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Registration Number: C5553

Middlesea Insurance p.l.c.

MSI/CF/MSE01110

# COMPANY ACCOUNCEMENT

The following is a Company Announcement issued by Middlesea Insurance p.l.c., pursuant to Malta Financial Services Authority Listing Rules Chapters 8 and 9:

*Quote*

The Board of Directors of Middlesea Insurance p.l.c., during the Board meeting held today the 27th April 2010, approved the audited financial statements of the Company and of the Group for the financial year ended 31st December 2009. The Board resolved that these audited financial statements be submitted for the approval of the shareholders at the forthcoming Annual General Meeting which is scheduled for Wednesday 9th June 2010. A preliminary statement of annual results is being attached herewith in terms of the Listing Rules. The Audited Financial Statements will be available for viewing on the Company's website at www.middlesea.com as from the 30th April 2010.

The Board of Directors do not recommend the payment of a dividend.

*Unquote*

Carlo Farrugia
Company Secretary

27th April 2010

## Commentary on the Financial Statements for the year ended 31st December 2009

The financial statements for 2009 have been significantly impacted by events that occurred during the year and subsequent to the year end (as detailed below) in relation to the operations of the Italian subsidiary, Progress Assicurazioni S.p.A. (Progress). The Group registered a loss of €55.2 million for the year to 31st December 2009 (FY 2009), inclusive of the impairment charge on Progress of €63.1 million. During the first part of 2010 important steps were undertaken in connection with this subsidiary, with the result that Middlesea Insurance plc has now put Progress and its losses behind it. The total write off of the investment in Progress, accounted for in the financial statements for FY 2009, represents the end of a very unfortunate saga for the Middlesea Group.

The domestic operations of the Group, namely, Middlesea Insurance p.l.c., International Insurance Management Services Ltd, together with the associate company Middlesea Valletta Life Assurance Co Ltd, generated a total profit before tax and impairment charges for FY 2009 amounting to €8.7 million – a considerable improvement when compared to a loss from these operations of €2.98 million in FY 2008.

Notwithstanding the substantial loss taken by the Group on Progress, Middlesea remains a financially strong company, with shareholders' equity at 31st December 2009 of over €48 million on a consolidated basis.

For reasons explained below in the paragraphs entitled "Significant Events and Basis of Preparation," the Group accounts of Middlesea Insurance plc have not consolidated Progress and have therefore departed from the requirements of IAS 27 "Consolidated and Separate Financial Statements". This course of action has been adopted in order to provide a more meaningful approach to the preparation of the FY 2009 accounts. This approach, in the opinion of the Directors, leads to financial statements that properly reflect the decisions undertaken in respect of Progress up to the date of this report. However, since in the opinion of the independent auditors, PricewaterhouseCoopers, this constitutes a departure from the said IAS 27, they have expressed a qualified opinion on the Group accounts in this particular regard. Separately, they have expressed an unqualified opinion on the Middlesea Insurance plc stand alone entity accounts. The auditors also draw attention, through an emphasis of matter, to note 5.4 of the financial statements which describes how Progress' results had a direct negative implication on the solvency position of Middlesea Insurance p.l.c during FY 2009 and as at the year end. The Company has agreed measures with the Regulator for the immediate reinstatement of its regulatory capital to the minimum amount required, plus the multiple requested, and is in the process of implementing this plan. The audit report is reproduced in its entirety in this Preliminary Statement of Annual Results.

### *Financial Highlights*

- The loss for the financial period increased to €55.2 million compared to €20.6 million in the previous year. This loss is stated after accounting for the full impairment of the investment in Progress of €63.1 million.
- The profit generated on the domestic operations amounted to €8.7 million, a significant improvement on the loss of €2.98 million registered in FY 2008.

- The operations of the stand alone Company registered significantly improved results. The profit generated by Middlesea Insurance p.l.c for FY 2009, prior to the impairment charge, amounted to €6.6 million, compared to a loss of €0.97 million in FY 2008.

- The associate company, specialising in life business, reported a considerable increase in profitability during 2009. The Group's share of profit of Middlesea Valletta Life Assurance Co Ltd for FY 2009 amounted to €3.1 million, as compared to €0.96 million in FY 2008.

- *Total equity of the Group at at 31st December 2009 was €48.7 million, down from €63.8* million as at December 2008.

## *Significant events during the year and subsequent to year-end (extract from Note 1 to the Financial Statements)*

During the year ended 31 December 2008, Progress Assicurazioni SpA (Progress) registered a loss after taxation as consolidated in the Group accounts of €19.1 million. In the first six months of 2009, Progress continued to report material negative results, with further losses of €19.4 million being included in the Middlesea Group results for the half year to 30 June 2009.

In view of the very serious adverse developments affecting the Progress operations, the Progress and Middlesea Insurance p.l.c. Boards of Directors moved to take various corrective actions during 2008 and 2009, with a series of radical remedial measures. Remedial actions included steps to radically downsize the portfolio through the termination of non-performing agencies (which were reduced from 164 to 39 at substantial cost), premium rate increases, claims management restructuring measures and the engagement of various specialist consultants, including anti-fraud investigators to review the legitimacy of the high level of claims being experienced. In addition, further specialised re-insurance cover was acquired to protect against any further deterioration in claims experience.

In an effort to ensure that Progress was able to withstand the substantial losses that were being incurred, the Board of Directors also sought financial support from the Parent Company. During 2009 Middlesea Insurance p.l.c. provided substantial financial support to Progress, injecting additional capital into the company in excess of €45 million. In turn, in order to stabilise the balance sheet of Middlesea Insurance p.l.c. so as to enable it to withstand the Progress losses, a Rights Issue amounting to €40.2 million was launched in November 2009. The three major institutional shareholders (Bank of Valletta, Mapfre Internacional and Munich Re) agreed to subscribe to the new issue of shares, with Bank of Valletta and Mapfre also agreeing to underwrite the issue. In the event, these three institutional shareholders subscribed to €35.6 million of the total amount of new capital of €40.2 million raised by the Rights Issue.

Progress' financial results continued to deteriorate further in the last quarter of 2009, with an extraordinarily high level of claims incidence being experienced, these claims exacerbating the losses of the company well beyond the estimates that had been prepared in anticipation of the Rights Issue. The position was reached in January 2010 whereby the draft unaudited management accounts of Progress as at 31 December 2009 indicated that the company had exhausted its shareholders' equity base, and in the absence of a reasonable expectation of further financial support from the parent company, it could not continue in operation in conformity with the requirements of Italian law. The Progress Board therefore asked the Board of Directors of Middlesea Insurance p.l.c. whether it was able to commit to providing further financial support to Progress, so as to enable the company to continue in business in conformity with Italian law and regulations. On 5 February 2010, the Middlesea Board informed the Progress Board that, having provided more than €45 million of capital support to Progress over the last year, Middlesea was not in a position to commit to inject further capital into Progress at that time without putting at risk its own viability.

Accordingly, Middlesea was not able to commit to Progress that it would be able to provide further capital to the company at that time so as to enable it to continue in operation.

In the above circumstances, and absent the reasonable expectation of further financial support from the parent Company or other source, there was not a reasonable prospect that Progress would be able to continue operating in the business of insurance in conformity with the requirements of the Italian law and regulations, and the Progress Board of Directors concluded on 5 February 2010 that they had no alternative other than to formally inform ISVAP and the MFSA (who had been kept fully informed of all developments throughout) of the economic and financial position of the company, and that it was the Board's view that the company should move to cease writing new business forthwith, and, in accordance with terms and conditions to be agreed with ISVAP, to initiate the necessary early steps and procedures to secure the orderly winding up of the company.

On 9 February 2010, ISVAP informed the company that it had appointed a Provisional Administrator of Progress Assicurazioni SpA with immediate effect. On 30 March 2010 ISVAP announced that it had placed Progress Assicurazioni SpA in Compulsory Administrative Liquidation.

Following the above, and for the reasons more fully set out in the paragraph on Basis of Preparation, the Middlesea Board of Directors resolved that the accounts of Middlesea and of the Middlesea Group as at 31 December 2009 should be drawn up on the basis that took cognisance of the above events (and therefore departed from the requirements of IAS 27), and recognized that Progress had been placed in Compulsory Administrative Liquidation. In adopting this approach it would be necessary for the total Middlesea investment in Progress would be written off, and for full provision to be made for the €8.5 million subordinated loan to Progress that had been guaranteed by Middlesea. This has resulted in an impairment charge being included in the 2009 accounts of €69.5 million for the Company and €63.1 million for the Group.

## *Basis of preparation (extract from Note 2 of the Financial Statements)*

These financial statements are prepared in accordance with International Financial Reporting Standards as adopted for use in the European Union, the Insurance Business Act, 1998 and the Maltese Companies Act, 1995 except for the fact that the directors have, for the reasons described below, elected to depart from the requirement under IAS 27 to consolidate Progress Assicurazioni SpA.

*Departure from IAS 27*

Reference is made to the note above which sets out details of the significant events that occurred during the year and subsequent to the year end in connection with the subsidiary company Progress Assicurazioni SpA (Progress). The note sets out the circumstances which culminated in Progress being placed in Compulsory Administrative Liquidation by ISVAP on 30th March 2010.

The Middlesea Board of Directors have given the most careful consideration as to how to account for the results and financial position of Progress in the Group and Company accounts for the financial year ended 31st December 2009 (FY 2009). The Board is advised that the technical requirements of IAS 27 provide that the results and balance sheet position of Progress should be consolidated in full in the Group accounts for FY 2009 on a line by line basis, and then be de-consolidated in the FY2010 accounts upon Middlesea "losing control" of Progress.

However, the Board has chosen to adopt a different and, it believes, a more pragmatic and practical approach to the preparation of the FY 2009 accounts. In preparing these accounts, the Board has written off in full the investment that Middlesea had made in Progress, together with making full provision for the €8.5 million subordinated loan to Progress that had been guaranteed by Middlesea. This has resulted in an impairment charge of €69.5 million being included in the FY 2009 accounts for the company and €63.1 million for the Group.

The reasons that the Board has chosen to adopt this approach are as follows:-

- Progress is now in Compulsory Administrative Liquidation, and in the view of the Board, there must be significant doubt as to whether the Middlesea investment in Progress has any residual value, and whether the subordinated loan guaranteed by Middlesea will be recovered;

- In these circumstances, it is believed that it is prudent to make full provision in the FY 2009 accounts against the investment held by Middlesea in Progress, and in respect of the subordinated loan guaranteed by the Company;

- The Board has been advised that as Progress is a limited liability company limited by shares, as a general principle of Italian Company law it benefits from the protection of limited liability, whereby the liability of each shareholder, in relation to the obligations of the company, is limited to the amount of the underwritten capital. Accordingly, capital payments may be requested from the shareholder only by reference (and limited to) any unpaid amount of the underwritten capital. The Board is also advised that as Middlesea has fully paid up the amount of share capital in Progress underwritten by it, no further payments can be requested from Middlesea qua shareholder;

- As explained in the note on significant events above, the Middesea Board resolved that it was not in a position to provide further capital support to Progress, Accordingly, the Board is of the opinion that it would be unrealistic to draw up the FY 2009 accounts on a basis that assumed the provision of such support – only to then reverse the position in the accounts for FY 2010. In the view of the Board, this would result in the mis-statement of both the FY 2009 and FY 2010 Group accounts;

- In any event, the Progress books of account and records are no longer under the control of Middlesea, and it would not be possible accurately to determine the amount of assets, liabilities, financial position and profit and loss for consolidation purposes. Furthermore, audited financial statements for Progress for FY2009 are not available and, in the circumstances, are unlikely to be produced within the required timeframes.

- Above all, the Board is anxious that the FY 2009 accounts should fairly reflect the decisions that have been taken in respect of Progress until the date of these financial statements – that is that, for the reasons explained in the note on significant events above, the Middlesea Group was not in a position to provide further capital support to Progress, and as a result of which the group was left with no option other than to exit the Italian insurance market. The Board believes that the accounts, as drawn up, properly reflect the reality of this position.

For the above reasons, the Middlesea Board believes that the adoption of a basis of preparation which writes off the totality of the investment in Progress and recognises the reality that no further capital support will be extended to the company is the most realistic basis to adopt in the prevailing circumstances. Accordingly, the Board has not consolidated Progress in the Group's financial statements for the year ended 31 December 2009, but has made full provision in respect of the investment in and guarantee extended to that company.

### *Looking Forward*

The events of the past two years have placed a huge strain on the financial resources and on the management and staff of Middlesea Insurance plc. Having taken the tough but necessary steps to bring to an end the undesirable impact of Progress on the operations and financials of Middlesea Insurance plc, the Board of Directors looks forward to a more focused Group with a clear objective of maintaining and strengthening the company's status as the leader in the local insurance industry. Going forward, the Board envisages the following:-

- Middlesea Insurance will enter into a period of consolidation and reorganisation, geared to maintaining its status as the clear local insurance leader and returning the company to the role of a client-centric, profitable and progressive domestic insurer. This it will do with its own fully fledged technical operations and support functions, in coordination with its distribution network.

- IIMS, as a fully owned subsidiary of MSI will transit to being an exclusively third party service provider to the insurance industry, attracting further foreign investment and reputable clients to Malta. In doing so it will continue to play a vital and creative role in the development of Malta as a respected and reputable financial services centre.

- Middlesea Valletta, which is an important 50% / 50% joint venture operation with Bank of Valletta plc, will maintain its status as the largest life insurer in Malta, building its own stand-alone capacity and self sufficient company structures. With a base of 80,000 customers, shareholders equity of over €100 million and total assets close to €1 billion, Middlesea Valletta is well placed to grow and develop further.

By Order of the Board

| Condensed Profit and Loss Accounts Non - technical accounts for the year ended 31 December | Group 2009 €'000 | Group 2008 €'000 | Company 2009 €'000 | Company 2008 €'000 |
|---|---|---|---|---|
| Balance on the general business technical account | 4,800 | (27,705) | 4,800 | (1,410) |
| Balance on the long term business technical account | 675 | 307 | 675 | 307 |
| | 5,475 | (27,398) | 5,475 | (1,103) |
| Share of profit of associated associated undertaking | 3,121 | 958 | - | - |
| Total income/(loss) from insurance activities | 8,596 | (26,440) | 5,475 | (1,103) |
| Other investment income | 5,474 | 3,480 | 6,943 | 5,210 |
| Investment expenses and charges | (1,213) | (8,775) | (1,213) | (6,890) |
| Allocated investment (return)/expense transferred to the general business technical account | (3,435) | 3,073 | (3,435) | 2,886 |
| Other income | 1,950 | 1,819 | - | - |
| Administration expenses | (2,699) | (2,956) | (1,127) | (1,068) |
| Profit/(loss) for the financial year before impairment charge and tax | 8,673 | (29,799) | 6,643 | (965) |
| Impairment of investment in group undertaking | (63,121) | - | (69,523) | (2,500) |
| Loss for the financial year before tax | (54,448) | (29,799) | (62,880) | (3,465) |
| Income tax (expense)/credit | (670) | 9,207 | (521) | (160) |
| Loss for the financial year | (55,118) | (20,592) | (63,401) | (3,625) |
| Attributable to: | | | | |
| - shareholders | (53,462) | (18,690) | (63,401) | (3,625) |
| - minority interests | (1,656) | (1,902) | - | - |
| | (55,118) | (20,592) | (63,401) | (3,625) |
| Loss per share attributable to shareholders | (€1.99) | (€0.75) | | |

**Condensed Statements of Comprehensive Income**
**for the year ended 31 December**

| | Group | | Company | |
|---|---|---|---|---|
| | 2009 | 2008 | 2009 | 2008 |
| | €'000 | €'000 | €'000 | €'000 |
| Loss for the financial year | (55,118) | (20,592) | (63,401) | (3,625) |
| Other comprehensive income: | | | | |
| Fair value gain/(loss) on investment in associate undertaking | - | - | 2,620 | (1,673) |
| Change in other available-for-sale investments | (129) | 100 | (133) | 100 |
| Revaluation of property, plant and equipment | - | 3,150 | - | - |
| Share of increase/(decrease) in value of in-force business of associated undertaking | 489 | (1,509) | - | - |
| Total other comprehensive income, net of tax | 360 | 1,741 | 2,487 | (1,573) |
| Total comprehensive income for the year | (54,758) | (18,851) | (60,914) | (5,198) |
| Attributable to | | | | |
| - shareholders | (53,102) | (17,265) | | |
| - minority interests | (1,656) | (1,586) | | |
| Total comprehensive income for the yaer | (54,758) | (18,851) | | |

| Condensed Consolidated Balance Sheets | Group | | Company | | |
|---|---|---|---|---|---|
| | At 31 December | | | | At 1 January |
| | 2009 | 2008 | 2009 | 2008 | 2008 |
| | €'000 | €'000 | €'000 | €'000 | €'000 |
| | | | | *restated* | *restated* |
| **ASSETS** | | | | | |
| Intangible assets | 700 | 1,030 | 454 | 607 | 656 |
| Property, plant and equipment | 1,721 | 9,719 | 1,006 | 1,100 | 1,126 |
| Investment property | 8,708 | 10,978 | 9,167 | 8,367 | 7,721 |
| Investment in subsidiary undertakings | - | - | 1,212 | 24,865 | 25,475 |
| Investment in associated undertakings | 51,957 | 41,734 | 51,957 | 42,542 | 43,090 |
| Other investments | 46,535 | 168,286 | 45,713 | 40,897 | 48,967 |
| Deferred income tax | 3,447 | 13,223 | 1,025 | 1,667 | - |
| Reinsurers' share of technical provisions | 13,793 | 29,360 | 13,793 | 13,645 | 13,685 |
| Deferred acquisition costs | 2,673 | 7,446 | 2,673 | 2,583 | 2,576 |
| Insurance and other receivables | 10,167 | 25,203 | 10,034 | 9,494 | 9,011 |
| Income tax receivables | 330 | 2,635 | 293 | 259 | - |
| Cash and cash equivalents | 3,724 | 6,361 | 3,080 | 3,418 | 3,076 |
| Total assets | 143,755 | 315,975 | 140,407 | 149,444 | 155,383 |
| **EQUITY** | | | | | |
| Capital and reserves attributable to shareholders | 48,664 | 62,123 | 44,387 | 65,658 | 74,058 |
| Minority interests | - | 1,656 | - | - | - |
| Total equity | 48,664 | 63,779 | 44,387 | 65,658 | 74,058 |
| **LIABILITIES** | | | | | |
| Deferred income tax | 1,044 | 1,525 | 1,041 | 1,525 | 1,201 |
| Provisions for other liabilities and charges | 9,402 | 1,716 | 9,402 | 804 | 706 |
| Technical provisions | 53,260 | 210,883 | 53,260 | 50,739 | 48,796 |
| Borrowings | 16,285 | 16,285 | 16,285 | 16,285 | 16,381 |
| Insurance and other payables | 15,096 | 21,770 | 16,032 | 14,433 | 14,049 |
| Income tax payable | 4 | 17 | - | - | 192 |
| Total liabilities | 95,091 | 252,196 | 96,020 | 83,786 | 81,325 |
| Total equity and liabilities | 143,755 | 315,975 | 140,407 | 149,444 | 155,383 |

These condensed financial statements were approved by the Board on 27 April 2010 and were signed on its behalf by:

Joseph F.X. Zahra
Chairman

Roderick E.D. Chalmers
Director

Group
Statements of Changes in Equity
for the year ended 31 December

| | Attributable to shareholders | | | | | |
|---|---|---|---|---|---|---|
| | Share capital €'000 | Share premium account €'000 | Other reserves €'000 | Profit & loss account €'000 | Minority interests €'000 | Total €'000 |
| Balance as at 1 January 2008 | 14,559 | 2,778 | 21,551 | 43,702 | 3,243 | 85,833 |
| **Comprehensive income** | | | | | | |
| Loss for the financial year | - | - | - | (18,690) | (1,902) | (20,592) |
| Other comprehensive income: | | | | | | |
| Change in other available-for-sale investments | - | - | 100 | - | - | 100 |
| Revaluation of property, plant and equipment | - | - | 2,834 | - | 316 | 3,150 |
| Share of decrease in value of in-force business of associated undertaking | - | - | (1,509) | - | - | (1,509) |
| *Total other comprehensive income, net of tax* | - | - | 1,425 | - | 316 | 1,741 |
| **Total comprehensive income** | - | - | 1,425 | (18,690) | (1,586) | (18,851) |
| **Transactions with owners** | | | | | | |
| Dividends for 2007 | - | - | - | (3,202) | (123) | (3,325) |
| Increase in share capital of subsidiary | - | - | - | - | 122 | 122 |
| Renominalisation of share capital | 441 | - | - | (441) | - | - |
| **Total transactions with owners** | 441 | - | - | (3,643) | (1) | (3,203) |
| *Balance as at 31 December 2008* | 15,000 | 2,778 | 22,976 | 21,369 | 1,656 | 63,779 |
| Balance as at 1 January 2009 | 15,000 | 2,778 | 22,976 | 21,369 | 1,656 | 63,779 |
| **Comprehensive income** | | | | | | |
| Loss for the financial year | - | - | - | (53,462) | (1,656) | (55,118) |
| Other comprehensive income: | | | | | | |
| Change in other available-for-sale investments | - | - | (129) | - | - | (129) |
| Transfer of revaluation surplus on de-recognition of subsidiary | - | - | (2,968) | 2,968 | - | - |
| Share of decrease in value of in-force business of associated undertaking | - | - | 489 | - | - | 489 |
| *Total other comprehensive income, net of tax* | - | - | (2,608) | 2,968 | - | 360 |
| **Total comprehensive income** | - | - | (2,608) | (50,494) | (1,656) | (54,758) |
| **Transactions with owners** | | | | | | |
| Increase in the share capital | 40,200 | (557) | - | - | - | 39,643 |
| **Total transactions with owners** | 40,200 | (557) | - | - | - | 39,643 |
| *Balance as at 31 December 2009* | 55,200 | 2,221 | 20,368 | (29,125) | - | 48,664 |

Company
Statements of Changes in Equity
for the year ended 31 December

| | Share capital €'000 | Share premium account €'000 | Other reserves €'000 | Profit & loss account €'000 | Total €'000 |
|---|---|---|---|---|---|
| **Balance as at 1 January 2008** | | | | | |
| - as previously stated | 14,559 | 2,778 | 33 | 25,517 | 42,887 |
| - impact of voluntary change in accounting policy | - | - | 31,171 | - | 31,171 |
| - as restated | 14,559 | 2,778 | 31,204 | 25,517 | 74,058 |
| **Comprehensive income** | | | | | |
| Loss for the financial year | - | - | - | (3,625) | (3,625) |
| Other comprehensive income: | | | | | |
| Fair value loss on investment in associate undertaking | - | - | (1,673) | - | (1,673) |
| Change in other available-for-sale investments | - | - | 100 | - | 100 |
| Total other comprehensive income, net of tax | - | - | (1,573) | - | (1,573) |
| *Total comprehensive income* | - | - | (1,573) | (3,625) | (5,198) |
| Transactions with owners | | | | | |
| Dividends for 2007 | - | - | - | (3,202) | (3,202) |
| *Renominilisation of capital* | 441 | - | - | (441) | - |
| Total transactions with owners | 441 | - | - | (3,643) | (3,202) |
| **Balance as at 31 December 2008** | 15,000 | 2,778 | 29,631 | 18,249 | 65,658 |
| **Balance as at 1 January 2009** | | | | | |
| - as previously stated | 15,000 | 2,778 | 133 | 18,249 | 36,160 |
| - impact of voluntary change in accounting policy | - | - | 29,498 | - | 29,498 |
| - as restated | 15,000 | 2,778 | 29,631 | 18,249 | 65,658 |
| **Comprehensive income** | | | | | |
| Loss for the financial year | - | - | - | (63,401) | (63,401) |
| Other comprehensive income: | | | | | |
| Fair value gain on investment in associate undertaking | - | - | 2,620 | - | 2,620 |
| Change in other available-for-sale investments | - | - | (133) | - | (133) |
| Total other comprehensive income, net of tax | - | - | 2,487 | - | 2,487 |
| Total comprehensive income | - | - | 2,487 | (63,401) | (60,914) |
| *Transactions with owners* | | | | | |
| Increase in the share capital | 40,200 | (557) | - | - | 39,643 |
| Total transactions with owners | 40,200 | (557) | - | - | 39,643 |
| **Balance as at 31 December 2009** | 55,200 | 2,221 | 32,118 | (45,152) | 44,387 |

| **Condensed consolidated statements of cash flows for the year ended 31 December** | **Group** | | **Company** | |
|---|---|---|---|---|
| | **2009** | 2008 | **2009** | 2008 |
| | **€'000** | €'000 | **€'000** | €'000 |
| Net cash generated from operating activities | **6,007** | 10,687 | **5,711** | 2,199 |
| Net cash (used in)/ generated from investing activities | **(46,103)** | (10,927) | **(46,040)** | 1,441 |
| Net cash generated from/(used in) financing activities | **39,991** | (3,298) | **39,991** | (3,298) |
| Net movement in cash and cash equivalents | **(105)** | (3,538) | **(338)** | 342 |
| Cash and cash equivalents at beginning of year | **6,361** | 9,899 | **3,418** | 3,076 |
| De-recognition of subsidiary undertakings | **(2,532)** | - | **-** | - |
| Cash and cash equivalents at end of year | **3,724** | 6,361 | **3,080** | 3,418 |

## Independent auditor's report

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

### Report on the financial statements

We have audited the accompanying financial statements of Middlesea Insurance p.l.c. and its subsidiaries ("the Group") and of Middlesea Insurance p.l.c. ("the Stand Alone Company" or "the Parent Company") which comprise the balance sheets as at 31 December 2009 and the profit and loss accounts, statements of comprehensive income, statements of changes in equity and statements of cash flows for the year then ended and a summary of significant accounting policies and other explanatory notes.

*Directors' responsibility for the financial statements*

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

*Auditor's responsibility*

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with International Standards on Auditing. Those Standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance whether the financial statements are free from material misstatement. An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

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

*Opinion – Stand Alone Company*

In our opinion, the financial statements of Middlesea Insurance p.l.c. (as a Stand Alone Company) give a true and fair view of its financial position as at 31 December 2009 and of its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards as adopted by the European Union and have been properly prepared in accordance with the requirements of the Insurance Business Act, 1998 and the Maltese Companies Act, 1995.

*Basis for qualified opinion – Group*

As explained in note 1 to the financial statements, the parent Company has, since the financial year-end, resolved that it was not in a position to provide further capital support to Progress Assicurazioni S.p.A. ("Progress") after it emerged that Progress' losses in the last quarter of 2009 materially exceeded those projected. The directors are of the opinion that the Group's ultimate liability towards Progress is now limited to the capital that the Parent Company injected into Progress together with a guarantee that it extended in connection with a subordinated loan taken by Progress. These accounts include full provision for both the investment and the guarantee. The directors believe that consolidating the further losses incurred by Progress beyond this amount, and their subsequent reversal in 2010, would render the Group's financial statements misleading. Furthermore, due to the fact that Progress has now been put into Compulsory Administrative Liquidation, the Group does not have access to the necessary information to enable it to account for its 2009 financial statements. For these reasons, the directors have not consolidated the financial statements of Progress in the period up to 31 December 2009, in accordance with IAS 27 "Consolidated and Separate Financial Statements" and have accordingly de-recognised Progress as a subsidiary of the Group as from 1 January 2009.

Under International Financial Reporting Standards, because Progress had not yet been put into Administration at 31 December 2009, and because it therefore was still controlled by the parent Company as at that date, its financial statements should have been consolidated in the Group's 2009 accounts in accordance with IAS 27. The early de-recognition of Progress from the consolidated financial statements as at 1 January 2009 therefore constitutes a departure from IFRSs as adopted by the EU.

The effect of this early de-recognition, based upon Progress' unaudited management accounts for the year ended 31 December 2009, is disclosed in detail in note 2 to the financial statements. Due to the fact, for reasons explained above, that Progress' audited financial statements as at that date are not available, we were unable to determine the impact of the early de-recognition of this subsidiary on the Group's financial statements.

*Qualified opinion – Group*

In our opinion, except for the effects of the matter relating to the early de-recognition of Progress as a subsidiary of the Group, described in the basis for qualified opinion paragraph above and that is contrary to the requirements of IAS 27, the financial statements give a true and fair view of the financial position of the Group as at 31 December 2009 and of its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards as adopted by the European Union and have been properly prepared in accordance with the requirements of the Insurance Business Act, 1998 and Maltese Companies Act, 1995.

*Emphasis of matter*

Without qualifying our opinion, we draw attention to note 5.4 to the financial statements, which describes the impact of the adverse results of Progress on Middlesea Insurance p.l.c.'s regulatory solvency margin. The Parent Company and Progress did not meet their regulatory solvency requirements at all times during the year and as at 31 December 2009. The same note describes the remedial measures that are being taken by the Parent Company to rectify its position.

## Report on Corporate Governance

The Listing Rules issued by the Malta Listing Authority require the directors to prepare and include in their Annual Report a Statement of Compliance providing an explanation of the extent to which they have adopted the Code of Principles of Good Corporate Governance and the effective measures that they have taken to ensure compliance throughout the accounting period with those Principles.

The Listing Rules also require the auditor to include a report on the Statement of Compliance prepared by the directors.

We read the Statement of Compliance and consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the financial statements included in the Annual Report. Our responsibilities do not extend to considering whether this statement is consistent with any other information included in the Annual Report.

We are not required to, and we do not, consider whether the Board's statements on internal control included in the Statement of Compliance cover all risks and controls, or form an opinion on the effectiveness of the Company's corporate governance procedures or its risk and control procedures.

In our opinion, the Statement of Compliance has been properly prepared in accordance with the requirements of the Listing Rules issued by the Malta Listing Authority.

## Report on other legal and regulatory requirements

We also read other information contained in the Annual Report and consider whether it is consistent with the audited financial statements. This other information comprises the directors' report and the statement of directors' responsibilities. Our responsibilities do not extend to any other information.

We also have responsibilities:

- Under the Maltese Companies Act, 1995 to report to you if, in our opinion:
    - The information given in the directors' report is not consistent with the financial statements.
    - Adequate accounting records have not been kept, or that returns adequate for our audit have not been received from branches not visited by us.
    - The financial statements are not in agreement with the accounting records and returns.
    - We have not received all the information and explanations we require for our audit.

- Certain disclosures of directors' remuneration specified by law are not made in the financial statements, giving the required particulars in our report.

- Under the Listing Rules to review the statement made by the directors that the business is a going concern together with supporting assumptions or qualifications as necessary.

We have nothing to report to you in respect of these responsibilities, except for the fact that, as discussed above, audited financial information relating to Progress for the year ended 31 December 2009 and as at that date was not available.

PRICEWATERHOUSECOOPERS

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Simon Flynn
Partner

27 April 2010