Group Global Reinsurance Security Committee. Stewart started his career in 1975 and has 28 years underwriting experience.

**Robert D Byler**  
**Chief Executive Officer,**  
**Alea Alternative Risk**

After securing his degree at the University of Alabama, Rob joined General Reinsurance Corporation in 1979 and he has worked exclusively in the alternative risk arena since 1984. Rob has 25 years of industry experience.

**Stephen Cane**  
**Chief Executive Officer Alea London**  
**and EVP of Group Compliance**

Stephen is also Chairman of the International Underwriting Association. He started his insurance career with the Corporation of Lloyds in 1970 and has 33 years of industry experience.

**Len Goldberg**  
**Chief Executive Officer,**  
**Alea North America Insurance Company**

Most recently, Len was Senior Vice President, Chief Actuary and Director of the Financial Products for Custom Risk Solutions LLC (a joint venture between Aon, ACE and Royal Sun Alliance). Len has over 17 years experience in both insurance and reinsurance.



**Michael Hayes**

**Chief Executive Officer, Alea North America**

Mike served as a Director of the Merrett Group in London from 1979 to 1986 before returning to the U.S. to take up the position of Senior Vice President with Trenwick from 1986 to 1988. Mike has over 27 years experience in the reinsurance industry.

**George P Judd**

**SVP, Group General Counsel and Secretary**

George began his career in the insurance industry in 1982 at American General Corporation. More recently he served as Assistant General Counsel to American Re-Insurance Company before joining Alea in 1999. George is a Certified Public Accountant and has been admitted to the New Jersey Bar Association and the Texas Bar Association. George has more than 20 years industry experience.

**Gilles Meyer**

**Chief Executive Officer, Alea Europe**

Gilles began his career at Swiss Re in 1982 as a facultative underwriter with particular responsibility for the London Market, Africa and Australia. Gilles has over 21 years experience in the industry and holds Master's degrees in both Economics and Business Administration.

**André Perez**

**SVP, Head of Office, Alea Bermuda**

André holds a Bachelor degree in Mathematics from the University of Montreal. He is a Fellow, Casualty Actuarial Society (FCAS) and a Fellow, Canadian Institute of Actuaries (FCIA). André has over 16 years of actuarial and underwriting experience in the insurance and reinsurance industry.

**Tim Riley**

**SVP, Group Chief Information Officer**

Tim started his career in underwriting but then moved into Information Technology, fulfilling a variety of roles in infrastructure and development. In total Tim has 14 years of industry experience, 11 of those years within Information Technology.

**Sean Sawyer**

**SVP, Chairman's office**

Sean is responsible for the Group's strategic and operational planning and a number of major corporate projects. Sean began his career at Cornhill and has over 13 years experience in the insurance and reinsurance industry.

## Board of directors

### Dennis Purkiss

Age 50, is Group Chairman and Group Chief Executive Officer of Alea Group Holdings (Bermuda) Ltd. Dennis has been a Board Member of the International Underwriting Association (“IUA”) and Chairman of the Legislation Committee of the IUA. He is an Associate of the Chartered Insurance Institute.

He was appointed Managing Director of Zurich Reinsurance London Limited in July 1994 having joined the company as its Chief Operating Officer in November 1993. Between October 1985 and November 1993, Dennis held various general management positions at the Merrett Group, latterly becoming Group Chief Executive Officer. At Merrett he was responsible for the establishment of the first corporate capital vehicle in Lloyds in partnership with Marsh McLennan and J.P. Morgan.

Dennis started his career at Eagle Star where he held a variety of positions over a fifteen-year period. He has over 34 years industry experience.

### Richard Delaney

Age 64, is an independent consultant on property and casualty insurance and reinsurance matters. Prior to his current consulting activities, Mr. Delaney was President and Chief Operating Officer of AM-RE Consultants, Inc. from its formation in 1994 until his retirement in 2000. Prior to joining AM-RE Consultants, Inc., Mr. Delaney was with Tillinghast/Towers Perrin for over twenty years, where he was a Vice President and Principal and led the Insurance Management and Operations Consulting Practice.

### Timothy Faries

Age 36, is a Partner and the Insurance Team Practice Leader at Appleby Spurling & Kempe, Barristers & Attorneys, in Bermuda. He has been a Partner at Appleby since 2000 and was an associate there from 1993–1999.

### James Fisher

Age 47, is the managing member and majority owner of Fisher Capital Corp. L.L.C. From 1986 through March 1997, Mr. Fisher was senior executive at American Re Corporation and served most recently as Senior Vice President and Chief Financial Officer of American Re-Insurance Company (American Re) and American Re Corporation, President of American Re Financial Products, and President and Chief Executive Officer of American Re Asset Management. Before joining American Re, Mr. Fisher was a Senior Accountant at Peat, Marwick, Mitchell & Co., Chief Financial Officer of The Lawrence Corporation and Senior Manager/Director of Insurance Industry Services at Price Waterhouse.

Mr. Fisher is also Chairman and Chief Executive Officer of BRW Acquisition Inc. (Bristol West) and a director of Willis Group Holdings Limited (Willis). Mr. Fisher also serves as Chairman of the Audit Committee of Alea.

### Todd A Fisher

Age 37, has been a member of KKR & Co. L.L.C. since 1 January 2001. Mr. Fisher was an executive of KKR from June 1993 to 31 December 2000. Mr. Fisher was an associate at Goldman Sachs & Co. from July 1992 to June 1993. He is also a member of the board of directors of Accuride Corporation, Layne Christensen Company, BRW Acquisition, Inc., Willis Group Holdings Limited and Rockwood Specialties, Inc.

### Perry Golkin

Age 49, has been a member of KKR & Co. L.L.C. since 1 January 1996. Mr. Golkin was a partner of KKR from 1995 to January 1996. Prior to 1995, he was an executive of KKR. He is also a member of the board of directors of BRW Acquisition, Inc., PRIMEDIA, Inc., Willis Group Holdings Limited, Rockwood Specialties, Inc. and Walter Industries, Inc.

### Scott Nuttall

Age 30, has been an executive with KKR & Co. L.L.C. since November 1996. Mr. Nuttall was with The Blackstone Group from January 1995 to November 1996. He is also on the board of directors of Willis Group Holdings Limited, Amphenol Corporation, BRW Acquisition, Inc., KinderCare Learning Centers Inc. and Walter Industries, Inc.

## Management discussion and analysis

Gross premiums written were USD 931.6 million in 2002 (2001: USD 493.2 million) an increase of 89%, with growth recorded in each of Alea London Ltd (96% increase) and Alea North America Insurance Co (103% increase) the latter comprising of Alea North America treaty (34% increase) and Alea Alternative Risk (591% increase). Alea Europe Ltd received the benefit of a 35% quota share treaty from Alea London Ltd which increased its total gross premiums to USD 263.7 million (49% increase). Alea (Bermuda) Ltd gross premiums were USD 242.2 million (42% increase) and included the benefit of a 70% quota share from Alea North America Insurance Company Ltd. Alea (Bermuda) Ltd put in place an aggregate excess contract with Alea Europe Ltd designed to protect the capital base of that entity.

The Group's total gross premium written in 2002 can be reconciled to that of insurance entities as follows:

USD m	Original business	Transferred through Intra-Group arrangements	Transferred through aggregate excess arrangements	Final gross written premium by entity
Alea London Ltd	375.0	(0.6)	–	374.4
Alea North America Insurance Co.	332.1	–	–	332.1
Alea Europe Ltd	157.6	106.1	–	263.7
Alea Global Risk Ltd	0.2	–	–	0.2
Alea (Bermuda) Ltd	66.7	170.6	4.9	242.2
<b>Total gross written premium</b>	<b>931.6</b>	<b>276.1</b>	<b>4.9</b>	<b>1,212.6</b>

Gross premiums earned were USD 674.0 million (2001: USD 517.1 million), an increase of 30%.

Net premiums written were USD 708.2 million (2001: USD 325.5 million), an increase of 118%. Net premiums earned were USD 518.1 million (2001: USD 360.3 million), an increase of 44%.

Overall, the Group's net paid claims were on plan and total operating cash flows were better than plan. The Group does not measure success by premium volume, rather by the quality of the business accepted which must meet our underwriting guidelines. In this context we are satisfied with our gross business growth of 89% in 2002.

The profit before tax of USD 55.0 million was a significant improvement on the USD 27.8 million loss booked in 2001. The Group made a profit after taxation of USD 56.2 million in 2002 (2001: USD 22.2 million loss).

The overall combined ratio ((net losses incurred + net expenses incurred) / net premiums earned) for the year ended 31 December 2002 was 100.4% (2001: 115.5%), an improvement of 15.1%.

The gross loss ratio for the year including catastrophes was 60.2% (2001: 99.5%), an improvement of 39.3%. The net loss ratio for the year including catastrophes was 62.1% (2001: 72.2%), an improvement of 10.1%.

The European floods in Alea Europe, USD 21.7 million gross (USD 14.9 million net), were categorised as a catastrophe loss and increased the gross loss ratio by 3.2% and the net loss ratio by 2.9%. All of the net numbers set out above are before the application of intra-group and aggregate excess reinsurance contracts.

In assessing the results for 2002, the Group has paid particular regard to the likely ultimate exposure to the 11 September terrorist attacks. In the three months to 30 September 2002, it became clear that the Group had overestimated the likely exposures of its property catastrophe business to the 11 September terrorist attacks and accordingly reduced its overall gross loss estimate from USD 94.4 million to USD 65.8 million leaving the net provision unchanged. Thus the decrease in gross loss ratio set out above included the reduction in 11 September terrorist attacks which reduced the gross loss ratio by 4.2%.

In 2001 the total gross loss estimate of catastrophes was USD 129.6 million including 11 September terrorist attacks (USD 94.4 million gross, USD 24.9 million net), Petrobas (USD 20.2 million gross, USD 3.2 million net) and Toulouse (USD 15.0 million gross, USD 6.3 million net). Together these catastrophes increased the gross loss ratio by 25.1% and the net loss ratio by 5.4%.

#### **2002 underwriting year**

The 2002 underwriting year shows a current gross loss ratio of 59.7% including catastrophes (56.4% net) which represents a very satisfactory performance at this stage of development. This premium is of course not yet fully earned so the final outcome of the 2002 underwriting year will also depend upon loss activity in subsequent periods, particularly 2003.

#### **2001 underwriting year**

The 2001 underwriting year is developing within the reserves previously set-up and currently has a net loss ratio of 64.9% (2001: 65.0%) an improvement in net losses of USD 0.3 million. The current gross loss ratio is 73.0% (2001: 78.0%). The improvement of 5% is mainly due to a reduction in gross losses of USD 28.6 million arising from the 11 September terrorist attacks which is equivalent to a gross loss reduction of 5.2%.

Both the 2001 and 2002 underwriting years are protected by an excess of loss contract with a significant reinsurer (A.M. Best A-, Fitch A) for business written worldwide from 1 January 2001 through to 31 December 2003, with the exception of Life and Finite business and property catastrophe losses other than those in excess of our traditional programmes. All amounts recoverable under this contract are fully collateralised. The contract provides coverage for potential speed-up of losses as compared to Plan, coverage for a portion of losses in excess of Plan, and significant de-leveraging of the Alea Group balance sheet. The losses covered under this transaction are collateralised by letters of credit and by liquid fixed income obligations with a weighted average AA rating held in a trust at Mellon Bank.

#### **2000 underwriting year**

On a gross loss ratio basis the performance gap between business underwritten under new underwriting guidelines compared to the non-renewed business was maintained, with a gross loss ratio overall of 89% (2001: 90%) made up of 73% (2001: 74%) for the new business and 100% (2001: 104%) on the substantially discontinued Basel and London Imperial books of business. The net loss ratio for the 2000 underwriting year was 85% (2001: 83%), an increase of 2% (2001: 3%) on the estimate as of the previous year end.

Substantially all of the increase in net loss reserves for the 2000 underwriting year, was in respect of two casualty losses in Alea Europe Ltd which arose from a limited number of two year contracts initiated in 1999 and allocated to the 2000 underwriting year. These contracts were discontinued as part of the restructuring of the company.

The 2000 underwriting year (including business underwritten by Imperial commencing 1 January 2000 subject to certain limitations) is protected by an aggregate excess stop loss contract provided by an A rated reinsurer with the backing of an AA- rated reinsurer.

### 1999 and prior underwriting years

For the 1986 to 1999 underwriting years incurred loss development remained fully in accordance with expectations and within the protection afforded by the reinsurance contracts put into place when the Group was re-capitalised in May 2000.

There were no significant new claims in Alea London Ltd. The US energy oil refinery loss reported last year (USD 14.0 million gross, USD 2.5 million net before reinstatement premium of USD 2.1 million) and the Piper Alpha loss (USD 19.7 gross, USD 4.9 million net) were both settled during 2002 for amounts less than the relevant loss reserves. Substantially all anticipated reinsurance recoveries in respect of these two losses have been received.

Paid claims for 1999 and prior were in line with expectations overall though the Basel book was under expectation. Paid claims for the much smaller portfolios in Singapore and Canada were above expectations and both of these books of business were substantially restructured in 2001. Overall loss reserves for the 1999 and prior portfolio in Alea Europe remain well within the aggregate excess protection purchased. The company made provision for the net effect of the resolution of two long outstanding arbitrations.

One of these arbitrations was in relation to a treaty in the 1986 and prior underwriting years of Alea Europe Ltd. This is the treaty which gives rise to the de minimis asbestos exposure which the Group has previously disclosed. Our liabilities under the treaty have been disputed by the company for many years. Our position in respect of this treaty was clarified at an arbitration decision in February 2003. As a result the Group has made additional provision in these accounts for potential asbestos liabilities based on an independent consultant's "ground-up" analysis of the underlying policy exposures covered by the treaty. Provision has been made at the high end of the range of potential losses provided by the consultant. According to the report, at this level the reserves we now hold approximate to a US industry reserve requirement of USD 98 billion as opposed to the USD 65 billion industry reserve requirement published by A.M. Best in the third quarter of 2002. Our total asbestos loss reserves remain de minimis to the Group.

The other dispute, which was in respect of marine business in Alea Europe Ltd, was settled in our favour as a full and final settlement and enabled a reduction in paid losses and the elimination of related outstanding losses for the 1999 and prior period. The benefit of the settlement was passed to our aggregate excess reinsurer for that period.

Overall the Group saw USD 11.8 million development in 1999 and prior underwriting years, substantially all of which was due to the 1986 and prior arbitration decision.

On a segmental basis the gross and net technical result before operating expenses in respect of casualty business was adversely affected by the 1986 and prior arbitration decision and the 2000 underwriting year casualty contract loss in Alea Europe. The property result benefited from the reduction in 11 September terrorist attack losses and the relatively benign catastrophe environment in 2002 and the marine result benefited from the favourable settlement of the 1999 and prior dispute in Alea Europe coupled with no significant marine catastrophe losses.

## Reserve ratios

The Group gross reserve ratio (gross loss reserves/gross premium earned) for 2002 was 167% (2001: 213%). The reductions in 2002 reflected the reduction in 11 September terrorist attacks reserves, the settlement of the arbitration case in Alea Europe, the settlement of the Piper Alpha loss, the US Energy oil refinery loss reported last year by Alea London and the relatively low catastrophe experience compared to 2001.

The Group net reserve ratio before aggregate excess contracts (net loss reserves before the aggregate excess contracts/net premium earned) was 171% (2001: 220%). The reinsurance recoverable excluding the aggregate excess contracts decreased by USD 69.8 million in 2002 as a result of the favourable elements outlined above. The Group net reserve ratio (net loss reserves/net premium earned) was 88% in 2002 (2001: 118%).

The increase in reinsurance recoverable under the aggregate excess contracts was USD 64.6 million and primarily related to new recoveries arising from premiums earned under the 2001 to 2002 underwriting year aggregate excess contract which is fully collateralised through AA rated trust funds and letters of credit.

## Net operating expenses

Net operating expenses were 39.4% of net premiums earned in 2002 (2001: 45.6%). 2001 included a 1.1% charge arising from the accelerated write-off of deferred acquisition costs in Alea Europe in 2001.

The expense ratio is still higher than the company anticipates achieving in the future. This is largely a result of the new business strain particularly in Alea Alternative Risk where the infrastructure costs in building the franchise have been sustained but the earned premium recorded in the profit and loss account in respect of the 591% increase in gross premium written is still relatively small.

## Investment returns

In 2001 and 2002 the Group deliberately continued its conservative investment strategy following the sale of its equity portfolio in May 2000. The strategy reflected our perception of the increased risk in equity and bond markets. We are pleased to report that this strategy has stood us in good stead achieving an overall investment return of 7.4% in 2002 (2001: 6.1%). The investment return comprises of 4.3% (2001: 5.1%) investment income, 0.8% (2001: 0.6%) realised gains and 2.3% (2001: 0.4%) unrealised gains on average invested assets of USD 1,119 million (2001: USD 791 million). As at 31 December 2002 98.1% (2001: 94.5%) of our invested portfolio is invested in entities rated AA and above and 99.7% (2001: 99.6%) is rated A or higher.

## Liquidity and capital resources

The Group's liquidity requirements have been met by funds provided by operations, from the maturity and sale of investments supplemented by the proceeds of the Capital Enhancement Program. The total additional funds available to the Group as a result of the CEP were USD 347.2 million.

Cash provided by operating activities primarily consists of premiums collected, investment income and collected reinsurance recoverable balances, less paid claims, retrocession payments, operating expenses and tax payments. Net cash flow from operating activities was positive USD 87.2 million (2001: negative USD 86.3 million).

The USD 87.2 million positive cash inflow in 2002 is after payment of USD 62.0 million (2001: USD 42.8 million) in respect of the aggregate excess contracts purchased. Previous contracts had been placed on a funds withheld basis such that there was no cash outflow to the Group. On a like-for-like basis after adjusting for the aggregate excess contracts cash flow was a positive USD 149.2 million (2001: negative USD 43.5 million). Thus, cash flow has improved by USD 192.7 million (2001: USD 68.2 million) year on year, reflecting the reduction in settlements related to reducing run-off portfolios in Basel and the Imperial book of business that was acquired in 2000.

Given the significant settlement of some large loss reserves during 2002, as set-out in the reserve ratio comments, the underlying cash flows in respect of other business was even more positive.

Overall net operating cash flow in 2002 was more than USD 25 million better than expected which primarily came from better than expected cash flow in Alea Europe. Net paid claims were in line with plan overall, and included the settlement of some significant long outstanding loss reserves as already outlined.

In 2001 substantially all of the net annual cash outflow took place in the first half of the year. The Group anticipated negative cash flow in 2001 as a result of the significant downsizing of the Alea Europe portfolio. The negative net operating cash flow for the year ended 31 December 2001 was more than USD 50 million better than expected with approximately 50% coming from lower than expected paid claims and 50% from higher than expected earned premiums.

The net cash invested in 2002 was USD 114.8 million (2001: USD 230.8 million). Aggregate invested assets, including cash and short-term investments and deposits with ceding undertakings were USD 1,228 million (2001: USD 1,070 million).

Alea Group total capital employed determined under UK GAAP as at 31 December 2002 was USD 492.2 million (2001: USD 433.6 million) inclusive of the subordinated preferred stock issues by subsidiaries of Alea Group Holdings (Bermuda) Ltd, which are subordinate to certain elements of the shareholders' funds under UK GAAP as set out in Note 19 to the financial statements.

No dividends were paid during the year. The increase in shareholders' funds during the year was primarily the result of the profits made.

#### **Alea London Limited**

Total gross premium written for the year ended 31 December 2002 was USD 374.4 million (2001: USD 190.8 million), an increase of 96.2%.

Alea London Ltd made a profit after taxation of USD 27.9 million (2001: loss USD 14.5 million).

London is the prime underwriter of property catastrophe business in the Group. Consequently Alea London took the greatest benefit from the reduction in gross provision for the 11 September terrorist attacks before taking into consideration the 35% quota share of Alea London's business to Alea Europe during 2001 and 2002.

Alea London has continued to develop its position in the London Market. Premium volume continued to grow in line with plan, though there were significant mix differences. In 2002 gross premiums written were split as follows: property treaty and property facultative 18% (2001: 30%), facilities 41% (2001: 35%), marine 10% (2001: 19%) and casualty 31% (2001: 16%). There were no

significant property catastrophe losses in 2002. The results of both the property facilities and facultative property portfolios were good, facilities particularly benefiting from the improved terms and conditions currently available in US surplus lines business. The company also successfully increased its product range to incorporate a small number of significant non USD contracts. The casualty portfolio grew substantially as a result of a significant contract (USD 65 million gross premium written in 2002). This is a three year contract with further growth anticipated in 2003 and 2004.

Alea London Ltd is now capitalised to USD 143.3 million. It is a recognised lead market within London and, after the recent renewal season, is on plan for all its new business targets for 2003. The franchise continues to act as the Group's primary test site for systems developments.

We are pleased to report that performance of the loss reserves acquired as part of the acquisition of Imperial Fire & Marine continued to be in line with expectations for 2002. The Piper Alpha claim (gross USD 19.7 million, net USD 4.9 million) was settled in January 2002, all related recoveries have now been collected. The US energy oil refinery loss (USD 14 million gross, USD 2.5 million net (before reinstatement premium of USD 2.1 million)), was settled in April 2002. There has been some development of the loss reserves compared to the aggregate excess protection purchased when the acquisition transaction was closed, however this has largely been due to the relative weakness of the USD in 2002. Overall the loss reserves remain within the range of the aggregate reinsurance protection purchased. The Group retained the premiums from this contract on a funds withheld basis, which effectively means that it has very little credit exposure to the reinsurance company with which it contracted.

The company has a bad and doubtful debt provision of USD 6.4 million (2001: USD 12.7 million).

Alea London Ltd is authorised to write excess and surplus lines insurance in 43 jurisdictions in the United States and has a branch in Sydney.

It has the benefit of cross guarantees provided by Alea (Bermuda) Ltd (capital USD 435.2 million) and other Group companies, which cover all contracts written. The wording of these guarantees has been approved by external rating agencies. In addition during 2002 Alea Group Holdings (Bermuda) Ltd issued a top down guarantee to Alea London Ltd.

### **Emerging Markets**

During the 2002 renewals season the Emerging Market franchise renewed less than half of the 2001 premium volume. Gross premiums written were only USD 11.7 million (2001: USD 30.3 million) split between Alea London Limited USD 6.5 million (2001: USD 20.1 million) and Alea Europe Ltd USD 5.2 million (2001: USD 10.2 million). Total premium volume was significantly under plan as the franchise was not able to obtain rates that it considered to be profitable and it became clear that competitors are continuing to underwrite premiums at uneconomic rates, with underlying insurance rates still being grossly inadequate. Following the disappointing level of business which met our underwriting goals the Group decided that underwriting conditions were simply not commensurate with continuing our presence in these markets. Consequently in November 2002 the Group decided to close the Singapore, Tunisia, and Bahrain offices with responsibility for the run-off passing to Alea London and certain business being renewed directly into Alea London.

### **Alea Jersey Limited and Alea Global Risk Limited**

These companies provide the Group with significant expertise in finite and banking oriented products and recorded another successful year in 2002 with combined profit after taxation of USD 4.7 million in 2002 (2001: USD 5.3 million). Results in 2002 are inclusive of commuting all involvement with a reinsurance pool.

### **Alea (Bermuda) Ltd**

Historically, Alea (Bermuda) Ltd has written most of its business through quota share arrangements with other Group companies and Lumbermens Mutual Casualty Company. The quota share arrangement with Lumbermens Mutual Casualty Company entered into in connection with the purchase of the Equus Re operation expired on 31 December 2001. In 2002 Alea (Bermuda) Ltd reported gross premiums written of USD 242.2 million (2001: USD 170.9 million), deriving income of USD 46.8 million (2001: USD 114.8 million) from the arrangement with Lumbermens and USD 160.8 million from the 70% quota share with Alea North America Insurance Company.

Alea (Bermuda) Ltd made a profit after taxation of USD 21.0 million and now has capital and surplus of USD 435.2 million (2001: USD 402.4 million). The Bermuda franchise will concentrate on finite risk transactions and will continue to provide capacity to other Group companies through quota share arrangements.

### **Alea Europe Ltd**

Total gross premiums written were USD 263.7 in 2002 (2001: USD 177.6 million). Net premiums written in 2002 were USD 216.2 million (2001: USD 136.8 million), an increase of 58.0%.

Alea Europe Ltd gross premiums include the premium from its branches in Canada and Singapore and a 35% quota share from Alea London Ltd. On a like-for-like basis, excluding the 35% quota share and premiums from both Canada and Singapore, Alea Europe wrote USD 145.9 million in 2002 (2001: USD 116.9 million). This includes life reinsurance USD 20.6 million (2001: USD 22.2 million) and finite USD 0.7 million (2001 USD 7.0 million). The Singapore branch was closed with effect from November 2002. The Australian branch of Alea Europe was also closed with a new Australian branch of Alea London being opened with effect from January 2002.

The Canadian branch premiums were USD 5.3 million in 2002 (2001: USD 7.5 million), in line with its plan.

Alea Europe Ltd received a further capital injection of USD 10 million in 2002 (2001: USD 10 million).

On a UK GAAP basis, Alea Europe recorded a profit after taxation of USD 3.3 million (2001: loss USD 13.6 million), after taking into consideration the anticipated loss from the European floods (USD 21.7 million gross, USD 14.9 million net), the two losses on discontinued business, and the settlement of the two arbitration cases and after recording the benefit of Alea Europe's 35% quota share of Alea London business.

The Group has continued its quarterly reserve process during 2002 and considers that the loss reserve estimates remain within the range of aggregate excess reinsurance protection purchased in respect of 1986 to 1999 loss reserves. Overall claims payments made in respect of this book of business remain in line with the original projections.

Alea Europe Ltd has the benefit of cross guarantees provided by Alea (Bermuda) Ltd (capital USD 435.2 million) and other Group companies which cover all contracts written. The wording of these guarantees has been approved by external rating agencies. During 2002 Alea Group Holdings (Bermuda) Ltd issued a top down guarantee to Alea Europe and Alea (Bermuda) Ltd issued an annual aggregate excess contract which for the 2002 financial year protects Alea Europe for losses excess of 102% combined ratio.

#### **Alea North America Insurance Company**

Alea North America Insurance Company (ANAIC) has licenses to underwrite both insurance and reinsurance business in 48 states and applications pending in the rest. Alea North America Specialty Insurance Company (ANASIC) (formerly Alea North America Reinsurance Company) is its wholly owned subsidiary and has reinsurance accreditation in 42 states and excess and surplus lines authority in four states with applications in progress in many others. These approvals will increase the range of options available for US clients.

ANAIC has total UK GAAP capital of USD 111.1 million as at 31 December 2002 including the contribution of ANASIC. The Group has put into effect a 70% quota share between ANAIC and Alea (Bermuda) Ltd enabling ANAIC to access that company's capacity. ANAIC also has the benefit of cross guarantees provided by Alea (Bermuda) Ltd (capital USD 435.2 million) and other Group companies, which covers all contracts written. The wording of these guarantees has been approved by external rating agencies. Finally during 2002 Alea Group Holdings (Bermuda) Ltd issued a top down guarantee to ANAIC.

ANAIC now has two underwriting franchises being Alea North America specialising in treaty underwriting and Alea Alternate Risk, specialising in individual account and programme alternate risk business.

#### **Alea North America**

During 2002 Alea North America moved to new offices in Wilton, Connecticut and concluded the year with a staff of 50. Gross premiums written were USD 192.3 million in 2002 (2001: USD 143.3 million), an increase of 34.2%. The unit specialises in providing reinsurance capacity to small and medium insurers, specialty insurers and specialty divisions of larger insurance groups. It specialises in working layer products with limited catastrophe exposures for focused business plans. The main competitive driver of the franchise is to provide superior service to strengthen relationships with current customers and create opportunities with new ones.

#### **Alea Alternative Risk**

Alea Alternative Risk has further developed its presence in Rocky Hill, Connecticut by expanding its office space and increasing staff numbers from 18 to 41. The unit strengthened its pricing function with the recruitment of a senior pricing actuary. It also implemented an insurance transactional system and acquired a reinsurance accounting and statutory reporting system, which is in course of installation.

Total Alea Alternative Risk gross premium written was USD 139.8 million (2001: USD 20.2 million), an increase of 591%. A substantial part of this growth came from the business previously underwritten by other carriers and reinsured by Alea into programmes underwritten on ANAIC paper. Net premiums written were USD 91.4 million (2001: USD 9.1 million), an increase of 904%.

During 2002 the Integrated Program business with gross written premiums of USD 84.1 million (2001: USD 48.1 million), previously part of the Alea North America franchise was transferred to Alea Alternative Risk. This transfer consolidated the management of insurance business in North America under one management structure. During 2002 both Alea Alternative Risk and Alea London excess and surplus lines business (the facilities division) focused on identifying best practise in working with insurance customers as both of these businesses share similar characteristics.

Alea Alternative Risk focuses on generating a well-priced and well-collateralised portfolio of alternative risk accounts, both individual accounts and program business. The account is protected through the purchase of a high quality reinsurance programme. Alea Alternative Risk has experienced underwriting, actuarial, finance, compliance and claims staff focused on taking full advantage of the opportunities that now exist in a changing market.

### Group loss reserves

The Group's total gross loss reserves in 2002 are USD 1,126.9 million (2001: USD 1,100.2 million). Net loss reserves before application of the 1999 and prior aggregate excess contracts, the 2000 aggregate excess contract and the 2001–2003 aggregate excess contract are USD 888.3 million (2001: USD 791.7 million). Net loss reserves after application of all of the reinsurance contracts are USD 458.1 million (2001: USD 426.1 million).

### Reinsurance recoverables

#### Aggregate excess reinsurance recoverables

Aggregate excess reinsurance recoverables were USD 430.2 million (2001: USD 365.6 million). As at 31 December 2002 some 87% (2001: 77%) of these amounts are collateralised through funds withheld arrangements or letters of credit and trust funds. The company believes it has minimal credit exposure to reinsurers under these arrangements as outlined below:

	Percentage of total reserves	Amount recoverable under aggregate excess contract USD m	Collateral available USD m
Loss reserves in respect of the Equus Loss Portfolio Transfer protected by stop loss unlimited in time and amount with BB+ rated reinsurer	6%	–	–
Loss reserves of Imperial protected by aggregate excess contract – maintained on a funds withheld basis	8%	84.5	71.8
Loss reserves in respect of 1987–1999 Rhine Re underwriting years protected by aggregate excess contract – with A rated reinsurer backed by AA– reinsurer maintained on a funds withheld basis	20%	161.7	112.2
Group 2000 underwriting year loss reserves protected by a limited aggregate excess contract – with A rated reinsurer backed by AA– reinsurer maintained on a funds withheld basis	17%	80.4	41.1
Group 2001 – 2002 underwriting years loss reserves protected by a limited aggregate excess contract – with A– rated reinsurer with full collateralisation of all recoverables through AA rated trust funds and letters of credit	40%	103.6	148.3
Other reserves	9%	–	–
	100%	430.2	373.4

The loss reserves held in respect of the Protected Business portion of the Equus Re/Lumbermens reinsurance transaction (Equus loss portfolio transfer) are USD 55.6 million as at 31 December 2002. This amount was deposit accounted because the level of risk included in the transaction did not meet the transfer of risk requirements under UK GAAP. As a deposit accounted transaction, the net balance, (being the amount due to Alea, up to the 75% aggregate attachment point after which the Lumbermens stop loss applies) has been reflected in our financial statements.

## Management discussion and analysis

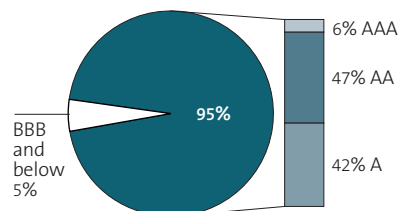
continued

Under US credit for reinsurance laws, as well as pursuant to the terms of the reinsurance arrangements for the Protected Business and the Fronted Business, Alea must collateralise amounts due to Lumbermens. In this connection, collateral has been established to secure reinsurance claim payments by Alea.

With the change in circumstance of Lumbermens (the ratings downgrades and the run off announcement), Alea is working with Lumbermens to ensure the continued smooth servicing and orderly run off of the Protected Business and the Fronted Business. In addition, a commutation of the Protected Business and a novation of the Fronted Business onto Alea paper is being discussed with Lumbermens, with a view to Alea assuming Lumbermens obligations under the Fronted Business (business written after acquisition of the Equus Re operation) and the release of corresponding collateral.

Alea is confident that it does not have significant credit exposure to Lumbermens under the Protected Business and the Fronted Business. In each case, Alea acts as a reinsurer of contracts written by Lumbermens. The amounts Alea currently owes to Lumbermens (for the post-acquisition underwriting periods) as a reinsurer, substantially exceed the amount Lumbermens owes to Alea under the 75% paid stop loss agreement. Our mutual obligations are subject to offset arrangements that are in accordance with Illinois law (the domicile of Lumbermens). In addition Lumbermens is obligated under our reinsurance intermediary agreement (whereby Alea pays claims on the Protected Business and the Fronted Business on behalf of Lumbermens) to fund losses owed by Lumbermens under the underlying contracts comprising the Protected Business, once the 75% paid stop loss ratio is met. Alea is not required to fund such amounts. Our stop loss agreement specifically recognises the obligation of Lumbermens to make such direct payment to its clients once the paid loss ratio is met.

95% of other reinsurance recoverables are A rated and above



### Other reinsurance recoverables

The total other reinsurers' share of claims outstanding as at 31 December 2002 was USD 238.6 million (2001: USD 308.5 million). The Group analyses potential doubtful debts carefully and holds a bad debt provision of USD 7.2 million (2001: USD 15.4 million) the majority of which is in Alea London Ltd relating to the Imperial business acquired.

2002 saw a substantial reduction in credit quality for the entire industry. Overall there were more than 870 downgrades during 2002 from Standard & Poor's alone. Alea's own reinsurance recoverable security profile has been affected by the industry change. We are pleased to report that following the settlement of a number of large claims this year the net balance due from reinsurers rated BBB or lower has reduced from 20% to 5% of the total other reinsurance recoverables.

95% (2001: 80%) of the net balance due from reinsurers, after taking into consideration amounts we owe those reinsurers, are in respect of A rated and above entities of which 6% (2001: 26%) is with AAA rated entities, 47% (2001: 27%) is in respect of AA rated entities and 42% (2001: 27%) is in respect of A rated entities. Other than recoveries due from companies where balances have been collateralised, no single reinsurer accounts for more than USD 22.2 million of net balances due. No reinsurer rated BBB or below accounts for more than USD 2.1 million of net balances due. The rating analysis is based on the ratings in place as at 31 December 2002.

Alea Alternative Risk has reinsurance recoverables due from a number of captive insurance companies which are not rated. The Group minimises its exposure to such entities by ensuring that it has adequate collateral in the form of funds due by Alea to the captive, funds withheld by Alea or trust funds and letters of credit established for the benefit of Alea. As at 31 December 2002 there were no net reinsurance recoverables under the Alea Alternative Risk programme which were not fully collateralised.

The Directors present their annual report and the audited consolidated financial statements for the year ended 31 December 2002.

### Activities

The principal activities of the Alea Group comprise of underwriting insurance and reinsurance business and the provision of finite and alternative solutions to insurance and reinsurance customers. The Group operates from its offices in Baar, Bahrain, Basel, Hamilton, Jersey, London, New York, Rocky Hill, Singapore, Stockholm, Sydney, Toronto, Tunis and Wilton.

### Review of the business and future developments

A review of developments affecting the Alea Group and its prospects for the future appear on pages 2 to 20.

Until 26 February 2002, the ultimate parent company was Alea Group Holdings Ltd, a company incorporated in Switzerland. On 7 December 2001 Alea Group Holdings (Bermuda) Ltd, a company incorporated in Bermuda, was formed to become the new ultimate holding company of the Group. As at 31 December 2001 Alea Group Holdings Ltd remained the ultimate holding company of the Group, however following a series of capital injections by Alea Group Holdings (Bermuda) Ltd in subsidiaries of Alea Group Holdings Ltd, Alea Group Holdings (Bermuda) Ltd held a substantial minority interest in the Group. As at 26 February 2002, following completion of regulatory approvals, Alea Group Holdings Ltd became a controlled subsidiary of Alea Group Holdings (Bermuda) Ltd and on 3 April 2002, following certain management share exchanges, Alea Group Holdings Ltd became a wholly-owned subsidiary of Alea Group Holdings (Bermuda) Ltd.

KKR 1996 Fund (Overseas) Limited Partnership is the majority shareholder of Alea Group Holdings (Bermuda) Ltd.

These accounts present the consolidated results of Alea Group Holdings (Bermuda) Ltd for the year ended 31 December 2002 and for the year ended 31 December 2001 under merger accounting, which is as if Alea Group Holdings (Bermuda) Ltd had controlled the Group since 1 January 2001.

### Results for the year

The results for the year are set out on pages 26 and 27.

### Dividends

The Directors do not recommend the payment of a dividend.

### Directors and their interests

The Directors during the year were:

#### Alea Group Holdings (Bermuda) Ltd

Directors

Mr Dennis W Purkiss (Chairman)\*  
Mr Richard T Delaney<sup>#</sup>  
Mr Timothy C Faries  
Mr James R Fisher<sup>#</sup>  
Mr Todd A Fisher<sup>\*#</sup>  
Mr Perry Golkin<sup>\*#</sup>  
Mr Scott C Nuttall<sup>#</sup>

#### Alea Group Holdings Ltd

Directors

Mr Dennis W Purkiss (Chairman)\*  
Mr James R Fisher<sup>#1</sup>  
Mr Todd A Fisher<sup>\*#2</sup>  
Mr Max F Furrer<sup>#3</sup>  
Mr Perry Golkin<sup>\*1</sup>  
Mr Gilles Meyer<sup>A</sup>  
Dr Rudolph Tschaeni<sup>#2</sup>

\*Member of the remuneration committee

<sup>#</sup>Member of the audit committee

All Directors were reappointed on 26 April 2002

\*Member of the remuneration committee

<sup>#</sup>Member of the audit committee

<sup>1</sup>Resigned 27 March 2002

<sup>2</sup>Resigned 28 March 2002

<sup>3</sup>Resigned 30 March 2002

<sup>A</sup>Appointed 5 April 2002

The Directors had the following interests and options in the non-voting common shares of Alea Group Holdings (Bermuda) Ltd at 31 December 2002 and in the non-voting share participation certificates of Alea Group Holdings Ltd at 31 December 2001.

	2002	2002	2001	2001
	Non-voting common shares	Options	Non-voting share participation certificates	Options
Mr Dennis W Purkiss	11,688	46,752	11,688	46,752
Mr Timothy C Faries	Nil	Nil	Nil	Nil
Mr Richard T Delaney	1,348	Nil	Nil	Nil
Mr James R Fisher	Nil	Nil	Nil	Nil
Mr Todd A Fisher	Nil	Nil	Nil	Nil
Mr Max F Furrer	100	400	100	400
Mr Perry Golkin	Nil	Nil	Nil	Nil
Mr Scott C Nuttall	Nil	Nil	Nil	Nil
Dr Rudolph Tschaeni	Nil	Nil	Nil	Nil

Messrs P Golkin, T A Fisher and S C Nuttall are connected with Kohlberg Kravis Roberts & Co. (an affiliate of our majority shareholder) which together with its affiliated companies owns 3,537,004 shares (2001: 3,537,004 shares). Mr J R Fisher is connected with Fisher Capital Corp. LLC, which owns 7,480 (2001: 7,480) non-voting common shares and 23,217 (2001: 11,586) options. See related party transactions in note 29.

All of the interests and options in Alea Group Holdings Ltd were exchanged for interests and options in Alea Group Holdings (Bermuda) Ltd on 2 April 2002.

#### Payments to creditors

The Group's current policy concerning the payment of suppliers, excluding amounts due in respect of the transaction of insurance and reinsurance business is:

- (a) Settle the terms of payment with suppliers when agreeing the terms of each transaction;
- (b) Ensure that suppliers are made aware of the terms of payment by inclusion of the relevant terms in contracts; and
- (c) Pay in accordance with its contractual and other legal liabilities.

The payment policy applies to all creditors for revenue and capital supplies of goods and services without exception.

#### Charitable donations

During the year, charitable donations amounted to USD 51,304 (2001: USD 37,483).

### **European Monetary Union and the Euro**

Pursuant to the Treaty establishing the European Community (as amended by the Treaty on European Union) the start of the third stage of the European Monetary Union effective 1 January 1999 irrevocably fixed the European Currency Unit (the Euro) which then became a currency in its own right.

From 1 January 1999 until 1 January 2002, the Euro existed in electronic form only and the participating countries' individual currencies persisted in tangible form as legal tender. During this transition period, transactions were managed in both the Euro and the participating countries' respective individual currencies. Management currently does not believe conversion to the Euro has (i) increased its currency exchange risk, (ii) jeopardised the continuity of any of its material contracts, (iii) resulted in any adverse tax consequences, or (iv) given rise to exposure leading to claims related to conversion to the Euro.

### **Directors' responsibility for financial statements**

The Directors prepare financial statements for each financial year which give a true and fair view of the state of affairs of the Group as at the end of the financial year and of the profit or loss of the Group for that period. In preparing these financial statements, the Directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgements and estimates that are reasonable and prudent;
- state whether applicable accounting standards have been followed subject to any material departures disclosed and explained in the financial statements; and
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the company will continue in business.

The Directors are responsible for keeping proper accounting records which disclose with reasonable accuracy at any time the financial position of the Group. They are also responsible for safeguarding the assets of the Group and hence taking reasonable steps for the prevention and detection of fraud and other irregularities.

### **Auditors**

Deloitte & Touche Ltd have expressed their willingness to continue in office as auditors and a resolution to reappoint them will be proposed at the following Annual General Meeting.

Approved by the Board of Directors and signed on behalf of the Board.

Dennis W Purkiss  
Chairman  
8 April 2003

**To the Members of Alea Group Holdings (Bermuda) Ltd**

We have audited the financial statements of Alea Group Holdings (Bermuda) Ltd and its subsidiaries (the 'Group') for the year ended 31 December 2002 which comprise the consolidated profit and loss account, consolidated statement of recognised gains and losses, the consolidated balance sheet, consolidated cash flow statement and the related notes 1 to 31. These financial statements have been prepared under the accounting policies set out therein.

**Respective responsibilities of Directors and auditors**

As described in the statement of Directors' responsibilities, the Group's Directors are responsible for the preparation of the financial statements in accordance with applicable United Kingdom accounting standards. Our responsibility is to audit the financial statements in accordance with the relevant United Kingdom requirements and auditing standards.

We report to you our opinion as to whether the financial statements give a true and fair view of the state of affairs of the Group. We also report if, in our opinion, the Directors' report is not consistent with the financial statements, if the Group has not kept proper accounting records or if we have not received all the information and explanations we require for our audit.

We read the Directors' report and the other information contained in the annual report for the above year as described in the contents section and considered the implications for our report if we became aware of any apparent misstatements or material inconsistencies with the financial statements.

**Basis of audit opinion**

We conducted our audit in accordance with United Kingdom auditing standards issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the financial statements. It also includes an assessment of the significant estimates and judgments made by the Directors in the preparation of the financial statements, and of whether the accounting policies are appropriate to the circumstances of the Group, consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or other irregularity or error. In forming our opinion, we also evaluated the overall adequacy of the presentation of information in the financial statements.

**Opinion**

In our opinion the financial statements give a true and fair view of the state of affairs of the Group as at 31 December 2002 and of its profit for the year then ended.

**Deloitte & Touche Ltd**

Tobias Pfeiffer      Bernardin Marty  
Zurich  
8 April 2003

Neither an audit nor a review provides assurance on the maintenance and integrity of the website, including controls used to achieve this, and in particular whether any changes may have occurred to the financial information since first published. These matters are the responsibility of the directors but no control procedures can provide absolute assurance in this area.

Legislation in the United Kingdom governing the preparation and dissemination of financial information differs from legislation in other jurisdictions.

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# The figures

## Consolidated profit and loss account

Year ended 31 December 2002

Technical account – general business	Notes	2002 \$'000	2001 \$'000
Gross premiums written			
– continuing operations		931,631	493,151
– acquisitions	4	–	30
	2, 3	931,631	493,181
Outward reinsurance premiums		(223,399)	(167,644)
Net premiums written		708,232	325,537
Change in the provision for unearned premiums			
– gross amount		257,603	(23,938)
– reinsurers' share		(67,422)	(10,806)
Change in the net provision for unearned premiums		190,181	(34,744)
<b>Earned premiums, net of reinsurance</b>		<b>518,051</b>	<b>360,281</b>
Other technical income, net of reinsurance		5,671	8,440
<b>Total technical income</b>		<b>523,722</b>	<b>368,721</b>
Claims paid			
– gross amount		397,422	361,080
– reinsurers' share		(77,663)	(57,367)
Net claims paid		319,759	303,713
Change in the provision for claims			
– gross amount		8,491	153,521
– reinsurers' share		(6,396)	(196,980)
Change in the net provision for claims	5	2,095	(43,459)
<b>Claims incurred, net of reinsurance</b>		<b>321,854</b>	<b>260,254</b>
Net operating expenses	6	203,982	164,419
<b>Total technical charges</b>		<b>525,836</b>	<b>424,673</b>
<b>Balance on the technical account – general business</b>	5	<b>(2,114)</b>	<b>(55,952)</b>

## Consolidated profit and loss account

Year ended 31 December 2002

Non-technical account	Notes	2002 \$'000	2001 \$'000
<b>Balance on the technical account – general business</b>		<b>(2,114)</b>	(55,952)
Investment income	7	57,647	45,280
Unrealised gains on investments	7	25,388	2,807
Investment expenses and charges	7	(25,968)	(19,902)
<b>Profit/(loss) on ordinary activities before tax</b>			
– continuing operations		54,953	(28,107)
– acquisitions	4	–	340
	2	54,953	(27,767)
Tax benefit on loss on ordinary activities	9	1,283	5,518
<b>Profit/(loss) for the financial year</b>		<b>56,236</b>	(22,249)

All activities derive from acquisitions or continuing operations.

## Consolidated statement of total recognised gains and losses

Year ended 31 December 2002

	Notes	2002 \$'000	2001 \$'000
Profit/(loss) for the financial year	18	56,236	(22,249)
Exchange differences	18	(444)	(900)
<b>Total profit/(loss) recognised since the last annual report</b>		<b>55,792</b>	(23,149)

# Consolidated balance sheet

31 December 2002

Assets	Notes	2002 \$'000	2001 \$'000
<b>Intangible assets</b>			
Licenses	10	9,968	9,968
		<b>9,968</b>	9,968
<b>Investments</b>			
Other financial investments	11	1,089,283	946,225
Deposits with ceding undertakings	11	109,562	92,021
		<b>1,198,845</b>	1,038,246
<b>Reinsurers' share of technical provisions</b>			
Provision for unearned premiums		101,312	34,427
Claims outstanding: Aggregate excess reinsurance	20	430,174	365,571
Claims outstanding: Other reinsurance	20	238,626	308,488
Claims outstanding	20	668,800	674,059
		<b>770,112</b>	708,486
<b>Debtors</b>			
Debtors arising out of reinsurance and insurance operations	12	489,143	316,869
Other debtors	13	50,429	75,858
		<b>539,572</b>	392,727
<b>Other assets</b>			
Tangible assets	14	13,130	9,912
Cash at bank and in hand		28,989	32,232
Other	15	65,517	88,550
		<b>107,636</b>	130,694
<b>Prepayments and accrued income</b>			
Accrued interest and rent		10,545	7,803
Deferred acquisition costs		97,449	49,192
Other prepayments and accrued income		8,708	8,720
		<b>116,702</b>	65,715
<b>Total assets</b>		<b>2,742,835</b>	2,345,836

# Consolidated balance sheet

31 December 2002

Liabilities	Notes	2002 \$'000	2001 \$'000
<b>Capital and reserves</b>			
Called up share capital	17, 18	53	52
Share premium account	18	390,448	383,529
Profit and loss account	18	(18,628)	(74,420)
Capital reserve	16, 18	70,325	74,432
<b>Shareholders' funds attributable to equity interests</b>		<b>442,198</b>	383,593
<b>Minority interests</b>			
– subordinated preferred issued by subsidiaries	19	50,000	50,000
<b>Total capital employed</b>		<b>492,198</b>	433,593
<b>Technical provisions</b>			
Provision for unearned premiums		477,122	207,830
Claims outstanding	20	1,126,949	1,100,157
		<b>1,604,071</b>	1,307,987
<b>Creditors</b>			
Creditors arising out of reinsurance and insurance operations:			
Funds withheld on aggregate excess reinsurance	20,22	225,144	208,467
Creditors arising out of reinsurance and insurance operations: Other	22	158,770	147,023
Creditors arising out of reinsurance and insurance operations	22	383,914	355,490
Amounts owed to credit institutions	23	168,536	156,623
Other creditors including taxation and social security	24	57,759	60,649
		610,209	572,762
<b>Accruals and deferred income</b>	25	36,357	31,494
		–	–
<b>Total liabilities</b>		<b>2,742,835</b>	2,345,836

Approved by the Board of Directors on 8 April 2003 and signed on its behalf by:

Dennis W Purkiss  
Chairman

## Consolidated cash flow statement

Year ended 31 December 2002

	Notes	2002 \$'000	2001 \$'000
<b>Net cash inflow/(outflow) from operating activities</b>	30(a)	<b>87,215</b>	(86,338)
<b>Servicing of finance</b>			
Interest paid		(6,530)	(2,784)
<b>Taxation</b>			
Taxation paid		6,422	(3,382)
<b>Capital expenditure</b>			
Purchase of tangible assets		(9,236)	(7,446)
Loan/Capital Costs		–	(4,362)
<b>Acquisition</b>			
Acquisition of insurance licenses		–	(8,400)
<b>Financing</b>			
Issue of ordinary share capital		7,092	244,312
Loan financing		–	100,000
Investors capital committed pre 31 December 2001 received in January 2002		30,000	–
Capital raising expenses		(172)	(819)
		<b>114,791</b>	230,781
<b>Cash flows were invested as follows:</b>			
Decrease in cash holdings	30(b)(c)	(3,243)	(6,189)
<b>Net portfolio investments</b>			
Land and buildings	30(c)(d)	–	(11,309)
Shares and other variable yield securities	30(c)(d)	(703)	803
Debt securities and other fixed income securities	30(c)(d)	414,078	100,773
Deposits with credit institutions	30(c)(d)	(295,341)	146,703
		<b>118,034</b>	236,970
<b>Net investment of cash flows</b>		<b>114,791</b>	230,781

# Notes to the accounts

Year ended 31 December 2002

## 1 Basis of preparation

The financial statements are prepared in accordance with applicable United Kingdom accounting standards and under the historical cost accounting rules as modified by the revaluation of investments. These consolidated accounts are prepared on the basis of the accounting policies set out below and comply with the material recommendations of the United Kingdom Statement of Recommended Practice on Accounting for Insurance Business issued by the Association of British Insurers in December 1998 (the 'ABI SORP').

These consolidated financial statements incorporate the financial statements of the Alea Group Holdings (Bermuda) Ltd, and its subsidiaries (the 'Group') as listed in note 31. Alea Group Holdings (Bermuda) Ltd, a company incorporated in Bermuda, files its entity accounts in Bermuda and consequently these accounts omit some disclosure required exclusively under the United Kingdom Companies Act 1985.

### Merger accounting

From 1 January 2001 to 26 February 2002 the ultimate parent company was Alea Group Holdings Ltd a company incorporated in Switzerland. On 7 December 2001 Alea Group Holdings (Bermuda) Ltd, a company incorporated in Bermuda, was formed to become the new ultimate holding company of the Group. As at 31 December 2001 following a series of capital injections, certain subsidiaries of Alea Group Holdings Ltd were partially owned by both Alea Group Holdings (Bermuda) Ltd and Alea Group Holdings Ltd, in varying percentages. Alea Group Holdings Ltd remained the controlling entity as at 31 December 2001. As at 26 February 2002 following completion of regulatory approvals, Alea Group Holdings Ltd became a 94.49% subsidiary of Alea Group Holdings (Bermuda) Ltd which became the new ultimate parent company. Following the staff equity exchange effective 2 April 2002, subject to certain repurchases from terminating employees, Alea Group Holdings Ltd became a wholly owned subsidiary of Alea Group Holdings (Bermuda) Ltd.

In accordance with FRS 6 Acquisitions and Mergers this Group reconstruction has been accounted for using merger accounting as the ultimate shareholders and their rights remain the same and there are no minority interests affected. Further details regarding the effect of the described Capital Enhancement Program are in note 16.

### Reporting currency

These financial statements have been prepared in US Dollars.

### Basis of accounting

The annual basis of accounting has been applied to all classes of business.

Reinsurance arrangements which do not involve significant transfer of insurance and timing risk are accounted for to reflect their economic substance. Premiums and claims are not recognised in the technical account but are accounted for as deposits due from, or liabilities due to, reinsurers.

### Premiums

Written premiums comprise the total premiums receivable for the whole period of cover under contracts incepting during the financial year, together with adjustments arising in the financial year to premiums receivable in respect of business written in previous financial years. Estimates of pipeline premiums due but not yet notified have been included.

All premiums are shown gross of commission incurred payable to intermediaries and are exclusive of taxes and duties levied thereon. The amount of taxes and duties due but not yet paid is included in "Other creditors including taxation and other social security" in the balance sheet. Commissions incurred is included within net operating expenses.

### Unearned premiums provision

Written premiums are recognised as earned income over the period of the policy on a time apportionment basis, having regard, where appropriate, to the incidence of risk. The provision for unearned premiums is calculated on a daily pro rata basis.

# Notes to the accounts

Year ended 31 December 2002

## 1 Basis of preparation continued

### Claims

Claims incurred comprise the estimated cost of all claims occurring prior to the balance sheet date, whether reported or not, including related internal and external direct and indirect claims handling costs and adjustments to claims outstanding from previous years.

The provision for claims outstanding is made on an individual case basis and is based on the estimated ultimate cost of all claims notified but not settled by the balance sheet date, together with the provision for related claims handling costs and net of salvage and subrogation recoveries. The provision also includes the estimated cost of claims incurred but not reported at the balance sheet date based on statistical methods.

The provision for claims outstanding is based on information available at the balance sheet date. Significant delays can be experienced in the notification and settlement of certain claims, and accordingly the ultimate cost of such claims cannot be known with certainty at the balance sheet date. Subsequent information and events may result in the ultimate liability being less than, or greater than, the amount provided. Any differences between provisions and subsequent settlements are dealt with in the technical account – general business of later years.

Estimates of technical provisions inevitably contain inherent significant uncertainties because significant periods of time may elapse between the occurrence of an insured loss, the claim triggering the insurance under a claims-made coverage, the reporting of that claim to the company and the company's payment of the claim and the receipt of reinsurance recoveries.

Whilst the Directors consider that the gross provision for claims and the related recoveries are fairly stated on the basis of the information currently available to them, there is inherent uncertainty in relation to the ultimate liability which will vary as a result of subsequent information and events and may result in adjustments to the amount provided. Adjustments to the amount of the provisions are reflected in the financial statements for the period in which the adjustments are made. The methods used, and the estimates made, are reviewed regularly.

Where appropriate, reserves are discounted in accordance with statutory regulations of the European Union. Discount rates are based on the expected future cash flow derived from assets set-up for the ultimate payment of reserves. Prior to 31 December 2001 the discount rate that has been applied is 5%. Reserves arising subsequent to 31 December 2001 have been discounted at a rate of 4%.

### Outward reinsurance recoveries

Outwards reinsurance recoveries are accounted for in the same accounting period as the claims for the related inwards insurance and reinsurance business.

### Deferred acquisition costs

Acquisition costs, comprising commission and other costs related to the acquisition of new insurance and reinsurance contracts, are deferred to the extent that they are attributable to premiums unearned at the balance sheet date.

### Unexpired risks

Provision is made where the cost of claims and expenses arising after the end of the financial year from contracts concluded before that date is expected to exceed the provision for unearned premiums net of deferred acquisition costs, and premiums receivable. The assessment of whether a provision is necessary is made on the basis of information available as at the balance sheet date, after offsetting surpluses and deficits arising on products which are managed together. Investment income is taken into account in calculating the provision.

### Investment income and expenses

Investment return, comprising investment income and realised and unrealised investment gains and losses, and investment expenses are included within the non-technical account. Dividends (exclusive of tax credits) are included as investment income received. Interest income is recognised on an accruals basis, as are investment expenses.

Realised investment gains and losses are calculated as the difference between net proceeds on disposal and their amortised cost.

Unrealised investment gains and losses represent the difference between the valuation at the balance sheet date and their purchase price. The movement in unrealised investment gains and losses therefore comprises the increase or decrease in the year in the value of investments held at the balance sheet date together with the reversal of previously recognised unrealised gains and losses of investments disposed of in the current year. All unrealised investment gains and losses are recognised in the profit and loss account.

## 1 Basis of preparation continued

### Investments

Investments, consisting of listed investments, units in authorised unit trusts and deposits with credit institutions, are stated at their fair values at the end of the year. Other listed investments are included in the balance sheet at market value.

In 2001, investments in land and buildings were sold for USD 11.3 million.

### Licenses

Capitalised licenses represent the cost of licenses acquired to conduct business in the United States. Annually an impairment review is completed and licenses are written off if required by this review.

### Taxation

Taxation is provided for by reference to the profits and losses recognised in these accounts after taking into account Group relief.

### Deferred taxation

Deferred taxation is provided in full on all timing differences which result in an obligation at the balance sheet date to pay more tax, or a right to pay less tax at a future date, at rates expected to apply when they crystallise based on current rates and law. Timing differences arise from the inclusion of items of income and expenditure in taxation computation in periods different to those in which they are included in the financial statements. Deferred tax assets are recognised to the extent that it is regarded as more likely than not that they will be recovered.

Deferred taxation is not provided on timing differences arising from the revaluation of fixed assets where there is no commitment to sell the asset, or on unremitted earnings of subsidiaries where there is no commitment to remit those earnings. Deferred tax assets and liabilities are not discounted.

### Tangible assets

Expenditures on computer equipment, computer software, fixtures and office equipment and other assets are capitalised and depreciated over the estimated useful economic lives of the assets on a straight line basis. The periods used are as follows:

Computer equipment	3 years
Computer software	5 years
Other assets	8 years
Fixtures and office equipment	10 years

Depreciation is charged to the technical account – general business and is included in administrative expenses.

### Pension costs

The employees of the Group are covered by defined contribution schemes the costs of which are charged to profits when incurred.

### Operating leases

Rental costs are recognised in the profit and loss account in equal annual amounts over the periods of the leases.

### Foreign currencies

The profit and loss account includes transactions denominated in foreign currencies which are translated into US Dollars at the average rate for the year. Assets and liabilities denominated in foreign currencies at the balance sheet date are translated at the rate of exchange ruling at that date. Transaction and translation exchange differences are taken directly to reserves.

### Prior period reclassification

Certain amounts in the profit and loss account for the year ended 31 December 2001 and the balance sheet as at 31 December 2001 have been reclassified on a basis more consistent with the disclosures provided in 2002.

## Notes to the accounts

Year ended 31 December 2002

### 2 Geographical analysis

Analysis by location of insured gross premiums written	2002 \$'000	2001 \$'000
Europe	176,936	135,149
Africa	3,063	16,343
Near & Middle East	9,738	28,287
Far East	11,286	25,810
Australia & Oceania	3,152	2,616
North America	714,687	270,831
Latin America	12,769	14,145
	931,631	493,181

Analysis by location of Alea entity	Gross premiums		Profit/(loss) before tax	
	2002 \$'000	2001 \$'000	2002 \$'000	2001 \$'000
United Kingdom	374,970	190,833	23,386	(20,289)
Bermuda	66,692	168,002	28,864	(3,120)
United States	332,079	30	(245)	2,246
Jersey	215	461	4,987	5,491
Switzerland	157,675	133,855	(2,039)	(12,095)
	931,631	493,181	54,953	(27,767)

#### Total technical income

In addition to gross premiums the Group's total technical income includes other technical income, net of reinsurance which represents fee income generated from finite banking and insurance products. This amounted to USD 5.7 million (2001: USD 8.4 million), of which USD 5.5 million (2001: USD 6.9 million) was generated in Europe and USD 0.2 million (2001: USD 1.5 million) was generated in North America.

### 3 Segmental information

#### Reinsurance

	Casualty \$'000	Property \$'000	Marine, Aviation & Transport \$'000	Other \$'000	Total \$'000
<b>2002</b>					
Gross premiums written	365,182	294,760	54,709	21,572	736,223
Gross premiums earned	285,193	210,055	48,853	20,565	564,666
Gross claims incurred	(245,785)	(65,889)	(21,216)	(16,988)	(349,878)
Gross incurred acquisition expenses	(81,259)	(47,047)	(7,812)	(5,337)	(141,455)
Gross technical result before operating expense	(41,851)	97,119	19,825	(1,760)	73,333

	Casualty \$'000	Property \$'000	Marine, Aviation & Transport \$'000	Other \$'000	Total \$'000
<b>2001</b>					
Gross premiums written	205,942	141,349	66,834	22,794	436,919
Gross premiums earned	217,001	162,299	73,749	33,419	486,468
Gross claims incurred	(174,701)	(182,956)	(109,972)	(30,820)	(498,449)
Gross incurred acquisition expenses	(58,851)	(30,693)	(9,678)	(22,301)	(121,523)
Gross technical result before operating expense	(16,551)	(51,350)	(45,901)	(19,702)	(133,504)

	Casualty \$'000	Property \$'000	Marine, Aviation & Transport \$'000	Other \$'000	Total \$'000
<b>2002</b>					
Net premiums written	305,024	225,375	40,333	22,348	593,080
Net premiums earned	239,817	150,065	34,235	21,158	445,275
Net claims incurred	(197,430)	(55,124)	(19,150)	(17,212)	(288,916)
Net incurred acquisition expenses	(63,918)	(31,390)	(5,921)	(5,322)	(106,551)
Net technical result before operating expense	(21,531)	63,551	9,164	(1,376)	49,808

	Casualty \$'000	Property \$'000	Marine, Aviation & Transport \$'000	Other \$'000	Total \$'000
<b>2001</b>					
Net premiums written	153,946	68,744	38,540	18,986	280,216
Net premiums earned	174,900	89,821	41,395	29,350	335,466
Net claims incurred	(113,633)	(75,829)	(37,432)	(21,044)	(247,938)
Net incurred acquisition expenses	(48,599)	(17,794)	(7,028)	(22,253)	(95,674)
Net technical result before operating expense	12,668	(3,802)	(3,065)	(13,947)	(8,146)

During the year Alea London Ltd entered into an inwards reinsurance contract with Bristol West Insurance Group, which is owned by a KKR Fund. Bristol West Insurance Group is controlled by a holding company different from Alea Group Holdings (Bermuda) Ltd, the ultimate holding company of the Alea Group. Mr James R Fisher, a director of Alea Group Holdings (Bermuda) Ltd, is the Interim CEO of Bristol West Insurance Group. Mr Fisher was not involved in underwriting deliberations. The contract was priced and terms and conditions established on an arm's length basis by an unrelated lead underwriter and found acceptable to the Group using the Group's normal actuarial practices.

## Notes to the accounts

Year ended 31 December 2002

### 3 Segmental information continued

#### Insurance

	Casualty \$'000	Property \$'000	Marine, Aviation & Transport \$'000	Other \$'000	Total \$'000
<b>2002</b>					
Gross premiums written	125,308	69,963	(78)	215	195,408
Gross premiums earned	57,353	50,950	394	665	109,362
Gross claims incurred	(26,797)	(28,854)	(75)	(309)	(56,035)
Gross incurred acquisition expenses	(13,583)	(18,471)	–	–	(32,054)
Gross technical result before operating expense	16,973	3,625	319	356	21,273

	Casualty \$'000	Property \$'000	Marine, Aviation & Transport \$'000	Other \$'000	Total \$'000
<b>2001</b>					
Gross premiums written	16,316	39,946	–	–	56,262
Gross premiums earned	8,407	20,590	1,654	–	30,651
Gross claims incurred	(4,684)	(11,468)	–	–	(16,152)
Gross incurred acquisition expenses	(3,683)	(8,654)	(264)	–	(12,601)
Gross technical result before operating expense	40	468	1,390	–	1,898

	Casualty \$'000	Property \$'000	Marine, Aviation & Transport \$'000	Other \$'000	Total \$'000
<b>2002</b>					
Net premiums written	55,925	59,163	(67)	131	115,152
Net premiums earned	29,927	41,777	491	581	72,776
Net claims incurred	(12,048)	(20,590)	(75)	(225)	(32,938)
Net incurred acquisition expenses	(7,677)	(13,290)	–	–	(20,967)
Net technical result before operating expense	10,202	7,897	416	356	18,871

	Casualty \$'000	Property \$'000	Marine, Aviation & Transport \$'000	Other \$'000	Total \$'000
<b>2001</b>					
Net premiums written	13,143	32,178	–	–	45,321
Net premiums earned	6,715	16,446	1,654	–	24,815
Net claims incurred	(3,572)	(8,744)	–	–	(12,316)
Net incurred acquisition expenses	(3,006)	(6,996)	(264)	–	(10,266)
Net technical result before operating expense	137	706	1,390	–	2,233

The Group has not provided an analysis of net assets by class and area because this would be misleading due to the existence of significant intra-group quota shares, Group aggregate excess contracts and the fact that the net assets of the Group are managed as a whole, subject to local regulatory and legal considerations.

#### 4 Acquisitions

The Group acquired 100% of the issued share capital of Seven Hills Insurance Company from Great American Insurance Company on 2 July 2001. All liabilities incurred by Seven Hills Insurance Company on or prior to the acquisition date were assumed by Great American. Seven Hills Insurance Company was renamed Alea North America Insurance Company on 8 August 2001. At 31 December 2001, Alea North America Insurance Company had not written any material business for 2001 and began underwriting in 2002.

The book assets acquired reflect their fair value. The cost per license acquired has been capitalised as an intangible asset. The Group considers the acquisition to be at fair value and therefore there was no goodwill arising on the acquisition.

These acquisitions were accounted for using the acquisition method of accounting. The Group's share of the results included in the consolidated technical and non-technical account in the year of acquisition were as follows:

	2001 \$'000
Gross premiums written	30
Earned premiums, net of reinsurance	–
Claims incurred, net of reinsurance	–
Operating expenses	(242)
Operating loss	(242)
Investment income	270
Other income	312
Exchange differences	–
Profit on ordinary activities before taxation	340

#### 5 Prior years' claims outstanding

The underwriting result was a loss of USD 2.1 million compared to a loss of USD 55.9 million in 2001. During 2002 the increase of prior year claims outstanding comprises less than 5.1% (2001: 2.7%) of claims outstanding as at the prior year end.

	2002 \$'000	2002 %	2001 \$'000	2001 %
Increase/(decrease) in claims outstanding				
Underwriting years 1999 and prior	11,864	2.8	4,593	0.8
Underwriting year 2000	10,303	2.4	11,361	1.9
Underwriting year 2001	(308)	(0.1)	–	–
	21,859	5.1	15,954	2.7
Claims outstanding as at prior year end	426,098		598,598	

## Notes to the accounts

Year ended 31 December 2002

### 6 Net operating expenses

	2002 \$'000	2001 \$'000
Acquisition costs	232,037	122,908
Changes in deferred acquisition costs	(58,528)	11,216
Administrative expenses	76,464	58,479
	249,973	192,603
Reinsurance commissions and profit participation	(45,991)	(28,184)
	203,982	164,419

### 7 Investment return

	2002 \$'000	2001 \$'000
<b>Investment income</b>		
Income from land and building	–	95
Income from other investments	49,170	40,255
	49,170	40,350
Net gains on the realisation of investments	8,477	4,930
	57,647	45,280
<b>Unrealised investment gains/losses</b>		
Movement during the year	25,388	2,807
<b>Investment expenses</b>		
Debt interest	6,530	2,784
Other interest and expenses	19,438	17,118
	25,968	19,902

### 8 Employee information

	2002 \$'000	2001 \$'000
Wages and salaries	42,214	22,818
Social security costs	3,186	2,589
Other pension costs	3,197	2,331
	48,597	27,738

The average number of employees, excluding executive directors, during the year was as follows:

	2002 No.	2001 No.
Underwriting	110	112
Finance	66	48
Information Technology	37	34
Claims	28	23
Technical Accounts	27	28
Management and Administration	75	66
	343	311

## 9 Taxation

	2002 \$'000	2001 \$'000
The credit/(charge) for taxation comprises:		
Current taxation	(918)	1,677
Deferred taxation	2,201	3,841
	<b>1,283</b>	<b>5,518</b>

### Analysis of taxation by country

Country	Profit/(loss) before tax	Standard rate of taxation	Tax charge (credit) at standard rate	Other tax charges (credits)	Deferred tax credit (charge) not recognised	Tax charge (credit) in accounts
Bermuda	28,864	0%	0	–	–	–
Jersey	4,987	0%	0	240	–	240
Switzerland	(2,039)	25%	(510)	1,575	2,117	3,182
United Kingdom	23,386	30%	7,016	(11,637)	–	(4,621)
United States	(245)	35%	(86)	–	2	(84)
	54,953	–	6,420	(9,822)	2,119	(1,283)

As a result of the large catastrophe losses experienced by the Group in the last few years and the acquisition of The Imperial Fire & Marine Re-Insurance Company Ltd in 2000, taxable losses have been incurred which are available for offset against future taxable profits. Tax losses of USD 23.0 million have been utilised in the United Kingdom during the year.

A deferred tax asset has been recognised in respect of these losses to the extent, based on detailed budgets, the Group anticipates taxable profits to arise within the immediate future.

The estimated value of the deferred tax asset not recognised is USD 16.1 million (2001: USD 24.5 million).

## 10 Intangibles

As a result of the purchase of Seven Hills Insurance Company, Insurance licenses for the US market, with a fair value of USD 8,400,000 were acquired during the year ended 31 December 2001. The Group has incurred additional expenses of USD 1,568,000 in obtaining US insurance licences. Based on their review, the Directors' believe that no impairment exists and therefore, as at 31 December 2002, the licences are valued at USD 9,968,000 (2001: USD 9,968,000).

## Notes to the accounts

Year ended 31 December 2002

### 11 Investments

	Current value		Historical cost	
	2002 \$'000	2001 \$'000	2002 \$'000	2001 \$'000
<b>Other financial investments</b>				
Shares and other variable yield securities				
– Listed	612	994	612	903
– Unlisted	338	346	338	750
	<b>950</b>	<b>1,340</b>	<b>950</b>	<b>1,653</b>
Debt securities and other fixed income securities				
– Listed	968,168	529,379	934,947	521,182
Deposits with credit institutions	120,165	415,506	120,165	415,506
	<b>1,088,333</b>	<b>944,885</b>	<b>1,055,112</b>	<b>936,688</b>
<b>Total other financial instruments</b>	<b>1,089,283</b>	<b>946,225</b>	<b>1,056,062</b>	<b>938,341</b>
<b>Deposits with ceding undertakings</b>	<b>109,562</b>	<b>92,021</b>	<b>109,562</b>	<b>92,021</b>
<b>Total investments</b>	<b>1,198,845</b>	<b>1,038,246</b>	<b>1,165,624</b>	<b>1,030,362</b>

Included within investments as at 31 December 2002 the Group held USD 11.1 million (2001: USD 13.2 million) as statutory deposits with local regulators. A further USD 402.0 million (2001: USD 279.8 million) are held in trust for the benefit of holders of North American policies. Included within this figure is USD 46.3 million (2001: nil) that Alea (Bermuda) Ltd has placed in trust on behalf of Alea North America Insurance Company due to the quota share between these companies. There is a floating pledge over certain investments for the issuance, in the normal course of business, of letters of credit. As at 31 December 2002 the pledge covered assets of USD 175.7 million (2001: USD 104.7 million).

All shares and other variable yield securities and debt securities and other fixed interest securities are listed on recognised stock exchanges.

#### Summary by rating – Debt securities and other fixed income securities

	2002 \$'000	2002 %	2001 \$'000	2001 %
AAA/US Govt or equivalent	923,365	84.8	534,552	56.6
AA	144,557	13.3	357,744	37.9
A	17,503	1.6	49,494	5.2
B	408	0.0	1,235	0.1
NR	2,500	0.3	1,860	0.2
	<b>1,088,333</b>	<b>100.0</b>	<b>944,885</b>	<b>100.0</b>

#### Summary by maturity – Debt securities and other fixed income securities

	2002 \$'000	2002 %	2001 \$'000	2001 %
Less than 1 year	202,484	18.6	489,390	51.8
1 year up to 3 years	281,954	25.9	110,189	11.7
3 years up to 5 years	178,037	16.4	168,072	17.8
5 years up to 10 years	147,961	13.6	96,619	10.2
More than 10 years	277,897	25.5	80,615	8.5
	<b>1,088,333</b>	<b>100.0</b>	<b>944,885</b>	<b>100.0</b>

Included within fixed income securities with a maturity of more than 10 years are mortgage backed securities issued by US Government Agencies with a market value of USD 181.9 million (2001: USD 71.0 million) and nominal weighted average life of 1.8 years (2001: 4.9 years).

## 12 Debtors arising out of reinsurance and insurance operations

	2002 \$'000	2001 \$'000
Pipeline premiums in respect of inwards reinsurance not yet due	244,383	174,118
Other debtors arising out of reinsurance operations	133,271	103,136
Pipeline premiums in respect of inwards insurance not yet due	70,929	33,790
Other debtors arising out of insurance operations	40,560	5,825
	<b>489,143</b>	<b>316,869</b>

## 13 Other debtors

	2002 \$'000	2001 \$'000
Amounts due from reinsurance arrangements not transferring significant insurance risk	50,429	75,858
	<b>50,429</b>	<b>75,858</b>

## 14 Tangible assets

The net book value of tangible assets is made up as follows:

Cost	Computer equipment and software \$'000	Fixtures and office equipment \$'000	Other \$'000	Total \$'000
As at 1 January 2002	12,901	4,043	1,246	18,190
Additions	6,410	1,662	1,164	9,236
Disposals	(381)	(146)	(151)	(678)
As at 31 December 2002	18,930	5,559	2,259	26,748
<b>Depreciation</b>				
As at 1 January 2002	(5,678)	(1,875)	(725)	(8,278)
Charge for the year	(4,181)	(627)	(752)	(5,560)
Disposals	–	98	122	220
As at 31 December 2002	(9,859)	(2,404)	(1,355)	(13,618)
<b>Net book value</b>				
As at 1 January 2002	7,223	2,168	521	9,912
As at 31 December 2002	<b>9,071</b>	<b>3,155</b>	<b>904</b>	<b>13,130</b>

## 15 Other assets

	2002 \$'000	2001 \$'000
Deferred taxation	45,946	37,964
Tax recoverable	2,300	3,206
Amounts due from investors	–	30,000
Other	17,271	17,380
	<b>65,517</b>	<b>88,550</b>

## Notes to the accounts

Year ended 31 December 2002

### 15 Other assets continued

The amount for other assets as at 31 December 2001 includes USD 30 million representing amounts due from investors as capital commitments related to the CEP which were received during January 2002.

The deferred tax asset included in other assets is analysed below.

Movements deferred tax asset:	2002 \$'000	2001 \$'000
Balance as at 1 January	37,964	33,800
Credit for the year	2,201	3,841
Exchange movement	5,781	323
<b>Balance as at 31 December</b>	<b>45,946</b>	<b>37,964</b>

### 16 Capital Enhancement Program

The Capital Enhancement Program comprised the following steps:

Alea Group Holdings (Bermuda) Ltd. was formed in December 2001 to become the new Bermuda holding company, all capital raised through the Capital Enhancement Program was raised by Alea Group Holdings (Bermuda) Ltd.

Sources of funds	Shares issued	\$'000
KKR 1996 Fund (Overseas) Limited Partnership	1,163,061	100,000
Other investors' capital injected and cash received pre 31 December 2001	1,312,222	112,825
Other investors' capital committed pre 31 December 2001; received in January 2002	348,918	30,000
As at 31 December 2001	2,824,201	242,825
Other investors January 2002	50,593	4,350
	2,874,794	247,175
Alea Group Holdings Ltd supplemental loan facility accessed by Alea Group Holdings (Bermuda) Ltd in exchange for an intercompany demand note		75,000
Alea Group Holdings Ltd revolver facility accessed by Alea Group Holdings (Bermuda) Ltd in exchange for an intercompany demand note		25,000
<b>Total operating capital raised from the Capital Enhancement Program</b>		<b>347,175</b>

Capital retained in Alea Group Holdings (Bermuda) Ltd as at 31 December 2001	(31,500)
Capital retained in Alea Group Holdings (Bermuda) Ltd in respect of capital raised in January 2002	(4,350)
Investment by Alea Group Holdings (Bermuda) Ltd in subsidiaries of Alea Group Holdings Ltd as at 31 December 2001	311,325

#### Uses of funds

Capital injected into:	
Alea (Bermuda) Ltd pre 31 December 2001	243,325
Alea (Bermuda) Ltd January 2002	20,000
Alea US Holdings Ltd	68,000
Costs of capital raising	819
	332,144
Capital retained by Alea Group Holdings (Bermuda) Ltd	15,031
<b>Total operating capital raised from the Capital Enhancement Program</b>	<b>347,175</b>

## 16 Capital Enhancement Program continued

### Other capital transactions prior to 31 December 2001

Alea (Bermuda) Ltd contributed USD 40 million to the Alea UK entities resulting in USD 40 million in increased share capital to Alea London Limited (“Alea London”).

Alea Holdings US Company contributed all of Alea North America Reinsurance Company shares to Alea North America Insurance Company further increasing Alea North America Insurance Company capital by USD 22 million to USD 109.5 million.

Alea Group Holdings Ltd contributed an intercompany note due from Alea Europe Ltd (“Alea Europe”) in the amount of CHF 16.5 million to Alea Europe as additional capital.

### Other capital transactions subsequent to 31 December 2001

Following the receipt of all necessary regulatory approvals in February 2002:

The shareholders of Alea Group Holdings Ltd exchanged their voting and non-voting common stock and options of Alea Group Holdings Ltd on a one-for-one basis for voting and non-voting common stock and options in Alea Group Holdings (Bermuda) Ltd.

Alea Group Holdings (Bermuda) Ltd exercised its warrants to acquire 72,201,117 shares of Alea (Bermuda) Ltd. common stock.

Upon completion of the Capital Enhancement Program, Alea Group Holdings (Bermuda) Ltd became the new holding company for the Alea Group.

In accordance with FRS 6 the Group reconstruction that occurred as part of the Capital Enhancement Program has been merger accounted. The application of merger accounting requires the addition of the individual assets, liabilities and result of Alea Group Holdings (Bermuda) Ltd to the consolidated assets, liabilities and result of Alea Group Holdings Ltd and the restatement of the 2001 consolidated figures for Alea Group Holdings (Bermuda) Ltd as if the issue and one-for-one exchange of non-voting participation shares in Alea Group Holding Ltd for voting and non-voting common stock in Alea Group Holdings (Bermuda) Ltd had occurred at 1 January 2001.

## Notes to the accounts

Year ended 31 December 2002

### 17 Share capital

	31 December 2002		31 December 2001	
	Number of shares	\$'000	Number of shares	\$'000
<b>Authorised:</b>				
Class A voting common shares of USD 0.01	95,000,000	950	95,000,000	950
Class B non-voting common shares of USD 0.01	5,000,000	50	5,000,000	50
Undesignated shares of USD 0.01	900,000,000	9,000	900,000,000	9,000
	<b>1,000,000,000</b>	<b>10,000</b>	<b>1,000,000,000</b>	<b>10,000</b>
<b>Allotted, called up and fully paid:</b>				
Class A voting common shares of USD 0.01	4,893,739	49	1,163,061	12
Class B non-voting common shares of USD 0.01	410,997	4	1,661,140	16
Total called up share capital	5,304,736	53	2,824,201	28
Exchange of shares under merger accounting			2,404,355	24
Total share capital under merger accounting			5,228,556	52

On 1 May 2002 a total of 1,991,041 class B non-voting common shares of USD 0.01 were reclassified as class A voting common shares of USD 0.01.

#### Stock options and restricted shares

Alea Group Holdings Ltd had in place a stock purchase and option plan for key employees and advisors known as the 1998 Amended and Restated Stock Option Plan for Key Employees and Subsidiaries (the "Swiss Plan"). Alea Group Holdings (Bermuda) Ltd adopted a 2002 Stock Purchase and Option Plan for Key Employees of Alea Group Holdings (Bermuda) Ltd and Subsidiaries (the "Bermuda Plan") in connection with the redomiciling of the ultimate parent company of the Alea Group to Bermuda and all awards under the Swiss Plan are now governed by the terms of the Bermuda Plan. The terms of the Bermuda Plan are substantially similar to the terms of the Swiss Plan. All Alea Group Holdings Ltd non-voting participation shares and options were exchanged for non-voting Class B common shares and options in connection with an equity exchange offer that was completed on 3 April 2002. In total, 750,000 shares of non-voting Class B common shares are authorised for use under the Bermuda Plan.

The terms of the company's Class B common shares and the exercise price of the options to acquire company Class B common shares on the purchase/grant date are determined by the Remuneration Committee in accordance with the terms of the Bermuda Plan. Generally, options vest ratably over a five-year period. The ability to exercise the options accelerates upon a change of control of the company. Options expire and are no longer exercisable on the tenth anniversary or in certain circumstances at the end of the three month period following such tenth anniversary of the grant date. The expiration of the options can accelerate due to termination as defined in the Plan.

In addition, the company has issued to Fisher Capital Corp., L.L.C. certain options to acquire Class B common shares, which options are fully vested and are exercisable within fifteen years of the date of grant. In connection with a consulting agreement, the company has issued restricted shares to Richard Delaney, a member of the Board of Directors, which restricted shares are fully vested.

## 17 Share capital continued

Transactions involving common share options and share participation certificate options are as follows:

Options	Number of shares 2002	Weighted average exercise price \$	Number of shares 2001	Weighted average exercise price \$
Outstanding as at 1 January	444,960	84	370,693	72
Granted	74,821	86	82,310	66
Forfeited	(40,898)	100	(8,043)	136
Outstanding as at 31 December	478,883	83	444,960	70

## 18 Movements in shareholders' funds

	Share capital \$'000	Share premium \$'000	Profit & loss account \$'000	Capital reserve \$'000	Total \$'000
<b>Balance as at 1 January 2002</b>	52	383,529	(74,420)	74,432	383,593
Additional capital injection January 2002	1	4,349			4,350
Retained profit for the financial year			56,236		56,236
Exchange differences			(444)		(444)
Movement in capital reserve				(2,414)	(2,414)
Share issues		2,802			2,802
Share repurchases		(60)			(60)
Capital raising expenses		(172)			(172)
Elimination of own shares				(1,693)	(1,693)
<b>As at 31 December 2002</b>	53	390,448	(18,628)	70,325	442,198

Reconciliation of the movement in shareholders' funds of the Alea Group	\$'000
Shareholder funds of Alea Group Holdings (Bermuda) Ltd as at 31 December 2001	242,018
Consolidated shareholder funds of Alea Group Holdings Ltd as at 31 December 2001	142,534
Elimination of own shares	(959)
<b>Consolidated shareholder funds of Alea Group Holdings (Bermuda) Ltd as at 31 December 2001 under merger accounting as above</b>	<b>383,593</b>
Additional capital injection January 2002	4,350
<b>Proforma reserves of Alea Group Holdings (Bermuda) Ltd shown in Alea Group Holdings Ltd 2001 Report and Accounts</b>	<b>387,943</b>
Total profit recognised since the last annual report	55,792
Share issues	2,802
Share repurchases	(60)
Capital raising expenses	(172)
Elimination of own shares	(1,693)
Movement in capital reserve	(2,414)
<b>Consolidated shareholder funds of Alea Group Holdings (Bermuda) Ltd as at 31 December 2002 under merger accounting as above</b>	<b>442,198</b>

## Notes to the accounts

Year ended 31 December 2002

### 19 Minority interest: subordinated preferred equity

	Number of shares	Number of shares
Redeemable 6% preferred shares of USD 1		
Authorised, issued and fully paid	30,000,000	30,000,000
Redeemable 6% preferred shares of USD 0.01 par value; authorised, issued and fully paid – purchase price of USD 100	200,000	200,000
	\$'000	\$'000
Redeemable 6% preferred shares		
Carrying value – USD	50,000	50,000

Under the terms of a Stock Purchase Agreement dated as of 4 September 1998, as amended by a Master Amendment and Agreement dated as of May 19, 2000 (the “Master Amendment”), entered into among Alea Group Holdings Ltd (the “Company”) and certain of its subsidiaries and Bankers Trust Corporation and certain of its affiliates, (collectively, the “Former BT Stockholders”), Alea Group Holdings Ltd acquired the reinsurance subsidiaries of the Former BT Stockholders. In connection with that transaction, in consideration of USD 20 million, Alea Holdings Guernsey Ltd. (“Guernseyco”) issued to BT (Pacific) Limited New York (“BTP”) 200,000 shares of 6% redeemable preferred stock USD 0.01 par value with a liquidation value of USD 100.00 per share (“Guernseyco Preferred Shares.”) Further, in consideration of USD 50 million, Alea (Bermuda) Ltd. (“AB”) issued to BTP thirty million, and to the Company, twenty million, shares of 6% redeemable preferred stock USD 1.00 par value with a liquidation value of USD 1.00 per share (the “AB Preferred Shares”) (together, the “Preferred Shares”).

Prior to 1 May 2000, the Preferred Shares paid dividends semi-annually in cash. In accordance with the Master Amendment, commencing 1 May 2000, only pay-in-kind preferred stock dividends are payable on the Preferred Shares. The Master Amendment was entered into between the Former BT Stockholders, AB, Guernseyco and the Company in connection with the investment by the KKR Fund (defined below) of USD 150 million in the Company’s Voting Share Participation Certificates.

The Preferred Shares may be optionally redeemed by the issuer at any time at the stated liquidation value. During the first two years after issuance of the Preferred Shares, the redemption price may be paid in preferred shares of Alea Holdings US Company. The Preferred Shares must be mandatorily redeemed in cash on the earlier of (i) 2013 and (ii) in the event of a Change in Control (as defined in the Subscription Agreements). On a mandatory redemption date or in the event that a Change of Control occurs within one year following an optional redemption by AB or Guernseyco, or upon liquidation, the cash amount due to BTP on the Preferred Shares shall be determined based upon the proceeds in the form of sale proceeds or dividends received by the KKR Fund 1996 Fund (Overseas) Limited Partnership (the “KKR Fund”) on its shares of the Company’s Voting Share Participation Certificates.

In the event that the KKR Fund has received proceeds in excess of USD 150 million plus an amount equal to an IRR of 6%, BTP shall receive an additional cash redemption or liquidation amount equal to 25% of the proceeds to the KKR Fund in excess of a 6% IRR to the KKR Fund, but not in excess of an 8% IRR.

In the event that the KKR Fund has not received USD 150 million in proceeds, no cash amount is due to BTP on redemption of the Preferred Shares or upon liquidation. In the event that the KKR Fund has received in excess of USD 150 million in proceeds, the redemption or liquidation amount shall equal the amount of such excess proceeds until BTP shall have received an IRR of 6%.

## 19 Minority interest: subordinated preferred equity continued

In the event that either or both AB or Guernseyco is liquidated, the holders of the Preferred Shares will be entitled to payment as set out above prior to any payments to the Company with respect to the Company's common stock ownership of such Subsidiaries. No common stock dividends may be paid by any issuer of Preferred Shares while redemption obligations on the Preferred Shares are in arrears.

Under the terms of the Master Amendment, no dividend may be paid by the Company to stockholders unless the Company has paid any amounts due BTP with respect to the Preferred Shares and AB and Guernseyco shall have assets that can be converted into cash that would be sufficient for the payment to BTP upon redemption as calculated in accordance with the Subscription Agreements.

## 20 Claims outstanding

	Gross \$'000	Aggregate Excess Reinsurance \$'000	Other Reinsurance \$'000	Net \$'000
<b>2002</b>				
Provision for claims incurred, reported and not reported	1,196,027	(478,598)	(244,122)	473,307
Discount	(79,912)	48,424	5,496	(25,992)
	1,116,115	(430,174)	(238,626)	447,315
Claims handling expenses	10,834	–	–	10,834
	1,126,949	(430,174)	(238,626)	458,149

Security on amounts recoverable under aggregate excess reinsurance

Funds withheld on aggregate excess contracts

225,144

Funds held by reinsurer in Trust and with Letter of Credit

148,264

Total collateral available against aggregate excess reinsurance recoverable

373,408

	Gross \$'000	Aggregate Excess Reinsurance \$'000	Other Reinsurance \$'000	Net \$'000
<b>2001</b>				
Provision for claims incurred, reported and not reported	1,149,084	(401,445)	(311,101)	436,538
Discount	(59,769)	35,874	2,613	(21,282)
	1,089,315	(365,571)	(308,488)	415,256
Claims handling expenses	10,842	–	–	10,842
	1,100,157	(365,571)	(308,488)	426,098

Security on amounts recoverable under aggregate excess reinsurance

Funds withheld on aggregate excess contracts

208,467

Funds held by reinsurer in Trust and with Letter of Credit

71,718

Total collateral available against aggregate excess reinsurance recoverable

280,185

Where appropriate, reserves are discounted in accordance with statutory regulations of the European Union. Discount rates are based on the expected future cashflow derived from assets set-up for the ultimate payment of reserves. Prior to 31 December 2001 the discount rate that has been applied is 5%. Reserves arising subsequent to 31 December 2001 have been discounted at a rate of 4%.

## Notes to the accounts

Year ended 31 December 2002

### 21 Other provisions

As at 31 December 2002, the Directors have determined that an unexpired risk provision to recognise the cost of claims and expenses arising after the end of the financial year from contracts concluded before that date in excess of the unearned premium reserve need not be established. At 31 December 2001 there was no provision.

### 22 Creditors

	2002 \$'000	2001 \$'000
Creditors arising out of reinsurance and insurance operations		
Funds withheld on aggregate excess reinsurance	225,144	208,467
Reinsurance balances payable	116,347	126,366
Insurance balances payable	42,423	20,657
Other reinsurance and insurance balances payable	158,770	147,023
	<b>383,914</b>	<b>355,490</b>

### 23 Amounts owed to credit institutions

Alea Group Holdings Ltd has entered into a term loan facility for CHF 100 million which is repayable in annual tranches in 2002 to 2004, with the balance due in 2005.

The company also has a revolving credit facility which it can draw down until the expiry of the loan facility in 2005. During 2002 the Group utilised CHF 25 million (2001: USD 25 million) of this facility.

In addition, during 2001 the Credit Agreement was supplemented with an additional USD 75 million "B" term loan component. This is due in 2007.

Total loan repayments under the above facilities fall due as follows:

Year ended 31 December	2002 \$'000	2001 \$'000
2002	–	8,929
2003	11,429	9,524
2004	11,429	9,524
2005	73,574	56,546
2006	–	–
2007	75,000	75,000
2008	–	–
Total before debt raising expenses	171,432	159,523
Debt raising expenses	2,896	2,900
Total	<b>168,536</b>	<b>156,623</b>

Interest is charged at a rate per annum according to applicable currency LIBOR rates designated as the British Bankers Association's interest settlement rate plus a margin of 0.625% (2001: 0.625%). The margin charged on the "B" term loan component is 3.25%. The interest expense for 2002 amounted to USD 6.5 million (2001: USD 2.5 million) and appears within investment expenses.

The loan imposes restrictive covenants including limitations on the granting of liens, other dispositions of assets, increased indebtedness and distribution of assets.

Debt raising expenses are capitalised and amortised over the period of the loan. As at 31 December 2002 the net capitalised debt raising expenses were USD 2.9 million (2001: USD 2.9 million).

## 24 Other creditors including taxation and social security

	2002 \$'000	2001 \$'000
Corporation tax	1,232	–
Other taxes, including insurance premium tax, and social security costs	3,397	713
Liabilities from reinsurance arrangements not transferring significant insurance risk	53,130	59,936
	<b>57,759</b>	<b>60,649</b>

## 25 Accruals and deferred income

	2002 \$'000	2001 \$'000
Deferred reinsurance commissions	7,740	5,311
Other accruals and deferred income	28,617	26,183
	<b>36,357</b>	<b>31,494</b>

## 26 Capital commitments

As at 31 December 2002 there were capital commitments of USD 1.5 million (2001: USD 1.9 million) relating to software, leasehold improvements and fixtures.

## 27 Operating lease

	Land and buildings 2002 \$'000	Land and buildings 2001 \$'000	Other 2002 \$'000	Other 2001 \$'000
Annual commitments under operating leases which expire:				
– within one year	147	198	71	35
– between two and five years	2,499	1,579	220	397
– over five years	1,263	1,826	–	–
	<b>3,909</b>	<b>3,603</b>	<b>291</b>	<b>432</b>

The amount incurred under operating leases during 2002 was USD 4.2 million (2001: USD 4.0 million).

## 28 Pension commitments

The employees of the Group are covered by defined contribution schemes the costs of which are charged to profits when incurred. The total cost of retirement benefits for the Group in 2002 was USD 3.3 million (2001: USD 2.3 million).

## 29 Related party transactions

The Group pays annual advisory fees of USD 750,000 and USD 350,000, payable quarterly to Kohlberg Kravis Roberts & Co. (KKR), an affiliate of KKR 1996 Fund (Overseas), Limited Partnership, a shareholder, and Fisher Capital L.L.C., also a shareholder, respectively.

As at 31 December 2002 the Group had loans to officers of USD 1,137,923 (2001: USD 1,199,152).

## Notes to the accounts

Year ended 31 December 2002

### 30 Notes to the statement of cash flows

	2002 \$'000	2001 \$'000
<b>(a) Reconciliation of operating profit/(loss) to net cash inflow from operating activities</b>		
Profit/(loss) before tax on ordinary activities	54,953	(27,767)
Depreciation of tangible assets	5,560	3,321
Loss on disposal of fixed assets	13	693
Realised and unrealised gains less losses on investments	(25,024)	6,169
Change in capital reserve	(2,414)	–
Elimination of own shares	(1,693)	–
Change in reinsurance debtors	(172,274)	69,698
Change in other debtors	25,429	38,721
Change in other assets	109	(7,756)
Change in prepayments and accrued income	12	28,508
Change in technical provisions	296,084	75,695
Change in technical provisions – reinsurers' share	(109,883)	(261,503)
Change in deposits with cedants	(17,541)	(2,672)
Change in reinsurance creditors	28,424	71,994
Change in other creditors	(5,933)	(95,252)
Change in accruals	4,863	11,029
Interest expense	6,530	2,784
<b>Net cash inflow from operating activities</b>	<b>87,215</b>	<b>(86,338)</b>

	2002 \$'000	2001 \$'000
<b>(b) Movement in opening and closing portfolio investments net of financing</b>		
Net cash (inflow) for the year	(3,243)	(6,189)
Cash flow – portfolio investments net of financing	118,034	139,871
Movement arising from cash flows	114,791	133,682
Changes in market value and exchange rates	13,111	2,653
<b>Total movement in portfolio investments net of financing</b>	<b>127,902</b>	<b>136,335</b>
Portfolio as at 1 January	821,834	685,499
<b>Portfolio as at 31 December</b>	<b>949,736</b>	<b>821,834</b>

	As at 1 Jan 2002 \$'000	Cash flow \$'000	Changes to market value and currencies \$'000	As at 31 Dec 2002 \$'000
<b>(c) Movement in cash and portfolio investments</b>				
Cash at bank and in hand	32,232	(3,243)	–	28,989
Shares and other variable-yield securities and units in unit trusts	1,340	(703)	313	950
Debt securities and other fixed income securities	529,379	414,078	24,711	968,168
Deposits with credit institutions	415,506	(295,341)	–	120,165
	978,457	114,791	25,024	1,118,272
Loan notes (net of expenses)	(156,623)	–	(11,913)	(168,536)
<b>Total</b>	<b>821,834</b>	<b>114,791</b>	<b>13,111</b>	<b>949,736</b>

### 30 Notes to the statement of cash flows continued

#### (d) Net cash outflow on portfolio investments

	Purchases 2002 \$'000	Sales 2002 \$'000	Net cash flow 2002 \$'000	Purchases 2001 \$'000	Sales 2001 \$'000	Net cash flow 2001 \$'000
Land and buildings	–	–	–	–	(11,309)	(11,309)
Shares and other variable yield securities	–	(703)	(703)	884	(81)	803
Debit securities and other fixed income securities	1,739,561	(1,325,483)	414,078	2,882,528	(2,781,755)	100,773
	1,739,561	(1,326,186)	413,375	2,883,412	(2,793,145)	90,267
Deposits with credit institutions			(295,341)			146,703
Net cash outflow on portfolio investments			118,034			236,970

### 31 Group companies

Name	Nature of business	Country of incorporation
Alea Group Holdings (Bermuda) Ltd	Ultimate Holding Company as at 26 February 2002 Minority shareholder as at 31 December 2001	Bermuda
Alea Group Holdings Ltd	Intermediate holding company as at 26 February 2002 Ultimate Holding Company as at 31 December 2001	Switzerland
Alea Europe Ltd	Reinsurance carrier	Switzerland
Alea (Bermuda) Ltd	Reinsurance carrier	Bermuda
Alea Holdings US Company	Intermediate holding company	USA
Alea North America Company	Underwriting agent	USA
Alea North America Insurance Company (formerly named Seven Hills Insurance Company)	Insurance & reinsurance carrier	USA
Alea North America Specialty Insurance Company (formerly named Alea North America Reinsurance Company)	Insurance & reinsurance carrier	USA
Alea Holdings UK Limited	Intermediate holding company	UK
Alea London Limited	Reinsurance and insurance carrier	UK
Alea Services UK Limited	Services company	UK
Alea Financial UK Limited	Risk intermediary	UK
Alea Technology Limited	Software & Systems	UK
IRM Management Services Ltd	Services company	Switzerland
Alea Jersey Limited	Reinsurance carrier	Jersey
Alea Global Risk Limited	Reinsurance carrier	Jersey
Alea Holdings Guernsey Limited	Dormant	Guernsey

All listed companies are wholly owned subsidiaries of the Group.

## Group contacts

### Alea Group Holdings (Bermuda) Ltd

Crown House, 3rd Floor  
4 Par-la-Ville Road  
PO Box HM 2983  
Hamilton HM 08  
Bermuda  
T +1441 (0)296 9150  
F +1441 (0)296 9152  
E bermuda@aleagroup.com

### Alea Group Holdings Ltd

Lindenstrasse 16  
6340 Baar ZG  
Switzerland  
T +41 (0)41 767 0400  
F +41 (0)41 767 0467  
E group@aleagroup.com

### Bahrain

Alea Bahrain  
PO Box 20050, U.G.B. Tower  
7th Floor  
Diplomatic Area, Manama  
Bahrain  
T +973 (0)538555  
F +973 (0)533881  
E bahrain@aleagroup.com

### Basel

Alea Europe  
Kornhausgasse 7  
CH-4051 Basel  
Switzerland  
T +41 (0)61 268 21 11  
F +41 (0)61 268 22 77  
E basel@aleagroup.com

### Bermuda

Alea Bermuda  
Crown House, 3rd Floor  
4 Par-la-Ville Road  
PO Box HM 2983  
Hamilton HM 08  
Bermuda  
T +1441 (0)296 9150  
F +1441 (0)296 9152  
E bermuda@aleagroup.com

### Jersey

Alea Financial  
33 Gloucester Street  
St Helier  
Jersey JE2 3QR  
Channel Islands  
T +44 (0)1534 285 127  
F +44 (0)1534 285 122  
E jersey@aleagroup.com

### London

Alea London  
London Underwriting Centre  
3 Minster Court  
Mincing Lane  
London EC3R 7DD  
UK  
T +44 (0)20 7621 3100  
F +44 (0)20 7621 3150  
E london@aleagroup.com

### New York

Alea Corporate Solutions  
45 Broadway  
17th Floor  
New York, NY 10006  
USA  
T +1 646 452 6630  
F +1 646 452 6636  
E newyork@aleagroup.com

### Rocky Hill

Alea Alternative Risk  
55 Capital Boulevard  
Corporate Ridge  
Rocky Hill, CT 06067  
USA  
T +1 860 513 4180  
F +1 860 529 1815  
E rockyhill@aleagroup.com

### Singapore

Alea Singapore  
24 Raffles Place  
27-04 Clifford Centre  
Singapore 048621  
T +65 (0)6538 4338  
F +65 (0)6538 4428  
E singapore@aleagroup.com

### Stockholm

Alea Stockholm  
Sveavagen 33  
111 34 Stockholm  
Sweden  
T +46 (0)8 24 09 01  
F +46 (0)8 24 09 08  
E stockholm@aleagroup.com

### Sydney

Alea Sydney  
The Re Centre, Level 21  
Australia Square  
264 George Street  
Sydney  
Australia  
T +61 (0)2 9274 3000  
F +61 (0)2 9274 3033  
E sydney@aleagroup.com

### Toronto

Alea Toronto  
55 University Avenue, Suite 900  
Box 6  
Toronto, Ontario M5J 2H7  
Canada  
T +1 416 366 3012  
F +1 416 366 3465  
E toronto@aleagroup.com

### Tunis

Alea Tunis  
4 Rue As-Sahab Ibn Abbad  
Cite Jardins  
Tunis Mahrajene 1082  
BP 182  
Tunis  
T +216 (0)1 787 532/842 175  
F +216 (0)1 789 335  
E tunis@aleagroup.com

### Wilton

Alea North America  
Wilton Corporate Park  
50 Danbury Road  
Suite 102  
Wilton, CT 06897  
USA  
T +1 203 563 6000  
F +1 203 563 6010  
E wilton@aleagroup.com



[www.aleagroup.com](http://www.aleagroup.com)

Alea Group Holdings (Bermuda) Ltd  
Crown House, 3rd Floor  
4 Par-la-Ville Road  
PO Box HM 2983  
Hamilton HM 08  
Bermuda  
T +1441 (0)296 9150  
F +1441 (0)296 9152  
E bermuda@aleagroup.com

Alea