LLOYD'S

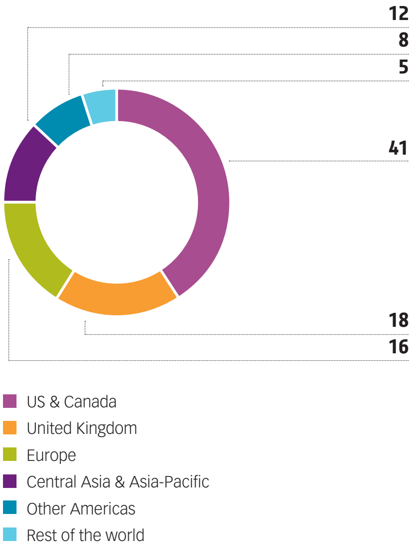
LLOYD'S ANNUAL REPORT 2011

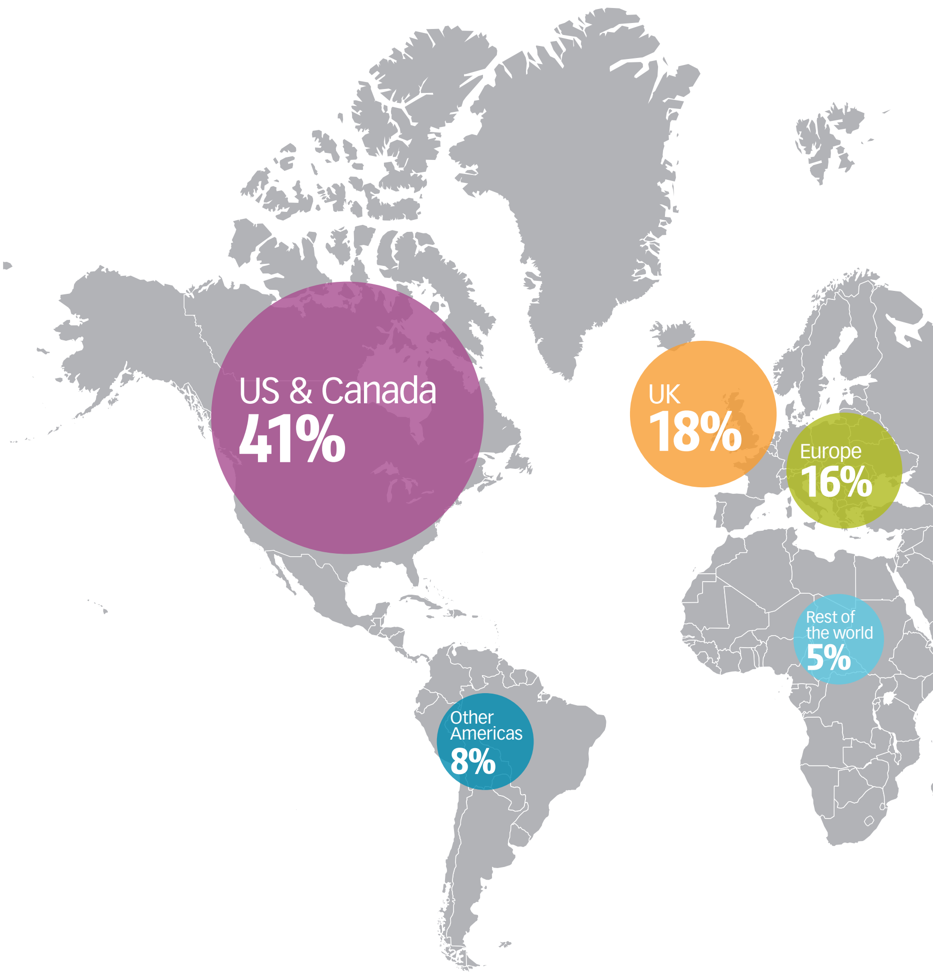
OUR BUSINESS

LLOYD'S ACCEPTS BUSINESS FROM OVER 200 COUNTRIES AND TERRITORIES WORLDWIDE

Our licences in over 75 jurisdictions, supported by a network of local offices, ensure access to insurance markets large and small.

LLOYD'S TOTAL BUSINESS BY REGION





LLOYD'S IN NUMBERS

88

SYNDICATES

of specialist underwriting experience and talent

186

BROKERS

daily creating insurance solutions in over…

200

COUNTRIES AND TERRITORIES

which covers…

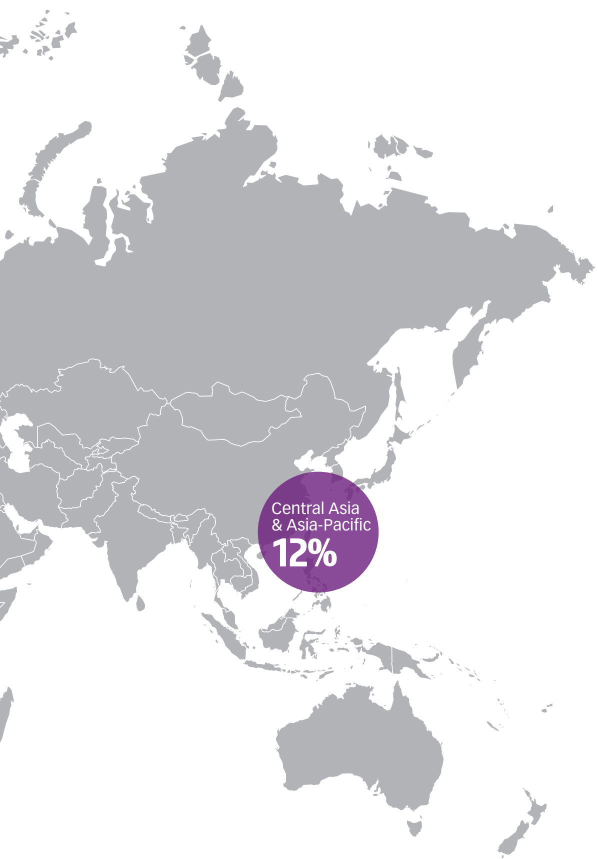
NORTH AMERICA
Lloyd's has offices in Atlanta, Chicago, Frankfort KY, Los Angeles, New York, Toronto and Montreal and is represented in the US Virgin Islands by an attorney in fact.

EUROPE
Lloyd's has full-time country managers supporting Lloyd's market development activities in Benelux, France, Germany/Austria, Iberia, Ireland, Italy, Poland, Nordic Area, Switzerland and the UK.

CENTRAL ASIA & ASIA-PACIFIC
Lloyd's has offices in Australia and Hong Kong (SAR). In addition, Lloyd's has three trading platforms to access business in China, Japan and Singapore.

LATIN AMERICA
Lloyd's has an office in Brazil with co-located syndicates to access reinsurance business.

AFRICA
Lloyd's has a full-time country manager in South Africa.



LLOYD'S CLASS BREAKDOWN BY REGION

	US & Canada	Other Americas	United Kingdom	Europe	Central Asia & Asia-Pacific	Rest of the world	TOTAL
REINSURANCE	29%	76%	29%	37%	48%	60%	38%
PROPERTY	31%	7%	18%	15%	13%	8%	21%
CASUALTY	19%	7%	18%	16%	28%	10%	18%
MARINE	7%	5%	6%	19%	6%	9%	8%
ENERGY	10%	3%	3%	7%	3%	3%	7%
MOTOR	1%	1%	24%	2%	0%	2%	5%
AVIATION	3%	1%	2%	4%	2%	8%	3%
ALL CLASSES	**41%**	**8%**	**18%**	**16%**	**12%**	**5%**	**100%**

94%
OF THE FTSE 100
and…

97%
OF DOW JONES
industrial average companies

all underpinned by…
324
YEARS OF UNDERWRITING EXPERIENCE

LLOYD'S VISION FOR 2025

TO BE THE GLOBAL CENTRE FOR SPECIALIST INSURANCE AND REINSURANCE

CONTENTS

WELCOME TO LLOYD’S

FINANCIAL HIGHLIGHTS

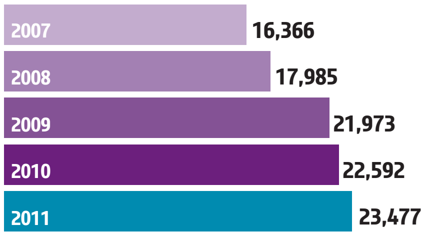
- Lloyd's made a loss before tax of £516m (2010: £2,195m profit) and a combined ratio of 106.8% (2010: 93.3%). This result reflects the frequency and severity of natural catastrophes throughout the year and the continuing low interest rate environment
- Gross premium income £23,477m (2010: £22,592m)
- Central assets maintained at record levels of £2,388m (2010: £2,377m)

The pro forma financial statements (PFFS) are prepared so that the financial results of Lloyd's and its members taken together and their net assets can be compared with general insurance companies. The PFFS include the aggregate of syndicate annual accounts (Aggregate Accounts), members' funds at Lloyd's (FAL) and the Society of Lloyd's financial statements.

To read more on our financial results see **page 37**.

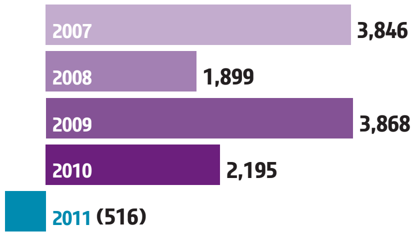
The Aggregate Accounts are reported as a separate document and can be found at **www.lloyds.com/financialreports**

GROSS WRITTEN PREMIUM
£m



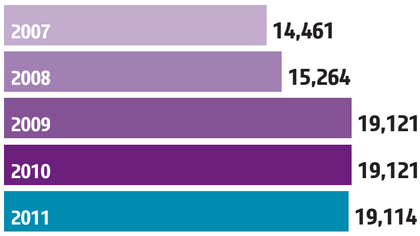
£23,477m

RESULT BEFORE TAX
£m



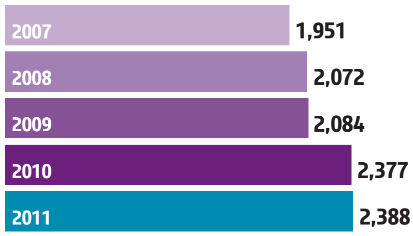
£(516)m

CAPITAL, RESERVES AND SUBORDINATED DEBT AND SECURITIES
£m



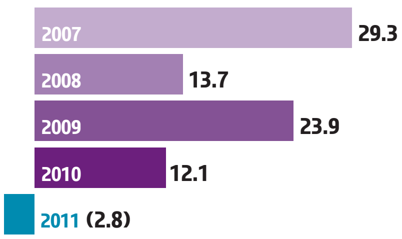
£19,114m

CENTRAL ASSETS*
£m



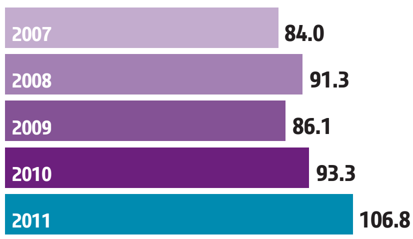
£2,388m

RETURN ON CAPITAL
%



(2.8)%

COMBINED RATIO*
%



106.8%

* See Glossary on page 139.
The basis for translating income and expenditure and assets and liabilities in foreign currency is set out on page 58.

CHAIRMAN'S STATEMENT

WE NEED TO CONTINUE TO ANTICIPATE AND MANAGE THE RISKS WE ARE FACING

I was honoured to be appointed as Lloyd's new Chairman last year. I arrived during an unquestionably difficult year for the global insurance industry, for Lloyd's and for many of our clients. This has been reflected by the fact that for the first time in six years, Lloyd's has posted a loss. This loss amounts to £516m, albeit encouragingly below the loss we were showing at the half year.

The events of 2011 have had a major impact on the insurance industry – leading to the second highest year of natural catastrophe claims for the industry as a whole and the highest ever for Lloyd's. That we have met such a volume of claims without any significant impact on our capital is indeed an affirmation of the work of the Franchise Board, acting with managing agents, in operating our performance management framework.

Against this background, we have been focusing on three principal objectives in the Corporation. The first is to maintain and enhance the high standards of performance management in the oversight of the Lloyd's market underwriting operations. The second is to accelerate the progress in improving the efficiency of Lloyd's for the benefit of the market and our customers. We are working hard to modernise both the back and front office processes within the Lloyd's market. We also undertook a cost reduction programme in the Corporation of Lloyd's towards the end of 2011 and have passed the benefits on to the market by not levying performance and risk management charges. Third, we have been developing, in consultation with the market, a longer term strategy, Vision 2025. In essence, this is a strategy designed to ensure that Lloyd's remains the global hub for specialist insurance and reinsurance.

We have also taken steps to improve the governance of Lloyd's. We have made some changes to the committee structure of the Council and the Franchise Board to improve the management of Lloyd's, its transparency, and the communication with our stakeholders. We have also reviewed executive remuneration. While we have concluded that the aggregate remuneration levels are appropriate, we have increased the proportion of fixed remuneration to variable. This better reflects the role of the Corporation itself.

We know that market conditions are likely to remain tough in 2012. Global economic conditions may mean that the insurance cycle will be slower to turn than in the past. The world economy is in a strange place, with little prospect of investment returns improving for some time and an insurance market which, in the absence of a market changing event, is likely to remain overcapitalised for the foreseeable future. We need to ensure that we actively work to anticipate and manage the risks we are facing, both as part of our longer term strategy and in terms of the actions we take year-on-year. With our Three-Year Plan in the shorter term and the development of our Vision 2025 in the longer term, I believe we are well placed to do so.

We also need to ensure that we continue to lead the industry as we move towards significant changes in the regulatory environment. Solvency II has been, and continues to be, a major challenge. However, we have made excellent progress to ensure that, whatever its final implementation date, the Lloyd's market will be operating to the standards required of Solvency II by January 2013. We also need to ensure that we make the strongest case to the government and the regulators as to the need to achieve firm and clear regulation which is prudential and proportionate. The restructuring of the FSA into the Prudential Regulation Authority (PRA), under the Bank of England, is an excellent opportunity to achieve these goals.

As we end one difficult year to face another which may be equally challenging, we should be proud of the service we have delivered. We have a new vision to deliver, to ensure that Lloyd's and London EC3 remain the true worldwide hub for specialist insurance and reinsurance as global needs evolve. In an increasingly competitive industry, we need to pull in more business from faster growing economies as well as strengthening our overseas underwriting centres. We envisage bringing in new capital and new people from the emerging markets of today and tomorrow. I would like to see the UK as one of the most competitive economies in the world, and the Chancellor's decision in the Budget to lower the Corporation tax rate was a very encouraging step towards this. Within two decades, I want to see a market that reflects the diversity of our worldwide network of licences, jurisdictions and business in the Underwriting Room and offices. This will add to the network of trusted relationships that form the foundation of the Lloyd's business.

Finally, on behalf of the Corporation and the market, I would like to thank those who left Lloyd's in 2011. In particular, Peter Levene, to whose nine-year tenure as Chairman, Lloyd's owes a substantial debt of gratitude. Under his leadership, Lloyd's has emerged as a powerful force in worldwide insurance. I would also like to thank the retiring members of the Council and Franchise Board; Ewen Gilmour, Barnabas Hurst-Bannister and David Shipley. Each of them has made a significant contribution to Lloyd's over a number of years.

JOHN NELSON
Chairman

THE WORLD'S SPECIALIST INSURANCE MARKET

With its unique concentration of expertise and talent, Lloyd's continues to be the first port of call for new or complex risks in over 200 countries and territories.

Lloyd's began over 300 years ago, in Edward Lloyd's coffee house in the City of London – where shipowners could meet people with the capital to insure them. Since then, Lloyd's has built on this maritime heritage to become the world's leading market for specialist property and casualty insurance. 94% of FTSE 100 companies insure through the Lloyd's market.

Lloyd's has always been a dynamic and innovative market, bringing together underwriters who provide insurance coverage with brokers seeking insurance on behalf of their clients. Business at Lloyd's is still conducted face-to-face, and the busy Underwriting Room is central to the smooth running of the subscription market, where different syndicates take a share of the same risk. Lloyd's offers a range of distribution channels which allow managing agents (those responsible for managing a syndicate) to access specialist business, primarily through brokers, coverholders (companies or partnerships given the authority to write business on behalf of underwriters) and service companies.

Lloyd's offers a unique concentration of expertise and talent, backed by strong financial ratings and international licences. Our strength comes from the diversity of the managing agents who operate at Lloyd's, supported by capital from across the world.

Always changing to meet current challenges, Lloyd's remains true to its original aim of helping clients rebuild after disaster and loss. Over the last few years, we have raised underwriting standards and strengthened the market's capital position. We will always pursue new ways of improving efficiency and service standards, to make Lloyd's an even easier and more attractive place to do business.

A COORDINATED RESPONSE TO CATASTROPHE

Even before a disaster strikes, our Exposure Management team monitor its development using, for example, data about hurricane paths and information from risk modelling companies.

As soon as a catastrophe hits, we convene the Lloyd's Catastrophe Response Team. Made up of senior representatives from across the Corporation, it includes experts from Risk Management, Relationship Management, Market Services, Claims and Communications.

Using the information gained from previous catastrophes, Realistic Disaster Scenarios and disaster modelling, the Team ascertains the likely impact of the catastrophe and communicates constantly with our country representatives on the ground. This model of global coordination means we can respond quickly – setting up and publicising claims hotlines and providing local relief agencies with details of our emergency processes to help those affected.

The Team also acts as the communications lynchpin for the Lloyd's market as a whole, keeping managing agents informed and providing them with the templates to report their exposure.

The Response Team never forgets that the purpose of their work is to ensure valid claims are paid as quickly as possible. Helping people to rebuild their lives, while making sure our financial strength is not impaired, ensuring we are always there for our clients the next time catastrophe strikes.

ABOUT LLOYD'S MANAGING AGENTS

As at 31 December 2011, the Lloyd's market consisted of 57 managing agents, whose logos are shown below, and 88 syndicates. While the sheer scale of the market is important, it is the scope of specialist broking and underwriting expertise brought together under the Lloyd's umbrella which is most significant.

For information on Syndicate Gross Written Premiums see **page 137**.

ACE

ADVENT A FAIRFAX Company

AEGIS London

Alterra

amlin

antares

Arch Underwriting at Lloyd's

Argenta

ARGO INTERNATIONAL Member Argo Group

ARK

ascot

ASPEN

ATRIUM

Barbican

Beaufort underwriting agency limited

beazley

Brit Insurance

CANOPIUS

CAPITA

CATHEDRAL UNDERWRITING LTD

CATLIN

Chaucer

CHUBB INSURANCE

equity REDSTAR

FARADAY

FLAGSTONE RE

HARDY

HCC

HISCOX

JUBILEE. GROUP

Kiln 1962 50 years of Kiln

Liberty Syndicates

MAP underwriting at lloyd's

MARKEL

Marketform

MSIG Mitsui Sumitomo Insurance Group

MONTPELIER UNDERWRITING AGENCIES LIMITED

Navigators Insuring A World In Motion

NEWLINE UNDERWRITING MANAGEMENT LIMITED SYNDICATE 1218 AT LLOYD'S

Novae

OMEGA

Pembroke MANAGING AGENCY

QBE

R&Q

RenaissanceRe

RITC Syndicate Management Limited

RIVERSTONE A FAIRFAX Company

S A Meacock & Company Limited

Sagicor AT LLOYD'S

SHELBOURNE SYNDICATE SERVICES

SPORTSCOVER UNDERWRITING LTD

STARR COMPANIES

TALBOT VALIDUS GROUP

TRAVELERS

Watkins Syndicate Syndicate 457 Underwriters at Lloyd's

Whittington

XL Group Insurance Reinsurance

HOW LLOYD'S WORKS
MARKET STRUCTURE

LLOYD'S OFFERS AN UNRIVALLED CONCENTRATION OF UNDERWRITING EXPERTISE AND TALENT

Lloyd's is not an insurance company; it is the largest insurance marketplace in the world, housing a range of insurers who provide different products for many insurable risks.

HOW LLOYD'S WORKS

The majority of business written at Lloyd's is placed through brokers who facilitate the risk-transfer process between policyholders and underwriters. Policyholders can access the Lloyd's market via a broker, a coverholder or a service company. Specialist underwriters in each syndicate price and underwrite these risks (see Figure 1 below).

MEMBERS

PROVIDING THE CAPITAL

Capital to support the syndicates' underwriting is provided by members of Lloyd's. These include many of the world's major insurance groups, listed companies, individuals and limited partnerships, with corporate groups providing most of the capital for the Lloyd's market (see Figure 2, page 8). Members' agents provide advisory and administrative services to members as required.

SYNDICATES

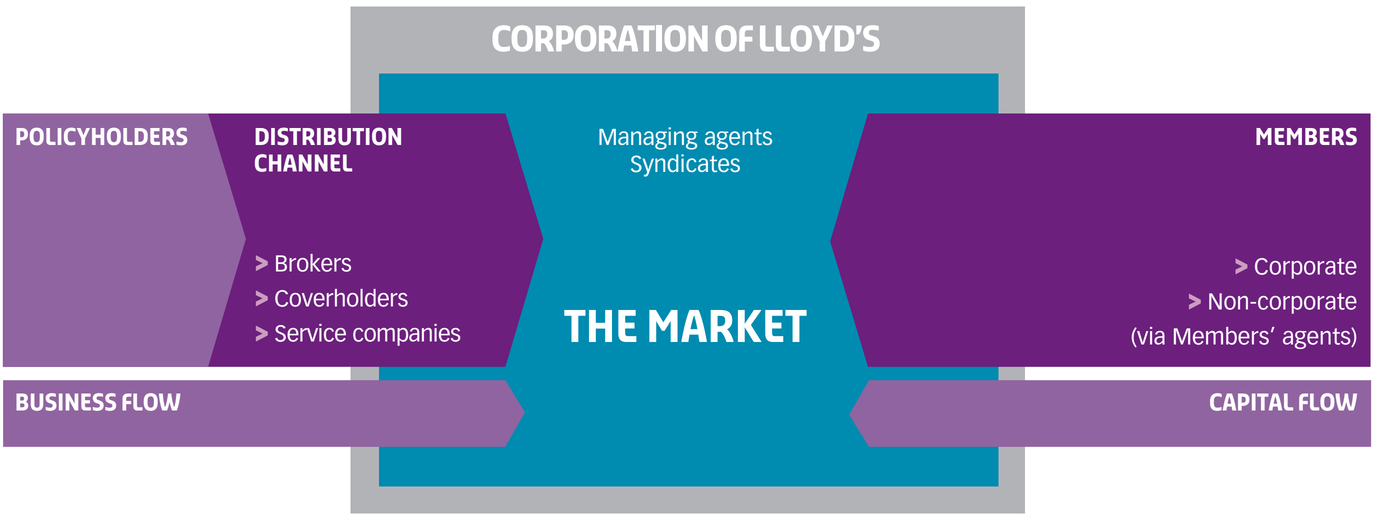
WRITING THE INSURANCE

A Lloyd's syndicate is formed by one or more members joining together to accept insurance risks. Most syndicates will write a range of classes of business, but many will have areas of particular expertise. Much of this business involves face-to-face negotiations between brokers and underwriters in the Underwriting Room in the Lloyd's building, where most syndicates trade.

While syndicates are technically annual ventures, they operate on an ongoing basis with members having the right, but no obligation, to participate in syndicates for the following year. This results in a great deal of continuity in the capital backing syndicates. The stability and range of these core capital providers mean syndicates function like permanent insurance operations under the Lloyd's umbrella.

Figure 1

HOW LLOYD'S WORKS



HOW LLOYD'S WORKS
MARKET STRUCTURE CONTINUED

MANAGING AGENTS

MANAGING THE SYNDICATES
A managing agent is a company set up to manage one or more syndicates on behalf of the members, who provide the capital. Managing agents are responsible for employing the syndicates' underwriters, overseeing their underwriting and handling the infrastructure and day-to-day operations.

A single corporate group will often both fund and manage a syndicate, aligning management and capital provision. In other, 'unaligned' syndicates, different members (which can include both private individuals and corporate groups) who are not connected with the managing agent provide the capital. New syndicates are often established under a 'turnkey' arrangement, with an existing managing agent setting up and managing the new syndicate on behalf of a third party capital provider. In due course, the capital provider may seek approval from Lloyd's to establish their own managing agent.

CORPORATION OF LLOYD'S

SUPPORTING THE MARKET
The Corporation of Lloyd's (the Corporation) oversees the market, setting standards, approving business plans, providing services to support its activity and managing the Central Fund. It also manages Lloyd's network of international licences.

The members of the Corporation's Executive Team exercise the day-to-day powers and functions of the Council of Lloyd's (the Council) and the Franchise Board. At the end of December 2011, the Corporation and its subsidiaries had 912 employees.

As well as providing services to support the smooth running of the market, the Corporation works to raise standards and improve performance. Its work covers two main areas:

1. Overall risk and performance management of the market, including:
   - Setting the level of capital Lloyd's members must provide for their proposed underwriting.
   - Overseeing the market's business activities by setting standards and monitoring syndicates' performance in areas including underwriting, exposure management, claims and operational risk.
   - Working with the managing agents of underperforming syndicates to improve performance, intervening directly where needed.
   - Managing the market's financial and regulatory reporting, including producing its results and international regulatory returns.
2. Maintaining and developing the market's attractiveness to capital providers, distributors and clients, while preserving its diversity and London-based model. This includes:
   - Managing and developing Lloyd's global network of licences and the Lloyd's brand.
   - Acting in the long-term interests of the market.
   - Representing Lloyd's to worldwide governments and regulators.

MANAGING INSURANCE RISK
Each syndicate sets its own appetite for risk, develops a business plan, arranges its reinsurance protection and manages its exposures and claims. Through Performance Management and other Directorates, the Corporation reviews and agrees business plans, monitors compliance against Lloyd's minimum standards and monitors syndicates' performance against their plan. All syndicates can only underwrite in accordance with these agreed business plans. If they fail to do so, Lloyd's can take a range of actions, including, as a last resort, requiring a syndicate to cease underwriting.

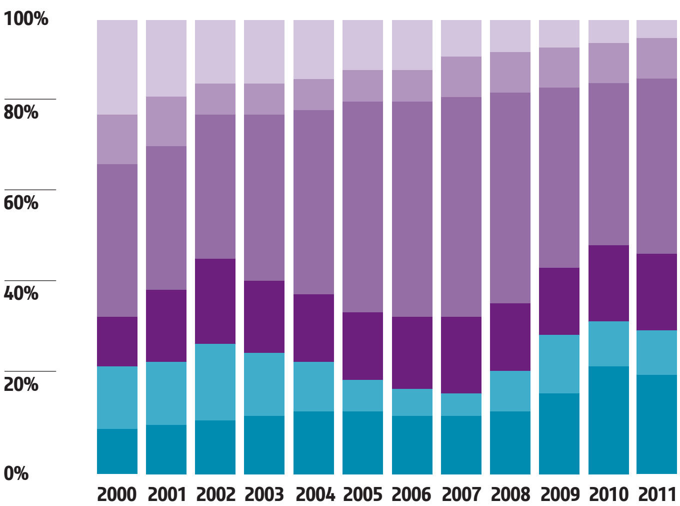
For a list of managing agents and the syndicates they manage see **page 137**.

See **page 11** for more detail on the governance of Lloyd's.

For more information on managing insurance risk see **page 43-44**.

Figure 2

LLOYD'S CAPACITY BY SOURCE AND LOCATION



	2011
Worldwide insurance industry	22%
Bermudian insurance industry	10%
US insurance industry	17%
UK insurance industry and other corporate	39%
Individual members (limited liability)	9%
Individual members (unlimited liability)	3%

HOW LLOYD'S WORKS
SECURITY AND RATINGS

LLOYD'S FINANCIAL STRENGTH COMES FROM ITS UNIQUE CAPITAL STRUCTURE

FINANCIAL STRENGTH

THE CHAIN OF SECURITY

Lloyd's unique capital structure, often referred to as the Chain of Security, provides excellent financial security to policyholders and capital efficiency for members.

There are three links in the Chain of Security (see Figure 3):

> Syndicate level assets
> Members' funds at Lloyd's
> Central assets

The funds in the first and second links are held in trust, primarily for the benefit of policyholders whose contracts are underwritten by the relevant member. Members underwrite for their own account and are not liable for other members' losses. The third link contains mutual assets held by the Corporation which are available, subject to Council approval, to meet any member's insurance liabilities.

The Chain of Security provides the financial strength that ultimately backs insurance policies written at Lloyd's and the common security that underpins the market's ratings and licence network.

The Corporation is responsible for overseeing both member and central capital levels to achieve a level of capitalisation that is robust.

FIRST LINK

SYNDICATE LEVEL ASSETS

The premiums received by a particular syndicate are kept in trust and are its first resource for paying policyholder claims. They are generally held in liquid assets to ensure liabilities can be met as they fall due. Profits are not released until future liabilities are fully provided for. Each syndicate's reserves for future liabilities are subject to annual independent audit and actuarial review.

SECOND LINK

MEMBERS' FUNDS AT LLOYD'S

Each member, whether corporate or individual, must provide capital to support its underwriting at Lloyd's. In accordance with FSA regulations, each syndicate produces an Individual Capital Assessment (ICA) stating how much capital it requires to cover its underlying business risks at a 99.5% confidence level.

The Corporation reviews each syndicate's ICA to assess the adequacy of the proposed capital level. When agreed, each ICA is then 'uplifted' (by 35% for 2011) to ensure enough capital is in place to support Lloyd's ratings and financial strength. This uplifted ICA is known as the syndicate's Economic Capital Assessment and drives member capital levels. This capital is held in trust as readily realisable assets and can be used to meet any Lloyd's insurance liabilities of that member, but not the liabilities of other members.

THIRD LINK

CENTRAL ASSETS

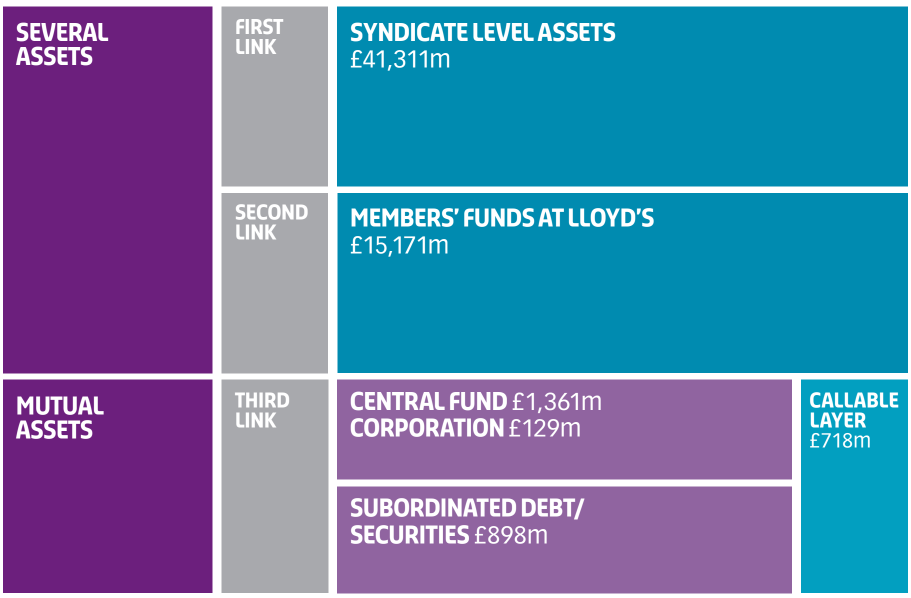
The Corporation's central assets are the third link of security. The Central Fund is available, at the discretion of the Council of Lloyd's, to meet any valid claim that cannot be met by the resources of any member. It is funded by members' annual contributions and subordinated debt issued by the Corporation in 2004 and 2007. Central assets may also be supplemented by a call on members of up to 3% of overall premium limits, known as the 'callable layer'.

The Corporation regularly undertakes detailed analysis to determine the optimum level of central assets, seeking to balance the need for financial security against members' desire for cost-effective mutuality of capital. In particular, the Corporation's sophisticated modelling tests each member's underwriting portfolio against a number of scenarios and a range of forecasts of market conditions.

The Corporation's current target for unencumbered central assets is that they should be at least 250% of the Society's Individual Capital Assessment (ICA) on a business as usual basis. Members' contributions to the Central Fund remain at 0.5% of gross written premiums for 2012. The Council of Lloyd's periodically reviews the central assets target and the level of contributions in light of the current financial position and forecast needs, and will adjust the contribution levels as required.

Figure 3

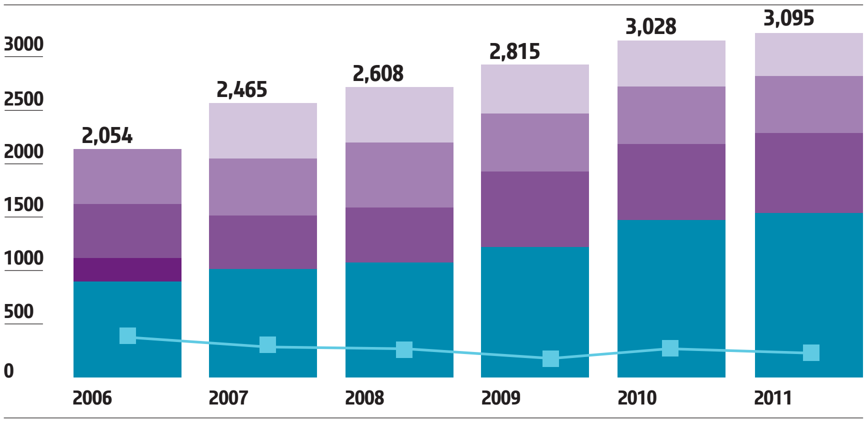
CHAIN OF SECURITY



HOW LLOYD'S WORKS
SECURITY AND RATINGS CONTINUED

Figure 4

CORPORATION & CENTRAL FUND NET ASSETS FOR SOLVENCY†
£m



	2011
Corporation & Central Fund net assets	1,479
Syndicate loans	0
Callable layer	718
Subordinated debt issued 2004	509
Subordinated perpetual securities issued 2007	389
Solvency deficits	115

† The aggregate value of central assets of the Corporation for solvency purposes at 31 December 2011, excluding the subordinated debt liabilities, including the callable layer.

Figure 5

LLOYD'S RATINGS

STANDARD & POOR'S A+ (STRONG)
FITCH RATINGS A+ (STRONG)

A+

A.M. BEST A (EXCELLENT)

A

As at 31 December 2011.

LLOYD'S ICA AND SOLVENCY

The Corporation also prepares an ICA for Lloyd's as a whole, using the FSA's six risk categories to examine the risks not included in each syndicate's ICA, such as damage to the Lloyd's building. The Corporation also calculates the statutory solvency position of the Society of Lloyd's and reports this to the FSA. At 31 December 2011, the Society had an estimated solvency surplus of £2,980m (see Figure 4).

LLOYD'S RATINGS

All Lloyd's syndicates benefit from Lloyd's central resources, including the Lloyd's brand, its network of global licences and the Central Fund. As all Lloyd's policies are ultimately backed by this common security, a single market rating can be applied. Lloyd's financial strength ratings apply to every policy issued by every syndicate at Lloyd's since 1993.

Three of the world's leading insurance rating agencies validate Lloyd's robust capitalisation and the financial strength of the market. In 2011, all three reaffirmed our ratings (Figure 5). In recognition of Lloyd's ongoing risk management improvements, Standard and Poor's also reaffirmed its 2010 upgrading of Lloyd's Enterprise Risk Management rating from 'adequate' to 'adequate with strong risk controls'.

"The rating reflects the strong financial profile of Lloyd's, which has successfully withstood the unprecedented catastrophe losses sustained by the insurance industry during Q111 [Quarter 1, 2011]...Lloyd's strong capital position and the conservative allocation of both several and mutual assets are also viewed as positive rating factors."

Fitch Ratings, July 2011

More information on the Chain of Security can be found on **page 9.**

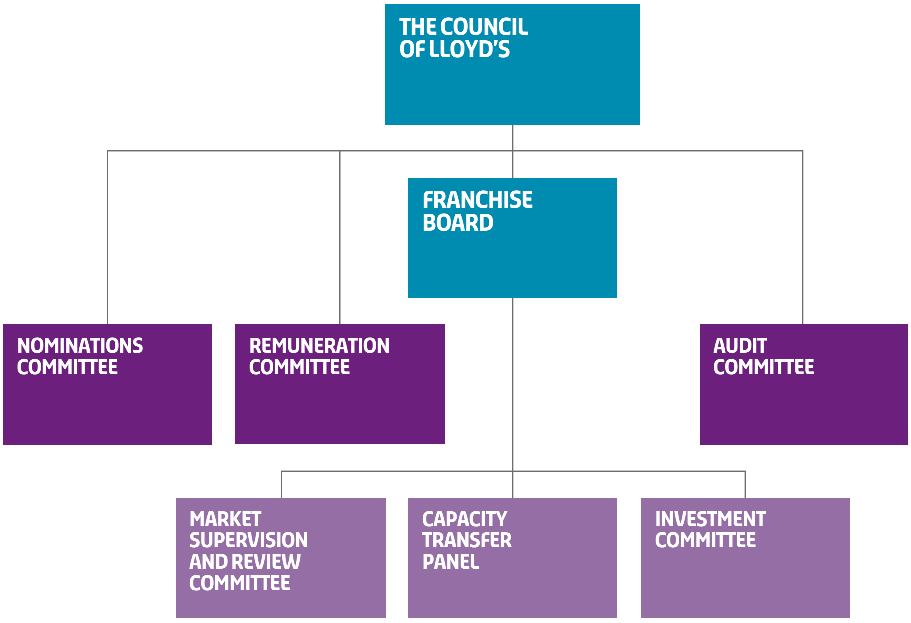
GOVERNANCE

LLOYD'S GOVERNANCE STRUCTURE PROVIDES CHALLENGE, CLARITY AND ACCOUNTABILITY

The Council of Lloyd's is responsible for supervising the market.

Figure 6

PRINCIPAL COMMITTEES OF LLOYD'S



THE COUNCIL AND FRANCHISE BOARD

The Council of Lloyd's is the governing body of the Society of Lloyd's and has ultimate responsibility for overall management of the market. The Council delegates many of its functions to the Franchise Board, whose members are appointed by the Council and come from both inside and outside the Lloyd's market.

The day-to-day powers and functions of the Council and Franchise Board are carried out by the Corporation's Executive Team – the Chief Executive Officer and Directors of the Corporation.

Lloyd's is regulated by the FSA, which undertakes direct supervision of managing agents and monitors capital and solvency. The Corporation plays an active role in managing risk within the market to ensure that Lloyd's central assets, brand, licences and reputation are protected.

The members of the Council of Lloyd's and Franchise Board are listed on **pages 12-15**.

For more information on corporate governance see **page 71-79**.

Details of the Executive Team can be found at: **www.lloyds.com/executiveteam**

GOVERNANCE
THE COUNCIL OF LLOYD'S

01	07	13
02	08	14
03	09	15
04	10	16
05	11	17
06	12	18

01 JOHN NELSON
Chairman of Lloyd's
(Nominated member)
Chairman of the Nominations Committee
Member of the Remuneration Committee
John Nelson was appointed Lloyd's Chairman in October 2011. He is also the Chairman of Hammerson plc. He is a chartered accountant, who worked in both the UK and the US while with Kleinwort Benson. He joined Lazard in 1986, whose Vice Chairman he became in 1990. He subsequently became Chairman of Credit Suisse First Boston (Europe), and Deputy Chairman of Kingfisher plc. In addition, he has been a non-executive director of BT, Woolwich plc, JP Morgan Cazenove and Cazenove Group. He is also an adviser to Charterhouse Capital Partners LLP and a trustee of the National Gallery.

02 DR RICHARD WARD
Chief Executive Officer
(Nominated member)
Richard Ward joined Lloyd's as Chief Executive Officer in April 2006. Previously he worked as both CEO and Vice-Chairman at the International Petroleum Exchange (IPE), re-branded ICE Futures. Prior to this, he held a range of senior positions at BP, after pursuing a scientific career with the Science & Engineering Research Council (SERC). He is a Board member of the Geneva Association, The Transatlantic Business Dialogue, Insurance Information Institute, New York and a Council Member of the Heart of the City charity.

03 PAUL JARDINE
Representative of Catlin Syndicate Limited
Deputy Chairman of Lloyd's
(External member)
Member of the Audit Committee
Member of the Remuneration Committee
Paul Jardine, a qualified actuary, is Deputy Chairman of Catlin Underwriting Agencies Limited and Chief Operating Officer of Catlin Group Limited. He has nearly 30 years of insurance industry experience and was Chairman of the Lloyd's Market Association from 2007 to 2010.

04 DR ANDREAS PRINDL CBE*
Senior Independent Deputy Chairman of Lloyd's
(Nominated member)
Member of the Audit Committee
Member of the Nominations Committee
Chairman of the Remuneration Committee
Andreas Prindl worked for Morgan Guaranty in New York, Frankfurt, London and as General Manager in Tokyo and then set up Nomura Bank International, which he chaired. He was appointed CBE for his contributions to financial services education in Britain and Eastern Europe.

05 GRAHAM WHITE
Deputy Chairman of Lloyd's
(Working member)
Member of the Nominations Committee
Graham White is Chairman of Argenta Private Capital Limited and Deputy Chairman of Argenta Syndicate Management Limited. He is a non-executive director of Marine Aviation and General (London) Limited and a trustee of The City Arts Trust Limited. He has worked in the Lloyd's market since 1968 as a reinsurance broker, company secretary and for members' agents and managing agents. In addition, he is a trustee of the Lloyd's Patriotic Fund.

06 LORD ASHTON OF HYDE
Representative of Faraday Capital Limited
(External member)
Henry Ashton is the Chief Executive Officer of the Faraday Group, the London broker market arm of General Re. He was a reinsurance broker in London and New York for ten years before joining the Lloyd's managing agent D P Mann, which was subsequently bought by General Re. He is a member of the House of Lords and a trustee of the Lloyd's Patriotic Fund.

07 RUPERT ATKIN
(Working member)
Rupert Atkin is the Chief Executive of Talbot Underwriting and was the active underwriter for syndicate 1183 from 1991 until 2007. He is a director of all Talbot Group companies. He was appointed Chairman of the Lloyd's Market Association with effect from 1 February 2012. He has served on various market bodies, including the Lloyd's Regulatory Board and has chaired both the Lloyd's Underwriters Association and the Joint War Risk Committee. He is a trustee of the Lloyd's Charities Trust.

08 SIMON BEALE
(Working member)
Simon Beale is Chief Executive of Amlin's London Division and joint active underwriter of Syndicate 2001. He is also Group Underwriting Director of Amlin Plc. He has worked in the Lloyd's market since 1984 and has served on various Lloyd's underwriting committees.

09 ROBERT CHILDS
Representative of Hiscox Dedicated Corporate Member Limited
(External member)
Robert Childs is Group Chief Underwriting Officer of Hiscox and an executive director of Hiscox Ltd. He was Chairman of the Lloyd's Market Association from January 2003 to May 2005, and is a Trustee of Enham (a charity for the disabled), Chairman of the Advisory Board of the School of Management of Royal Holloway University and Chairman of The Bermuda Society.

10 MICHAEL DEENY
Representative of The Michael Deeny LLP
(External member)
Michael Deeny is a chartered accountant. He was the Chairman of the Association of Lloyd's Members. His career has principally been in the music industry, where he has promoted U2, Bruce Springsteen, Nirvana and Luciano Pavarotti amongst others. He underwrites through a Limited Liability Partnership and is Deputy Chairman of the Equitas Trust.

11 SIR ROBERT FINCH*
(Nominated member)
Member of the Audit Committee
Sir Robert Finch qualified as a Solicitor in 1969 when he joined Linklaters, becoming Partner in 1974 and Head of Real Estate in 1997. He retired in 2005 to take the Chairmanship of Liberty International plc for three years. He became Chairman of the Royal Brompton and Harefield Hospital Foundation Trust in January 2009. In February 2009 he became the Chairman of the Aviva Mall Fund. He is a director of FF&P Russia, Governor of the College of Law, served as a Church Commissioner from 2003 to 2008 and was Lord Mayor of London for the year 2003/04. He is a trustee of the Lloyd's Patriotic Fund.

12 MATTHEW FOSH
Representative of Novae Corporate Underwriting Limited
(External member)
Matthew Fosh is the Chief Executive Officer of Novae Group plc which he joined in 2002. He is a non-executive director of Ariscom Compagnia di Assicurazioni S.p.A. He previously worked in the capital markets, where in 1989 he co-founded a derivative trading business, which he subsequently sold in 2002 to ICAP plc.

13 CHRISTOPHER HARMAN
(Working member)
Christopher Harman has worked in the Lloyd's market as a reinsurance broker since 1971, specialising in reinsurances of Lloyd's syndicates and companies writing global business. He is a Partner in Jardine Lloyd Thompson Reinsurance Brokers Ltd, who bought Harman Wicks & Swayne Ltd in 2008, an independent Lloyd's broker of which he was founder and Deputy Chairman. He has been an unlimited Name since 1979 as well as writing through a Nameco. He is a trustee of the Lloyd's Charities Trust.

14 DR REG HINKLEY*
(Nominated member)
Member of the Audit Committee
Reg Hinkley was Bursar at Christ's College Cambridge. Until July 2007 he was Chief Executive Officer of BP's UK pension fund. He joined BP in 1981, and worked in finance, planning and risk management roles. Previously he worked at HM Treasury. He is an independent Trustee and Deputy Chairman of the Lloyd's Pension Scheme.

15 LAWRENCE HOLDER
(Working member)
Lawrence Holder has been Managing Director of Cathedral Underwriting Limited since 2000 and has worked in the Lloyd's market since 1983. He is a member of the board of the Lloyd's Market Association and is a trustee of the Lloyd's Charities Trust.

16 ALAN LOVELL
(External member)
Member of the Remuneration Committee
Alan Lovell is Executive Chairman of Tamar Energy, an anaerobic digestion business, and has other green energy roles. He was previously Chief Executive of Costain, Dunlop Slazenger, Jarvis and Infinis. He is Chief Adviser to the restructuring practice of PwC and is a Trustee of The Mary Rose and of Winchester Cathedral. He is a director of the Association of Lloyd's Members and of Alpha Insurance Analysts Ltd (a members' agent).

17 SIR DAVID MANNING GCMG CVO*
(Nominated member)
Member of the Nominations Committee
Sir David Manning retired from the Diplomatic Service in 2007 after four years as British Ambassador to the United States. He is now a director of Gatehouse and a non-executive director of the BG Group and of Lockheed Martin UK. He is Chair of 'IDEAS' at the London School of Economics and on the panel of Senior Advisers at the Royal Institute for International Affairs.

18 NICHOLAS MARSH
(Working member)
Nicholas Marsh is Director of Underwriting Review at Atrium Underwriters Limited and Executive Director of Atrium Underwriting Group Limited, having been Chief Executive for the Group from 2000 to 2005. His Lloyd's career started in 1973, when he joined Syndicate 570 and was Active Underwriter from 1989 to 2005.

The Council as at 27 March 2012.

* Considered to be an independent member of Council.

GOVERNANCE
THE FRANCHISE BOARD

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01 JOHN NELSON
Chairman of Lloyd's
Biography on page 13.

02 DR RICHARD WARD
Chief Executive Officer
Biography on page 13.

03 TOM BOLT
Director, Performance Management
Tom Bolt joined Lloyd's in September 2009. Previously, he was Managing Director of Marlborough Managing Agency. He has extensive experience in international insurance and reinsurance across the UK, US and Europe and has held senior roles in Berkshire Hathaway's reinsurance divisions and as President of some of its insurance subsidiaries. He also assisted in the formation of Bankers Trust Insurance Derivatives business, as well as a related group of insurance and reinsurance companies.

04 SIR ANDREW CAHN KCMG*
Sir Andrew Cahn is Vice Chairman at Nomura International plc and Chairman of the UK Advisory Board of Huawei Technologies Ltd. He is on the Board of TheCityUK, the Institute for Government, the Gatsby Charitable Foundation, the Arvon Foundation, the Japan Society and is an Association Member of BUPA. He was previously Chief Executive of UK Trade and Investment.

05 CHARLES FRANKS
Member of the Audit Committee
Charles Franks became Chief Executive Officer of Kiln Group in 2009 and its Lloyd's managing agency, R J Kiln & Co, in 2007. He joined Kiln in 1993. He was appointed as a Director of R J Kiln in 1995 and Active Underwriter of the Marine division in 2001. He is a member of the board of the Lloyd's Market Association.

06 NICHOLAS FURLONGE
Member of the Nominations Committee
Nicholas Furlonge has worked in the Lloyd's market since 1972 and co-founded Beazley. He has served on a number of Lloyd's boards and committees including the Lloyd's Market Association. He is a non-executive director of Beazley Furlonge Ltd, Chairman of the Lloyd's Community Programme and a member of the Claims Implementation Board.

07 CLAIRE IGHODARO CBE*
Chairman of the Audit Committee
Claire Ighodaro is Audit Committee Chair. She is a Board member and Audit Committee Chair of the British Council, the Lending Standards Board and the Open University. She was a senior executive at BT, an independent director at BIS and UK Trade and Investment and is a past President of CIMA (the Chartered Institute of Management Accountants).

08 ANDREW KENDRICK
Member of the Audit Committee
Member of the Remuneration Committee
Andrew Kendrick is Chairman of ACE European Group. Prior to this, he served as President and Chief Executive Officer, ACE Bermuda. He has over 30 years of insurance industry experience. He is a member of the board of the Lloyd's Market Association (LMA) and was Chairman of the LMA from January 2006 to June 2007.

09 DR MARTIN READ CBE*
Member of the Remuneration Committee
Martin Read is a non-executive director of Invensys, Aegis Group and the UK Government Cabinet Office Efficiency and Reform Board and is the independent Chair of the Remuneration Consultants Group. He was Chief Executive of international IT services company Logica from 1993 to 2007 and has served as a non-executive director on the boards of British Airways, Siemens Holdings, Boots and ASDA. He led a UK Government review of back office operations and IT across the public sector which reported in 2009.

10 LUKE SAVAGE
Director, Finance, Risk Management and Operations
Luke Savage originally trained as a chartered accountant with Price Waterhouse. He joined Lloyd's in 2004 as Director of Finance and Risk Management, subsequently assuming responsibility for operations. Prior to joining Lloyd's he worked in the financial services sector for over 20 years, working with Lloyds Bank, Morgan Stanley and most recently Deutsche Bank.

11 ANDRE VILLENEUVE*
Member of the Nominations Committee
Andre Villeneuve is Chairman of the City of London's International Regulatory Strategy Group. He is an Independent Director of United Technologies Corporation and TheCityUK. He served as Chairman of Euronext-LIFFE, non-executive director of Aviva, and executive director of Reuters where he worked for many years.

The Franchise Board as at 27 March 2012.

* Considered to be an independent non-executive director.

STRATEGIC OVERVIEW

CHIEF EXECUTIVE OFFICER'S STATEMENT

2012 WILL INEVITABLY PRESENT US WITH CHALLENGES

2011 was an exceptional year for catastrophes, with floods in Australia, earthquakes in New Zealand, the Japanese earthquake and tsunami, an active windstorm season in North America and the Thailand floods, and their global impact has been reflected in our results. Despite this, the Lloyd's market remains robust and as well capitalised as it has ever been.

The strength of our reputation and financial position has again been confirmed by the A+ ratings with a stable outlook from Standard and Poor's and Fitch Ratings, and the A rating from A.M Best. Corporation and central assets now stand at a record £2.4bn.

2012 will inevitably present us with challenges. Market rates remain soft and it is clear there will be no major strengthening of the weak investment environment in the foreseeable future.

Our main priority for 2012, as it was for 2011, must be performance management. The changes we made this year to the structure of our Performance Management Directorate (PMD) are an important step forwards. Reorganising the responsibilities of the Syndicate Underwriting Performance team allows us both to maintain the day-to-day oversight of market performance and standards, while heightening our responsiveness to serious performance issues.

The appointment of two senior special advisers to PMD was a direct response to these challenging market conditions, providing Lloyd's with swift access to additional market opinion, knowledge and experience.

2011 saw us step up the pace of our market modernisation programme. The successful pilot to speed up claims processing, which concluded last year, delivered a 39% improvement in the average time taken to process claims. This year we will analyse the recommendations of last year's feasibility study to deliver an integrated Volume Claims Service. In 2011 we also analysed ways in which we could reduce the error rate in reporting claims. The agreement to incorporate pre-adjusting checks into a wider broker portal will be taken forward in 2012 as we develop the specification further.

We are operating in an increasingly competitive industry and we want to improve the efficiency of working at Lloyd's for all market participants. The Market Operations Review is a joint Lloyd's and Lloyd's Market Association (LMA) programme to design and agree an evolutionary roadmap that moves towards the London Market Group's (LMG) Future Processing Model, reviews current back office processes and technology and prepares Lloyd's for the future.

The take-up of The Exchange for the transmission of standard ACORD messages and endorsements in 2011 was also encouraging. Over 700,000 messages passed over it in 2011 and it went live for all classes of business at the start of March 2012.

In the current climate, we have to be especially aware both of costs and the tough conditions faced by the market. The Corporation will cut spending by 8% this year, saving £17m overall. We will pass around £14m of this back to the market in 2012, by waiving performance and risk management charges. We have also frozen service charges for this year at 2011 levels.

The economic environment in which the industry operates will eventually improve. Last year saw the joining-up of both our tactical and strategic strengths with the creation of our Vision 2025, delivering a clear direction for Lloyd's in the decade ahead.

Building on the market's resilience and the strength of our brand, 2011 has demonstrated once again why Lloyd's remains a robust place to do business in challenging times, while showcasing our ability to make the most of evolving business opportunities.

RICHARD WARD
Chief Executive Officer

2011 BUSINESS HIGHLIGHTS

A STRONG PERFORMANCE AGAINST 2011 PRIORITIES IN AN EXCEPTIONALLY CHALLENGING YEAR

MARKET OVERSIGHT

ENHANCED RISK GOVERNANCE STRUCTURE

The key focus of our risk governance has been the delivery of a more proactive approach to risk management across Lloyd's. The Corporation's framework is now more cohesive, with additional management tools to identify, assess and manage risks, including robust analysis of different scenarios and stress testing to monitor changes to Lloyd's risk profile. This year, management action has focused on the challenging insurance cycle, the volume and severity of natural catastrophes, analysis of economic slowdown and the Eurozone crisis and managing the implications of evolving regulation across multiple jurisdictions.

SOLVENCY II

A NEW EU-WIDE REGULATORY FRAMEWORK FOR INSURERS

Lloyd's preparations for Solvency II advanced well in 2011, both within the Corporation and the market, and the entire programme across all relevant parts of the business is on track. The date for implementation of Solvency II remains uncertain. We continue to work with managing agents to ensure that Solvency II calibrated internal models can be used for capital setting in 2013. More broadly, having led industry efforts to secure recognition of geographical diversification in the catastrophe risk part of the standard formula for setting capital, we continue to lobby the EU to modify the formula in terms of currency risk, to better reflect the need to hold assets to pay claims by currency.

CLAIMS TRANSFORMATION

Lloyd's reputation for paying claims is dependent on the speed and quality of the service provided. In 2011, our Claims Transformation Programme pilot delivered an average 39% improvement in transaction times for the 16,000 claims involved. We extended the classes of business handled this way from January 2012, to include professional indemnity, financial institutions, directors and officers and medical malpractice.

Additionally, we consulted on improvements to the Claims Scheme, revised Minimum Standards and Lloyd's Claims Metrics. These have now been published and the revised Claim Scheme and Minimum Standards came into force from January 2012.

THE LLOYD'S RISK INDEX 2011

At the height of the credit crunch in 2009, Lloyd's asked the Economist Intelligence Unit to carry out our first ever global survey into business leaders' attitudes to key risks. In 2011, we commissioned an expanded version of the survey.

The findings revealed that in every region of the world, across all industries, business leaders now perceive the world as an inherently riskier place. Interestingly, they also believe they are more than adequately prepared to deal with virtually all the types of risk suggested.

The change in their priorities was revealing; two years ago the availability of credit took the number one spot, now this has been replaced by the loss of customers and orders created by a new age of universal austerity. Perhaps more surprisingly, the risk posed by talent and skills shortages shot up to become the second highest priority risk facing businesses today.

The significance of every category of risk for business leaders in the Asia-Pacific region rose even more sharply than in other parts of the world.

To see the Risk Index in full, or to find out more about Lloyd's Risk Insight work, visit www.lloyds.com/riskinsight

THE EXCHANGE

2011 saw a marked increase in both the level of market support and volume of messages sent across The Exchange. The Contacts Portal – a central database of underwriters and brokers open for electronic business – went live, enabling organisations to update their contacts online. Over the year, additional classes of endorsements (amendments to a contract) were added to include marine, property, specie and professional indemnity. Additionally, accounting and settlement messages are now being transacted over The Exchange. By the end of 2011, 29 brokers, 57 managing agents and 25 International Underwriting Association carriers were connected to The Exchange and more than 700,000 messages had been sent across it. We expect to see the number of endorsement, placing and accounting messages increase significantly during 2012. The electronic endorsements initiative was extended to all classes of business from 5 March this year.

ACCESS TO BUSINESS

In an increasingly competitive environment, Lloyd's is always looking for ways to make it easier for new business to come to the market. Last year, the Lloyd's market approved 13 new brokers, bringing the total for 2011 to 186 Lloyd's registered brokers.

LICENCES

In 2011, the most high-profile addition to Lloyd's suite of licences was the new direct licence in China. Our network of licences remains one of the key benefits of trading at Lloyd's and enables the market to operate in an increasingly global industry.

Against the backdrop of the rapidly changing supervisory and regulatory environment in the UK, Europe, the US and elsewhere, Lloyd's made significant efforts to ensure that reforms did not disadvantage or inappropriately affect the market.

INTERNATIONAL MARKETS

Our International Markets team has continued to build on its success in a number of countries this year. The opening of a new office in the Netherlands in 2011 will support market development in the Benelux region, as will the appointment of a new regional development manager in France. Our 2011 events programme spanned Stockholm to South Africa, delivering 44 individual events in 24 countries.

MAKING ACCESS EASIER FOR COVERHOLDERS

Coverholders are companies or individuals who have been given delegated authority to write business on behalf of a Lloyd's syndicate. They are important to Lloyd's as they offer new routes to business and strengthen our distribution chain. Making it easier for coverholders to do business with us is a priority.

In 2011, we made further progress on making it easier for coverholders to report to Lloyd's by developing a new claims reporting standard and hosting a technology forum to raise awareness about systems that simplify and improve the process.

We also responded to coverholder requests by delivering a new sub-brand to help them market themselves as part of Lloyd's. We want to ensure coverholders have the same opportunities to develop their specialist knowledge as any other part of the market. In 2011, we launched a Coverholder Toolkit and helped develop a new Australian Diploma in delegated underwriting. Lloyd's also hosted an EU conference specifically for coverholders. In 2012, we will deliver a programme to further raise awareness of the Lloyd's market among coverholders and provide them with the tools they need to make the most of their Lloyd's contracts.

KEY PERFORMANCE INDICATORS 2011

MEASURING PERFORMANCE AT LLOYD'S

Key performance indicators (KPIs) are used by the management team to evaluate both the Lloyd's market and the Society's performance. Lloyd's has a range of metrics used internally for tracking and performance management. Those shown here best illustrate Lloyd's financial performance and progress against delivering our strategy in 2011.

Some of the measures change over time as more comparative information becomes available or to reflect any substantive change in strategy. Directional trends are important, even in a market made up of independent businesses.

MARKET PERFORMANCE

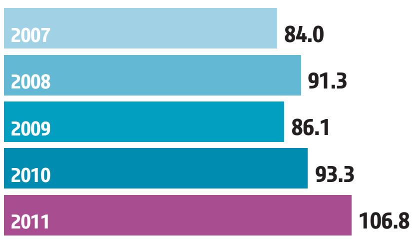
Combined ratio

- Definition: The combined ratio is an expression of net incurred claims and expenses against net earned premium. Any figure that is less than 100% signifies a technical underwriting profit.
- Rationale: Headline financial indicator for measuring underwriting performance. Lower is better.
- Progress: Severity and frequency of natural catastrophes in 2011 led to the market having to report its first combined ratio greater than 100% in six years.

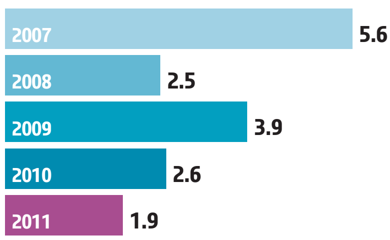
Investment return

- Definition: Net investment income plus realised and unrealised return on investments as a percentage of average total investments.
- Rationale: Investment return can have a significant impact on overall profitability for insurers/reinsurers.
- Progress: A return of 1.9% represents a solid performance in the continued low interest rate environment based on a conservative portfolio.

COMBINED RATIO
%



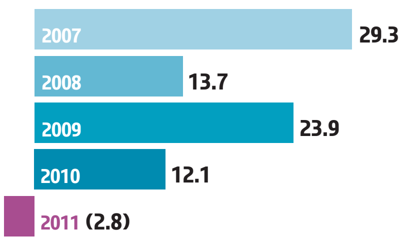
INVESTMENT RETURN
%



Pre-tax return on capital

- Definition: Profits on ordinary activities before tax as a proportion of average capital and reserves held.
- Rationale: Indicates the capital efficiency of Lloyd's. The goal of the Franchise Board and Council is to support the market in monitoring cross-cycle returns to all capital providers.
- Progress: While 2011 produced a negative return on capital, Lloyd's ten-year average return is 15%.

PRE-TAX RETURN ON CAPITAL
%



STRATEGIC PERFORMANCE

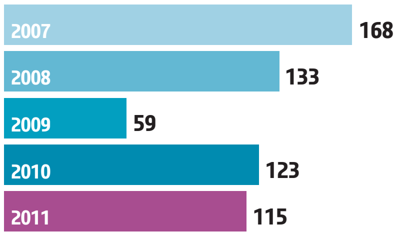
Solvency deficit

- Definition: The aggregate shortfalls for all members where the member's assets are insufficient to cover its underwriting liabilities and member capital requirement.
- Rationale: Indication of success at mitigating Central Fund exposure. Lower is better.
- Progress: Solvency deficits have remained low in the year despite the large scale of claims from 2011.

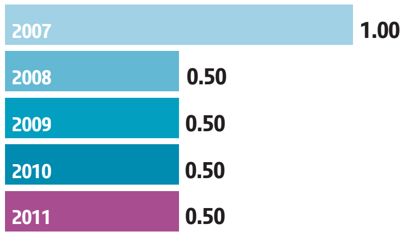
Cost of mutuality

- Definition: Central Fund contribution rate charged to members. This includes the syndicate loans charged in 2005 and 2006, and subsequently repaid in 2007.
- Rationale: Medium-term cost indicator for the operational efficiency of mutually available assets. Lower is better.
- Progress: The 2011 contribution rate of 0.5% continues to represent a cost-effective benefit of mutuality; the rate for 2012 is set to remain at 0.5%.

SOLVENCY DEFICIT
£m



COST OF MUTUALITY
%



Security and ratings

- Definition: Lloyd's financial strengths as evaluated by the world's leading insurance rating agencies, taking into account operating performance, capitalisation, global competitiveness and financial flexibility.
- Rationale: Indicates the financial robustness of Lloyd's.
- Progress: Lloyd's ratings from all three ratings agencies are at the target level and were reaffirmed in 2011.

	Actual	Target
STANDARD & POOR'S	A+	✓
FITCH RATINGS	A+	✓
A.M. BEST	A	✓

Brand strength

- Definition: Non-financial indicator – independent brand tracking survey of brokers, coverholders and policyholders run biennially. The brand 'health score' is a combination of scores for brand affinity (familiarity, favourability, trust and recommendation) and awareness (percentage of respondents who, unprompted, mentioned Lloyd's as one of the first insurance/reinsurance brands which came to mind). The measure is an index and tracks relative changes in perception over time.
- Rationale: A leading global brand and reputation helps managing agents win and retain preferred business.
- Changes to the 2011 survey: The countries included in the survey were reduced from 19 in 2009 to 13 which consisted of Lloyd's top ten markets and three countries where the Lloyd's brand is relatively new (China, Singapore and Brazil). In addition, there was a big increase in the number of potential Lloyd's brokers and policyholders included. As a result, Lloyd's has two sets of results for brand health in 2011. 2011(a) represents the overall scores of just those countries included in both the 2011 and 2009 surveys; while 2011(b) illustrates the overall scores for all 13 of the 2011 countries. The differences between the 2009 and 2011 scores are due to the higher proportion of potential Lloyd's users and the inclusion of the newer countries to Lloyd's in 2011.
- Progress: Lloyd's has maintained strong brand health in the insurance sector with consistently high scores across all brand measures (scoring 75 out of a possible 100 for brand affinity and with 33% unprompted awareness). In the reinsurance sector the Lloyd's brand is also strong (scoring 76 out of a possible 100 for brand affinity and with 36% unprompted awareness). The next survey will take place in 2013 and will be reported in our 2013 Annual Report.

INSURANCE

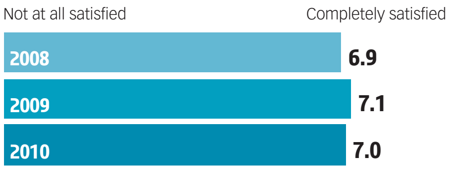
REINSURANCE

2011 (a) Excludes China, Japan and Switzerland to allow comparison with previous years.
2011 (b) Includes all 13 countries from the 2011 survey.

Managing agent satisfaction levels

- Based on feedback from managing agents we have changed the timings of the survey, therefore the survey used to measure 'Managing Agent Satisfaction Levels' was not carried out in 2011.
- Definition: A non-financial indicator measuring Lloyd's managing agents' overall satisfaction levels with Lloyd's service, taken from an independent survey.
- Rationale: Recognition of managing agents as customers of the Lloyd's platform and the importance of tracking their satisfaction.

MANAGING AGENT SATISFACTION LEVELS
Average score out of 10



BUSINESS ENVIRONMENT

IN A VOLATILE ECONOMIC CLIMATE, INSURERS NEED TO COMBINE DISCIPLINE WITH FORWARD THINKING

THE ECONOMY

GLOBAL ECONOMY

2011 started with cautious optimism that the worst of the global downturn was over, and that the balance was tipping towards a slow but sure economic recovery. However, it ended on a much more pessimistic note, compounded by the ongoing sovereign debt crisis in the Eurozone and a growing list of European countries re-entering recession in 2012.

The US economy, hampered by an anaemic housing market and persistently high unemployment, saw disappointing economic growth although GDP did grow in the third and fourth quarters. The increase in fiscal tightening which began in 2011 is expected to continue in 2012. While US inflation remained very low in the first half of the year, the final six months saw it rise above the Federal Reserve Bank's 2% target. This level may well ease back during 2012.

While the growing BRIC (Brazil, Russia, India and China) economies started the year with predictions of strong growth for 2011, they actually slowed significantly towards the end of the year. The final months of the year saw Chinese manufacturing output fall to a 32-month low while ratings agencies revised their growth projection for India downwards in the face of the global slowdown, high domestic interest rates and sustained inflation. The year's natural catastrophes in the Asia-Pacific region, particularly Japan and Thailand, have had a significant negative impact on their economies, although reconstruction efforts may stimulate domestic investment in 2012.

UK ECONOMY

Government spending cuts, tax rises and growing inflation drove down consumer confidence and spending. Over the year, this resulted in rising levels of unemployment, which were not compensated for by job creation in the private sector. Growth forecasts for 2011 and 2012 were steadily revised downwards during 2011.

Sterling remained a preferred currency for international investors which kept the Government's cost of borrowing lower than many of its European neighbours. However, low interest rates continued to deliver poor returns for investors.

INSURANCE INDUSTRY

The global insurance industry is facing significant challenges in a number of areas:

IMPACT OF ECONOMIC CONDITIONS

Looking ahead, the insurance market may be negatively impacted by a period of suppressed demand driven by economic uncertainty. The full impact of recession-related claims remains unknown, but the number of attritional claims and claims notifications in some classes of business increased. In addition, the volatility of global markets has depressed investment returns.

The risk of a double-dip recession has created a very cautious investment environment, particularly in Europe and the City of London, while the reduction in government spending in many countries has reduced the range of new product initiatives coming to market.

Similarly, the Eurozone crisis is slowing insurance growth across Europe as fewer infrastructure projects are initiated and businesses close. There are, however, a number of important developing markets, particularly in Latin America and Asia, where the demand for insurance is growing.

IMPACT OF NATURAL CATASTROPHES

The number and severity of natural catastrophes in 2011 has had a significant impact on the volume of claims. However, despite this being one of the highest years of claims for the insurance industry, the level of capital held by the industry as a whole means that the outlook for the non-life sector remains stable overall.

IMPACT OF UNDERWRITING CONDITIONS

Despite the volume of catastrophe claims in 2011, an excess of capital in both insurance and reinsurance markets has kept underwriting conditions soft in many areas of business, including casualty and property. Casualty lines, in particular, ended the year under even greater pressure than in 2010. However, the year's events highlighted the importance of understanding the impact of aggregation – a high number of different types of claims from one event – to ensure risks are priced appropriately.

The trend towards mergers within the industry caused by current conditions continued in 2011, although uncertainty about the impact of the year's catastrophes on the value of some insurers meant a number of anticipated deals had stalled by the end of the year.

IMPACT OF REGULATORY CHANGE

The insurance industry faced major changes in the structure and substance of regulation. Globally, regulatory regimes are being created for the identification and supervision of Systemically Important Financial Institutions (SIFIs) and Internationally Active Insurance Groups. Insurers falling under these regimes could face an increased regulatory burden, possibly including higher capital requirements.

EU institutions continue to discuss the legislative rules for the Solvency II regime. The regime will reform the capital setting process, governance, risk management, supervision and disclosure requirements of (re)insurers in the EU. Uncertainty over full implementation of Solvency II has been compounded by the delay in approving the Omnibus II Directive, which must be done before Solvency II can be implemented. The proposed Omnibus II Directive amending the Solvency II regime will be the subject of discussions between the EU institutions over the coming months with a view to adoption of an agreed final text.

The UK Parliament is considering Government proposals for changes to financial supervision. These include disbanding the FSA and replacing it with the Prudential Regulation Authority (PRA) and the Financial Conduct Authority (FCA). There is a risk that the UK's new regulatory structure will increase the costs and burden of regulation.

Lloyd's and the industry continue to lobby to influence the evolution of the UK, European and global regulatory frameworks to ensure that the competitive position of the UK insurance sector is both protected and promoted.

CHANGING BUSINESS FLOWS

The insurance expertise and capability in established and emerging regional insurance hubs outside the UK continued to develop. While business from many of the markets served by these hubs flows into London on a cross-border basis, the emergence and evolution of local and regional markets and hubs may reduce London's share of this business in the future.

Stronger economic growth in emerging markets, among other factors, is fuelling quicker premium growth in these markets compared to advanced economies. In some countries, access to this business requires local regulatory approval and sometimes the establishment of a local presence.

Insurers and brokers are reacting to these changes by expanding their global reach to protect existing business flows and increase the amount of business they can access.

INSURERS' BUSINESS MODELS

Given that key regional insurance hubs are now well established, the multiplatform model (with insurers operating from several locations) has become the standard business model for specialist insurers. Platform selection decisions are primarily driven by client choice, which platform is most economically efficient for the insurer and its trading and processing infrastructure. Lloyd's continues to work with multiplatform agents to identify opportunities to attract suitable business.

Developments in national, EU and global regulation (particularly Solvency II) could impact insurers' multiplatform strategies. This may result in consolidations, additions or relocations of platforms in order to gain access to a wide range of business as efficiently as possible.

BROKERS' BUSINESS MODELS

Soft market conditions and cost conscious clients have placed downward pressure on brokers' revenues. In response, brokers are pursuing strategies to reduce costs and increase revenue. Such strategies include mergers and acquisitions; insurer panel rationalisation; increased participation in the insurance value chain (ie delegated authorities, claims); and other initiatives designed to raise revenue from insurers. As Lloyd's is fundamentally a broker market, the Corporation will continue to work closely with the London & International Insurance Brokers' Association (LIIBA) and the wider broking community.

CHANGING RISKS AND PRODUCTS

Insurers face changes in the underlying risk landscape, with the average cost of claims increasing. The increasing severity of both natural and man-made catastrophe events is mainly attributable to factors such as climate change, economic development and increasing risk aggregation in catastrophe-prone areas. New categories of risk exposure and insurance claims are emerging, especially those connected with globalisation and new technologies. A more litigious culture is also increasing the cost of claims associated with more traditional risks.

New catastrophe bond issuance figures for 2011 fell just short of those for 2010. Catastrophe bonds continue to be used primarily in relation to extreme natural catastrophe risks such as windstorms and earthquakes in the US and Europe. Further significant growth in this sector will likely be driven by interest from mainstream investors, governments and increased demand for cover for other geographies or risk types.

CHALLENGES FACING THE LLOYD'S MARKET

LLOYD'S PRIORITIES

Despite the impact of this year's economic and catastrophic events, Lloyd's continues to retain its strong position in an increasingly competitive market. Our balance sheet remains healthy, our conservative investment strategy has safeguarded capital and our business model has continued to prioritise underwriting discipline and underwriting profitability.

However, the market clearly faces a number of challenges. The five principal challenges identified in our Three-Year Plan 2012-2014 remain broadly the same as in our previous strategic plan, although with an added emphasis on modernising, internationalising and diversifying the Lloyd's market.

BUSINESS ENVIRONMENT
CHALLENGES FACING THE LLOYD'S MARKET

MARKET PRIORITIES

In a competitive market, we are addressing these challenges through the market's priorities for the Three-Year Plan period. Overseeing the performance of the market, which has been a fundamental part of Lloyd's success over recent years, remains a top priority. This should maintain the market's strong financial security and build on Lloyd's reputation as a highly secure insurance market.

More specific responses on the part of market participants and the Corporation are outlined in the table below.

For further information please read Lloyd's Three-Year Plan 2012-2014 at **www.lloyds.com/strategy**

CHALLENGES	RESPONSES
MAINTAINING MARKET PERFORMANCE GIVEN INDUSTRY CONDITIONS > Challenging rating environment > Excess capital within the industry > Increasing claims severity and inflation	> Managing agents: demonstrate appropriate discipline across all aspects of their insurance operations > Corporation: maintain challenging business partner role and embed Lloyd's Risk Appetite Framework
MAINTAINING MARKET PERFORMANCE GIVEN WIDER ECONOMIC CONDITIONS > Protracted global economic uncertainty > Decreased demand for insurance in developed markets > Low investment return and higher inflation environment > Risk of sovereign default and resulting impact on insurer balance sheets	> Managing agents and Corporation: maintain underwriting discipline while managing the impact of economic uncertainty on rates, claims and investments and apply robust risk management standards > Corporation: continue to embed Lloyd's Risk Appetite Framework
A CHANGING SUPERVISORY AND BUSINESS ENVIRONMENT > Uncertainty around global financial services regulatory reform > Changes to the UK architecture of financial supervision and regulation > Operational and strategic implications of Solvency II and uncertainty around the implementation timetable > Impact of regulatory reform and the tax environment on the attractiveness of London as a domicile of choice	> Managing agents and Corporation: continued commitment to implementation of Solvency II > Market and Corporation: continue to work together and with other stakeholders to promote the competitiveness of London as a financial services centre > Corporation: continue lobbying activities to influence the design of domestic and international regulatory frameworks
MAINTAINING THE ATTRACTIVENESS OF LLOYD'S > Ensuring brand strength is not undermined > Maintaining market cohesion > Changing nature of market participants > Ensuring any new entrants, including through acquisition of an existing managing agent or syndicate, are of an appropriate quality > Addressing the length and complexity of the Lloyd's distribution chain > Maintaining a vibrant subscription market > Continuing to modernise the market's operating environment > Attracting and developing talent	> Market: active participation in market modernisation initiatives by brokers and managing agents; managing agents to continue to operate in line with franchise standards and guidelines > Market and Corporation: continue to work to develop and implement strategies to attract and retain high quality insurance talent > Corporation: enhance Lloyd's existing strengths; continue to co-ordinate, lead and resource market modernisation initiatives; defend and explain the pro-competitive nature and benefits of the subscription market
MAINTAINING ACCESS TO CHANGING BUSINESS FLOWS AND DISTRIBUTION > Consolidation of brokers; dominance of the largest three brokers > Lloyd's platform increasingly used to write more 'volatile' business > Choice of locations for accessing insurance business flows > Regionalisation of specialist insurance business > Growth of 'Lloyd's type' business in emerging markets > Leveraging position in established markets	> Managing agents and Corporation: continue to develop effective relationship management programmes with brokers to deliver reciprocal benefits; encourage insurance industry capital from countries that would improve Lloyd's geographic diversification and potentially provide access to new sources of business and broaden the market's pool of intellectual capital > Corporation: maintain Lloyd's licence network and, subject to market demand, pursue market development opportunities

UNDERLINING THE IMPORTANCE OF MANAGING RISK

Effective risk management is the bedrock of Lloyd's, ensuring potential risks are identified, current risks are accurately assessed and both are proactively managed.

RISK MANAGEMENT

Lloyd's uses a comprehensive Risk Management Framework which provides oversight and challenge to the risks facing both the market and the Corporation.

Lloyd's performance management framework details what is required of businesses operating at Lloyd's and seeks to raise standards across the market. Our risk governance structure provides oversight of the risks facing Lloyd's based on both quantitative and qualitative risk information. This structure is made up of the Executive Risk Committee (ERC), which is chaired by the CEO and focuses on oversight of key strategic risks facing the Society, and three specialist sub-committees:

- The Syndicate Risk Committee (SRC) – oversight of syndicate and market level risks.
- The Financial Risk Committee (FRC) – oversight of financial market risks across the Chain of Security.
- The Corporation Risk Committee (CRC) – oversight of all material risks associated with operations at the Corporation.

The Franchise Board has overall responsibility for risk management, including the Risk Management and Risk Appetite Frameworks. The ERC provides them with assurance, via the CEO, that risks to the Society are identified and managed in accordance with approved policies and risk appetites.

This year, the risk committees have further developed their proactive approach to risk management, including the use of tools such as scenario analysis and stress testing to assess risk. Management information for the risk committees has been significantly improved to ensure appropriate oversight and challenge. A new style risk and capital management information report is being produced for the ERC, bringing together the views of its sub-committees to provide complete coverage of all risks plus relevant capital and solvency information. This report is also issued to the Franchise Board, which retains ultimate ownership of risk management at Lloyd's.

ASSESSING ECONOMIC AND EUROZONE RISK

The impacts of the current economic crisis are interdependent and constantly evolving, and Lloyd's has been assessing these risks since the downturn began. At the end of 2010, our risk governance structure identified sovereign debt and Eurozone failure as critical potential factors in the overall economic risk landscape. Throughout 2011, we developed a range of economic scenarios and ran stress tests against them to analyse the possible impacts on Lloyd's assets.

As the level of uncertainty in the Eurozone has grown, the Executive Risk Committee has extended this analysis to cover all key risk areas for Lloyd's, including insurance and operational risk. We have used the results to create additional controls and contingency plans, such as the swift transfer of funds in the event of a major EU or American bank failure and creating varying clauses in euro-written contracts. More directly, we have used it to adjust our risk management exposure, including reducing our investment in peripheral EU government bonds.

Unless and until the sovereign debt and Eurozone crisis is resolved, Lloyd's cross-business working group will continue to closely monitor these risks, with regular updates to our risk governance structure as a whole.

RISK MANAGEMENT
CONTINUED

A UNIQUE ANALYSIS OF RISK

The challenging conditions of the insurance cycle make it more important than ever to have access to reliable business information which accurately reflects existing conditions and provides a historical context.

The report 'Statistics Relating to Lloyd's' brings together an unrivalled data set of key facts and figures relating to the Lloyd's market, providing a unique resource for analysis and management information.

As this report provides statistics based on classes of business, it offers a particularly in-depth picture of past and present trends, syndicates' performance and historical detail.

The report is accompanied by a series of supporting spreadsheets as well as motion charts and data visualisation tools, providing an engaging way of spotting trends and patterns in data and the ability to study several dimensions simultaneously.

RISK MANAGEMENT FRAMEWORK

The Risk Management Framework includes management tools, a formal governance structure and a defined approach to identifying, assessing, monitoring and managing key risks. This year, the Framework was enhanced to ensure Lloyd's has increased capability to manage its key risks in line with the Society's risk appetites and to meet the new requirements of the Solvency II regime.

OWN RISK AND SOLVENCY ASSESSMENT

Lloyd's has also further developed its approach to the Own Risk and Solvency Assessment (ORSA) – which aligns all of the activities Lloyd's uses to manage risks and ensure the right level and type of capital. This alignment improves the quality of management information and the resulting decisions. In 2011, we produced a series of pilot reports to enable senior management to review the ORSA's proposed structure and content. A live report was finalised and approved by the Franchise Board during the first quarter of 2012. In future, the report will be produced at least annually.

LLOYD'S RISK APPETITE FRAMEWORK

Lloyd's risk appetite defines the level of risk-taking which the Franchise Board believes is acceptable for Lloyd's, using the Framework as its main tool to monitor Lloyd's risk profile. Risk appetite statements – detailing the appropriate level of risk for Lloyd's – have been produced for each area of material risk. Some are market risks and some are Corporation risks.

There are 14 risk appetite statements in all, each supported by detailed metrics used for in-depth monitoring against each statement. These are examined by the Franchise Board and regularly reported to the risk committees. Key metrics act as early warning triggers, ensuring timely management of the risks to reduce their impact. Because Lloyd's has oversight responsibilities for the market but not direct control over its risk-taking, some metrics are early warning triggers, others are guidelines only. However, if the market operates outside a guideline this will be investigated and the implications assessed.

The Corporation metrics, on the other hand, operate as formal limits. Breaching a Corporation metric may require intervention and action to bring the risk profile back on track.

Primary operational oversight of the Risk Appetite Framework comes through Lloyd's risk governance structure, with the Franchise Board retaining ultimate ownership (see Figure 7).

Figure 7

RISK GOVERNANCE STRUCTURE

KEY RISK ISSUES

While the Risk Management Framework provides a structured approach for individuals at Lloyd's to identify, assess and manage all risks facing the Society, there are a number of key risk issues that remain under constant review by Lloyd's senior management. The Framework ensures that we keep pace with evolving economic, environmental and geopolitical risks, actively monitoring their potential impact on the business and escalating them up the risk governance structure as required. Oversight and challenge is provided at this stage to ensure appropriate management actions are established.

There are currently three key risk issues (listed in the table below), which are the focus of senior management and the risk governance structure at Lloyd's. These risks were identified through the Risk Management Framework and have been confirmed as the current key risk issues facing Lloyd's through an additional risk assessment process involving Franchise Board and ERC members.

RISK ISSUE	POTENTIAL IMPACT	MITIGATION
THE INSURANCE CYCLE	Lloyd's businesses suffer losses or erode their capital base through inadequate pricing and reserving or insufficiently robust management processes.	> Reviewed and agreed business plans, realistic disaster scenarios and capital assessments remain fundamental controls. > Greater focus on oversight of performance by business criteria, reserving and compliance with minimum standards. > Ongoing detailed reviews of key classes of business. Including: – Marketwide review of the casualty class of business. – Robust challenge of planned growth throughout the review of business plans.
UNSTABLE ECONOMIC AND FINANCIAL CLIMATE	Lloyd's suffers increased insurance liabilities, decreased asset values or capital constraints.	> An enhanced framework for monitoring and managing financial risk across the Chain of Security has been implemented. > Continued close monitoring of assets and the credit ratings of top counterparties. > Contingency plans in the event of Eurozone issues are being established across key areas. Including: – Marketwide Eurozone risk workshops to ensure a cohesive approach to the assessment and management of this risk. – Creation of Eurozone risk Corporation working group to drive mitigating actions and share information.
SIGNIFICANT REGULATORY CHANGE ACROSS MULTIPLE JURISDICTIONS AND IN PARTICULAR THE IMPACT OF THE SOLVENCY II REGIME	Lloyd's competitive position is weakened, and suffers regulatory sanctions and disadvantageous capital requirements.	> Proactive engagement with key policymakers and regulators in the UK and internationally (including UK policymakers on proposed new regulatory architecture). > Intensive lobbying of key policymakers in UK and EU has ensured the Solvency II regime is not over-prudent. > Comprehensive Solvency II programme in place; key actions include: – Tracking syndicate progress and taking mitigation action where needed. – Working closely with the FSA towards implementation of Solvency II at Lloyd's.

For more on risks and uncertainties, see **page 43.**

STRATEGY

THREE-YEAR PLAN

Lloyd's Three-Year Plan highlights the Corporation's priorities for 2012.

LLOYD'S THREE-YEAR PLAN 2012-2014: KEY HIGHLIGHTS

KEY CHARACTERISTICS

- Lloyd's model – a subscription market backed by a layer of mutual security – is one which positions the market well over the plan period.
- Lloyd's is a broker market – brokers continuing to access the market on behalf of their clients is critical to the market's ongoing success.
- Lloyd's is a London-based international business – it is a major role of the Corporation to maintain and enhance market access and to ease the flow of business into the market.
- Diversity underpins the market's attractiveness – this includes diversity in the market portfolio (product and geographic balance) and in the size and structure of market participants and capital providers.

THE ROLE OF THE CORPORATION

The role of the Corporation is fundamentally unchanged from previous years. The Corporation's market oversight responsibilities remain prominent given current market conditions.

The Corporation's role is as follows:

- To undertake the overall risk and performance management of the market.
- To maintain and develop the attractiveness of the market for capital providers, distributors and clients while preserving Lloyd's diversity and London-based business model.

As in previous years, this plan is built around the needs of Lloyd's market participants and expresses what the Corporation can do to support their business aims. The Corporation will take action where necessary in the long-term interests of the market, but in general its actions are guided by market need and demand.

CORPORATION PRIORITIES FOR 2012

- **Market oversight**
  - A resolute focus on underwriting discipline and risk management.
- **Solvency II**
  - Implement and embed Solvency II to protect and, where possible, enhance Lloyd's capital structure and efficiency.
- **Claims Transformation Programme**
  - Transform the way the Lloyd's market handles claims to enhance the experience of the customer.
- **Market Operations Review**
  - Agree and implement an evolutionary roadmap that renews the current back office processes and technology to prepare Lloyd's for the future.

For further information please read Lloyd's Three-Year Plan 2012-2014 at **www.lloyds.com/strategy**

INTERNATIONAL REACH

RESPONDING TO THE WORLD'S CHANGING INSURANCE NEEDS

Lloyd's has licences and authorisations to trade in over 75 countries and the ability to conduct business in over 200 countries and territories worldwide.

The impact of Lloyd's global reach has been particularly apparent this year, with swift responses to major natural catastrophes across the world. Lloyd's has 40 offices around the world – from third party legal representatives who maintain our licences, to the larger offices of our country managers who also help develop our regional markets.

Around 41% of our business comes from North America, which includes Canada, 18% from the UK and 16% from the rest of Europe. The final 25% comes from business from Central Asia and Asia-Pacific, other Americas and the rest of the world.

LLOYD'S AND CHINA

In September 2011, Lloyd's wrote its first direct policy in China.

In November, Catlin announced a strategic partnership with China Re, which led to the creation of a special purpose syndicate at Lloyd's. The quota-share reinsurance underwritten by syndicate 2088, which is backed by China Re, provides Catlin with additional capacity and will give China Re a share of the business underwritten by Catlin's syndicate 2003. The deal between China Re and Catlin brings new capital into the market and provides an opportunity for the sharing of knowledge and the exchange of personnel.

A MAGNET FOR REGIONAL LEADERSHIP

Our international reach helps the Lloyd's market build relationships with local insurers and brokers. In 2011, Lloyd's hosted 44 individual events in 24 different countries.

As international economies evolve, we also continue to explore new opportunities in less traditional markets. Our market development work last year included Lloyd's then-Chairman, Lord Levene, leading the largest ever market delegation to Turkey where he held meetings with the Turkish Prime Minister and the Minister of Finance.

In October, Lloyd's managing agents met more than 200 representatives from the Brazilian insurance and reinsurance industry at the Lloyd's Brazil 'meet the market' event held in Rio de Janeiro. With eight Lloyd's syndicates in Brazil, six of which are co-located at Lloyd's Brazil, bringing together the Brazilian reinsurance community in one place proved hugely popular.

We continued to put a lot of effort into maintaining our traditional business. North America continues to provide the largest proportion of this and in 2011 we opened an office in Atlanta to service the Southeastern US, the fourth and newest region within Lloyd's America. In May, over 80 representatives from the Lloyd's market took part in the annual Risk Management Society (RIMS) event held in Vancouver. In Canada, Lloyd's were major sponsors of the key industry conferences and held coverholder gatherings in three cities, attended by over 150 coverholders.

Italy is one of Lloyd's largest sources of direct business in continental Europe. The annual Lloyd's ILLCA conference (the flagship Italian insurance event) attracted over 600 insurance professionals. This event has become a vital regional point of reference for the industry, with a growing profile year-on-year.

BUILDING BUSINESS IN THE UK

The Lloyd's model of building relationships with regional brokers and coverholders (Managing General Agents) has also delivered strong results in the UK. In particular, it provided greater scope to underwrite risks for small and medium enterprises (SMEs). A 2011 survey of the UK insurance market helped us to develop a programme of regional events to enable UK brokers and coverholders to understand how to access the Lloyd's market. This included presentations at 14 events across the country and 35 on-site coverholder visits, with more planned for 2012. In September 2011, the Managing General Agents Association (MGAA) was created to help clarify the role of MGAs for regulatory purposes and to set best practice guidelines. Lloyd's has representation on the MGAA's board and is actively involved in its events programme.

BUILDING OUR STRENGTH IN SINGAPORE

Singapore is the hub for the Asia-Pacific market, placing an increasing volume of business into the London market since 2000. A decade ago, Lloyd's Asia had just two syndicates here, writing a US million dollar premium in single figures. Today there are 22 syndicates, with over $330m in premium written in 2010.

Lloyd's profile in the region is clearly growing, but the sheer volume of business meant Lloyd's Asia recently outgrew its original offices. As Lloyd's Head of Asia-Pacific, Kent Chaplin, pointed out, "We've increased our headcount from a handful of people in 2004 to over 250 today – quite simply, we'd run out of space."

This year, Lloyd's moved into its new offices in Singapore's Marina Bay with impressive eco credentials as well as ample space for underwriting. With plenty of room for expansion, Kent is confident Lloyd's Asia will not have to look for a new home for many years.

PEOPLE STRATEGY

AIMING TO BE A FIRST-CHOICE EMPLOYER FOR THE BRIGHTEST AND THE BEST

The ultimate source of value in our business is its people. Recognising this, Lloyd's tackles the challenge of attracting the best talent in a dynamic and proactive way.

The depth and quality of the talent pool in London is central to the ongoing success of the Lloyd's market. Recruiting, retaining and developing talent in the insurance industry remains challenging. Both the Corporation and the market are working hard to explain that careers in insurance are increasingly international with many diverse paths available in this fascinating area of financial services. The Corporation, in conjunction with the Lloyd's market, has developed a number of initiatives to support this.

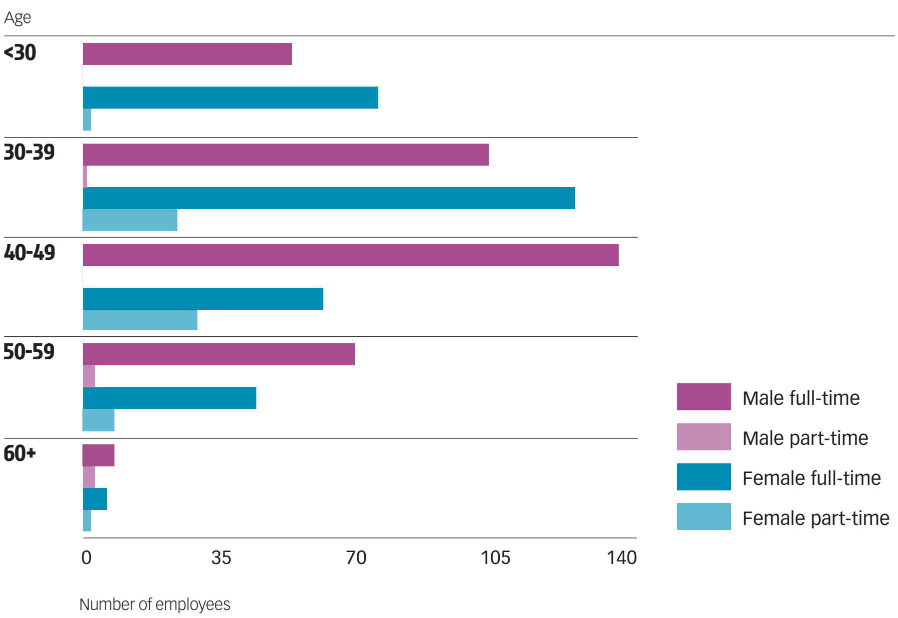
DEVELOPING LEADERSHIP AND TALENT

GRADUATE PROGRAMMES

We believe in investing time and commitment to develop our employees at the start of their careers. The Corporation offers two graduate programmes – a generalist programme and a new programme launched in 2011 for claims specialists – as well as a summer internship scheme. Eighteen new starters joined our two graduate schemes in September 2011. The nine graduates on the generalist programme will complete three placements over 18 months across different areas in both the Corporation and the market. The nine claims graduates will carry out two placements in the market with both a broker and a managing agent, and take up a range of job-shadowing opportunities during their 12-month programme.

Figure 8

UK CORPORATION EMPLOYEE PROFILE



EMPLOYEE AND MANAGEMENT DEVELOPMENT

Lloyd's Management Programme for all Corporation line managers was launched in June 2011, with the aim of delivering the highest standards of, and a consistent approach to, people management. Reactions to the programme have been very positive and it will continue to be rolled out throughout 2012 and 2013.

New international staff handbooks were developed last year. These have been issued to colleagues in the US, Singapore and China, with Ireland and South Africa to launch in early 2012.

Talent Reviews were completed across all Directorates in the Corporation, while the sixth annual group – including market participants – completed the 'Developing Leaders at Lloyd's' programme in partnership with the London Business School. Feedback from the delegates continues to be extremely positive and a seventh group began the programme in January 2012.

The LLMIT Education Committee reviewed the Lloyd's and London Market Introductory Test (LLMIT) programme and syllabus to ensure standards and relevance to the market remain high, and created an on-site testing facility in the Lloyd's building. The amended syllabus, including new material on Solvency II, claims and delegated underwriting, will be launched at the start of 2012.

EMPLOYER OF CHOICE

In 2011, Lloyd's was awarded a place in *The Sunday Times*' 100 Best Companies to Work For and was also recognised as one of Britain's Top Employers 2011 by the *Daily Telegraph*.

ATTRACTING CLAIMS TALENT TO LLOYD'S

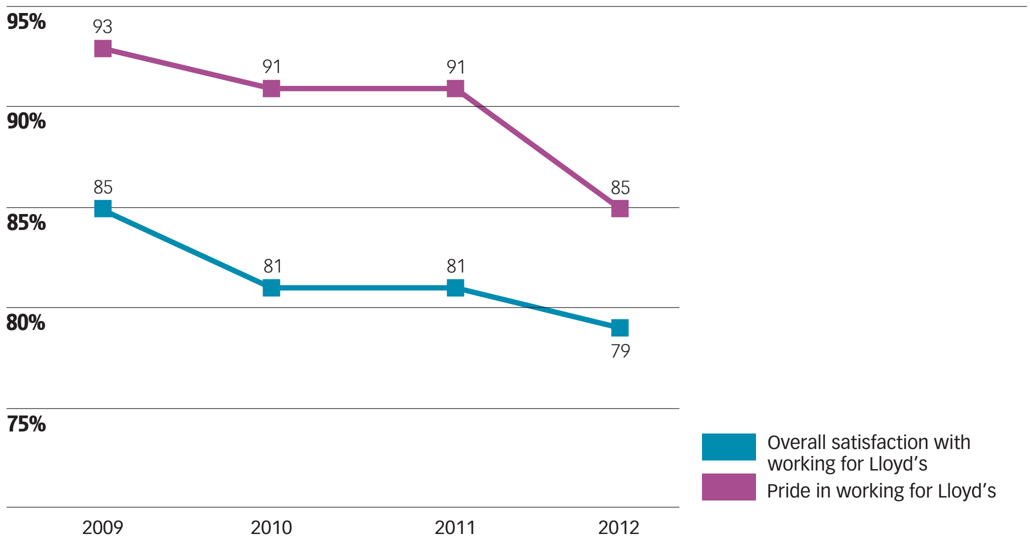
When Emily Lewis was studying for her maths degree, it didn't take her long to decide she wanted to use her knowledge in a business environment. An internship with a Lloyd's broker convinced her that she wanted to start her career with Lloyd's. "Everything about Lloyd's just clicked," she says, "The people, history and ethos – for me it was clearly the best place to be."

Emily applied for the Claims Graduate Programme and started at Lloyd's in September 2011. "Because it was a new programme, I wasn't sure what to expect. Yet the overview of the business I've already gained is fascinating. From claims, to Xchanging and really getting a perspective on the broker's point of view; it's been invaluable."

So where does Emily want to end up? "As a claims adjuster in the market, definitely. I think we need to value claims much more. If more people saw the work that goes into claims and the impact the Claims team's decisions have on the whole of the business they would realise how important that role is. After all, if people need help, it's Claims they come to."

Figure 9

EMPLOYEE OPINION SURVEY
% in agreement



Lloyd's has maintained a strong set of results with half of questions scoring over 80%. There is a slight decrease in staff engagement since 2011, with the overall engagement index (not shown in Figure 9) dropping by 3% points to 76%.

PEOPLE STRATEGY
CONTINUED

CORPORATION EMPLOYEE DEMOGRAPHICS
UK EMPLOYEE TURNOVER AND ABSENCE

	2011 number	2010 number
Employees as at 1 January 2011	**748**	738
Total joiners	**182**	138
Total voluntary leavers	**(75)**	(67)
Total involuntary leavers (redundancies, dismissals)	**(39)**	(22)
Total retirements	**(1)**	(2)
Contracts completed	**(63)**	(37)
Employees as at 31 December 2011	**752**	748

UK EMPLOYEE TURNOVER AND ABSENCE

	2011 %	2010 %
Total turnover	**23.7**	17.1
Turnover (excluding contracts completed)	**15.3**	12.2
Industry average turnover	**13.8**	14.6
Voluntary turnover	**10.0**	9.0
Industry average voluntary turnover	**8.7**	7.4
Absence	**1.8**	2.4
Industry average absence	**2.2**	2.3

TOTAL EMPLOYEES

	2011 number	2010 number
UK	**752**	748
US	**32**	32
Canada	**6**	4
Asia	**67**	59
Europe	**46**	45
Africa, Australia and South America	**9**	7
	912	895

The Corporation regularly monitors the level of staff turnover and absence against suitable industry benchmarks and corrective action is taken if required. During 2011, UK voluntary staff turnover, excluding redundancies, dismissals, retirements and contracts completed, continued to be above the industry average at 10.0% and sickness absence was below the industry average at 1.8%. The reasons for the increases are understood and not considered to be detrimental to the performance of the Corporation.

The Corporation's UK employee segmentation and profile as at 31 December 2011 is shown below:

UK employee segmentation	Executive*		Head of function		Manager		Professional/ technical		Admin		Total	
Figures in numbers	**2011**	2010	**2011**	2010	**2011**	2010	**2011**	2010	**2011**	2010	**2011**	2010
Male	**5**	5	**29**	28	**136**	131	**171**	179	**35**	32	**376**	375
Female	**1**	1	**7**	8	**76**	72	**179**	178	**113**	114	**376**	373
Total	**6**	6	**36**	36	**212**	203	**350**	357	**148**	146	**752**	748
Figures in years	**2011**	2010	**2011**	2010	**2011**	2010	**2011**	2010	**2011**	2010	**2011**	2010
Average age	**50**	49	**49**	48	**43**	43	**39**	39	**35**	36	**40**	40
Average service	**7**	6	**9**	9	**9**	9	**8**	8	**6**	6	**8**	8

*The Chairman of Lloyd's has been excluded from these employee statistics.

The employee demographics shown above include both permanent staff and those working on a contract basis, directly employed by the Corporation. The segmentation as shown above includes 8 male and 65 female part-time employees as at 31 December 2011 (31 December 2010: 9 male; 66 female).

RESPONDING TO THE IMPACT OF CLIMATE CHANGE IN A YEAR DEFINED BY NATURAL CATASTROPHES

MAKING CLAIMS MORE SUSTAINABLE

The ClimateWise Sustainable Claims Committee held meetings in June, July and November, involving claims professionals from the market and Lloyd's. The group has reviewed various claim scenarios and identified a wide range of areas where standard claim handling practices might add to greenhouse gas emissions. The Carbon Trust has also worked with the group to provide estimates of the carbon footprint for different areas of the claims process, allowing members of the group to strengthen business cases for implementing sustainable claims practices into their own business operations.

FIRST PRINCIPLES FOR NATURAL CATASTROPHE COVER

Given the devastation which natural catastrophes caused in 2011, the issue of managing the escalating risks they pose came under renewed scrutiny. The unintended consequences of government-run insurance programmes, for example, can reduce incentives to mitigate risk and improve infrastructure and force all taxpayers to bear the costs for those living in catastrophe-exposed areas. The situation in the US is particularly acute, with ongoing debate about the sustainability of the National Flood Insurance Programme.

In September 2011, Lloyd's published a report into the issue, 'Managing the Escalating Risks of Natural Catastrophes in the United States.' The report set out nine fundamental principles for managing natural catastrophe risk in the US and urged greater co-operation between government, insurers and planners.

THOUGHT LEADERSHIP IN RESEARCH

Lloyd's, working in collaboration with the emerging risks Special Interest Group of representatives from the Lloyd's market, produces a range of reports dealing with current and emerging risks facing the industry. In 2011, these included a report on how insurers and key stakeholders can work together to improve flood resilience, response and recovery and, working with the Met Office, a report on the value of long-range forecasting for the insurance industry. This report examines how emerging forecasting methods and techniques can provide insurers with ways to further develop their modelling practices, particularly in response to the growing impacts of climate change.

LLOYD'S ENVIRONMENTAL ACTION PLAN

Lloyd's constantly seeks ways to reduce the environmental impact of our operations. Our Environment Working Group meets quarterly to review progress against our Action Plan, including analysing data on energy consumption, air travel and recycling rates for all our UK operations. However, our aim to reduce our environmental impact applies wherever we work. The move to our new office in Singapore means that Lloyd's Asia now occupies one of the region's greenest buildings, with a bio-diesel plant and rooftop solar panels. It will consume 35% less energy than standard commercial buildings and the energy it will save each year – 10 million kWh – will be enough to power 2,000 homes for a month.

CARBON EMISSIONS

Carbon Smart consultants helped Lloyd's to calculate the greenhouse gas emissions from its UK operations, over which it has total operational control, according to the internationally recognised Greenhouse Gas (GHG) Protocol.

Lloyd's total reported GHG emissions for 2011 added up to 13,891 tonnes of Co_2 equivalent; this represents a reduction of 1.7% for the year compared to 2010 (14,126 tonnes of Co_2).

Lloyd's rolling programme of improving the infrastructure and technology in the Lloyd's 1986 building has delivered a 10.7% reduction in the amount of electricity we use since 2008 (2008: 19,871,729 kWh and 2011: 17,752,433 kWh).

Business flights taken by Lloyd's decreased in 2011, resulting in carbon savings of 138 tonnes compared to 2010. Lloyd's offset the emissions from its air travel by buying carbon credits for renewable energy projects through The CarbonNeutral Company.

To read more visit
www.lloyds.com/carbonemissions

CORPORATE SOCIAL RESPONSIBILITY
COMMUNITY

LLOYD'S COMMUNITY PROGRAMME

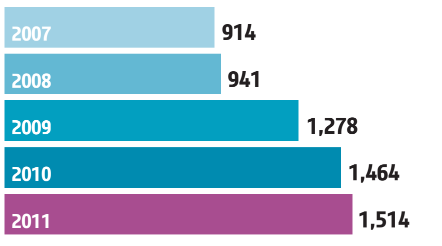
Through the Lloyd's Community Programme, over 1,500 people from the Lloyd's market played their part in changing lives in 2011.

The Lloyd's building is situated in a part of London where its neighbouring communities face significant challenges. The Lloyd's Community Programme (LCP) has always been keen to support its neighbours and our focus is to invest in the future of the next generation.

LCP received an overwhelming level of support in 2011, with 1,514 people from the market volunteering through 16 schemes. In total, they contributed 13,858 hours and reached over 2,900 people. These volunteers carry out a wide range of activities, from reading schemes in schools to cooking meals for the vulnerable at shelters for the homeless.

Figure 10

LLOYD'S COMMUNITY PROGRAMME VOLUNTEER INVOLVEMENT
Number of volunteers



LLOYD'S COMMUNITY PROGRAMME MEMBERS

ACE
Advent Underwriting Ltd
Amlin plc
Antares Managing Agency Limited
Aon Ltd
Argo International
Ascot Underwriting Limited
Atrium
Barbican
Barlow, Lyde & Gilbert
Beazley
Besso Ltd
BMS Group Ltd
Brit Syndicate Ltd
Canopius Managing Agents Ltd
Capita Insurance Services
Catlin Underwriting
Chaucer Syndicates Ltd
Chubb Managing Agent Ltd
Clyde & Co
Dewey & LeBoeuf
Edwards Wildman UK LLP
Faraday Underwriting Ltd
Glencairn
Hampden Agencies Ltd
Hardy Underwriting Agencies Ltd
Heath Lambert Group
Hiscox Syndicates Limited
Ince & Co
Liberty Syndicates
Lloyd's
Lockton
Markel
Marketform Group
Mazars
Miller Insurance Services Ltd
Munich Re Underwriting Ltd
Newline Underwriting Management Ltd
Novae
Omega Underwriting Agents Ltd
PricewaterhouseCoopers LLP
QBE European Operations
R J Kiln & Co Ltd
Renaissance Re
Reynolds Porter Chamberlain LLP
RK Harrison Group Ltd
Sagicor Underwriting Ltd
Talbot
Thompson Heath & Bond Limited
Travelers Syndicate Management Limited
Whittington Capital Management Ltd
Xchanging
XL Group

AIM 2 ATTAIN

LCP agreed to sponsor a two-year pilot scheme in Tower Hamlets. Aim 2 Attain helps students from disadvantaged backgrounds to attend university and achieve their full potential. In 2011, students from colleges and schools in the borough started the programme which includes interview master classes, revision workshops, residential weekends and university visits with sample lectures. The initial scheme is aimed at children between 14 and 17 years old and, if the pilot is a success, the programme will be extended to students at more schools in Tower Hamlets.

READY FOR WORK

With the economic downturn making it harder than ever for young people to get their first job, LCP's 'Ready for Work' initiative helps 15-to-18 year-old students from East London to prepare for the job market.

Over 100 market participants act as mentors to the students, offering anything from educational games to advice on how to create a CV or get the most from an interview. The students also get experience of an office environment to help them make the leap from college to the workplace.

LLOYD'S UNIVERSITY BURSARY PROGRAMME

Each year, 20% of Year 13 students in Tower Hamlets go to university, around 600 in all. Of those, 500 stay in London to study, in order to live at home and minimise costs. This year, LCP launched the Lloyd's University Bursary Programme, which provides inner city students with a bursary of £3,000 per year to help them undertake studies outside of London.

The worthy winner of the 2011 award was Annalie James from Cambridge Heath Sixth Form College, enabling her to take up a place at the University of Leicester to read History.

Annalie said, "I am ecstatic! I have worked so hard for this and I can't believe how great it feels to be going to university to study what I love. I have had such great support from my college and teachers and I'm so pleased to be the first Lloyd's University Bursary recipient."

REINSURANCE
See page 45

PROPERTY
See page 46

CASUALTY
See page 47

MARINE
See page 48

ENERGY
See page 49

MOTOR
See page 50

AVIATION
See page 51

HOW THE MARKET PERFORMED IN 2011

2011 MARKET PERFORMANCE REVIEW

2011 HIGHLIGHTS

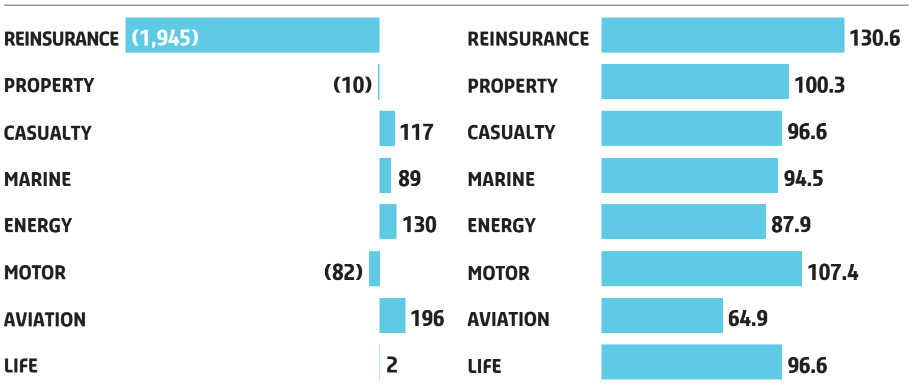
- Loss before tax of £516m (2010: profit £2,195m) and a combined ratio of 106.8% (2010: 93.3%)
- Total investment return of £955m (2010: £1,258m)
- Overall surplus on prior years of £1,173m (2010: £1,016m)
- Pre-tax return on capital of (2.8)% (2010: 12.1%)

2011 COMBINED RATIO*

ACCIDENT YEAR	113.3%
PRIOR YEAR RESERVE MOVEMENT	(6.5)%
CALENDAR YEAR	106.8%

UNDERWRITING RESULTS BY CLASS
£m

COMBINED RATIO BY CLASS
%



* The combined ratio for the market and by class of business is the ratio of net incurred claims and net operating expenses to net earned premiums. The prior year reserve movement represents the ratio of the surplus/deficit arising on reserves at December 2010 to overall net earned premiums in calendar year 2011. The overall combined ratio includes central adjustments in the technical account in respect of transactions between syndicates and the Society as described in notes 2 and 8 to the PFFS (pages 57 and 60). The combined ratios and results for individual classes of business do not include these adjustments as the market commentary for each class reflects trading conditions at syndicate level as reported in syndicate annual accounts.

The Lloyd's market has reported a loss of £516m in 2011 driven by catastrophe claims and a lower contribution from investments. The catastrophe loss activity cost the Lloyd's market £4,608m (2010: £2,175m) and represented the highest level of major claims on record.

At the time of writing the 2010 Annual Report, 2011 had already experienced substantial claims from the heavy rainfall and flooding in Australia, another earthquake in New Zealand, and then the earthquake and tsunami that devastated North East Japan in March. From that starting point, 2011 was always going to be challenging for the insurance industry.

The remaining nine months of the year saw further major insurable events with the series of US tornadoes in the second quarter and the recent flooding in Thailand being particularly significant, both in terms of the human misery they caused and their cost to the insurance industry. However, going into 2012, the Lloyd's market remains well capitalised and positioned to take advantage of any opportunities that become available.

The accident year loss was offset by a strong performance on reserves with actual experience more favourable than projected. This produced a release of over £1bn, reducing the combined ratio by 6.5%.

MARKET PERFORMANCE CONTINUED

LOOKING AHEAD

Despite the level of claims experienced during 2011, there is little evidence to date of a material change in the general rating environment. The property catastrophe treaty sector in aggregate managed modest rate increases at the January 2012 renewals. With a large proportion of the 2011 claims emanating from the Asia-Pacific region, more pronounced rate hardening is anticipated in April and July when most Asia-Pacific programmes renew.

The current economic conditions and lack of alternative investment opportunities means that capital continues to be attracted to the insurance industry and this is expected to remain the case for the foreseeable future. The high capacity levels in the industry continue to act as a barrier to obtaining more widespread improvement. Contrary to the views of certain industry commentators, in the absence of any market changing events, the general rate environment is expected to remain flat in 2012 with further softening of some lines.

Although catastrophe events in the first three months of 2012 are not at the level experienced in the same period last year, January saw the sinking of the Costa Concordia with its tragic loss of life after hitting a reef off the Italian coast. Severe flooding is currently threatening the Australian Southeast once again. Similarly, the US is already experiencing a very active tornado season.

With the soft phase of the underwriting cycle looking set to continue, it is imperative that underwriting discipline is maintained with robust pricing methodologies, careful risk selection and diligent exposure management. This need is further heightened by the outlook for the investment environment remaining weak for the foreseeable future.

2011 PERFORMANCE

Gross written premium for the year increased by 3.9% to £23,477m (2010: £22,592m). In underlying currency the increase is closer to 6% as the small appreciation in sterling has decreased the reported value in converted terms. US dollar denominated business accounts for the largest share of Lloyd’s business and the average rate for US dollars in 2011 was US$1.60:£1 compared to US$1.55:£1 in 2010. This increase is attributable to reinstatement premiums following the reinsurance claims payable in respect of the catastrophes in 2011 and Lloyd’s market participants taking advantage of new opportunities, in particular those syndicates that commenced trading in recent years establishing their businesses, combined with a slight increase in risk adjusted rates for the Lloyd’s market as a whole.

ANALYSIS OF EXCHANGE GAIN/(LOSS)

	2011 £m	2010 £m
Impact of translating non-monetary items at average rates and monetary items at closing rates	**38**	(9)
Accident year – other	**(47)**	99
Prior years	**(10)**	138
(Loss)/profit on exchange	**(19)**	228
Gain within premiums/expenses through reversal of exchange movement reported in previous year	**9**	9
Total	**(10)**	237

ACCIDENT YEAR PERFORMANCE

For 2011, the Lloyd's market recorded an accident year combined ratio of 113.3% (2010: 99.2%).

The underlying accident year ratio, excluding major claims, was 87.8% (2010: 86.5%); a similar result to calendar years 2007 to 2010 on the same basis.

With regards to major claims, the first quarter experienced an unprecedented number of events with the Queensland floods in Australia, the earthquake in Christchurch, New Zealand and the Tohoku earthquake and ensuing tsunami in Japan. Much has already been written about these tragic events and the Lloyd's market is still working with affected policyholders to rebuild their lives, homes and businesses. Lloyd's aggregate estimate of the ultimate claims arising from these events remains within our announcement made last May (US$3,800m). Estimates for earthquake-related claims should always be accompanied by a note of caution in view of historical experience which shows that uncertainty in estimates persists for many years after the event. Assessing claims from the Christchurch earthquake is not made any easier by the fact that the area suffered from further earthquakes in June and December.

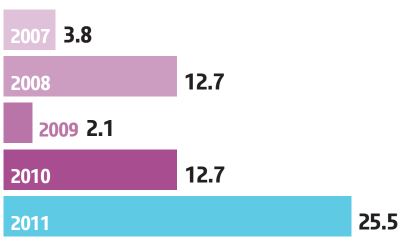
The second quarter of the year saw further catastrophe events and some of the deadliest tornadoes to ever hit the US. In particular, on 27 April 316 tornadoes were reported across the US of which 117 occurred in Alabama. The month of May saw a further 362 tornadoes, the majority of which occurred on 25 May. There were 168 fatalities from the May tornadoes, and 159 of these resulted from a tornado on 22 May in Jasper County, Missouri.

The Atlantic windstorm season saw a relatively high number of named tropical cyclones, 18 (2010: 19) compared to the long-term average of 11. However, as in 2010, the number of these storms that made landfall was low with only Hurricane Irene creating large economic losses. While there was a lower than average level of claims arising from the Atlantic windstorm season, the second half of the year saw Thailand experience severe flooding after prolonged monsoon rainfalls. The north and centre of Thailand experienced their highest levels of rainfall in 50 years. In terms of insurance claims the scale of the losses arising from these floods is due to the significance of Thailand in the global industry supply chain, particularly for the car market and digital and electrical goods. The Lloyd's market provided an initial estimate that the net ultimate claims arising from these floods will be US$2,200m and the latest assessment remains within that total. However, as with the floods and earthquakes in the first quarter, assessing the claims to come from this type of event is notoriously difficult and it will be some time before the final figures are established.

ACCIDENT YEAR EXCLUDING MAJOR CLAIMS
%

5 year average 87.7
10 year average 86.1

MAJOR CLAIMS
%



5 year average 11.4
10 year average 10.3

MARKET PERFORMANCE CONTINUED

As well as the significant level of natural catastrophes during 2011 there were also some major claims arising from man-made events. Notably, the Maersk Oil's Gryphon floating production storage and offloading vessel suffered heavy damage in the North Sea during February and had to be shut down for repairs. Events in a number of Middle East and North African states were also a source of man-made insurance losses.

In both our 2009 and 2010 Annual Reports we noted that we had not yet seen the full anticipated claims impact of the worldwide recession. To support this view, the underwriting attritional claims activity in the liability lines was higher than in 2010.

PRIOR YEAR MOVEMENT

The accident year loss has been reduced by prior year reserve releases which have improved the combined ratio by 6.5% (2010: 5.9%). The release represents 4.1% of net claims reserves brought forward at 1 January 2011. While prior year reserve releases have in aggregate increased, the 2010 year was adversely impacted by the claims deterioration for motor business which resulted in material reserve strengthening in that class.

This was the seventh successive year of prior year surpluses. The strong level of claims reserves support the releases that are being made from all classes of business, and are spread over most prior years of account with the experience still allowing significant contributions from the older years (2006 and prior). Actual claims development for prior years remains significantly below expected levels and the development on the longer-tail business written in the soft market conditions of 1997-2001 continues to be within expectations.

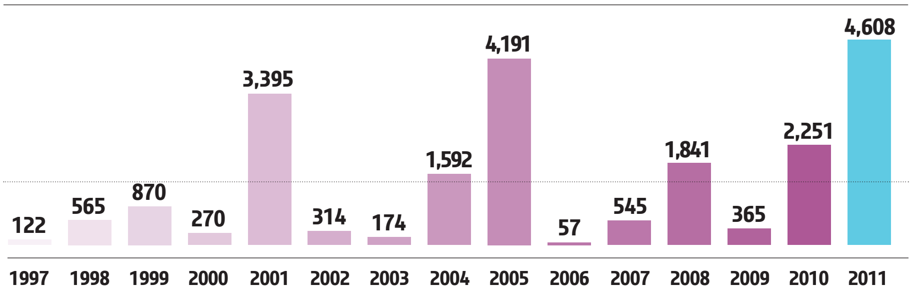
REINSURANCE PROTECTION

The credit quality of the Lloyd's market's reinsurance cover remains extremely high with over 94% rated 'A' and above. While there are few 'AAA' rated reinsurers, the top ten reinsurers are all rated 'A' or better.

RESULT FOR THE CLOSED YEAR AND RUN-OFF YEARS OF ACCOUNT

Under Lloyd's three-year accounting policy for final distribution of each underwriting year of account, the 2009 account reached closure at 31 December 2011. The 2009 calendar year saw just five events that incurred losses of US$1bn or more, and no one event cost insurers more than US$3.5bn. 2008 had seen unprecedented turmoil in the financial markets but considerable efforts were made by central governments to re-establish confidence in the banking system so that in 2009, capital and surplus levels had largely been replenished. The 2009 year of account was therefore able

LLOYD'S MAJOR LOSSES: NET ULTIMATE CLAIMS
£m



Indexed for inflation to 2011. Claims in foreign currency translated at the exchange rates prevailing at the date of loss.

£1,250m 18-year average
···· £1,411m 15-year average

to close with a profit of £3,107m. The result includes a surplus of £757m arising on the 2008 and prior reinsurance to close (RITC) received as at 31 December 2010.

In aggregate, run-off years reported a loss of £87m including investment income (2010: profit of £127m). This drop in result is mainly due to the fact that some of the more significant run-off syndicates were able to finally close at 31 December 2010 with a final calendar year surplus, while the syndicates that were in run-off in 2011 were fewer, and continued to experience deterioration in results.

Of the ten years of account that were in run-off at the beginning of 2011, six were closed by the end of the year. However, three syndicates were unable to close their 2009 year of account at the year end and, therefore, the net reduction in open years was three.

The results of the major classes of business are discussed in detail on pages 45 to 51.

INVESTMENT REVIEW

Uncertainty surrounding global economic developments generated significant volatility in financial markets during 2011. Developments in the Eurozone crisis dominated the headlines, as concerns grew that some euro sovereign issuers may ultimately default on their debt obligations, and political efforts to resolve the crisis appeared ineffective. The risk of contagion to the financial sector (both within Europe and more widely) combined with faltering economic growth in many parts of the world, led to increasing risk aversion among investors. The concept of 'risk free' sovereign debt was further impaired as even the US Government lost its 'AAA' credit rating, suffering from growing public debt and an absence of political agreement on how to control expenditure.

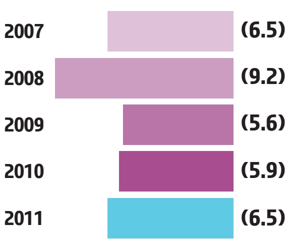
Against this background, 'safe haven' investments did well. Yields on debt issued by the highest rated sovereigns, including the UK and US, fell to new lows, generating capital gains on these investments as the need for interest rates to remain lower for longer became increasingly apparent. Conversely, debt securities issued by some of the sovereigns under most financial scrutiny experienced losses as their yields rose significantly. Corporate debt issued by some Eurozone and global banks also suffered as fears of contagion from euro sovereign default were exacerbated by poor profitability and developing legislation which will restrict future bank activity in many jurisdictions. Global equity markets also fell as economic news disappointed and investor confidence dwindled.

Towards the end of the year, coordinated efforts by central banks globally to inject substantial liquidity into the financial sector had some effect and many riskier asset classes recovered some value as confidence grew that proactive monetary policies may be sufficient to avoid the worst outcomes of the current crisis.

Syndicate premium assets form the largest element of investment assets at Lloyd's. Managing agents are responsible for the investment of these funds, which are used to meet insurance claims as they become payable. Traditionally, syndicates adopt conservative investment policies, utilising cash and high quality fixed interest securities of relatively short duration. Some syndicates' investments include elements of more volatile asset classes, such as equities, hedge funds and lower rated debt securities. However, high quality, short dated, fixed interest securities continue to dominate syndicate portfolios.

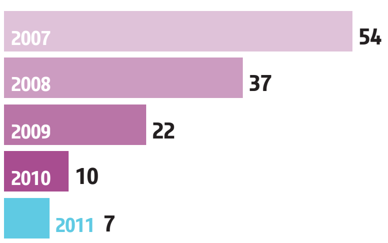
Overall, syndicate investments returned £791m, or 2.4% in 2011 (2010: £914m, 2.9%). Investments are valued at market prices and unrealised gains and losses are included within reported investment returns.

PRIOR YEAR RESERVE MOVEMENT
%



Combined ratio

YEARS OF ACCOUNT IN RUN-OFF



The results of the major classes of business are discussed in detail on **pages 45-51**.

MARKET PERFORMANCE CONTINUED

As in 2010, syndicate investment returns, while modest, are higher than would be expected given the low level of prevailing yields at the beginning of the period, thanks to capital gains generated from falling yields. The high average credit quality of syndicate investments meant that exposures to lower rated sovereign and corporate bonds, which were adversely impacted in 2011, were limited, supporting returns. In general, syndicates with investment portfolios of longer average duration have achieved the best performance in this period.

Members' capital is generally held centrally at Lloyd's. A proportion of this capital is maintained in investment assets and managed at members' discretion. A notional investment return on members' capital of £69m, or 0.5% (2010: £211m, 1.5%) has been included in the pro forma financial statements (PFFS). This is based on the investment disposition of the relevant assets and market index returns. The low return in 2011 reflects the high proportion of cash and equivalent instruments held within members' capital.

The investment return on Lloyd's central assets is also included in the PFFS. This was £95m or 3.9% in 2011 (2010: £133m, 5.6%). The investment performance of central assets is discussed on page 93. The total contribution from investment returns, including syndicate assets, members' capital and central assets, was £955m, or 1.9% (2010: £1,258m, 2.6%).

The low prevailing level of yields globally will continue to make it difficult to achieve attractive investment returns and risks remain that a rapid rise to more historically typical levels could generate investment losses in the short term. The global economic background remains uncertain and there is potential for further volatility in financial markets.

RESULTS SUMMARY

Lloyd's reported a loss before tax for the financial year of £516m (2010: profit of £2,195m) and a combined ratio of 106.8% (2010: 93.3%). The PFFS aggregates the results of the syndicate annual accounts, notional investment return on funds at Lloyd's (FAL) and the Society of Lloyd's financial statements. The basis of preparation of the PFFS is set out in note 2 on page 57. The syndicate annual accounts reported an aggregate loss of £710m (2010: profit of £1,790m).

These results are reported in a separate document (the Aggregate Accounts) and can be viewed at **www.lloyds.com/financialreports**

RISKS AND UNCERTAINTIES

RISKS AND UNCERTAINTIES

The approach to risk adopted by the Corporation is discussed in the Strategic Overview (pages 25 to 27). This includes oversight of the risks present in the market. In addition, managing agents are responsible for identifying the risks that they and each of their syndicates face and developing relevant policies and procedures to mitigate those risks. Syndicates' risk profiles vary so the steps taken to mitigate those risks will differ from one managing agent to another. While this section provides an overview of the main risks faced by managing agents and their syndicates, the descriptions are generic in nature, based on the minimum standards Lloyd's requires of managing agents in dealing with risk.

INSURANCE RISK

The dominant category of risk faced by Lloyd's syndicates is insurance risk. This can be defined as the risk arising from the inherent uncertainties as to the occurrence, amount and timing of insurance liabilities. In practice, insurance risk can be subdivided into underwriting risk and reserving risk.

UNDERWRITING RISK

This includes the risk that a policy will be written for too low a premium or provide inappropriate cover, or that the frequency or severity of insured events will be higher than expected.

Underwriting strategy is agreed by the board of each managing agent and set out in the Syndicate Business Plan which is submitted to the Corporation each year.

The managing agents' underwriting controls should ensure that underwriting is aligned with their strategy, approved business plan and underwriting policy.

Managing agents are expected to have controls in place to ensure that regulatory requirements and the scope of Lloyd's market licences are clearly understood and that risks are written within those requirements.

Managing agents need to have clear processes for pricing business and an audit trail to show how pricing will deliver the projected results within the approved business plan and how pricing will be managed over the relevant underwriting cycle.

Managing agents may use catastrophe modelling software, where appropriate, to monitor aggregate exposure to catastrophe losses. The Corporation has developed a suite of Realistic Disaster Scenarios to measure syndicate level and aggregate market exposure to both natural catastrophes and man-made losses. These are monitored frequently and revised annually.

The Corporation reviews all Syndicate Business Plans to ensure that it is content with those plans at the syndicate level and also from the perspective of the market as a whole. Once a plan is accepted, the Corporation uses performance management data to identify whether each syndicate's business performance is progressing in line with the business plan or that variations are understood and accepted.

RESERVING RISK

Reserving risk arises where the reserves established in the balance sheet are not adequate to meet eventual claims arising. The level of uncertainty varies significantly from class to class but can arise from inadequate case reserves for known large losses and catastrophes or from inadequate provision for incurred but not reported (IBNR) claims. These shortfalls can arise from inadequate reserving processes or from the naturally uncertain progress of insurance events.

Currently Lloyd's view of the underwriting cycle is that following several years of reserve releases, reserves could start to come under pressure, particularly in the casualty classes which have been historically most susceptible to increases due to cyclic effects. This risk has been emphasised to managing agents via a number of seminars and in a letter to the Finance Directors of managing agents. This is the second year in succession that a letter was issued.

Syndicate claim reserves should make financial provision at reported loss levels, without prejudice to coverage, based on currently available information and factual supporting information in the claim file.

The advice of legal advisers and loss adjusters, together with underwriters' informed knowledge and judgement, are used to set the estimated level of reserves required.

In the reserving process managing agents will be assisted by the use of statistical analyses of historical loss development patterns, adjusted for known changes to wordings or the claims environment. Lloyd's syndicates have significant exposure to volatile classes of business which carry material inherent risk that the ultimate claims settlement will vary from previous assessments of reserves.

The syndicates' full reserves are subject to actuarial opinion at the year end and the level of market reserves is actively monitored and tested by the Corporation.

RISKS AND UNCERTAINTIES CONTINUED

REGULATORY RISK

Regulatory risk is the risk of loss owing to a breach of regulatory requirements or failure to respond to regulatory change. Managing agents monitor regulatory development to ensure ongoing compliance and any impact on claims reserves.

CREDIT RISK (INCLUDING REINSURER COUNTERPARTY RISK)

Credit risk is the exposure to loss by a syndicate if a counterparty fails to perform its contractual obligations.

The market's principal credit risk is that the reinsurance purchased to protect the syndicate's gross losses does not respond as expected. This can occur because the reinsurance policy is poorly worded, there is a mismatch with the gross loss, reinsurance limits are exhausted or a combination of willingness and ability to pay by reinsurers.

Managing agents are expected to have a clear and comprehensive plan for the reinsurance of each syndicate. This takes into account risk appetite for retained insurance risk and the potential for the accumulation of risk.

The managing agent should monitor and assess the security of, and exposure to, each reinsurer and intermediary. Reinsurance credit risk is subject to quarterly review by Lloyd's.

Syndicates are also exposed to credit risk in their investment portfolio and their premium debtors. FSA investment guidelines are designed to mitigate credit risk by ensuring diversification of holdings. Credit risk in respect of premium debt is controlled through broker approval and regular monitoring of premium settlement performance.

MARKET RISK

Market risk is the risk that the value of financial instruments will fluctuate because of movements in foreign currency or interest rates.

Syndicate assets are held in premiums trust funds and are subject to the asset rules contained in the FSA's handbook. Managing agents manage asset risk through their investment strategy.

There is greater oversight of market risk in light of the volatile economic climate, which includes the implementation and monitoring of Investment Governance Minimum Standards.

The potential financial impact of changes in market value is monitored through the ICA process and asset mix must be reported to Lloyd's on a quarterly basis, including credit rating analysis of fixed income portfolios.

CURRENCY RISK

Managing agents must identify the main currencies in which each syndicate transacts its business. For the market overall, the US dollar is the largest currency exposure. Assets are then held in each of those currencies to match the relevant liabilities. Managing agents must ensure that assets match liabilities and take corrective action where a mismatch arises. Lloyd's also reviews the matching of assets to liabilities at the syndicate level as well as at the market level.

INTEREST RATE RISK

Interest rate risk is the risk that the value and future cash flows of a financial instrument will fluctuate because of changes in interest rates. Lloyd's syndicates operate a generally conservative investment strategy with material cash and short dated bonds portfolios which reduces the interest rate risk exposure.

LIQUIDITY RISK

Liquidity risk arises where a syndicate has insufficient funds to meet its liabilities as they fall due, particularly claims. Managing agents are expected to manage the cash needs of their syndicates on an ongoing basis and to avoid becoming forced sellers of assets. They are required to match the duration of their syndicates' investments with the liabilities to policyholders.

One of the key strengths of Lloyd's is that syndicates generally have a high concentration of liquid assets, namely cash and government securities, to ensure liabilities can be met as they fall due. Lloyd's centrally monitors syndicate liquidity both in terms of asset mix and future funding needs.

OPERATIONAL RISK

Operational risk is the risk of loss resulting from inadequate or failed internal processes, people and systems, or from external events. Managing agents manage these risks through internal compliance monitoring and the use of detailed procedure manuals. Lloyd's sets minimum standards to be applied by agents and monitors to ensure these are met.

REINSURANCE

SEVERE EARTHQUAKES AND FLOODS RESULT IN MAJOR COST TO REINSURERS

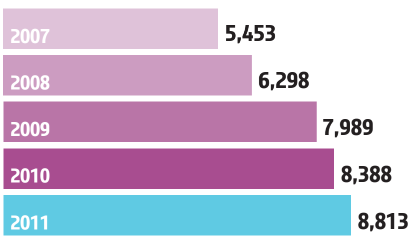
2011 HIGHLIGHTS

- Unprecedented year for international (non-US) property catastrophe claims
- Industry capital levels remain at near peak levels

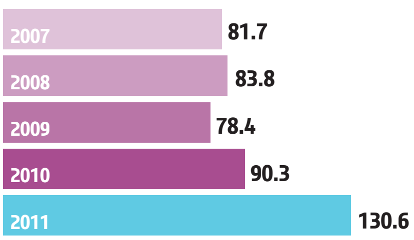
2011 COMBINED RATIO

ACCIDENT YEAR	**138.1%**
PRIOR YEAR RESERVE MOVEMENT	**(7.5)%**
CALENDAR YEAR	**130.6%**

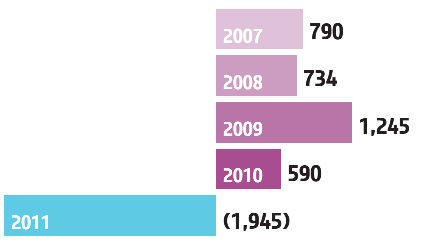
GROSS WRITTEN PREMIUM
£m



COMBINED RATIO
%



UNDERWRITING RESULT
£m



The reinsurance market at Lloyd's covers a wide range of classes, both short and long-tail. Business is written as both facultative and treaty, mainly on an excess of loss basis.

The predominant class is property, which includes catastrophe risks worldwide with a significant exposure to the US and global markets. Other reinsurance classes include accident and health, casualty, motor, general liability and professional liability, energy, marine and aviation.

2011 PERFORMANCE

Lloyd's gross written premium for 2011 was £8,813m (2010: £8,388m), an increase of 5%. The overall premium growth was mainly driven by rate increases, most markedly in those areas affected by the major claims. Overall exposures have reduced on a number of catastrophe exposed accounts in international markets because renewal terms were inadequate.

ACCIDENT YEAR PERFORMANCE

The reinsurance sector reported an accident year combined ratio of 138.1% (2010: 99.8%). The main influence on results has been the frequency and severity of natural catastrophes in Asia-Pacific markets, which have produced the highest level of catastrophe claims experienced by the Lloyd's market. The cluster of catastrophe claims which began with the severe floods and cyclone Yasi in Australia, two major earthquakes in New Zealand and the devastating earthquake and tsunami in Japan, and culminated with the serious flooding in Thailand in the second half of the year, created the largest bill on record for insurance claims outside the US.

These claims were tempered by better than average results in the US, where the damage from Hurricane Irene was largely retained locally and the losses from the tornadoes in April and May were contained within planned loss ratios. The market benefitted from the change in rating environment which started in the second quarter and developed through the year.

Aside from the frequency of property-oriented catastrophe claims, reinsurers also experienced a number of large risk losses in other classes, notably in the onshore and offshore energy arena.

PRIOR YEAR MOVEMENT

The prior year reserve movement was a surplus of 7.5% (2010: 9.5%). Catastrophe risk loadings continue to be released with stable development in property claims from recent major events.

LOOKING AHEAD

As a result of unprecedented loss activity, the reinsurance sector is benefitting from a rising rate environment which is expected to continue through 2012 renewals. However, the property treaty market has not responded as dramatically as might have been expected given the size and frequency of catastrophe losses. In 2011 rate rises have mostly been confined to those markets that suffered the losses. This is explained by surplus reinsurance industry capacity levels which are still at or near peak levels.

The Thailand floods have particularly highlighted the market's sensitivity to 'unmodelled' losses, with exposure to contingent business interruption ('CBI') still proving extremely difficult to assess. Furthermore, the adoption of the latest RMS model version 11 for risks exposed to US catastrophe has increased expected loss costs and is being incorporated into pricing and capital models. While rate improvement continues to be subdued, it is likely that the Lloyd's market will reduce its appetite for writing business in 'cold spot' areas or peak aggregate zones where the risk reward ratio is deemed inadequate or where the exposure information is poor. This is expected to result in a lower level of premium growth than might have been expected. Growth will also be hampered by sluggish rate and asset development in primary insurance markets, resulting from the depressed economic environment. Other reinsurance sectors remain more stable but momentum is building for an improving marketplace.

The trend towards Periodic Payment Orders ('PPOs') has accelerated over the past year, partly driven by low interest rates. This presents a real challenge for casualty treaty reinsurers, particularly those protecting motor portfolios.

Looking further ahead, Solvency II may have a positive impact on the reinsurance sector by increasing demand for reinsurance products.

PROPERTY

PERFORMANCE REFLECTS LEVEL OF CATASTROPHE CLAIMS

2011 HIGHLIGHTS

- Significant property catastrophe claims
- Market remains competitive with some improvement in catastrophe exposed rates

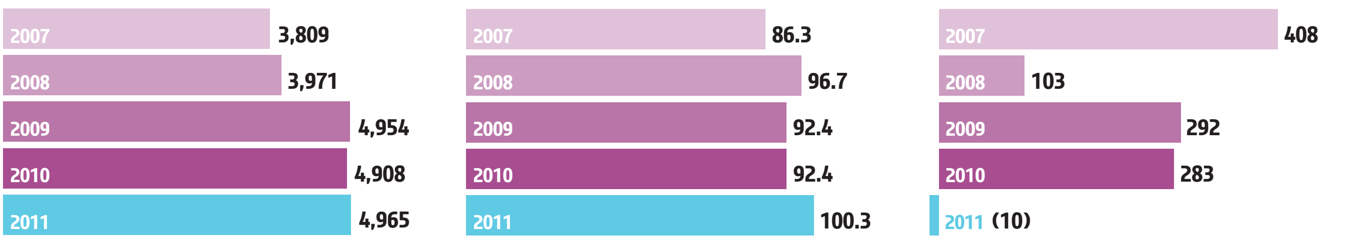
2011 COMBINED RATIO

ACCIDENT YEAR	106.3%
PRIOR YEAR RESERVE MOVEMENT	(6.0)%
CALENDAR YEAR	100.3%

GROSS WRITTEN PREMIUM
£m

COMBINED RATIO
%

UNDERWRITING RESULT
£m



The property sector consists of a broad range of risks written worldwide. It is predominantly made up of surplus lines business with a weighting to the industrial and commercial sectors, binder business of mainly non-standard commercial and residential risks, and specialist classes including terrorism, power generation, engineering, nuclear and bloodstock/livestock risks.

Business is written both open market through the broker network and via delegated authority by coverholders and service companies.

2011 PERFORMANCE

Gross written premium for the Lloyd's property sector in 2011 was £4,965m (2010: £4,908m), an increase of 1%. Rates have responded positively in those territories directly affected by the catastrophe claims. Within other segments and areas the market has remained competitive with further pressure on rates, which, combined with the current economic environment, have depressed any material premium growth.

ACCIDENT YEAR PERFORMANCE

The 2011 accident year combined ratio for the property sector was 106.3% (2010: 99.1%). The Lloyd's property sector was, like the reinsurance sector, heavily impacted by the unprecedented levels of natural catastrophes outside of the US. Irrespective of the catastrophe events, international property (open market and binder) and power generation have been particularly poor performers. The former line has run at consistently high attritional loss ratios whilst the latter has been subject to several large fires and explosions.

The overall results were mitigated by positive results in the US market, as well as strong performing specialist lines such as terrorism. The catastrophe events in the US were not as severe as anticipated with Hurricane Irene mainly impacting the retentions of the admitted market.

PRIOR YEAR MOVEMENT

Surpluses were generated in 2011 as releases from the reserves established in 2002 to 2006 continued while more recent year claims estimates remained stable. This improved the combined ratio by 6.0% (2010: 6.7%).

LOOKING AHEAD

The market should benefit from an overall improvement in the rating environment in the mainstream property lines throughout 2012, but the extent of any improvement will be dependent on territory. Indeed, the international property arena is expected to remain highly competitive and price-adequacy in many territories will continue to be difficult to achieve. In particular, it is questionable that rate increases on international binder business will be sufficient to restore this line to profit. The specialty lines are expected to remain competitive while results are positive.

There remains some considerable uncertainty about the development of claims, especially relating to contingent business interruption ('CBI') losses arising from the floods in Thailand. Indeed, the market still has much to learn about the potential for CBI losses to arise from many other industrial hubs around the world where exposure information is poor.

Premium growth will be restrained by the fragile economic environment affecting many of the main markets where Lloyd's operates.

CASUALTY

SURPLUS CAPACITY MAINTAINS PRESSURE ON RATES

2011 HIGHLIGHTS

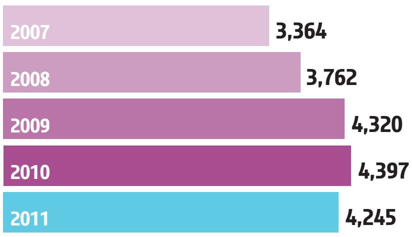
> Surplus capacity prevails in most lines maintaining downwards pressure on rates

> Prior year reserve releases declining

2011 COMBINED RATIO

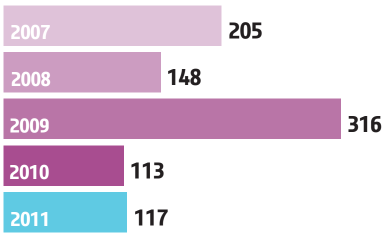
ACCIDENT YEAR	**98.4%**
PRIOR YEAR RESERVE MOVEMENT	**(1.8)%**
CALENDAR YEAR	**96.6%**

GROSS WRITTEN PREMIUM
£m



COMBINED RATIO
%

UNDERWRITING RESULT
£m



The casualty market at Lloyd's comprises a broad range of classes. The most significant are general liability, professional liability and medical malpractice. Although shorter tail in nature than most casualty lines, accident and health business is also included within this sector. The US market is the largest single market for Lloyd's casualty business followed by the UK/Europe, Canada and Australia.

2011 PERFORMANCE

Lloyd's gross written premium for 2011 was £4,245m (2010: £4,397m), a decrease of 3%. Despite isolated pockets of rate hardening in certain underperforming classes and improving stability elsewhere, surplus capacity was still evident in most lines and this resulted in further downwards rating pressure and further pressure on margins.

With a continuation of the very challenging macro market conditions, particularly in the financial sector, underwriters continued to refine and reposition their portfolios. This included line size reduction or in some cases exiting certain lines entirely.

ACCIDENT YEAR PERFORMANCE

The casualty sector reported an accident year combined ratio of 98.4% (2010: 101.1%).

The financial institutions book relating to the US sub-prime banking crisis and global economic downturn that followed continues to produce a significant portion of the claims activity and the class remains an area under some scrutiny. Indeed, in view of the long-tail nature of this business, the market will continue to see new claims alleging wrongdoing by the professionals involved. The correlation between economic downturns and the claims frequency and severity affecting the casualty lines of business is not restricted to financial lines but stimulates a general claims and litigation culture across all lines.

Given the long-tail nature of many of the lines written and the depth and longevity of the recession, it will take a considerable time for the full effects of the downturn to be determined.

PRIOR YEAR MOVEMENT

Although the casualty sector continues to generate surpluses on prior years, improving the combined ratio by 1.8% (2010: 4.5%), the level continues to decrease as historical prior year releases are offset by some reserve strengthening on the more recent years. While the prospect of additional future releases are dwindling, potential for reserve strengthening, driven by the financial crisis, remains a possibility as the claims from the economic downturn further develop.

LOOKING AHEAD

The prevailing low interest rates impact on casualty performance more than on other classes of insurance. The reduced investment returns on technical claims reserves means that casualty underwriters need to work to lower planned combined ratios to achieve the required return on capital. This pressure on margins is compounded by the potential for higher claims inflation.

Given the significantly less favourable economic landscape since 2007 and the long-tail nature of business written, there is still significant reserving uncertainty, particularly among the more recent underwriting years. However, casualty rates are substantially off peak levels and softening is still evident in some lines. With the current European debt crisis having the potential to evolve into another banking crisis and/or 'double-dip' recession, a significant rise in claims activity, particularly in the professional lines, remains a realistic possibility going forward.

Despite the poor current and immediate future outlook, there is no lack of appetite for entering the casualty market. Indeed the much debated forthcoming 'hard market' has led to insurers positioning themselves to take full advantage of better trading times when they arrive, often by acquiring business at today's unprofitable rates with the goal of having the payback when the market turns. This has led to a prolonging of the soft market.

There is increased appetite for the more recently developed products such as cyber liability and environmental impairment liability, as underwriters look to diversify their portfolios away from traditional saturated lines.

MARINE

ACCIDENT YEAR LOSSES OFFSET BY RESERVE RELEASES

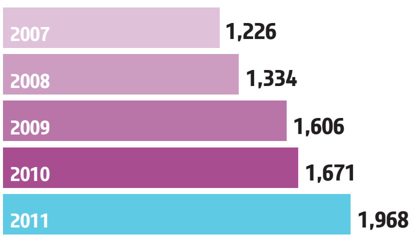
2011 HIGHLIGHTS

- Limited total loss claims
- Market remains highly competitive with capacity levels increasing

2011 COMBINED RATIO

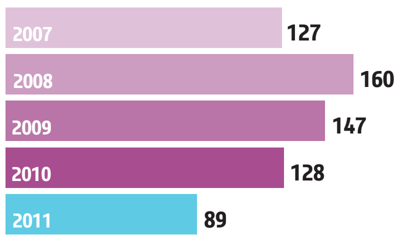
ACCIDENT YEAR	102.3%
PRIOR YEAR RESERVE MOVEMENT	(7.8)%
CALENDAR YEAR	94.5%

GROSS WRITTEN PREMIUM
£m



COMBINED RATIO
%

UNDERWRITING RESULT
£m



Lloyd's is an industry leader of marine business. Main classes include hull, cargo, marine liability, specie (the insurance of valuable property such as precious metals, art or jewellery), war and political risks.

2011 PERFORMANCE

Gross written premium for the Lloyd's marine sector in 2011 was £1,968m (2010: £1,671m), an increase of 18%. Despite the global economic downturn, which has led to reductions in insured values for vessels, lay-ups, and flat or falling rates in most marine lines, a number of Lloyd's syndicates have increased their presence in this sector. Premium growth is evident in most classes, particularly political risks and trade credit where there is increasing demand for cover within the oil and telecommunications sectors.

The market remains competitive with capacity continuing to be attracted during the year due to the perceived consistency of performance and relative lack of volatility in recent years.

ACCIDENT YEAR PERFORMANCE

The 2011 accident year combined ratio for the marine sector was 102.3% (2010: 98.4%).

The marine sector experienced some large claims arising from Japan's Tohoku earthquake and ensuing tsunami and the Thailand floods. In addition, the market was impacted by bunker fuel pollution, debris removal and cargo claims as a result of the grounding and subsequent breakup of the container ship 'MV Rena' off New Zealand's North Island coast. Elsewhere loss activity in the marine market was relatively light.

Piracy continues to raise its profile with insurers remaining concerned about the robustness of preventative measures deployed on board vessels in the affected areas.

PRIOR YEAR MOVEMENT

The prior year reserve movement improved the combined ratio by 7.8% (2010: 7.5%), continuing the trend for prior years to develop within expectation, with a surplus for the eighth consecutive year.

LOOKING AHEAD

Although the sinking of the Costa Concordia off the Italian coast on 13 January 2012, with its tragic loss of life, is likely to result in a significant claim for the marine market, it has had little impact on the rating environment so far. With capacity remaining plentiful, resistance to upward pricing pressure is expected to continue for the foreseeable future. Increased reinsurance costs following the spate of recent property-related catastrophe and energy losses will add to the pressure on marine insurers.

ENERGY

STABLE PERFORMANCE ABSORBING THE IMPACT OF MAJOR CLAIMS

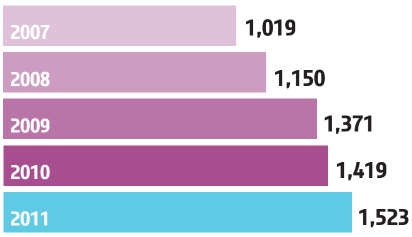
2011 HIGHLIGHTS

- Large risk losses offset strong US performance
- Over-capacity continues to constrain rate increases

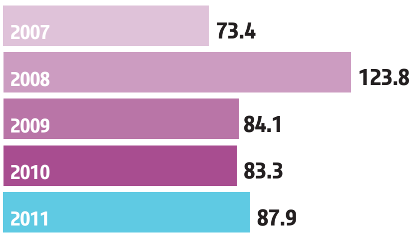
2011 COMBINED RATIO

ACCIDENT YEAR	97.6%
PRIOR YEAR RESERVE MOVEMENT	(9.7)%
CALENDAR YEAR	87.9%

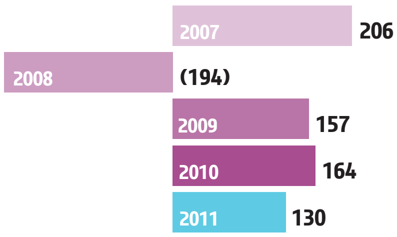
GROSS WRITTEN PREMIUM
£m



COMBINED RATIO
%



UNDERWRITING RESULT
£m



The Lloyd's energy sector includes a variety of onshore and offshore property and liability classes, ranging from construction to exploration and production, refinery and distribution.

A significant part of the portfolio is offshore energy business and a large proportion of this is located in the Gulf of Mexico (GOM).

2011 PERFORMANCE

Lloyd's gross written premium for 2011 was £1,523m (2010: £1,419m), an increase of 7%. The growth in premium was largely rate driven with increases particularly evident in offshore liability following the Deepwater Horizon disaster. Both onshore and offshore energy markets remain over-capitalised.

The pressure to compete for premium income and market share intensified in some areas.

ACCIDENT YEAR PERFORMANCE

The energy sector reported an accident year combined ratio of 97.6% (2010: 101.6%).

The overall result was impacted by a series of major claims in both the downstream and upstream energy markets, including the Horizon oil sands upgrader fire in Alberta and Maersk's Gryphon Alpha loss in the North Sea. In total, global industry losses in 2011 are estimated at US$5bn.

PRIOR YEAR MOVEMENT

An overall release from prior years' reserves improved the combined ratio by 9.7% (2010: 18.3%) continuing the positive trend of recent years.

LOOKING AHEAD

The Deepwater Horizon disaster highlighted the significant exposures that exist offshore. The industry was expected to review the way it provided coverage and revisit its pricing assumptions. While some progress has been made, there is still room for material improvement.

The recent Transocean legal victory is positive for insurers. The payments made by Anadarko and Mitsui, coupled with the US Interior Department's direct action against BP, Transocean and other contractors, indicate that in future most parties will be implicated and held to account. This in turn could lead to greater liabilities for the insurance industry.

The events in 2011 have generated large claims for the reinsurance market and reinsurers are expected to increase rates. While this will increase pressure on insurers, there continues to be plenty of capacity available in the direct market. This will likely stifle the ability to pass the increases on to their clients.

MOTOR

RESERVES HAVE STABILISED ALTHOUGH CLAIMS INFLATION CONTINUES AT RECORD LEVELS

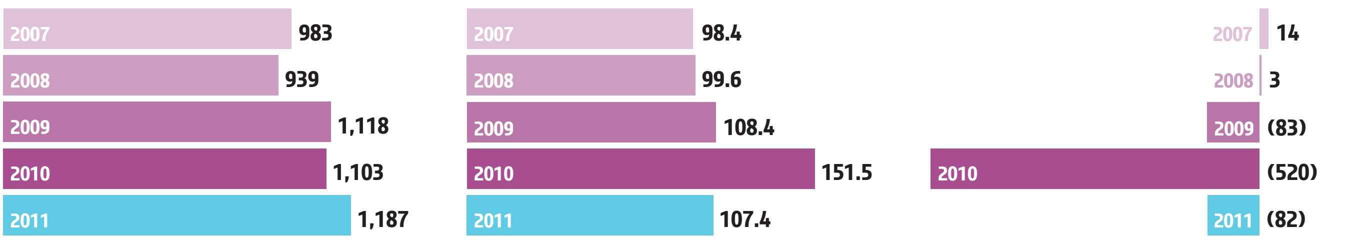
2011 HIGHLIGHTS

- Above inflation rate rises leads to improvement although claims inflation is still at historical high levels
- UK motor market remains highly competitive

2011 COMBINED RATIO

ACCIDENT YEAR	109.1%
PRIOR YEAR RESERVE MOVEMENT	(1.7)%
CALENDAR YEAR	107.4%

GROSS WRITTEN PREMIUM £m | **COMBINED RATIO** % | **UNDERWRITING RESULT** £m



Lloyd's motor market primarily covers UK private car, motorcycle and commercial/fleet business. Private car represents about 50% of Lloyd's UK motor premium and includes niche motor risks. Lloyd's commercial/fleet business is very diverse, ranging from light commercial vehicles and taxis to buses and heavy haulage.

International motor is also written and a large proportion of this is from North America, including private auto and static risks such as dealers open lot.

2011 PERFORMANCE

Gross written premium for the Lloyd's motor sector in 2011 was £1,187m (2010: £1,103m), an increase of 8%.

Above-inflation rate increases have been evident across most UK personal motor lines during 2011 although some moderation was noted towards the year-end. Commercial motor has not been affected to the same extent by such severe claims inflation. While this market was slower to turn, the rating environment started to improve in the latter half of the year.

ACCIDENT YEAR PERFORMANCE

The 2011 accident year combined ratio for the motor sector was 109.1% (2010: 114.8%).

2011 developed more favourably than the preceding few years but the claims environment continued to be extremely challenging. Claims inflation remained at historically high levels with 'claims farming' by accident lawyers, claims management companies and credit hire organisations, and economic induced fraud driving the significant increase in frequency and severity of third party property and bodily injury claims.

PRIOR YEAR MOVEMENT

Following the reserve strengthening required in recent years to reflect this severe claims inflation, prior year reserves stabilised during 2011 with a small release of 1.7% (2010: deterioration 36.7%). However, there remains a risk that claims inflation will continue to outpace allowances within reserves.

LOOKING AHEAD

Private car rate rises are decelerating and long term profitability is now once again in question. With industry pricing and premium levels expected to peak shortly, 2012 should offer the best opportunity for profitable underwriting. Unfortunately, for those insurers with high operating ratios, price-adequacy may still be lacking at the peak of the market.

Given the low interest rate environment, Periodical Payment Orders ('PPOs') are an increasing feature of the motor market. These present a number of negative ramifications for insurers, not least the increased cost of claims and administration, and an extension to the liability tail.

The Government has indicated its support for Lord Jackson's recommendations regarding removing premium recoveries for Success Fees and 'After-the-Event' (ATE) policies. The Ministry of Justice has also decided to outlaw the payment of referral fees in personal injury cases in England and Wales. The Government is also planning to extend the RTA Claims Portal – the fixed-fee, rapid settlement process – to include motor personal injury claims up to £25,000, and to extend the scope of the Portal to include EL and PL claims. A consultation on reducing fixed legal costs is also expected in March 2012. These reforms will help to reduce insurers' costs if they are enacted.

The Ministry of Justice is expected to consult on the discount rate in 2012, changes to which could have significant implications for insurers' reserving costs. This issue remains a significant financial uncertainty in the short term.

In September 2011, the Office of Fair Trading (OFT) launched a call for evidence on the private motor insurance market. The main aim of the review was to respond to concerns over the rise in private car premiums by understanding the causes. On the basis of the evidence gathered, the OFT has embarked on a market study into the supply of private motor insurance in the UK, with a specific focus on credit vehicle hire companies and insurers' repairers, which it expects to complete by Spring 2012.

In a more recent initiative, a specialist police unit (the Insurance Fraud Enforcement Department or IFED), funded by ABI members, has been launched to combat UK insurance fraud (all classes).

AVIATION

SECTOR REMAINS PROFITABLE PUTTING FURTHER PRESSURE ON RATES

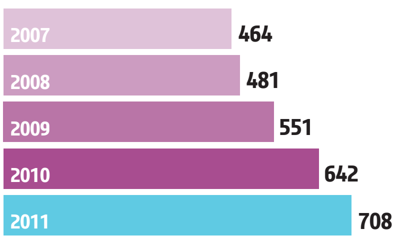
2011 HIGHLIGHTS

- Benign airline loss activity
- Over-capacity continues to limit ability to restore rating levels

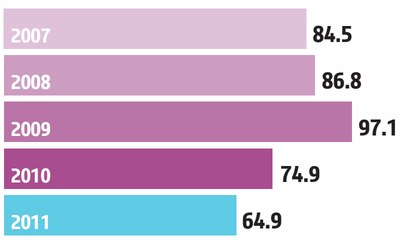
2011 COMBINED RATIO

ACCIDENT YEAR	**91.4%**
PRIOR YEAR RESERVE MOVEMENT	**(26.5)%**
CALENDAR YEAR	**64.9%**

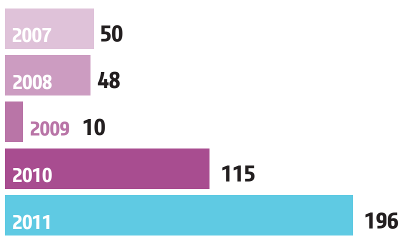
GROSS WRITTEN PREMIUM
£m



COMBINED RATIO
%



UNDERWRITING RESULT
£m



Lloyd's is an industry leader in the global aviation market and writes across all main business segments including airline, aerospace, general aviation and space. Airline (hull and liability) is the largest segment but Lloyd's aviation is also actively involved in the underwriting of general aviation (eg privately owned light aircraft, helicopters and large private corporate jets), airport liability, aviation product manufacturers' liability, aviation war/terrorism and satellite launch/in-orbit risks.

2011 PERFORMANCE

Aviation business is written as both direct and reinsurance acceptances, on an excess of loss, proportional or facultative basis. Direct gross written premium was £708m (2010: £642m). In 2011, Lloyd's syndicates also wrote £491m (2010: £399m) of aviation business on a facultative and treaty reinsurance basis.

There continued to be significant over-capacity across the aviation sector, with rate reductions increasingly evident in airline, aerospace (product manufacturers and airport liabilities) and aviation war. At industry level, premium volumes were reported to be broadly flat despite a material growth in underlying exposures including airline fleet values and passenger numbers.

ACCIDENT YEAR PERFORMANCE

The Lloyd's aviation sector reported an accident year combined ratio of 91.4% (2010: 99.4%).

Total airline claims in 2011 were significantly below levels experienced in recent years, almost half that recorded in 2010. Notable claims included September's Reno Air Race disaster in the US and three large satellite failures, impacting general aviation and space markets respectively.

PRIOR YEAR MOVEMENT

Surpluses on prior years' claims reserves improved the combined ratio by 26.5% (2010: 24.5%) as the benign development across the entire portfolio continued.

LOOKING AHEAD

Despite airline pricing already being at a relative low, the benign loss activity contributed to further rate reductions in the final quarter of 2011 when most major airline programmes renew.

Without a significant withdrawal of capacity, the aviation market could well experience further downward pressure on rates in most lines during 2012. Robust pricing and risk-selection capabilities remain critical in 2012.

CONTENTS

THE MARKET'S FINANCIAL RESULTS

STATEMENT OF COUNCIL'S RESPONSIBILITIES AND REPORT OF ERNST & YOUNG LLP TO THE COUNCIL OF LLOYD'S ON THE 2011 LLOYD'S PRO FORMA FINANCIAL STATEMENTS

STATEMENT OF COUNCIL'S RESPONSIBILITIES

The pro forma financial statements (PFFS) are prepared so that the financial results of Lloyd's and its members taken together and their net assets can be compared with general insurance companies.

The Council of Lloyd's is responsible for the preparation and approval of the PFFS.

REPORT OF ERNST & YOUNG LLP TO THE COUNCIL OF LLOYD'S ON THE 2011 PRO FORMA FINANCIAL STATEMENTS

In accordance with the engagement letter dated 13 December 2011 (the Instructions), we have examined the Lloyd's pro forma financial statements for the year ended 31 December 2011, which comprise the pro forma profit and loss account, the pro forma statement of total recognised gains and losses, the pro forma balance sheet and the pro forma cash flow statement and the related notes 1 to 17 which have been prepared on the basis set out in note 2.

This report is made solely to the Council of Lloyd's in accordance with the instructions. Our examination has been undertaken so that we might state to the Council those matters which we are required to state in this report in accordance with the instructions and for no other purpose. To the fullest extent permitted by law, we do not accept or assume any responsibility to anyone other than the addressees of this report for our work, for this report, or for the conclusions we have formed.

RESPECTIVE RESPONSIBILITIES OF THE COUNCIL OF LLOYD'S AND ERNST & YOUNG LLP

The Council of Lloyd's is responsible for the preparation and approval of the PFFS.

Our responsibility is to express a conclusion on this pro forma financial information based upon our examination.

BASIS OF CONCLUSION

The PFFS have been compiled in part from an aggregation of financial information extracted from the balance sheet and profit and loss account included in syndicate annual accounts by the managing agent of each syndicate, which has been submitted to the Council of Lloyd's and on which the auditors of each syndicate have reported. We have relied absolutely on those reports by syndicate auditors. Our work is solely intended to enable us to make this report.

Our examination, which has been carried out in accordance with International Standard on Assurance Engagements, ISAE 3000, 'Assurance Engagements other than audits or reviews of Historical Financial Information', consisted principally of testing, on a sample basis, that financial information included in the PFFS has been correctly extracted from the syndicate accounts and the Society of Lloyd's financial statements, making enquiries of the Council of Lloyd's and applying analytical procedures to the financial information and underlying financial data. It excludes audit procedures such as tests of controls and verification of assets, liabilities and transactions as included in the PFFS.

We have also carried out such investigations and examined such evidence, on a test basis, as we considered necessary to form an opinion as to whether the PFFS have been prepared in accordance with the basis of preparation set out in note 2.

An examination is substantially less in scope than an audit conducted in accordance with International Standards on Auditing and consequently does not enable us to obtain assurance that we would become aware of all significant matters that may be identified in an audit. Accordingly, we do not express an audit opinion.

CONCLUSION

In our opinion, the PFFS for the financial year ended 31 December 2011 have been prepared, in all material respects, in accordance with the basis of preparation set out in note 2.

Ernst & Young LLP, London
27 March 2012

PRO FORMA PROFIT AND LOSS ACCOUNT

for the year ended 31 December 2011

Technical account	Note	2011 £m	2011 £m	2010 £m	2010 £m
Gross written premiums					
– continuing operations		**23,419**		22,537	
– discontinued operations	5	**58**		55	
	9		**23,477**		22,592
Outward reinsurance premiums			**(5,005)**		(4,936)
Premiums written, net of reinsurance			**18,472**		17,656
Change in the gross provision for unearned premiums		**(473)**		(517)	
Change in the provision for unearned premiums, reinsurers' share		**101**		(28)	
			(372)		(545)
Earned premiums, net of reinsurance			**18,100**		17,111
Allocated investment return transferred from the non-technical account			**711**		865
			18,811		17,976
Claims paid					
Gross amount		**12,159**		11,565	
Reinsurers' share		**(2,343)**		(2,751)	
			9,816		8,814
Change in provision for claims					
Gross amount		**4,960**		1,298	
Reinsurers' share		**(1,876)**		(83)	
			3,084		1,215
Claims incurred, net of reinsurance			**12,900**		10,029
Net operating expenses	11		**6,437**		5,939
Balance on the technical account for general business			**(526)**		2,008
Attributable to:					
– continuing operations		**(461)**		1,805	
– discontinued operations	5	**(65)**		203	
Total			**(526)**		2,008
Non-technical account					
Balance on the technical account for general business			**(526)**		2,008
Investment return on syndicate assets	12	**791**		914	
Notional investment return on funds at Lloyd's	6	**69**		211	
Investment return on Society assets		**95**		133	
		955		1,258	
Allocated investment return transferred to the technical account		**(711)**		(865)	
			244		393
Other income			**80**		66
Other expenses			**(314)**		(272)
Result for the financial year before tax	8		**(516)**		2,195

	Note	2011 £m	2010 £m
Statement of total recognised gains and losses			
Result for the financial year		**(516)**	2,195
Other recognised gains and losses		**(46)**	68
Total recognised gains and losses since previously reported	8	**(562)**	2,263

PRO FORMA BALANCE SHEET
as at 31 December 2011

Investments	Note	£m	2011 £m	£m	2010 £m
Financial investments	13		**41,370**		39,833
Deposits with ceding undertakings			**8**		11
Reinsurers' share of technical provisions					
Provision for unearned premiums		**1,556**		1,458	
Claims outstanding		**10,597**		8,779	
	16		**12,153**		10,237
Debtors					
Debtors arising out of direct insurance operations		**5,172**		4,825	
Debtors arising out of reinsurance operations		**3,958**		3,572	
Other debtors		**1,032**		691	
			10,162		9,088
Other assets					
Tangible assets		**43**		44	
Cash at bank and in hand	14	**10,046**		8,650	
Other		**8**		33	
			10,097		8,727
Prepayments and accrued income					
Accrued interest and rent		**81**		83	
Deferred acquisition costs		**2,478**		2,371	
Other prepayments and accrued income		**199**		260	
			2,758		2,714
Total assets			**76,548**		70,610
Capital and reserves					
Members' funds at Lloyd's	6	**15,171**		13,832	
Members' balances	15	**1,555**		2,912	
Members' assets (held severally)		**16,726**		16,744	
Central reserves (mutual assets)		**1,490**		1,447	
	8		**18,216**		18,191
Subordinated debt			**509**		514
Subordinated perpetual capital securities			**389**		416
Capital, reserves and subordinated debt and securities			**19,114**		19,121
Technical provisions					
Provision for unearned premiums		**10,605**		10,125	
Claims outstanding		**41,313**		36,303	
	16		**51,918**		46,428
Deposits received from reinsurers			**87**		89
Creditors					
Creditors arising out of direct insurance operations		**724**		722	
Creditors arising out of reinsurance operations		**3,030**		2,820	
Other creditors including taxation		**1,346**		1,046	
			5,100		4,588
Accruals and deferred income			**329**		384
Total liabilities			**76,548**		70,610

Approved by the Council of Lloyd's on 27 March 2012 and signed on its behalf by

John Nelson
Chairman

Richard Ward
Chief Executive Officer

PRO FORMA CASH FLOW STATEMENT

for the year ended 31 December 2011

	2011 £m	2010 £m
Result on ordinary activities before tax	**(516)**	2,195
Depreciation	**8**	6
Realised and unrealised (gains)/losses and foreign exchange	**(45)**	(2,112)
Net purchase of investments	**(1,415)**	(470)
Notional return on funds at Lloyd’s	**(69)**	(211)
Increase/(decrease) in technical provisions	**3,650**	2,559
(Increase)/decrease in debtors	**(1,206)**	(590)
Increase/(decrease) in creditors	**437**	427
Cash generated from operations	**844**	1,804
Tax paid	**(84)**	(71)
Net cash from operating activities	**760**	1,733
Cash flows from financing activities		
Net profits paid to members	**(1,579)**	(2,993)
Net movement in funds at Lloyd’s	**1,339**	673
Capital transferred into syndicate premium trust funds	**964**	243
Purchase of debt securities	**(23)**	(20)
Interest paid	**(65)**	(68)
Net increase/(decrease) in cash holdings	**1,396**	(432)
Cash holdings at 1 January	**8,650**	9,082
Cash holdings at 31 December	**10,046**	8,650

NOTES TO THE PRO FORMA FINANCIAL STATEMENTS

as at 31 December 2011

1. INTRODUCTION

Lloyd's is not an insurance company. It is a Society of members which underwrite insurance (each for their own account) as members of syndicates. The pro forma financial statements (PFFS) are prepared so that the financial results of Lloyd's and its members taken together and their net assets can be compared with general insurance companies.

2. BASIS OF PREPARATION

GENERAL

The PFFS include the aggregate of syndicate annual accounts (Aggregate Accounts), members' funds at Lloyd's (FAL) and the financial statements of the Society of Lloyd's on pages 68 to 136.

The Aggregate Accounts do not present a consolidated view of the results of Lloyd's business taken as a single entity. In particular, each managing agent selects the accounting policies most appropriate to its managed syndicates. Where UK GAAP permits different accounting policies and managing agents have adopted various accounting treatments, these are reflected in the PFFS without making consolidation adjustments. In addition, the PFFS do not eliminate inter-syndicate reinsurances.

The Aggregate Accounts report the audited results for calendar year 2011 and the financial position at 31 December 2011 for all syndicates which transacted business during the year. They include the syndicate level assets, which represent the first link in the Chain of Security (see pages 65 to 66). The Aggregate Accounts are reported as a separate document and can be viewed at www.lloyds.com/financialreports. During 2011, certain syndicates changed their accounting policies in relation to foreign exchange resulting in a restatement of the comparative figures for 2011 within their annual accounts and the Aggregate Accounts have been restated accordingly. The restatements are not material and, therefore, the comparative figures within the PFFS have not been restated.

The capital provided by members is generally held centrally as FAL and represents the second link in the Chain of Security. The non-technical account of the PFFS includes a notional investment return on FAL.

The Society of Lloyd's audited financial statements report the central resources of the Society, which forms the third link in Lloyd's Chain of Security.

The profit and loss account in the PFFS aggregates the syndicate results, the notional investment return on members' capital and the results of the Society of Lloyd's. The balance sheet in the PFFS aggregates the assets held at syndicate level, members' assets held as FAL and the central resources of the Society.

Overall, the PFFS aggregate the results and resources of the Society and its members and reflect all the links in Lloyd's Chain of Security as described in detail in the 'Security underlying policies issued at Lloyd's' section on pages 65 to 67. The PFFS may, therefore, be used as a reasonable presentation of the results and state of affairs of the Lloyd's market on a basis that is broadly comparable with general insurance companies.

TAXATION

The PFFS report the market's result before tax. Members are directly responsible for tax payable on their syndicate results and investment income on FAL. For consistency, the results of the Society are also included pre-tax in the profit and loss account. The balance sheet includes the tax provisions in the Society financial statements.

FUNDS AT LLOYD'S

FAL comprise the capital provided by members to support their underwriting, and are the equivalent of capital shown in insurance companies' accounts. The valuation of FAL has, therefore, been included in the pro forma balance sheet. FAL are available to meet cash calls made on the member in respect of a syndicate. The assets in FAL must be readily realisable, may include letters of credit and bank and other guarantees, and must be at least equivalent to the aggregate of the member's economic capital assessment (ECA) requirement and certain liabilities in respect of its underwriting business. Each member's ECA to support its underwriting at Lloyd's is determined using Lloyd's Individual Capital Assessment (ICA) capital setting methodology.

A notional investment return on FAL has been calculated, which is the equivalent of insurance companies generating investment return on the capital that they hold to support their underwriting. Where Lloyd's is the investment manager for FAL, the actual return achieved has been included. For other assets the notional investment return, net of management fees, is calculated on the average value of FAL during the year, based on indices yields for each type of asset held. The typical investment return on bank deposits has been applied to FAL provided as letters of credit or bank guarantees. The actual return achieved on FAL investments will differ from the notional return due to individual stocks held, daily cash flows and transactional charges.

SOCIETY OF LLOYD'S FINANCIAL STATEMENTS

The PFFS include the results and assets reported in the consolidated financial statements of the Society of Lloyd's, comprising the financial statements of the Society of Lloyd's and all its subsidiary undertakings, the Lloyd's Central Fund and the Society's interest in associates.

TRANSACTIONS BETWEEN SYNDICATES AND THE SOCIETY

> Central Fund contributions, members' subscriptions and other market charges levied by the Society are reported as net operating expenses in the syndicate annual accounts and as income in the Society financial statements.
> Central Fund claims and provisions to discharge the liability of members where they have unpaid cash calls, and do not have the resources to meet those cash calls, are reported as a profit and loss charge and balance sheet liability in the Society financial statements. The Central Fund's other income includes recoveries from insolvent members. The syndicate annual accounts for calendar year 2011 and earlier years include those members' results and at the balance sheet date will report the outstanding liability within members' balances.
> Loans funding statutory overseas deposits are reported as assets within the syndicate annual accounts and as liabilities in the Society financial statements.

Transactions between the syndicates and the Society which have been reported within both the syndicate annual accounts and the Society financial statements have been eliminated (note 8).

NOTES TO THE PRO FORMA FINANCIAL STATEMENTS CONTINUED

as at 31 December 2011

2. BASIS OF PREPARATION CONTINUED

INTER-SYNDICATE LOANS

The syndicate annual accounts report debtor and creditor balances for inter-syndicate loans totalling £170m (2010: £158m). These amounts have been eliminated from the amounts reported in the balance sheet to provide a more meaningful presentation of the balance sheet for users of the PFFS.

SUBORDINATED DEBT AND SECURITIES

In accordance with the terms of the subordinated debt and securities, the capital raised is available for payment to policyholders in advance of repayment to the note holders and is included in 'capital, reserves and subordinated debt and securities' in the pro forma balance sheet. The Society financial statements on pages 99 to 103 provide additional information.

3. ACCOUNTING POLICIES NOTES

A. AGGREGATE ACCOUNTS

General

Under the Insurance Accounts Directive (Lloyd's Syndicate and Aggregate Accounts) Regulations 2008, managing agents must prepare the syndicate annual accounts under UK GAAP. However, where UK GAAP permits different accounting treatments, each managing agent is able to adopt the accounting policies it considers most appropriate to its syndicate. In particular, in certain circumstances, UK GAAP permits various accounting treatments for the movement in foreign exchange. The following accounting policies are, therefore, generic in nature.

Premiums written

Premiums written represent premiums on business incepting during the year, together with adjustments for premiums written in previous accounting periods. Premiums written are stated before deduction of commissions but net of taxes, duties levied on premiums and other deductions.

Unearned premiums

Written premiums are recognised as earned according to the risk profile of the policy. Unearned premiums represent the proportion of premiums written in the year that relate to unexpired terms of policies in force at the balance sheet date, calculated on the basis of established earnings patterns or time apportioned as appropriate.

Outwards reinsurance premiums

Outwards reinsurance premiums comprise the cost of reinsurance arrangements placed and are accounted for in the same accounting period as the related insurance contracts. The provision for reinsurers' share of unearned premiums represents that part of reinsurance premium ceded which is estimated to be earned in following financial years.

Claims provisions and related recoveries

Gross claims incurred comprise the estimated cost of all claims occurring during the year, whether reported or not, including related direct and indirect claims handling costs and adjustments to claims outstanding from previous years.

The provision for claims outstanding is assessed 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. The provision also includes the estimated cost of claims incurred but not reported (IBNR) at the balance sheet date based on statistical methods.

These methods generally involve projecting from past experience of the development of claims over time to form a view of the likely ultimate claims to be experienced for more recent underwriting, having regard to variations in the business accepted and the underlying terms and conditions. For the most recent years, where a high degree of volatility arises from projections, estimates may be based in part on output from rating and other models of the business accepted and assessments of underwriting conditions. The amount of salvage and subrogation recoveries is separately identified and, where material, reported as an asset.

The reinsurers' share of provisions for claims is based on the amounts of outstanding claims and projections for IBNR, net of estimated irrecoverable amounts, having regard to the reinsurance programme in place for the class of business, the claims experience for the year and the current security rating of the reinsurance companies involved. Statistical techniques are used to assist in making these estimates. The two most critical assumptions as regards claims provisions are that the past is a reasonable predictor of the likely level of future claims development and that the rating and other models used for current business are fair reflections of the likely level of ultimate claims to be incurred.

The directors of each syndicate's managing agent consider that the provisions for gross claims and related reinsurance recoveries are fairly stated on the basis of the information currently available to them. However, the ultimate liability will vary as a result of subsequent information and events, which may result in significant adjustments to the amounts provided. Adjustments to the amounts of claims provisions established in prior years 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.

Unexpired risks provision

A provision for unexpired risks is made where claims and related expenses arising after the end of the financial period in respect of contracts concluded before that date, are expected to exceed the unearned premiums under these contracts, after the deduction of any acquisition costs deferred.

The provision for unexpired risks is calculated at syndicate level by reference to classes of business which are managed together, and may take into account relevant investment return.

Acquisition costs

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

Foreign currencies

Income and expenditure in foreign currencies are translated into pound sterling using the exchange rates prevailing at the date of the transactions or the average rate may be used when this a reasonable approximation.

Where the international operations for a syndicate are treated as a branch, its branch assets and liabilities are translated into pound sterling at the rates of exchange ruling at the balance sheet date. The exchange differences arising are normally accounted for through the statement of total recognised gains and losses.

3. ACCOUNTING POLICIES NOTES CONTINUED

For other international operations, monetary assets and liabilities are translated into pound sterling at the rates of exchange ruling at the balance sheet date. Non-monetary assets and liabilities at the balance sheet date, primarily deferred acquisition costs and unearned premiums, are maintained at the rate of exchange ruling when the contract was entered into (or the approximate average rate). Resulting exchange differences on translation are recorded in the profit and loss account.

Investments

Investments are stated at current value at the balance sheet date. For this purpose listed investments are stated at their bid price market value, and deposits with credit institutions and international deposits are stated at cost.

Unlisted investments for which a market exists are stated at the average price at which they are traded on the balance sheet date or the last trading day before that date.

Syndicate investment return

Syndicate investment return comprises all investment income, realised investment gains and losses and movements in unrealised gains and losses, net of investment expenses, charges and interest.

Realised gains and losses on investments carried at market value are calculated as the difference between sale proceeds and purchase price.

Unrealised gains and losses on investments represent the difference between the valuation at the balance sheet date and their valuation at the previous balance sheet date, or purchase price, if acquired during the year, together with the reversal of unrealised gains and losses recognised in earlier accounting periods in respect of investment disposals in the current period.

Syndicate investment return is initially recorded in the non-technical account. A transfer is made from the non-technical account to the general business technical account where the investments generating the return relate to insurance business.

Taxation

Under Schedule 19 of the Finance Act 1993 managing agents are not required to deduct basic rate income tax from trading income.

In addition, all UK basic rate income tax deducted from syndicate investment income is recoverable by managing agents and consequently the distribution made to members or their members' agents is gross of tax. Capital appreciation falls within trading income and is also distributed gross of tax.

No provision has been made for any United States Federal Income Tax payable on underwriting results or investment earnings. Any payments on account made by the syndicate during the year are included in the balance sheet under the heading 'other debtors'.

No provision has been made for any international tax payable by members on underwriting results.

Operating expenses

Operating expenses (including pension and other staff costs) have been charged to the syndicates in accordance with the policies adopted by the managing agents.

Profit commission

Where profit commission is charged by the managing agent it will normally be fully paid once the appropriate year of account closes, normally at 36 months. The profit commission is accrued in the profit and loss account in accordance with the earned profit.

Managing agents may make payments on account of their anticipated profit commission from the syndicate premiums trust funds prior to the closure of a year of account where they have transferred open year surpluses (interim profits) from the syndicate level premiums trust funds to the members' personal reserve fund. Any payments on account of such commission are restricted to the profit commission expensed in the profit and loss account in striking the level of interim profits declared and subsequently released.

B. FUNDS AT LLOYD'S

FAL are valued in accordance with their market value at the year end, and using year end exchange rates.

Investments are stated at current value at the balance sheet date. For this purpose, listed investments are stated at their bid price market value, and deposits with credit institutions and international deposits are stated at cost.

Unlisted investments for which a market exists are stated at the average price at which they are traded on the balance sheet date or the last trading day before that date.

Members that only participate on one syndicate may hold the capital supporting their underwriting in their syndicate's premium trust funds. Where a member takes advantage of this facility, the capital held in the premium trust fund is reported within members' balances and the investment return retained within the non-technical account.

C. SOCIETY OF LLOYD'S

The accounting policies adopted in the Society of Lloyd's financial statements are set out on pages 104 to 109.

4. VARIABILITY

Calendar year movements in reserves are based upon best estimates as at 31 December 2011 taking into account all available information as at the balance sheet date. These estimates are subject to variability until the date at which the underlying claims are settled. Such changes in best estimate are reflected in the technical account of the year in which they occur.

5. DISCONTINUED OPERATIONS

Continuing/discontinued operations represent the analysis reported in the syndicate annual accounts between business that they are continuing to underwrite and business that they have ceased to underwrite. It is quite possible, however, that business discontinued by one syndicate continues to be written at Lloyd's by one or more other syndicates.

When a syndicate has ceased underwriting, its operations are reported as discontinued within the syndicate's annual accounts. Where the entire book of business continues to be written by another syndicate, however, an adjustment is made in the PFFS to reflect the continuing nature of this business to Lloyd's and its members as a whole.

Where business has been reported as discontinued in 2011, the results for that business have also been reported as discontinued in the 2010 comparative figures.

NOTES TO THE PRO FORMA FINANCIAL STATEMENTS CONTINUED

as at 31 December 2011

6. MEMBERS' FUNDS AT LLOYD'S

The valuation of members' FAL in the balance sheet totals £15,171m (2010: £13,832m). The notional investment return on FAL included in the non-technical profit and loss account totals £69m (2010: £211m).

The notional investment return on FAL has been calculated by applying quarterly indices yields, net of management fees, to the value of FAL at the beginning of each quarter except where Lloyd's is the investment manager for FAL, in which case the actual return achieved has been included. A significant proportion of FAL investments are US dollar denominated and, for these assets, US dollar indices yields are applied.

The following table shows the indices used and the yields applied for the full year.

Investment type	Index	Proportion of FAL December 2011 %	Investment Return 2011 %	Investment Return 2010 %
UK equities	FTSE All share	**5.2**	**(4.2)**	13.5
UK fixed income securities	UK Gilts 1-3 years	**12.4**	**3.1**	2.4
UK deposits managed by Lloyd's	Return achieved	**5.6**	**0.3**	0.4
UK deposits managed externally	LIBID	**23.2**	**0.4**	0.3
US equities	S&P 500 Index	**3.0**	**(3.7)**	11.8
US fixed income securities	US Treasuries 1-3 years	**18.4**	**1.4**	2.1
US deposits managed by Lloyd's	Return achieved	**1.6**	**0.0**	0.1
US deposits managed externally	LIBID	**30.6**	**0.0**	0.0

7. SOCIETY OF LLOYD'S

The results of the group financial statements of the Society included in the profit and loss account are a profit of £266m (2010: £267m) in the technical account and a loss of £141m (2010: £73m) in the non-technical account.

8. AGGREGATION OF RESULTS AND NET ASSETS

A reconciliation between the results, statement of realised gains and losses and net assets reported in the syndicate annual accounts, members' FAL and by Society is set out below:

Profit and loss account	2011 £m	2010 £m
Result per syndicate annual accounts	**(710)**	1,790
Result of the Society	**89**	322
Central Fund claims and provisions released in Society financial statements	**15**	(34)
Central Fund recoveries from insolvent members	**(4)**	(215)
Taxation charge in Society financial statements	**29**	122
Notional investment return on members' funds at Lloyd's	**69**	211
Society income not accrued in syndicate annual accounts	**(4)**	(1)
Result on ordinary activities before tax	**(516)**	2,195

Statement of total recognised gains and losses	2011 £m	2010 £m
Result for the financial year	**(516)**	2,195
Foreign currency movements in the syndicate annual accounts	**–**	64
Other recognised gains and losses per syndicate annual accounts	**–**	6
Other recognised gains and losses of the Society	**(46)**	(2)
Total recognised gains and losses	**(562)**	2,263

8. AGGREGATION OF RESULTS AND NET ASSETS CONTINUED

Capital and reserves	2011 £m	2010 £m
Net assets per syndicate annual accounts	**1,581**	2,931
Net assets of the Society	**1,490**	1,447
Central Fund claims and provisions	**8**	9
Members' funds at Lloyd's	**15,171**	13,832
Unpaid cash calls reanalysed from debtors to members' balances	**(17)**	(15)
Society income receivable not accrued in syndicate annual accounts	**(17)**	(13)
Total capital and reserves	**18,216**	18,191

Transactions between syndicates and the Society which have been reported within both the syndicate annual accounts and the Society financial statements have been eliminated in the PFFS as set out in note 2.

9. SEGMENTAL ANALYSIS

The syndicate returns to Lloyd's provided additional information to derive the following table in respect of the classes of business reviewed in the market commentary.

2011	Gross written premiums £m	Net earned premium £m	Under-writing Result £m
Reinsurance	**8,813**	**6,365**	**(1,945)**
Property	**4,965**	**3,847**	**(10)**
Casualty	**4,245**	**3,467**	**117**
Marine	**1,968**	**1,609**	**89**
Energy	**1,523**	**1,080**	**130**
Motor	**1,187**	**1,113**	**(82)**
Aviation	**708**	**559**	**196**
Life	**67**	**59**	**2**
Total from syndicate operations	**23,476**	**18,099**	**(1,503)**
Transactions between syndicates and the Society (notes 2 and 8) and insurance operations of the Society	**1**	**1**	**266**
Total per PFFS	**23,477**	**18,100**	**(1,237)**

2010	Gross written premiums £m	Net earned premium £m	Under-writing Result £m
Reinsurance	8,388	6,112	590
Property	4,908	3,736	283
Casualty	4,397	3,353	113
Marine	1,671	1,408	128
Energy	1,419	983	164
Motor	1,103	1,009	(520)
Aviation	642	458	115
Life	63	51	3
Total from syndicate operations	22,591	17,110	876
Transactions between syndicates and the Society (notes 2 and 8) and insurance operations of the Society	1	1	267
Total per PFFS	22,592	17,111	1,143

NOTES TO THE PRO FORMA FINANCIAL STATEMENTS CONTINUED

as at 31 December 2011

10. LIFE BUSINESS

The PFFS include the results of all life and non-life syndicates transacting business during 2011. The results and net assets for life syndicates are not material and have not been separately disclosed in the profit and loss account and balance sheet. The results for life business are reported in the segmental analysis (note 9).

11. NET OPERATING EXPENSES

	2011 £m	2010 £m
Acquisition costs	**5,066**	4,827
Change in deferred acquisition costs	**(116)**	(135)
Administrative expenses	**1,468**	1,475
Underlying operating expenses	**6,418**	6,167
(Profit)/loss on exchange	**19**	(228)
	6,437	5,939

12. SYNDICATE INVESTMENT RETURN

	2011 £m	2010 £m
Income from investments	**786**	798
Net realised gains on investments	**57**	82
Net unrealised gains on investments	**(8)**	77
Investment management expenses, including interest	**(44)**	(43)
	791	914

The breakdown of the Society investment return is provided in the Society’s financial statements on page 115. This analysis is not appropriate for the notional investment return on funds at Lloyd’s.

13. FINANCIAL INVESTMENTS

	2011 £m	2010 £m
Shares and other variable yield securities and units in unit trusts	**4,182**	4,188
Debt securities and other fixed income securities	**30,066**	28,886
Participation in investment pools	**1,639**	1,652
Loans and deposits with credit institutions	**5,461**	5,086
Other	**22**	21
	41,370	39,833

13. FINANCIAL INVESTMENTS CONTINUED

The following table provides an analysis of the credit disposition of syndicate investments.

	2011 £m	2010 £m
Government, agency and supranational	**13,179**	11,790
'AAA' rated	**4,369**	5,319
'AA' rated	**4,397**	4,342
'A' rated	**4,079**	3,447
'BBB' and lower rated	**1,224**	1,156
Equity and hedge funds	**904**	897
Cash equivalents	**3,759**	3,537
Total syndicate investments	**31,911**	30,488
FAL investments	**7,071**	7,060
Society investments	**2,388**	2,285
Total per PFFS	**41,370**	39,833

The following table provides an analysis of the average duration of syndicate fixed income securities.

	2011 %	2010 %
Less than one year	**32**	15
Between one and two years	**35**	34
Between two and three years	**24**	30
Over three years	**9**	21
Total per PFFS	**100**	100

14. CASH AT BANK AND IN HAND

Cash at bank and in hand includes letters of credit and bank guarantees held in trust within members' FAL to meet policyholder claims as required, totalling £8,100m (2010: £6,772m).

15. MEMBERS' BALANCES

	2011 £m	2010 £m
Balance at 1 January	**2,912**	3,878
Result for the year per syndicate annual accounts	**(710)**	1,790
Distribution on closure of the 2008 (2007) year of account	**(1,448)**	(2,495)
Advance distributions from open years of account	**(587)**	(524)
Movement in cash calls	**434**	(16)
Capital transferred into syndicate premium trust funds	**964**	243
Foreign currency movements	**(5)**	69
Other movements	**(5)**	(33)
Balance at 31 December	**1,555**	2,912

Members participate on syndicates by reference to years of account. Members' ultimate results, assets and liabilities are assessed by year of account with reference to policies incepting in that year of account. Members' balances represent the net profit/(loss) to be distributed/(collected) by syndicates to/(from) the members. Where there are profits and funds at Lloyd's held in excess of members' capital requirements, they will be distributed in the second quarter of 2012.

Members that only participate on one syndicate may hold the capital supporting their underwriting in their syndicate's premium trust funds. Where a member takes advantage of this facility in the year, the movement is reflected in the above table as 'capital transferred into syndicate premium trust funds'.

NOTES TO THE PRO FORMA FINANCIAL STATEMENTS CONTINUED

as at 31 December 2011

16. TECHNICAL PROVISIONS

Gross	2011 £m	2010 £m
Claims reported	**22,848**	19,468
Claims incurred but not reported and unallocated loss adjustment expenses	**18,465**	16,835
Unearned premiums	**10,605**	10,125
Total technical provisions, gross	**51,918**	46,428
Recoverable from reinsurers		
Claims reported	**6,257**	5,201
Claims incurred but not reported and unallocated loss adjustment expenses	**4,340**	3,578
Unearned premiums	**1,556**	1,458
Total reinsurers' share of technical provisions	**12,153**	10,237
Net		
Claims reported	**16,591**	14,267
Claims incurred but not reported and unallocated loss adjustment expenses	**14,125**	13,257
Unearned premiums	**9,049**	8,667
Total net technical provisions	**39,765**	36,191

17. FIVE YEAR SUMMARY

Results	2011 £m	2010 £m	2009 £m	2008 £m	2007 £m
Gross written premiums	**23,477**	22,592	21,973	17,985	16,366
Net written premiums	**18,472**	17,656	17,218	14,217	13,256
Net earned premiums	**18,100**	17,111	16,725	13,796	13,097
Result attributable to underwriting	**(1,237)**	1,143	2,320	1,198	2,099
Result for the year before tax	**(516)**	2,195	3,868	1,899	3,846
Assets employed					
Cash and investments	**51,416**	48,483	46,254	44,370	36,981
Net technical provisions	**39,765**	36,191	33,613	35,792	27,963
Other net assets	**6,565**	5,899	5,522	5,604	4,431
Capital and reserves	**18,216**	18,191	18,163	14,182	13,449
Statistics					
Combined ratio (%)	**106.8**	93.3	86.1	91.3	84.0
Return on capital (%)	**(2.8)**	12.1	23.9	13.7	29.3

SECURITY UNDERLYING POLICIES ISSUED AT LLOYD'S

as at 31 December 2011

SUMMARY

Lloyd's is not an insurance company, it is a Society of members, both corporate and individual, which underwrite insurance in syndicates. These syndicates can comprise one single corporate member or any number of corporate members, underwriting severally for their own account.

There were 88 syndicates, (excluding syndicates set up to accept RITC of orphan syndicates but excluding the Special Purpose Syndicates) as at 31 December 2011, registered to conduct business at Lloyd's. Each syndicate is managed by a managing agent. Managing agents write insurance business on behalf of the member(s) of the syndicate, which receive profits or bear losses in proportion to their share in the syndicate for each underwriting year of account. The adoption of annual accounting and presentation of the syndicate annual accounts do not change the allocation of profits and losses to members.

THE LLOYD'S CHAIN OF SECURITY

The three key features of the Lloyd's Chain of Security provide strong security to all Lloyd's policyholders, reflected in the high ratings assigned by leading rating agencies.

The first two links in the Lloyd's Chain of Security each operate on a several basis: each member's resources are only available to meet their share of claims. The third link represents assets available to meet the liabilities of any member on a mutual basis. The key features of the Chain of Security are summarised below and the sections which follow describe each of these links in greater detail.

The Chain of Security supports policies written for the 1993 and subsequent years of account for non-life business and all life business written at Lloyd's. Liabilities in relation to the 1992 and prior years of account for non-life business were reinsured into Equitas as at 31 December 1995, as part of 'Reconstruction and Renewal'.

FIRST LINK – SYNDICATE LEVEL ASSETS

All premium receipts and reserves at syndicate level are held in premiums trust funds or overseas regulatory deposits. Profits are distributed only after provision for all outstanding liabilities.

SECOND LINK – MEMBERS' FUNDS AT LLOYD'S (FAL)

The capital provided by every member is assessed according to the Lloyd's Individual Capital Assessment (ICA) capital setting framework. When agreed, each ICA is then 'uplifted' (by 35% for 2011) to provide an extra buffer to support Lloyd's rating and financial strength. This uplifted ICA, which is the Economic Capital Assessment (ECA), is used to determine members' capital requirements subject to prescribed minimum levels.

The FSA oversees the annual review of syndicate ICAs by the Corporation, which reviews the historical performance, business plans and risk appetite of that syndicate in assessing the adequacy of the capital level proposed. The FSA also reviews a small sample of syndicate ICAs in order to validate the effectiveness of the reviews carried out by the Corporation.

THIRD LINK – CENTRAL ASSETS

At the discretion of the Council, the Central Fund is available to meet any proportion of any member's insurance liabilities that the member is unable to meet in full.

THE FIRST LINK

The first link in the Chain of Security is the member's premiums trust funds, and other assets held in trust at syndicate level. To protect the interests of policyholders, all premiums and other monies received or receivable in connection with the member's underwriting business are initially paid into the premiums trust funds of the syndicate concerned. Payments from these funds may only be made to meet permitted trust outgoings: claims, reinsurance premiums, underwriting expenses and the like, including funding international regulatory deposits. Profit is not distributed until provision has been made for all outstanding liabilities.

There are separate premiums trust funds for life business and non-life business. There is a further segregation in that a number of the premiums trust funds are exclusively available to support certain international underwriting of members. The Lloyd's Dollar Trust Funds (LDTF) receive premiums in respect of US dollar denominated non-life business underwritten or incepting on or after 1 August 1995. Receipts in respect of non-life US dollar denominated business originally written and incepting before that date were held in the Lloyd's American Trust Fund (LATF) of each member, in New York. During 2009 arrangements were made, in agreement with the New York Insurance Department, to transfer the non-life underwriting liabilities in relation to the insurance business incepting before 1 August 1995 previously held in the LATF, into the LDTF.

The other international premiums trust funds are the Lloyd's Canadian Trust Fund (LCTF) in Canada, comprising members' receipts in respect of Canadian situs business and the Lloyd's Asia trust funds for general business written by members through service companies in Singapore.

Members must ensure that there are sufficient funds in the members' premiums trust fund for the syndicate to meet all claims, necessary expenses and outgoings in connection with the syndicate business; they are required to meet a request to make such funds available (a 'cash call'). Cash calls are met by members from their own resources or, if necessary, from their FAL or, at the Council's discretion, the New Central Fund.

Premiums trust funds are used to fund international regulatory deposits. The US situs business of each syndicate is supported by US situs syndicate level trust funds (for US situs surplus lines business, US situs reinsurance business as accredited reinsurers, and for Illinois and Kentucky licensed business respectively). In addition, separate joint asset trust funds provide joint security for members' US situs surplus lines, US situs reinsurance and Kentucky business respectively.

These deposits would be available to meet judgement debts of a member in respect of business connected with the relevant international territory in the event that the relevant premiums trust fund for the member, even after replenishment from other links in the Chain of Security and other free assets of the member in question, was inadequate.

Underwriters also maintain regulatory deposit trust funds in Australia and South Africa and various deposits in other countries.

The total value of all the above funds was £41,311m at 31 December 2011.

THE SECOND LINK

The second link is members' capital provided to support their underwriting. This is commonly held as FAL but from 1 July 2007 can be held by aligned corporate members within the premiums trust fund (see first link above). FAL comprise the three trust funds in which members' assets may be held: the Lloyd's deposit, the special reserve fund and the personal reserve fund. These are each available to meet cash calls made on the member in respect of a syndicate. The assets in FAL must be readily realisable, this includes letters of credit and

SECURITY UNDERLYING POLICIES ISSUED AT LLOYD'S CONTINUED

as at 31 December 2011

bank and other guarantees. A member is required to have sufficient assets at least equivalent to the aggregate of the member's ECA and certain liabilities in respect of its underwriting business. The amount of FAL assets required will depend on the net open year underwriting position of the member, ie if the net open year position is a deficit then the member will be required to add additional FAL to cover this deficiency, if the net open year position is a surplus the member can use these surplus assets towards their ECA requirement thus reducing the value of their assets to be held as FAL.

Minimum capital ratios are set at 40% of overall premium limits (25% for those members writing mainly EU motor business).

Individual members underwrite with unlimited liability and thus may be required to meet their share of claims to the full extent of their wealth. A corporate member may also have assets, beyond its capital to support underwriting, which can be called upon to meet its underwriting liabilities.

At 31 December 2011, the total value of capital supporting underwriting held in trust by members amounted to £15,171m (a further £2,521m of capital supporting underwriting is held in members' premiums trust funds as part of the first link).

THE THIRD LINK

The third link is the central resources of the Society. These are the assets of the Central Fund (comprising the New Central Fund and the 'Old' Central Fund and other assets of the Society).

The New Central Fund has been established to be available, at the discretion of the Council of Lloyd's, to ensure that policyholders' claims are met in the event of members being unable to meet their underwriting liabilities relating to 1993 and post non-life business and all life business. In practice, this entails the payment of syndicate cash calls where a member is unable to do so from their FAL or their own resources.

The New Central Fund is funded by annual contributions from members.

The net assets of the Central Fund as at 31 December 2011 were £1,361m.

In 2004 and 2007, Lloyd's issued subordinated loan notes and perpetual capital securities respectively which, as at 31 December 2011, are included as a liability of £898m within the Society's financial statements. As set out in note 17 to the Society's financial statements, payments on the notes are subordinated to certain payments which may be made out of central assets, including payments made to discharge the liabilities of an insolvent member to any person (including any policyholders) arising out of or in connection with insurance business carried on at Lloyd's by that insolvent member.

Central Fund assets may be supplemented by a 'callable layer' of up to 3% of members' overall premium limits in any one calendar year. These funds would be drawn from premiums trust funds (described and included in the first link).

In addition, the other assets of the Society, totalling £129m at 31 December 2011, are available to meet underwriting liabilities in the last resort.

In aggregate, the value of the central resources of the Society (excluding the subordinated debt liability and the callable layer), amounted to £2,388m at 31 December 2011.

AGGREGATE RESOURCES

The total of syndicate assets, members' capital to support underwriting (ie funds at Lloyd's and capital held in syndicate premiums trust funds) and central resources of the Society as at 31 December 2011 was £58,870m. The total of net syndicate technical provisions at the end of 2011 was £39,756m. The total net resources of the Society and its members were therefore £19,114m (excluding the subordinated debt liability) as shown in the PFFS on page 55.

The aggregated resources are based on the total of the assets and liabilities of all members and those of the Society. The aggregate declared resources of the Society do not represent a consolidated statement of the financial position of Lloyd's business taken as a single entity and, as indicated above, the first two links of the Chain of Security operate on a several, not mutual, basis.

SOLVENCY CONTROLS

One of the most important controls on the solvency of the members of Lloyd's is the annual solvency test.

The annual solvency process requires the managing agent of each syndicate to estimate and provide for all current and future liabilities for each year of account. These liabilities 'technical provisions for solvency' are subject to a statement of actuarial opinion. The requirement for an opinion and its required wording, that the net technical provisions for solvency are not less that the current and future liabilities, is a higher test than required in the UK company market. In the event that it is not possible for the managing agent to secure an unqualified actuarial opinion for any reason, the technical provisions for solvency would be determined by the Lloyd's Actuary, who would provide a report to the FSA. In addition, any syndicate which is not able to secure an unqualified actuarial opinion will normally be subject to a monitoring review by Lloyd's. There were no qualified actuarial opinions as at 31 December 2011.

The Lloyd's solvency test has two stages to the calculation:

First, each member's solvency position is calculated. Each member must have sufficient assets – those held in the premiums trust funds, international regulatory deposits and its capital to support underwriting – to cover its underwriting liabilities and on top of this an additional margin known as the member's capital resources requirement (MCRR). The MCRR is calculated separately for each member, determined as the greater of 16% of annual premium income or 23% of average claims incurred over a three-year period. Premiums and claims in respect of certain types of liability business have their value increased by 50%, for the purpose of this calculation. Where a member's assets are not sufficient to cover the aggregate of its underwriting liabilities and its MCRR, the member has a solvency shortfall.

The second part of the solvency test calculation requires that the net central assets of the Society must be sufficient to cover the aggregate of all members' shortfalls calculated at the solvency test date. Central assets include the value of the Central Fund and the other net assets of the Society, excluding the subordinated debt liability but including the callable layer – for this purpose, the 'effective' callable layer, ie that part of the callable layer not attributable to members with a solvency shortfall.

Lloyd's is required to maintain solvency on a continuous basis, and the solvency position of each member, and thus of Lloyd's as a whole, is monitored on a regular basis. The FSA are advised of the results of this monitoring.

RECAPITALISATION AT MEMBER LEVEL

The free funds available to a member to meet its capital requirements may fall below the required level for two reasons: first, increases to syndicate ICAs, following a material change to the risk profile of the business; or second, erosion of funds due to losses.

In either case, the timetable for recapitalisation and the intervention by Lloyd's will depend on the extent of the shortfall.

All members are subject to bi-annual (June and November) Coming into Line (CIL), where members are required to hold free funds to meet their ECA. Lloyd's has powers to require members to meet their ECA at all times, but will normally permit recapitalisation in accordance with this bi-annual timetable, provided that members' free funds remain above their ICA. Where a member's funds fall below their ICA level, Lloyd's requires members to inject additional capital outside of the normal CIL timetable.

Where there is a material exposure to the Central Fund and policyholder security, underwriting restrictions or other measures may be imposed to mitigate the risks until capital is lodged at Lloyd's.

In accordance with the continuous solvency regime, where a member's free funds fall below the level of regulatory solvency (underwriting losses plus MCRR), the existing powers to immediately suspend underwriting or take any other measures deemed appropriate to Lloyd's may be used.

THE LLOYD'S RETURN

Each year, Lloyd's files the Lloyd's Return with the FSA. This return is intended to ensure Lloyd's regulatory reporting requirements are in line with other UK insurers, adapted where appropriate to reflect Lloyd's unique structure. This return reports the results of the Lloyd's solvency test.

	2011 £m	2010 £m
I Syndicate level assets (several basis)	**41,311**	39,021
II Members' funds at Lloyd's (several basis)	**15,171**	13,832
III Central assets (mutual basis)		
Net Central Fund assets	**1,361**	1,285
Subordinated debt	**509**	514
Subordinated perpetual capital securities	**389**	416
Other net assets of the Society	**129**	162
	2,388	2,377
Total resources of the Society of Lloyd's and its members	**58,870**	55,230
Net syndicate technical provisions	**(39,756)**	(36,109)
Total net resources of the Society of Lloyd's and its members	**19,114**	19,121

Notes
1. This financial summary has been compiled by aggregating the assets and liabilities of all the underlying syndicates, members' funds at Lloyd's and other net assets of the Society of Lloyd's. The statement does not purport to disclose the solvency position of each member of Lloyd's.
2. The 'total net resources of the Society of Lloyd's and its members' represents the capital, reserves and subordinated notes and securities shown in the PFFS as set out on page 55.
3. Syndicate level assets includes capital to support underwriting held by aligned corporate members in the syndicate premiums trust funds.

CONTENTS

SOCIETY REPORT

INTRODUCTION

THIS REPORT

This Report sets out the principal activities, 2011 consolidated financial statements and governance arrangements of the Society of Lloyd's.

In order to obtain an overview of the Society's operations, however, this Report should be read in conjunction with the rest of the Annual Report that looks at the Lloyd's market as a whole.

The Lloyd's market comprises members underwriting through syndicates and members' and managing agents each supported by the Society of Lloyd's. The interests of the Society and the market are inter-related and therefore the sections above may refer to both.

The Society's 2011 consolidated financial statements are included in this Report together with a financial review. The financial results of the members of Lloyd's are not part of those financial statements but can be found within the market results section starting on page 52.

THE SOCIETY

By Lloyd's Act 1871, the then existing association of underwriters was incorporated as the Society and Corporation of Lloyd's (the 'Society').

Its activities are governed by statute and, since 1982, have been managed by the Council of Lloyd's pursuant to Lloyd's Act 1982.

The Society is not an insurance company, although the group does include insurance company subsidiary undertakings.

Its principal activities are:

> To facilitate the carrying on of insurance business by members of Lloyd's, who join together as syndicates to insure and reinsure risks, and the protection of their interests in this context.

> To maintain the Lloyd's Central Fund where assets are held and administered at the discretion of the Council of Lloyd's, primarily as funds available for the protection of policyholders.

FINANCIAL HIGHLIGHTS

	2011 £m	2010 £m	2009 £m	2008 £m	2007 £m
Operating result					
Operating and other group income	**222**	427	254	248	262
Central Fund contributions	**95**	101	100	84	168
Total income	**317**	528	354	332	430
Central Fund claims and provisions (incurred)/released	**(15)**	34	19	6	18
Contribution to Equitas – Berkshire Hathaway transaction	**–**	–	–	–	(90)
Net insurance claims and provisions	**24**	17	(6)	(34)	(1)
Other group operating expenses	**(249)**	(214)	(240)	(188)	(188)
Surplus before finance, associates and tax	**77**	365	127	116	169
Net finance income and unrealised exchange differences on borrowings	**36**	75	70	22	57
Share of profits of associates	**5**	5	3	4	4
Surplus before tax	**118**	445	200	142	230
Tax charge	**(29)**	(122)	(57)	(40)	(66)
Surplus for the year	**89**	323	143	102	164
Balance sheet					
Net assets	**1,490**	1,447	1,126	990	939
Movement in net assets %	**2.97%**	28.5%	13.7%	5.4%	(1.9)%
Solvency*					
Central assets for solvency purposes	**3,095**	3,028	2,815	2,624	2,465
Solvency shortfalls	**(115)**	(123)	(59)	(134)	(167)
Excess of central assets over solvency shortfalls	**2,980**	2,905	2,756	2,490	2,298
Solvency ratio %	**2691%**	2462%	4771%	1958%	1476%
Movement in central assets for solvency purposes %	**2.2%**	7.6%	7.9%	6.5%	20.0%

* The solvency position for 2011 is estimated and will be finalised in June 2012 for submission to the FSA.

CORPORATE GOVERNANCE

The Council of Lloyd's is committed to the principle of good corporate governance and supports the application of the principles of the UK Corporate Governance Code, as far as they can be applied to the governance of a Society of members and a market of separate competing entities.

GOVERNING BODY: THE COUNCIL OF LLOYD'S

Under Lloyd's Act 1982, the Council of Lloyd's has the management and superintendence of the affairs of the Society and the power to regulate and direct the business of insurance at Lloyd's. Certain functions are reserved to the Council including:

- The making, amendment or revocation of byelaws (which are available at www.lloyds.com/byelaws).
- The setting of Central Fund contribution rates.
- Appointing the Chairman and Deputy Chairmen of Council.

Beyond the reserved functions, the Council can delegate its powers or functions to any person, committee or employee of the Society.

In line with the recommendations of the 2002 Chairman's Strategy Group, the Council has delegated authority for the day-to-day management of the market to the Franchise Board (established in 2003). The Franchise Board is able, in turn, to sub-delegate authority to the CEO and through him to the Lloyd's Executive. In addition, the Council has delegated authority to carry out specified functions to committees including the Audit, Remuneration, and Nominations Committees, as summarised below.

The relationship between the Council and the Franchise Board is defined in the Council's Governance Policies implemented in 2006 to clarify the role of the Council and to establish a more structured relationship with the Franchise Board. Further details on the role and functions of the Franchise Board and the Governance Policies are set out below.

MEMBERSHIP

The Council comprises a maximum of 18 members, split between six working, six external and six nominated members. The biographical details of the current members of the Council (as at 27 March 2012) are listed on page 13.

Nominated members are usually appointed for three-year terms which can be renewed. They may be regarded, for the purposes of the Code, as independent members of the Council with the exception of the Chairman and CEO who are included within their number.

Working and external members are generally elected for terms of three years by the working and external members of the Society respectively. In the elections for working members, voting operates on a one member, one vote basis. In the elections for external members, the voting entitlement of an external member of the Society is based on the member's allocated underwriting capacity as determined under the Constitutional Arrangements Byelaw (No.2 of 2010).

The presence of working and external members of the Council enables the nominated members to gain an understanding of the views of key stakeholders in the Lloyd's market.

Other than the CEO, no member of Council may serve more than nine years in aggregate on the Council.

CHAIRMAN AND DEPUTY CHAIRMEN

In accordance with Lloyd's Act 1982, the Chairman and Deputy Chairmen of Lloyd's are elected annually by special resolution of the Council from amongst its members. One of the Chairman and Deputy Chairmen must be a working member of the Council. This position is currently filled by Graham White.

The Chairman of Lloyd's is contracted to work three days a week but commits as much time as is necessary to undertake the role. The Council acknowledges that the Chairman has other commitments outside Lloyd's (see page 13) and is satisfied that these can be accommodated with the Chairmanship of Lloyd's.

Andreas Prindl (a nominated member) was appointed Senior Independent Deputy Chairman by Council in February 2012 (Lloyd's equivalent of the Senior Independent Director).

MEETINGS

The Council met six times in 2011. These meetings are structured to allow open discussion. At each meeting the Council receives certain regular reports – for example, a written report from the CEO and oral updates from its principal committees. It also reviews the quarterly Management Information Pack.

A table showing Council members' attendance at Council and committee meetings which they were eligible to attend is set out on page 78.

The detailed arrangements for Lloyd's governance processes are set out in the Council's Governance Policies and the Constitutional Requirements as set out in the Constitutional Arrangements Byelaw.

CORPORATE GOVERNANCE
CONTINUED

GOVERNANCE POLICIES AND THE CONSTITUTIONAL REQUIREMENTS

THE GOVERNANCE POLICIES

Amongst other matters, the Governance Policies are intended to improve the clarity around the role of the Council and to establish a more structured relationship with the Franchise Board.

The Governance Policies establish the purpose for Lloyd's: 'To maintain, in accordance with Lloyd's Acts, an organisation that will enable the long-term return from carrying out the business of insurance to be maximised for capital providers' (ie members).

Under the Governance Policies, the Council is responsible for assessing the long-term strategic development of Lloyd's by reference to both the interests of capital providers and other stakeholders and through an evaluation of economic, political and social issues impacting the international insurance and reinsurance markets.

As the Council has delegated authority for the majority of its functions (other than its reserved matters) to the Franchise Board, the Governance Policies also define the accountability linkage between the Franchise Board and the Council. This includes determining the boundaries within which the Franchise Board will operate (the Franchise Board Limitations) and establishing a Monitoring and Assurance regime which, among other matters, requires the Chairman of the Franchise Board to report to the Council on all material issues impacting the world insurance market and Lloyd's as well as providing a summary of key performance indicators.

THE CONSTITUTIONAL REQUIREMENTS

The Constitutional Requirements align, so far as appropriate, Lloyd's governance arrangements with the Companies Act 2006. They include provisions concerning the duties and responsibilities of Council members. These same duties also apply to members of the Franchise Board and the other Lloyd's committees.

In summary, members of the Council, Franchise Board and their committees are required to act in a way which 'would be most likely to promote the success of the Society for the benefit of the members as a whole' and must have regard to:

- The likely consequences of any decision in the long term.
- The need of the Society:
  - To foster business relations with those who do business at Lloyd's.
  - To have regard to the interests of its employees.
  - To consider the impact of its operations on the community and the environment; and
  - To maintain a reputation for high standards of business conduct.

The Constitutional Requirements also deal with conflicts of interest and collective responsibility.

FRANCHISE BOARD

The Council established the Franchise Board as from 1 January 2003 and set it a goal: 'To create and maintain a commercial environment at Lloyd's in which the long-term return to all capital providers is maximised'.

Specific functions delegated to the Franchise Board include:

> Determining the major risks to the Lloyd's market and determining appropriate action to address or mitigate those risks.
> Determining the key factors, levers and drivers which may affect the profitability of the Lloyd's market.
> Developing and implementing a strategy to achieve the Franchise Goal.
> Supervising, regulating and directing the business of insurance at Lloyd's.

The Franchise Board has reserved to itself a list of specific functions and powers that only it may deal with. The Franchise Board may sub-delegate authority to the CEO, directors and employees of the Corporation save in respect of those functions and powers reserved to it, the Council and their committees. The Franchise Board's committees, the CEO, directors and employees must act in accordance with the Franchise Board Limitations (including the Franchise Principles) and in accordance with the strategy, policy and principles set by the Franchise Board.

Matters reserved to the Franchise Board include:

> Setting the policy and principles relating to the supervision, regulation and direction of the business of insurance at Lloyd's (the Market Supervision Framework), in compliance with FSA requirements.
> Considering and approving Lloyd's risk appetite (both at Corporation and market level).
> Setting policy for the admission and removal of participants in the Lloyd's market.
> Admitting and removing managing agents.
> Determining the Franchise Standards for managing agents and approving the Three-Year and Annual Plan and Budget of the Corporation.

MEMBERSHIP AND MEETINGS

Biographical details of the members of the Franchise Board as at 27 March 2012 are listed on page 15. In 2011, the Franchise Board comprised:

> The Chairman of Lloyd's (who was also its Chairman).
> The CEO, the Director, Performance Management, and the Director, Finance, Risk Management and Operations.
> Three non-executives connected with the Lloyd's market.
> Four independent non-executives.

The presence of market-connected non-executive directors enables the independent non-executives to gain an understanding of market practitioner views and perspectives.

The Franchise Board held ten scheduled meetings in 2011. It also held a half day offsite focusing on the next iteration of the Three-Year Plan. These meetings were structured to allow open discussion. At each scheduled meeting the Franchise Board receives certain regular reports – for example, a written report from the CEO. It also reviews the quarterly Management Information Pack. The Franchise Board papers and minutes are made available to members of Council.

A table showing Franchise Board members' attendance at Franchise Board and committee meetings which they were eligible to attend is set out on page 78.

CORPORATE GOVERNANCE
CONTINUED

THE PRINCIPAL COMMITTEES OF THE COUNCIL

AUDIT COMMITTEE

The Audit Committee's role is to ensure that the financial activities of Lloyd's are subject to independent review and audit. The Audit Committee's functions include:

- Reviewing Lloyd's annual and interim financial statements, the aggregate syndicate results and the Lloyd's Return to the FSA.
- Reviewing both the external and internal audit plans and the compliance plan.

The CEO, Director, Finance, Risk Management and Operations, Director, North America and General Counsel, senior managers and the external and internal auditors attend meetings as appropriate.

Reports from the internal and external auditors on aspects of internal control and reports from the Legal and Compliance department on internal and international compliance are reviewed by the Audit Committee and appropriate action taken in response.

The Audit Committee submits an annual report to the Council. It also reports to the Council and the Franchise Board on its proceedings after each meeting. Additional reports are submitted to the Council and/or the Franchise Board on matters of material interest as and when necessary. The minutes of Audit Committee meetings are submitted to the Franchise Board and the Council.

The Audit Committee is chaired by Claire Ighodaro (an independent non-executive director on the Franchise Board) and its remaining members are drawn from both the Council and the Franchise Board. A table showing Audit Committee members' attendance at Audit Committee meetings is set out on page 78.

The Audit Committee met on five occasions in 2011.

The Audit Committee's full report is on pages 89 and 90.

NOMINATIONS COMMITTEE

Until November 2011, the Nominations, Appointments and Compensation Committee (NACC) was responsible for making recommendations to the Council on the appointment of the Chairman, CEO, new nominated Council members, Franchise Board members (including the Director, Finance, Risk Management and Operations and the Director, Performance Management), members of a number of the Council and Franchise Board committees and the Secretary to the Council. The NACC was also responsible for succession planning arrangements for these positions. These functions were assumed by the newly formed Nominations Committee in November 2011.

The NACC was chaired by Andreas Prindl, Deputy Chairman, and consisted of six other Council members and one Franchise Board non-executive director. A table showing NACC members' attendance at NACC meetings is set out on page 78. The NACC met on four occasions in 2011.

The Nominations Committee will meet at least twice annually and otherwise at the discretion of its Chairman or as directed by Council. The Nominations Committee reports to the Council and Franchise Board on its proceedings after each meeting on all matters relating to its duties and powers. A written report is submitted to the Council annually.

Apart from the annual exercise of making recommendations with respect to the composition of Council and Franchise Board committees (together with any other necessary changes in composition during the year), the NACC made the following major recommendations to Council during 2011:

- To appoint John Nelson as Chairman of Lloyd's. This followed an extensive search process in which the NACC was assisted by an external search consultant (Odgers Berndtson). The search was conducted based on a job description and an evaluation of the necessary skills and experience to undertake the role. Through its Chairman, the NACC consulted Lloyd's market practitioners in determining the job description. Mr Nelson's appointment as Chairman of the Council and Chairman of the Franchise Board is for a three-year term which commenced on 17 October 2011.
- To appoint Sir Andrew Cahn as a member of the Franchise Board for a three-year term commencing on 4 April 2011. Neither an external search consultant nor open advertising were used to identify Sir Andrew as the NACC was able to make use of its own resources and expertise.

The Nominations Committee made the following major recommendations to Council in 2011:

- To appoint Charles Franks as a market-connected director on the Franchise Board. Neither an external search consultant nor open advertising were used to identify Mr Franks as the Nominations Committee was able to make use of its knowledge of senior market practitioners in making the recommendation. Mr Franks' three-year term commenced on 1 January 2012.
- To reappoint Sir Robert Finch as a nominated member of Council for a one-year term commencing on 1 January 2012.

Both the NACC and the Nominations Committee's recommendations were accepted by Council.

THE PRINCIPAL COMMITTEES OF THE COUNCIL CONTINUED

To assist with succession planning, the Nominations Committee also considered the future skills, knowledge and experience likely to be needed by the Franchise Board and within the non-elected positions on the Council, given wider trends in the financial services sector. The Nominations Committee, like the NACC before it, is fully apprised of, and supportive of, the need for recent and relevant experience and diversity and will seek to increase the overall diversity (including gender) of the Franchise Board and the non-elected positions on the Council as vacancies arise.

The Nominations Committee is chaired by the Chairman of Lloyd's and its remaining members are drawn from both the Council and the Franchise Board.

A table showing Nominations Committee members' attendance at Nominations Committee meetings is set out on page 78.

The Nominations Committee met on one occasion in 2011.

REMUNERATION COMMITTEE

Until November 2011, the NACC was responsible for reviewing and making recommendations to Council on the remuneration arrangements for the Chairman, CEO, executive directors and the members of the Council and Franchise Board and their principal committees. It also reviewed the remuneration of the Secretary to the Council. As from November 2011, the newly formed Remuneration Committee assumed responsibility for setting remuneration for these individuals (other than the non-executive members of the Council, the Franchise Board and their committees). The Council considers the Remuneration Committee's proposals.

Non-executive remuneration is decided by the Council, on recommendation from the Chairman and CEO who may consult the Remuneration Committee as part of that process.

The Remuneration Committee will meet at least twice a year and otherwise at the discretion of its Chairman or as directed by the Council. The Remuneration Committee reports to the Council and Franchise Board on its proceedings after each meeting on all matters relating to its duties and powers and makes recommendations to the Council or Franchise Board on any area within its remit where action or improvement is needed. The Remuneration Committee submits a written report to the Council annually.

The Remuneration Committee is chaired by the Senior Independent Deputy Chairman. The Chairman is a member of the committee and its remaining members are drawn from both the Council and the Franchise Board. A table showing Remuneration Committee members' attendance at Remuneration Committee meetings is set out on page 78.

The Remuneration Committee met on one occasion in 2011.

The Remuneration Committee's full report is on pages 81 to 88.

CORPORATE GOVERNANCE
CONTINUED

THE PRINCIPAL COMMITTEES OF THE FRANCHISE BOARD

MARKET SUPERVISION AND REVIEW COMMITTEE (MSARC)

MSARC takes decisions regarding the exercise of Lloyd's enforcement powers. It also acts as a review body capable, where appropriate, of amending, modifying or withdrawing certain decisions taken by the Executive affecting managing agents. It also acts as the body that determines whether certain decisions can be referred to the Lloyd's Appeal Tribunal and can also make certain business decisions.

MSARC meets at the discretion of its Chairman. MSARC submits a written report to the Franchise Board annually and may submit additional reports to inform the Franchise Board of any matters of material concern as and when required.

A table showing MSARC members' attendance at MSARC meetings is set out on page 78. MSARC met on six occasions in 2011.

CAPACITY TRANSFER PANEL

The Capacity Transfer Panel (CTP) was established principally to exercise the Council's powers in relation to minority buyouts and mergers. The Panel meets at the discretion of its Chairman. The Panel submits a written report to the Franchise Board annually and may submit additional reports on matters of material concern as and when necessary.

A table showing CTP members' attendance at CTP meetings is set out on page 78. The Panel met on four occasions in 2011.

INVESTMENT COMMITTEE

The Investment Committee sets the investment objectives and parameters of centrally-managed assets and is responsible for monitoring the performance of these funds. In addition, it monitors the investment operations of the Treasury department in respect of all funds under its management and approves all investment counterparties. It may also make more general recommendations concerning investment activity at Lloyd's.

The Investment Committee meets at the discretion of its Chairman. The Investment Committee submits a written report to the Franchise Board annually and may submit additional reports on matters of material concern as and when necessary. The Investment Committee is required to obtain the approval of the Franchise Board before making any decisions which may materially affect the financial risks applying to the Society or Lloyd's market entities. A table showing Investment Committee members' attendance at Investment Committee meetings is set out on page 78. The Investment Committee met on five occasions in 2011.

TERMS OF REFERENCE AND APPOINTMENT TERMS

The terms of reference for the Council, Franchise Board and their committees (including the Audit, Remuneration and Nominations Committees) can be found on Lloyd's website. The terms of reference for the Chairman, Deputy Chairmen (including Senior Independent Deputy Chairman), CEO and executive directors can also be found on Lloyd's website.

The terms and conditions of appointment of non-executive directors and non-executive members of Council are available on request from the Secretary to the Council.

ANNUAL GENERAL MEETING

The Council reports to the members at the Annual General Meeting. A summary business presentation is given at the AGM, by the CEO and Director, Finance, Risk Management and Operations, before the Chairman deals with the business of the meeting.

Voting entitlement at general meetings is generally capacity-based for both external and working members, except at general meetings called on the requisition of members under section 6(4) of the Lloyd's Act 1982 for the purpose of revoking or annulling byelaws, at which each member has one vote. The resolutions to be considered at general meetings are published on the Lloyd's website.

INDEMNITIES

The Society has given indemnities to certain of its subsidiary undertakings, and the directors thereof, in respect of any claims or actions which may be brought against them or any future operating losses incurred by them in connection with the companies' activities. The Society has also given indemnities to and has agreed to cover certain specific costs that may be incurred by members of the Council, the Franchise Board, Lloyd's Regulatory Board and Lloyd's Market Board (the latter two boards ceased during 2002) and of their respective sub-committees, the Society staff and also certain individuals and organisations who have been asked to carry out or provide services to the Society or on behalf of, or for the benefit of, its members.

COUNCIL, FRANCHISE BOARD AND COMMITTEE ASSESSMENTS

An evaluation of the performance of the Council and its principal committees in 2011 (defined for this purpose as the Franchise Board, the Audit Committee and the NACC) was undertaken. The evaluation also covered the performance of the members of the Council and principal committees. It was conducted by the Secretary to the Council who issued questionnaires to individual Council and committee members seeking their views on 2011 performance.

The assessment covered the performance of the Chairmen of the Audit Committee and the NACC and committee members' comments were discussed privately with them. As the assessment was conducted in the fourth quarter of 2011, it did not cover Mr Nelson's performance as Chairman of the Council and the Franchise Board as he was only appointed in October 2011.

The principal conclusion of the assessment was that the current governance arrangements were working effectively and in accordance with the Governance Policies and that the Council and its principal committees were operating in accordance with their terms of reference.

Among the other major findings of the review was the need for:

> More senior underwriting and broking experience on Council.
> Effort to be continued to improve the clarity and focus of Council and Franchise Board papers.
> More visibility around the work of the Franchise Board's committees.

These and other suggestions for improvement will be taken forward by the Council and the relevant committees.

As a result of a recommendation in the 2010 performance assessment, the Council agreed in March 2011 to undertake a review of the effectiveness and appropriateness of Lloyd's delegation arrangements. Each member of the Council and the Franchise Board was interviewed and the review concluded that the current division of responsibilities between the Council and the Franchise Board worked well and was effective. The principal recommendations for improvement were:

> To increase the interaction between the independent members of both bodies.
> To highlight better the key issues/areas of concern when presenting management information to the Council and Franchise Board.
> To amend the terms of reference for the Council, Franchise Board, their committees and the Executive to reflect technical changes to the way authority is delegated and to ensure that responsibility for risk considerations was effectively embedded across the organisation.

Steps have been taken to address each of these recommendations.

INDIVIDUAL ASSESSMENT

For 2012 and future years, the Chairman will meet each member of Council and each non-executive Franchise Board director to appraise their performance. The Senior Independent Deputy Chairman will lead the appraisal of the Chairman which will also be undertaken once a year.

TRAINING AND INDUCTION

All new appointments to the Council, Franchise Board and Lloyd's committees receive an induction pack containing guidance notes on Lloyd's governance arrangements.

In addition, new members of the Council and Franchise Board without extensive knowledge of Lloyd's are offered briefing sessions with senior executive management and others. Members of the Council and Franchise Board with pre-existing knowledge and involvement at Lloyd's are given the opportunity to receive briefings on subjects of particular interest to them.

In addition, in 2011 four briefing sessions on a range of Lloyd's related topics were made available to all members of the Council and the Franchise Board.

INDEPENDENT PROFESSIONAL ADVICE

Members of the Council and Franchise Board have access to independent professional advice, if required.

CONFLICTS OF INTEREST

A register of interests is maintained by the Secretary to the Council for members of Council, Franchise Board and their committees and is available for inspection by members.

CORPORATE GOVERNANCE OF THE LLOYD'S MARKET

The corporate governance of each entity within the Lloyd's market is the responsibility of that entity. The Council provides, through the Corporation, a framework for the governance of these businesses including the assessment of capital adequacy and market supervision (including inspections, visits and audits of market entities). Managing agents' governance arrangements are also reviewed on registration and as part of risk management assessments.

CORPORATE GOVERNANCE
CONTINUED

ATTENDANCE RECORD

	Council	Franchise Board	Audit Committee	NACC[1,12]	Nominations Committee[12]	Remuneration Committee[12]	MSARC[2]	CTP[3]	Investment Committee
Chairman of the Council of Lloyd's									
John Nelson[4]	[a]2/2	[a]4/4			[a]1/1	1/1			
Lord Levene of Portsoken[5]	[a]5/5	[a]7/7							
Executive Directors									
Richard Ward	6/6	10/10							
Luke Savage		9/10							5/5
Tom Bolt		10/10							
Non-Executive Council members									
Working members									
Rupert Atkin	4/6			1/4					
Ewen Gilmour[10]	6/6		0/3	3/4					
Christopher Harman	6/6								
Nick Marsh	6/6								
Graham White	6/6			4/4	1/1				
External members									
Lord Ashton of Hyde	6/6								
Michael Deeny	5/6								
Matthew Fosh	6/6								
Barnabas Hurst-Bannister	5/6								
Paul Jardine[9]	6/6		2/3	4/4		1/1			
Alan Lovell	5/6			4/4		1/1		4/4	
Nominated members									
Celia Denton[6,9,14]	1/1		2/2				1/1		
Sir Robert Finch	5/6		4/5	4/4			[a]5/6		
Reg Hinkley[14]	6/6		5/5				5/5		
Sir David Manning	6/6				1/1				
Andreas Prindl	6/6		5/5	[a]4/4	1/1	[a]1/1		[a]4/4	[a]5/5
Non-Executive Franchise Board members									
Sir Andrew Cahn[7]		6/7							
Nick Furlonge		7/10			1/1				
Claire Ighodaro		10/10	[a]5/5						
Andrew Kendrick[11]		9/10	4/5	2/3		1/1			
Martin Read		9/10				0/1			
David Shipley[8]		10/10	5/5						
Andre Villeneuve		9/10			1/1				

	Council	Franchise Board	Audit Committee	NACC[1,12]	Nominations Committee[12]	Remuneration Committee[12]	MSARC[2]	CTP[3]	Investment Committee
Other Committee members									
Martin Bride									3/5
Margaret Chamberlain								4/4	
Edward Creasy[13]							5/5		
Christine Dandridge							6/6		
Lady Delves Broughton								3/4	5/5
David Gittings								4/4	
Michael Green									5/5
Peter Grove							6/6		
Ian Salter								2/4	
Paul Swain								4/4	
David Winkett									4/5

[a] Chairman.

Notes
1. Nominations, Appointments and Compensation Committee.
2. Market Supervision and Review Committee.
3. Capacity Transfer Panel.
4. John Nelson was appointed as a nominated member of Council and as the Chairman of Council and the Franchise Board on 17 October 2011. He also attended the Council meeting on 20 September and the Franchise Board meeting on 19 September as an observer (included in the statistics above).
5. Lord Levene stood down as Chairman of Council and as a working member of Council on 16 October 2011. He also stood down as the Chairman of the Franchise Board on 16 October 2011.
6. Celia Denton retired as a nominated member of Council on 15 March 2011.
7. Sir Andrew Cahn was appointed to the Franchise Board on 4 April 2011.
8. David Shipley retired as a Franchise Board member on 31 December 2011. He also resigned from the Audit Committee on 31 December 2011.
9. Celia Denton's term on Audit Committee ended on 25 March 2011. Paul Jardine joined the Audit Committee on 26 March 2011.
10. Ewen Gilmour resigned from the Audit Committee on 14 September 2011.
11. Andrew Kendrick joined NACC on 7 February 2011.
12. NACC was dissolved as a committee of the Council on 18 November 2011. Separate Nominations and Remuneration Committees were established on 18 November 2011.
13. Edward Creasy joined MSARC on 1 February 2011.
14. Celia Denton resigned from MSARC on 15 March 2011. Reg Hinkley joined MSARC on 16 March 2011.

INTERNAL CONTROL STATEMENT

The Franchise Board, on behalf of the Council of Lloyd’s, has responsibility for the Society’s system of internal control and for reviewing its effectiveness. The Executive Team is responsible for the implementation and maintenance of the internal control system. This incorporates an embedded, ongoing process for identifying, evaluating and managing significant business, operational, financial, compliance and other risks. The system is designed to reduce, rather than eliminate, the risk of failure to achieve business objectives and can only provide reasonable but not absolute assurance against material misstatement or loss.

The Audit Committee monitors and reviews the effectiveness of the system of internal control of the Society and biannual reports are provided to the Franchise Board. There is an ongoing process, in accordance with the guidance of the UK Corporate Governance Code on internal control, which has been established for identifying, evaluating and managing significant risks. Other procedures such as whistle-blowing whereby any member of staff may take matters that concern them to the Head of Internal Audit, the Legal and Compliance department or, where appropriate, to the Chairman of the Audit Committee or the FSA, are clearly set out. Associate companies, Ins-sure Holdings Limited and Xchanging Claims Services Limited, are not dealt with as part of the group for the purposes of applying the UK Corporate Governance Code.

The group’s key risk management processes and the system of internal control procedures include the following:

MANAGEMENT STRUCTURE

‘Lloyd’s Governance Arrangements: A Guide for Members of Lloyd’s Committees’ outlines the governance structure and committee members’ duties and responsibilities, including confidentiality and conflicts and declarations of interest.

There is a clearly defined organisation structure with terms of reference agreed for the CEO and all directors which set out, inter alia, their functions and powers, authority to act and limitations on authority. Employees have role profiles agreed by their line manager which set out equivalent information.

The Society is committed to the highest standards of business conduct. Corporate policies and procedures are available to all staff and include the Code of Conduct, Compliance Manual, Employee Handbook, Health & Safety Policy, Information Security and Computer Usage Policy, Procurement Policy, Financial Policies and authorisation limits. These policies and procedures are regularly reviewed and updated.

Lloyd’s maintains an internal audit function that reports to the CEO and the Audit Committee. The Head of Internal Audit is supported by Deloitte LLP who provide resources to complete the internal audit plan.

IDENTIFICATION AND EVALUATION OF BUSINESS RISKS

The Risk Management Framework ensures that the identification, assessment, monitoring and management of the major risks affecting the Society takes place on an ongoing basis. The Framework includes a number of risk assessment techniques, which are tailored to specific risk areas. One such technique is the comprehensive risk and control assessment procedure, which is conducted on a regular basis. This review re-assesses the existing risks and identifies any new risks. It evaluates controls in terms of adequacy of performance and also seeks to monitor the action plans in place to help manage risks. These processes are described in more detail in the Risk Management section on pages 25 to 27.

One of the key objectives of the Lloyd’s risk governance structure is to provide assurance to the Franchise Board that risks facing the Society are identified and managed in accordance with approved policy and appetite. This is achieved by the risk committees having the appropriate management information (MI) to oversee and challenge. The MI includes information from many different sources within the Risk Management and internal control frameworks, such as the various risk and control assessments, details of the operating and regulatory environment and capital management reports. The risk governance structure comprises of the Executive Risk Committee plus three specialist sub-committees; the Syndicate Risk Committee, the Financial Risk Committee and the Corporation Risk Committee. These provide clear independent challenge to the risk takers at Lloyd’s and enables tailored risk management operating models, rather than a ‘one size fits all’ platform. The Risk Management Framework enables Lloyd’s to undertake a more forward looking assessment of risk, building in capital consideration into the decision making process and a formal Risk Appetite Framework with defined escalation routes.

A framework of regular self-certification, with targeted independent challenge, is in place and where control failures have been reported, details of the circumstances are required together with appropriate corrective actions. A summary of these reports is reviewed by the Executive Team, the Corporation Risk Committee, Franchise Board and the Audit Committee on a regular basis.

Internal auditors also perform independent reviews of control activities as part of their annual programme as approved by the Audit Committee. The Head of Internal Audit and the Legal and Compliance department report to the Executive Team on a regular basis and to each Audit Committee meeting.

A compliance plan is in place to manage the risk associated with non-compliance with FSA regulatory processes. The Head of Internal Audit and the Legal and Compliance department provide progress reports to the Risk Committees and the Audit Committee. The Risk Committees also oversee the wider coordination of international regulatory compliance.

INFORMATION AND FINANCIAL REPORTING SYSTEMS

An annual budget for the Society is reviewed in detail by the Executive and is considered and approved by the Franchise Board and Council. Monthly financial reports compare actual performance with the annual budget and management action is taken, where appropriate, when variances arise. Revised forecasts are prepared regularly.

REPORT OF THE REMUNERATION COMMITTEE

This report is based upon best practice as set out in the UK Corporate Governance Code. This code is directed at companies listed on the London Stock Exchange, whereas Lloyd's is a market of many separate and competing trading entities; nonetheless, Council supports its principles insofar as they can be applied to the governance of the Society.

COMPOSITION OF THE REMUNERATION COMMITTEE AND THE NACC

REMUNERATION COMMITTEE

The Remuneration Committee was established in November 2011. Previously, its functions were undertaken by the Nominations, Appointments and Compensation Committee (NACC).

The Remuneration Committee currently comprises six members – three members of Council, two members of the Franchise Board and the Chairman of Lloyd's. It is chaired by Andreas Prindl (a Nominated member of Council and Senior Independent Deputy Chairman). The Remuneration Committee members for 2011 are shown in the remuneration table on page 86.

The Remuneration Committee met once in 2011. The attendance record is set out in the Corporate Governance report, page 78. The Committee's terms of reference are available on the Lloyd's website and on request from the Secretary to the Council.

NACC

The Nominations, Appointments and Compensation Committee (NACC) comprised seven members of Council – two nominated, two external and three working members – and one market-connected non-executive director on the Franchise Board. The NACC members for 2011 are indicated within the remuneration table on page 86.

The Committee met four times during the year. The attendance record is set out in the Corporate Governance report, page 78.

REMUNERATION AND COMPENSATION

EXECUTIVE REMUNERATION

Within the policy for remuneration approved by the Council, the Remuneration Committee is responsible for setting the total individual remuneration package for the Chairman of Lloyd's, the Chief Executive Officer, each executive director, the Secretary to the Council and other members of staff (including individual consultants) above certain thresholds.

CORPORATION REMUNERATION POLICY

The remuneration policy for all current and future employees is set out in the HR Policies & Procedures as follows: 'Lloyd's operates a Total Reward approach, which is designed to meet employee and Corporation needs by providing rewards that are linked to individual performance and the delivery of Lloyd's Corporation objectives.

Lloyd's Total Reward approach is supported by the following practices:

- We look beyond base salary to the value of the total reward package in meeting the needs of employees.
- We recognise and reward superior performance.

Lloyd's policy is therefore based on providing a package of rewards (salary plus benefits) that is business driven, competitive, fair and flexible. It is also founded on the proposition that the ultimate source of value in the business is people. Combining this creates a reward offering which:

- Emanates from business strategies and priorities.
- Is based on business success (ie our ability to pay).
- Provides a flexible mix of rewards, designed to attract, retain and motivate a performance driven workforce with the varied range of experience and skills the business requires.
- Is externally competitive and regularly monitored by means of benchmarking exercises.
- Rewards for performance rather than cost of living.
- Ensures employees understand the criteria by which rewards are determined and reviewed.
- Gives managers the tools to make informed decisions regarding rewarding their teams.
- Is in line with our equality and diversity policy.'

Salary increases are based primarily on external benchmarking and commerciality. Salaries are reviewed annually but there is no automatic entitlement to an increase (eg for cost of living).

Annual individual performance bonus awards are discretionary.

The policy outlined above has been applied throughout 2011. The Remuneration Committee will, however, continue to monitor its policies, particularly its arrangements for performance related pay, against evolving market practice and relevant guidelines prepared in response to the current economic climate. Many of the proposals under consideration in the wider financial services sector are aimed at curbing excessive risk-taking at financial institutions. The Corporation is focused on market oversight and promoting the attractiveness of Lloyd's. Risk-taking is primarily undertaken at syndicate level rather than within the Corporation.

REPORT OF THE REMUNERATION COMMITTEE CONTINUED

REMUNERATION AND COMPENSATION CONTINUED

CEO AND EXECUTIVE DIRECTORS

The current remuneration package of the CEO and the executive directors comprises both performance and non-performance related components. The performance-related components comprise annual bonuses as well as a Lloyd's Performance Plan award. The former is determined by reference to performance against objectives while the latter is linked to the overall performance of the Lloyd's market. The non-performance related components comprise base salaries, benefits and pension entitlements.

The annual salaries and bonuses of the CEO and the executive directors are reviewed by the Remuneration Committee (and before that, the NACC) annually. For 2011, increases took effect from 1 February. No director plays a part in any discussion about his or her own remuneration.

The CEO and executive directors are entitled to receive certain benefits including private medical and life insurance in addition to their base salary.

In December 2011, the Remuneration Committee considered the results of an external review (undertaken by FIT Remuneration Consultants LLP) into the remuneration arrangements for the CEO and executive directors. The Remuneration Committee concluded that while overall remuneration levels – ie: fixed (non-performance related) plus variable (performance related) – were reasonable, the balance between the fixed and variable elements should be realigned by increasing the former and reducing the latter, in order to reflect better the role of the Corporation of Lloyd's and bring remuneration arrangements more in line with other organisations with a similar role.

The Remuneration Committee also agreed that more specific and measurable targets and KPIs should be established, where possible, to help determine bonus awards. Over the last three years average bonus payments (as a percentage of the maximum bonus opportunity) have been 88% for the CEO, 96% for the Director, Finance, Risk Management and Operations and 85% for the Director, Performance Management. In future, payments are likely to be more variable because of the introduction of the more specific targets and KPIs.

As a result of the review, the maximum bonus opportunity for 2012 and subsequent years for the CEO and the executive directors has been reduced and their base salaries increased.

	2012 maximum bonus opportunity	2012 base salaries % increase on 2011*	2012 base salaries £000
CEO	100% of base salary (2011: 150%)	20%	668
Director, Performance Management	67% of base salary (2011: 100%)	18%	577
Director, Finance, Risk Management & Operations	50% of base salary (2011: 75%)	15%	518

* Base salaries will be increased with effect from 1 January 2012.

It remains Remuneration Committee policy that a significant proportion of executive remuneration should be performance-related and determined by annual performance reviews.

THE CHAIRMAN

Lord Levene retired as Chairman on 16 October 2011. In addition to his annual salary, Lord Levene was eligible for a bonus and was also entitled to receive private medical and life insurance. He also received a cash allowance in lieu of pension contributions.

John Nelson was appointed Chairman with effect from 17 October 2011. In addition to his salary, Mr Nelson is entitled to receive private medical insurance. Neither Mr Nelson nor Lord Levene participated in the Lloyd's Performance Plan.

LLOYD'S PERFORMANCE PLAN

The Lloyd's Performance Plan (LPP) was introduced from 1 January 2008. It replaced the previous long-term incentive plan (LTIP) available to the CEO, Directors and Level 1 employees. The transitional arrangements to the LPP came to an end on 31 December 2010.

The LPP is available to all employees and has been designed to meet strategic objectives by enabling the Corporation to offer an incentive which:

- Is directly linked to the profitability of the Lloyd's market and will therefore encourage an attitude of commercial partnership with the market and align the interests of participants with capital providers.
- Will provide a competitive reward and therefore assist Lloyd's in attracting and retaining the talented individuals required to develop and support future strategy.

The plan is operated at the discretion of the Remuneration Committee and can be amended or terminated at any time.

ELIGIBILITY

All employees of the Corporation and international offices are eligible to participate in the LPP on the basis set out below.

New employees will become eligible to participate in the LPP from the first full financial year following their recruitment.

LLOYD'S PERFORMANCE PLAN CONTINUED

CALCULATION OF LPP AWARDS

Awards under the LPP (LPP Awards) are calculated by reference to profit on ordinary activities before tax (PBT), as reported in the pro forma financial statements in the Lloyd's Annual Report for each financial year. LPP Awards will only be triggered if PBT in excess of £100m is achieved.

The LPP Awards for each financial year will be calculated as a percentage of the participants' salaries at 31 December in that year, for each £1bn of PBT.

The LPP Awards are as follows:

Job level	Amount of LPP Award	Limits on LPP Awards ('trigger')	Limits on LPP Awards ('cap')
CEO and directors	20% salary per £1bn of PBT	LPP Awards will be triggered only on the achievement of a minimum threshold of £100m PBT. If PBT is below £100m, no LPP Awards will be made for that financial year.	100% of salary ie £5bn of PBT
Senior managers (Level 1)	10% salary per £1bn of PBT		30% of salary ie £3bn of PBT
Other employees (Level 2-4)	5%-3% salary per £1bn of PBT depending on grade		15%-9% of salary (depending on grade) ie £3bn of PBT

STRUCTURE AND TIMING OF PAYMENTS

For directors and Level 1 employees the LPP will operate as an ongoing fund, rather than as a series of annual awards. For these employees, the LPP Award for each financial year will be added to the particular employee's notional LPP fund (the 'LPP Fund') and paid out in future years as described in the table below:

Job level	Awards	Payments
CEO, directors and Level 1 employees	Any LPP Award will be notified to the employee after the PBT for the relevant year has been announced (eg the employee will be notified normally in May 2012 of any LPP Award relating to the financial year 2011). The total amount of the LPP Award will be added to the particular employee's LPP Fund.	Each October one half of the total contents of the LPP Fund will be paid to the employee.

For Level 2–4 employees, any LPP Award will be paid in full during the year in which it is notified to the employee. For example, for the financial year 2011, employees will be notified of any LPP Award normally in May 2012 (once PBT for 2011 has been announced) and the LPP Award for 2011 will be paid to these employees in full in October 2012.

LEAVING EMPLOYMENT

The Remuneration Committee will retain absolute discretion over the payment of any and all LPP Awards to participants whose employment is terminated (regardless of the reason for termination). However, the general intention is as follows:

Directors and Level 1 participants

(a) If a director or Level 1 participant leaves the Corporation's employment and is classified as a 'good leaver' (as determined by the rules of the LPP) the provisions set out in paragraphs (b) and (c) below will apply.

(b) The director or Level 1 participant will receive a pro-rated LPP Award for each complete month of service in respect of his/her year of departure. The LPP Award will be notified to the employee and paid in accordance with the usual timescales.

(c) Any balance which remains in the LPP Fund for directors or Level 1 participants will be paid in full in the October at the same time as the final LPP Award which is due to the employee.

(d) If a director or Level 1 participant leaves the Corporation's employment due to any reason other than those referenced in paragraph (a) above (as determined by the Remuneration Committee acting in its absolute discretion), he/she will forfeit any and all outstanding and future LPP Awards (including, for the avoidance of any doubt, any balance of the LPP Fund) with immediate effect from the date that he/she serves or receives notice of termination.

Level 2–4 participants

If a Level 2–4 participant serves or receives notice of termination (regardless of the reason of termination), he/she will forfeit any and all outstanding and future LPP Awards with immediate effect from the date of such notice.

REPORT OF THE REMUNERATION COMMITTEE CONTINUED

PENSION ARRANGEMENTS

The CEO, Director, Finance, Risk Management and Operations, and the Director, Performance Management are members of the Lloyd's Pension Scheme.

Their dependants are eligible for dependants' pensions and the payment of a lump sum in the event of death in service. The pension arrangements for the Director, Finance, Risk Management and Operations provide for a pension at normal retirement of two-thirds base annual salary after 20 years' eligible service less any entitlement from previous pension arrangements and subject to a Scheme earnings cap of £129,600 from 6 April 2011. The pension arrangements for the CEO provide for a pension on retirement based on a standard accrual rate of one sixtieth of base annual salary subject to the Scheme earnings cap, for each year of eligible service, with the facility to increase the accrual rate to one thirtieth for an additional contribution. The pension arrangements for the Director, Performance Management provide for a pension at retirement built in annual blocks based on a standard accrual rate of one eightieth of base annual salary subject to the Scheme earnings cap in each year of eligible service with the facility to increase the accrual rate to one thirtieth for an additional contribution. No other payments to the CEO, the Director, Finance, Risk Management and Operations or the Director, Performance Management are pensionable.

The CEO, Director, Finance, Risk Management and Operations, and the Director, Performance Management receive a cash allowance of 20% of their base salary to compensate for their pension benefits being based on the Scheme earnings cap rather than their base salaries.

A cash allowance of £51,840 was payable in respect of Lord Levene for 2011 which equates to 40% of the Scheme earnings cap applicable during the period.

The Lloyd's Pension Scheme is contributory and the Director, Finance, Risk Management and Operations made salary sacrifices of 10% of the earnings cap in exchange for additional employer pension contributions of the same amount. The CEO made a salary sacrifice of 5% of the earnings cap in exchange for an additional employer contribution for a sixtieth accrual rate and sacrificed an extra 25.9% of the earnings cap in exchange for an additional employer contribution to increase the accrual rate to thirtieths. The Director, Performance Management, made a salary sacrifice of 5% of the earnings cap in exchange for an additional employer contribution for an eightieth accrual rate.

CONTRACTS OF EMPLOYMENT

Mr Nelson's contract covers his services as Chairman of Lloyd's and Chairman of the Franchise Board, as did Lord Levene's contract.

Lord Levene's contract expired on 9 December 2011 and he was paid in full until then.

The CEO, the Director, Finance, Risk Management and Operations and the Director, Performance Management, have rolling one-year contracts providing for a maximum of one year's notice.

	Effective date of contract	Unexpired term as at 31 December 2011	Notice period[1]
John Nelson[5]	17/10/11	33 months	12 months
Richard Ward[2]	24/04/06	rolling 1 year	12 months
Tom Bolt[3]	01/09/09	rolling 1 year	12 months
Luke Savage[4]	20/09/04	rolling 1 year	12 months

Notes
1. Employment contracts do not contain provisions for compensation payable upon early termination.
2. Richard Ward was appointed to the Franchise Board and Council on 24 April 2006.
3. Tom Bolt was appointed to the Franchise Board on 1 January 2010.
4. Luke Savage was appointed to the Franchise Board on 30 September 2004.
5. John Nelson was appointed to the Franchise Board and Council on 17 October 2011.

REMUNERATION AND CONTRACTS OF SERVICE FOR MEMBERS OF THE COUNCIL OF LLOYD'S AND FRANCHISE BOARD WHO ARE NOT EMPLOYEES OF THE CORPORATION

The Chairman and CEO are responsible for making recommendations to the Council for the remuneration of members of Council, the Franchise Board and their committees (other than themselves and the executive directors). In making their recommendations, the Chairman and CEO may liaise and consult with the Remuneration Committee as they think appropriate.

Remuneration for all members of Council and Franchise Board who are not employees of the Corporation is designed to attract people of sufficient calibre and experience to govern Lloyd's affairs by providing an appropriate level of fees which reflects the demands made upon them. Reference is also made to independent surveys of fees paid to non-executive directors of similar organisations.

In 2011, fees for members of Council and Franchise Board were £35,700 and £56,100 per annum, respectively. The Deputy Chairmen were paid £45,900 per annum. Fees are also payable in respect of membership of a number of Council and Franchise Board committees, including a number of ad hoc committees established to consider specific issues requiring a significant time commitment. Non-employee members of the Council and Franchise Board are not eligible to join the Lloyd's Pension Scheme.

Individual remuneration of all members of the Council and Franchise Board can be found in the table on page 86.

External and working members are elected to Council while nominated members are appointed to Council, usually for a three-year period. Members of the Franchise Board are appointed by Council with non-executive directors' terms of office varying between one and three years. These are not contractual arrangements and compensation is not paid if a member leaves early.

INFORMATION SUBJECT TO AUDIT

BASIS OF PREPARATION

The following section provides details of the remuneration of all members of the Council of Lloyd's and the Franchise Board for the year ended 31 December 2011. This section contains the following information in the form specified in Schedule 8 Part 3 of the Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008:

> Amount of each member's emoluments and compensation in the current and previous financial year.
> Details of each member's accrued benefits in the Lloyd's Pension Scheme and transfer values of those accrued benefits.
> Details of each member's interests under the LPP.

REPORT OF THE REMUNERATION COMMITTEE CONTINUED

REMUNERATION OF MEMBERS OF THE COUNCIL OF LLOYD'S AND THE FRANCHISE BOARD

Individual remuneration for the year to 31 December is shown in the table below. More detail on LPP Awards is shown on page 88.

	Salary/Fees		Taxable benefits[1]		Annual bonus		Other[2]		LPP Award		Total	
	2011 £000	2010 £000	**2011 £000**	2010 £000	**2011 £000**	2010 £000	**2011 £000**	2010 £000	**2011 £000**	2010 £000	**2011 £000**	2010 £000
Chairman of the Council of Lloyd's												
John Nelson[3,4,6,8]	**111**	–	**3**	–	**–**	–	**5**	–	**–**	–	**119**	–
Executive Directors												
Richard Ward[3,4]	**556**	540	**13**	13	**752**	730	**118**	114	**–**	312	**1,439**	1,709
Tom Bolt[3,5,20]	**488**	473	**12**	12	**450**	450	**104**	100	**–**	209	**1,054**	1,244
Luke Savage[3,5]	**449**	436	**13**	13	**338**	325	**93**	90	**–**	252	**893**	1,116
Non-Executive Council members												
Working members												
Rupert Atkin[7]	**41**	43	**–**	–	**–**	–	**–**	–	**–**	–	**41**	43
Ewen Gilmour[7]	**45**	56	**–**	–	**–**	–	**–**	–	**–**	–	**45**	56
Christopher Harman	**36**	36	**–**	–	**–**	–	**–**	–	**–**	–	**36**	36
Nick Marsh	**36**	36	**–**	–	**–**	–	**–**	–	**–**	–	**36**	36
Graham White, Deputy Chairman[7]	**53**	53	**–**	–	**–**	–	**–**	–	**–**	–	**53**	53
External members												
Lord Ashton of Hyde[9]	**36**	33	**–**	–	**–**	–	**–**	–	**–**	–	**36**	33
Michael Deeny	**36**	36	**1**	1	**–**	–	**–**	–	**–**	–	**37**	37
Matthew Fosh[10]	**36**	33	**–**	–	**–**	–	**–**	–	**–**	–	**36**	33
Barnabas Hurst-Bannister[11]	**36**	36	**–**	–	**–**	–	**–**	–	**–**	–	**36**	36
Paul Jardine, Deputy Chairman[12,8,7]	**60**	49	**–**	–	**–**	–	**–**	–	**–**	–	**60**	49
Alan Lovell[7,8]	**50**	50	**–**	–	**–**	–	**–**	–	**–**	–	**50**	50
Nominated members												
Sir Robert Finch[7]	**63**	64	**–**	–	**–**	–	**–**	–	**–**	–	**63**	64
Reg Hinkley	**52**	45	**–**	–	**–**	–	**–**	–	**–**	–	**52**	45
Sir David Manning[13]	**37**	12	**–**	–	**–**	–	**–**	–	**–**	–	**37**	12
Andreas Prindl, Deputy Chairman[7,8,22]	**84**	84	**–**	–	**20**	–	**–**	–	**–**	–	**104**	84
Non-Executive Franchise Board Members												
Sir Andrew Cahn[14]	**42**	–	**–**	–	**–**	–	**–**	–	**–**	–	**42**	–
Nick Furlonge	**57**	56	**–**	–	**–**	–	**–**	–	**–**	–	**57**	56
Claire Ighodaro	**71**	71	**–**	–	**–**	–	**–**	–	**–**	–	**71**	71
Andrew Kendrick[7,8]	**72**	65	**–**	–	**–**	–	**–**	–	**–**	–	**72**	65
Martin Read[8]	**57**	56	**1**	1	**–**	–	**–**	–	**–**	–	**58**	57
David Shipley	**65**	65	**–**	–	**–**	–	**–**	–	**–**	–	**65**	65
Andre Villeneuve[15]	**57**	42	**–**	–	**–**	–	**–**	–	**–**	–	**57**	42
Former Members of Council												
Celia Denton	**12**	54	**–**	–	**–**	–	**–**	–	**–**	–	**12**	54
Philip Lader[16]	**–**	7	**–**	1	**–**	–	**–**	–	**–**	–	**–**	8
Lord Levene of Portsoken[4,17,23]	**441**	596	**1**	1	**–**	–	**96**	107	**–**	–	**538**	704
Eileen McCusker[18]	**–**	3	**–**	–	**–**	–	**–**	–	**–**	–	**–**	3
Barbara Merry[19]	**–**	3	**–**	–	**–**	–	**–**	–	**–**	–	**–**	3
Former Members of the Franchise Board												
Dipesh Shah[21]	**–**	56	**–**	–	**–**	–	**–**	–	**–**	–	**–**	56

Notes

1. Taxable benefits include items such as benefit allowances, medical and life insurance.
2. For executive directors, other includes payments of 20% of annual base salary as their pension benefits are based on a maximum earnings cap, which from 6 April 2011 was £129,600. The amount stated in respect of Lord Levene represents a cash allowance in lieu of pension contributions and the premium in respect of additional life cover.
3. Employee of the Corporation of Lloyd's.
4. Member of both Council and the Franchise Board for 2011.
5. Member of the Franchise Board only.
6. John Nelson's term as Chairman of Lloyd's started on 17 October 2011.
7. Member of the Nominations, Appointments and Compensation Committee (NACC) for 2011. The NACC ceased in November 2011.
8. Member of the Remuneration Committee for 2011. The Remuneration Committee was established in November 2011.
9. Lord Ashton (as the representative of Faraday Capital Limited) joined Council on 1 February 2010.
10. Matthew Fosh (as the representative of Novae Corporate Underwriting Limited) joined Council on 1 February 2010.
11. Representative of Aprilgrange Ltd.
12. Representative of Catlin Syndicate Limited.
13. Sir David Manning was appointed to Council on 1 September 2010.
14. Sir Andrew Cahn was appointed to the Franchise Board on 4 April 2011.
15. Andre Villeneuve was appointed to the Franchise Board on 11 May 2010.
16. Philip Lader retired from the Council and the NACC on 2 March 2010.
17. Lord Levene retired as Chairman on 16 October 2011, although his contract expired on 9 December and he was paid in full to that date. He was contracted to work four days per week but with effect from 1 October 2010, one of those four days was associated with duties to NBNK Investments plc and was paid directly by NBNK Investments plc.
18. Eileen McCusker, as the representative of Dornoch Limited, retired from Council on 31 January 2010.
19. Barbara Merry, as the representative of Hardy Underwriting Limited, retired from Council on 31 January 2010.
20. Tom Bolt is a non-executive director of Xchanging Claims Services. No fees are payable.
21. Dipesh Shah retired from the Franchise Board on 31 December 2010.
22. On the recommendation of the NACC, the Council agreed to award Andreas Prindl a special bonus of £20,000 for the additional work he undertook as Chairman of the NACC in successfully leading the search for a new Chairman.
23. Former employee of the Corporation.

REPORT OF THE REMUNERATION COMMITTEE CONTINUED

LLOYD'S PENSION SCHEME PROVISIONS

	Salary sacrifice in year to 31 December 2011[1] £000	Age at 31 December 2011	Increase in pension in year to 31 December 2011 – actual £000	Increase in pension in year to 31 December 2011 – net of price inflation £000	Total accrued annual pension in year to 31 December 2011 £000 pa	Normal retirement age
Richard Ward	39	54	5	5	24	65
Tom Bolt	6	55	2	1	4	65
Luke Savage	13	50	9	9	28	60

Note
1. The Lloyd's Pension Scheme was made a contributory pension scheme with effect from 1 July 2006. The CEO, Director, Finance, Risk Management and Operations, and the Director, Performance Management have made salary sacrifices in exchange for Lloyd's making additional employer contributions.

TRANSFER VALUES OF ACCRUED PENSION BENEFITS

	Transfer value to accrued pension as at 31 December 2010 £000	Transfer value of accrued pension as at 31 December 2011 £000	Movement in transfer value over the year less amounts salary sacrificed £000
Richard Ward	242	274	(7)
Tom Bolt	25	39	8
Luke Savage	292	378	73

The transfer value represents a liability of the Lloyd's Pension Scheme, not a sum paid or due to the individual.

MEMBERS OF THE COUNCIL OF LLOYD'S AND FRANCHISE BOARD'S SHARE OF THE LLOYD'S PERFORMANCE PLAN

	Estimated long-term bonus			
	Total award outstanding as at 31 December 2010 £000	Change in year £000	Amount paid during the year ended 31 December 2011 £000	Total award outstanding as at 31 December 2011 £000
Richard Ward	605	–	302	303
Tom Bolt	209	–	105	104
Luke Savage	520	–	260	260

Andreas Prindl, CBE
Chairman, Remuneration Committee

REPORT OF THE AUDIT COMMITTEE

This report sets out the role, remit and activities of the Audit Committee during 2011.

COMPOSITION OF THE AUDIT COMMITTEE

At the end of 2011, the Audit Committee comprised three nominated members of Council, one external member of the Council and three non-executive members of the Franchise Board. The Audit Committee met five times during the year. The members of the Audit Committee in 2011 and their attendance at meetings are shown in the Corporate Governance report on page 78.

All of the Audit Committee have extensive commercial experience. For the purposes of the UK Corporate Governance Code, Reg Hinkley, Paul Jardine, and Claire Ighodaro, the Chairman of the Audit Committee, are considered by the Council to have recent and relevant financial experience.

TERMS OF REFERENCE

The Council has delegated to the Audit Committee responsibility for overseeing the financial reporting and internal controls of the Society and its subsidiaries and the Central Fund. The Audit Committee follows an agreed annual work plan. The principal responsibilities of the Audit Committee include:

> Ensuring that the financial activities of Lloyd's are subject to independent review and audit. The Audit Committee reviews Lloyd's published annual and interim financial statements including the pro forma financial statements, the Aggregate Accounts, the group financial statements of the Society of Lloyd's and Lloyd's Return to the FSA.
> Reviewing and monitoring the arrangements for ensuring the objectivity and effectiveness of the external and internal audit functions.
> Considering, on behalf of the Council, the appointment or removal of the external auditors.
> Reviewing and monitoring the effectiveness of the systems of internal control of the Society.
> Ensuring that appropriate arrangements are in place for ensuring compliance by the Society with relevant laws and regulations.
> Ensuring appropriate whistle-blowing arrangements are in place by which members of staff can, in confidence, raise concerns relating to possible improprieties.

The Audit Committee's terms of reference are available on request from the Secretary to the Council.

REPORT ON THE AUDIT COMMITTEE'S ACTIVITIES IN 2011

The principal issues addressed during 2011 were:

> The annual financial statements for 2010 including the pro forma financial statements and Aggregate Accounts, the financial statements of the Society and financial disclosures and various accounting matters raised by management and auditors.
> The interim financial statements for the six months to 30 June 2011 including the pro forma financial statements and the financial statements of the Society of Lloyd's.
> The interim management statements of the Society of Lloyd's.
> A consideration of those accounting policies which involved significant estimates and judgements.
> The 2010 Lloyd's Return to the FSA.
> The external auditors' status reports and management letters.
> The independence and objectivity of the external auditors, including a review of non-audit fees.
> The external and internal audit plans.
> The reports of the Head of Internal Audit and the Legal and Compliance department, including follow-up of internal audit findings and the annual compliance plan.
> Reports from the Executive Risk Committee, covering key aspects of the Lloyd's Risk Framework and risk reporting.
> Assessment of the effectiveness of internal controls.
> Assessment of the effectiveness of the internal and external auditors.

REPORT OF THE AUDIT COMMITTEE CONTINUED

The Audit Committee believes that the auditor's performance should be considered fully every year. Therefore, there is a standing agenda item to review the performance of the auditors in detail against the relevant criteria in the Committee's terms of reference and the auditors are not present for this. Following the 2011 effectiveness review, the Committee concluded that it was appropriate to recommend that the present auditors be reappointed. The external auditors are required to rotate the audit partner responsible for the audit every 5 years. In 2010, a new lead audit partner was appointed by Ernst & Young LLP. There are no contractual obligations restricting the company's choice of external auditor.

The Audit Committee monitors the implementation of the policy on non-audit services provided by the external auditors. The policy sets out the approach to be taken by the Society when using the services of the external auditors, including requiring that certain services provided by the external auditors are pre-approved by the Audit Committee or its Chairman. The approval of the Audit Committee is always required if a non-audit service provided by the auditors is expected to cost more than £100,000.

The Audit Committee also carried out an effectiveness review of the internal auditors and is satisfied with their performance.

The Audit Committee held a workshop training session during 2011 with a presentation made by Ernst & Young on the current status of IFRS 4, Phase II.

The Audit Committee also reviewed its own performance.

SUPPORT

The CEO, Director, Finance, Risk Management and Operations, General Counsel, senior managers and the external and internal auditors attended meetings as appropriate. During the year, the Audit Committee met separately with the external and internal auditors without executive management present.

The Audit Committee has access to external independent advice, if required.

Claire Ighodaro, CBE
Chairman, Audit Committee

REPORT OF THE LLOYD'S MEMBERS' OMBUDSMAN

REPORT BY MARK HUMPHRIES, LLOYD'S MEMBERS' OMBUDSMAN

I am pleased to present the Annual Report of the Lloyd's Members' Ombudsman to the Council of Lloyd's for the year ended 31 December 2011.

The role of the Lloyd's Members' Ombudsman is to investigate complaints by members and former members who were members at any time after 30 November 2001, who believe that they have suffered injustice in consequence of maladministration in relation to any action taken by or on behalf of the Society.

COMPLAINTS RECEIVED

During the year three complaints were received, none of which justified a finding of maladministration.

COSTS

The expenses incurred by my office amounted to £15,000.

FINANCIAL REVIEW

This review should be read in conjunction with the financial statements of the Society on pages 99 to 135.

OPERATING SURPLUS

The Society of Lloyd's achieved an operating surplus for the year of £77m (2010: surplus of £365m). The operating surplus by business segment is set out below:

	Corporation of Lloyd's £m	Lloyd's Central Fund £m	Insurance activities £m	2011 Total £m	2010 Total £m
Total income	**212**	**100**	**5**	**317**	528
Central Fund claims and provisions (incurred)/released	**–**	**(15)**	**–**	**(15)**	34
Net insurance claims	**–**	**–**	**24**	**24**	17
Other group operating expenses	**(231)**	**(8)**	**(10)**	**(249)**	(214)
Operating (deficit)/surplus	**(19)**	**77**	**19**	**77**	365

CORPORATION OF LLOYD'S

Total income for the Corporation of Lloyd's remained relatively stable at £212m (2010: £207m). The members' subscription rate was unchanged during 2011 at 0.5% of written premium.

Other group operating expenses increased by £28m to £231m (2010: £203m). The increase includes an additional £20m contribution to the Lloyd's Pension Scheme to fund future discretionary increases to pensions in payment and a restructuring provision of £6.6m (see note 19). After adjusting for these items, operating expenses are in line with the 2011 Budget approved by Council and reflect the continued focus on achieving the strategic plan.

CENTRAL FUND

Total income for the Central Fund decreased by £216m to £100m (2010: £316m). Other income, which mainly represents recoveries in respect of undertakings given by the Central Fund, decreased to £5m (2010: £215m) as 2010 benefited from a number of underwriting years in run-off declaring a profit upon closure. The decrease in Central Fund contributions to £95m (2010: £101m) reflects a decrease in the level of new corporate members that are charged the additional contribution rate of 1.5% for their first three years of operation. The standard Central Fund contribution rate was unchanged during 2011 at 0.5%.

Central Fund claims and provisions is a net charge for the year of £15m (2010: credit of £34m). The 2010 credit included a reassessment of provisions as at 31 December 2010 which resulted in £35m being released. Undertakings to meet the liabilities of insolvent members to policyholders are approved at the discretion of the Council and are normally based on anticipated cash flow requirements of insolvent members in the following 12 months. During 2011, payments made in respect of insolvent corporate members were £17m (2010: £1m) with additional payments made in respect of individual members of £2,000 (2010: £1m).

Other group operating expenses increased to £8m (2010: £6m) representing foreign exchange losses and increased bank charges.

INSURANCE ACTIVITIES

The Society has three insurance company subsidiary undertakings, Centrewrite Limited, Lloyd's Insurance Company (China) Limited (LICCL) and Lioncover Insurance Company Limited.

Total income remained at £5m (2010: £5m).

Net insurance claims is a credit for the year of £24m (2010: £17m). The reinsurance to close portfolio of Centrewrite has itself been successfully novated from 1 January 2012, which, combined with the impact of syndicates closing on the Estate Protection Plan and Exeat portfolios, has enabled significant releases to be achieved while maintaining the same confidence level within the technical provisions as in previous years.

Other group operating expenses have increased marginally, representing the impact of foreign exchange and work undertaken on the China Direct Licence.

INVESTMENT PERFORMANCE

	2011 £m	2010 £m
Finance income	**91**	132
Finance costs	**(64)**	(66)
Unrealised exchange gains on borrowings	**5**	8
	32	74
Surplus on subordinated debt repurchase	**4**	1
	36	75

The Society's investments returned £91m, or 3.4% during the year (2010: £132m, 5.6%). Most of the Society's investments are held within the Central Fund. Of these assets, the majority are invested in fixed interest securities of high credit quality. These investments performed strongly in the period as yields continued to decline in key developed economies. Also helping performance, there were no exposures to peripheral European countries, where yields rose significantly. Returns from more volatile asset classes were less good during this period of economic uncertainty and some equity portfolios, in particular, experienced losses. Overall, the well diversified disposition of the Society's assets has helped us achieve a satisfactory investment return during a period of significant uncertainty in financial markets. A commentary on investment strategy is set out on page 95. The disposition of the Society's financial investments is set out in note 15 on pages 122 to 124.

Finance costs of £64m in 2011 (2010: £66m) predominantly relate to interest on the subordinated notes and perpetual subordinated capital securities. The decrease in the level of finance costs is mainly as a result of the reduction in the level of outstanding debt securities.

Unrealised exchange gains on borrowings reflect the impact of foreign exchange movements on the Society's outstanding debt securities. The exposure to movements in the euro is naturally hedged through euro-denominated investments held.

Adjusting for interest costs and foreign exchange movements results in a net investment return of £32m (2010: £74m).

During 2011, the Society of Lloyd's repurchased a principal amount of £27m of its 2007 perpetual subordinated capital securities at a cost of £23m. The Society additionally paid accrued interest on the purchased securities. The profit on the repurchase was £4m.

TAXATION

A tax charge of £29m (2010: £122m) on the surplus before tax of £118m (2010: £444m) has been recognised for the year ended 31 December 2011. Further details are set out in note 8 on pages 115 and 116.

MOVEMENT IN NET ASSETS
£m

The net assets of the Central Fund are included within the above amounts and at 31 December 2011 were £1,361m (2010: £1,281m).

FINANCIAL REVIEW
CONTINUED

PENSION SCHEMES
LLOYD'S PENSION SCHEME
On an IFRS basis, the group pension scheme valuation at 31 December 2011 was a deficit of £24m before allowance for deferred tax asset of £6m (31 December 2010: £26m surplus before allowance for a deferred tax liability of £7m).

The movement in the pension asset/(liability) during the year is summarised below:

	2011 £m
Pension surplus as at 1 January 2011	26
Pension expense recognised in the group income statement	(29)
Employer contributions	
– normal	5
– special	31
Actuarial loss recognised in the group statement of comprehensive income	(57)
Pension deficit as at 31 December 2011	**(24)**

The movement in the valuation was mainly due to a fall in the discount rate from 5.5% to 4.9%, driven by lower bond yields, and the return on assets during the year being lower than expected.

The actuarial valuation of liabilities is particularly sensitive to changes in market conditions, which determine the discount rate, and changes to mortality assumptions. Further details are provided in note 18 on pages 126 to 130 which includes the sensitivity of the valuation to changes in these assumptions.

The latest triennial funding valuation of the scheme was carried out as at 30 June 2010, which showed a shortfall of £70m. To eliminate the funding shortfall Lloyd's made a special contribution of £20m in December 2010 and agreed a recovery plan with the Trustees. An advance payment of £25m was also made in December 2010 and, as a result, Lloyd's obligations under the recovery plan until 2014 have been met.

OVERSEAS PENSION SCHEMES
Overseas pension schemes' actuarial valuation at 31 December 2011 was £1.3m (2010: £1m). Further details are provided in note 18.

SOLVENCY
Total assets for solvency purposes are set out below. The 2011 position is an estimate of the amount which will be finalised in June 2012 for submission to the FSA:

	2011 £m	2010 £m
Net assets at 31 December	1,490	1,447
Subordinated notes and perpetual subordinated capital securities	898	930
Central assets	2,388	2,377
Callable Central Fund contributions	718	683
Other solvency adjustments	(11)	(32)
Central assets for solvency purposes	3,095	3,028
Solvency shortfalls	(115)	(123)
Excess of central assets over solvency shortfalls	2,980	2,905

Based on central assets for solvency purposes of £3.1bn (2010: £3.0bn), the estimated solvency ratio is 2691% (2010: 2462%). In setting contribution levels, account is taken of the Society's ICA to ensure that Lloyd's is prudently but competitively capitalised. Unencumbered central assets should be at least 250% of the Society's ICA on a business as usual basis.

CASH FLOWS AND LIQUIDITY
Cash and cash equivalents decreased during the year ended 31 December 2011 by £19m to £127m (2010: £146m). Cash balances are maintained at appropriate levels to meet the short-term operating expenses of the Society. Any surplus cash balances are invested and are included as financial investments within the group balance sheet.

CASH FLOWS AND LIQUIDITY CONTINUED

The Corporation's free cash balances are regularly monitored. Free cash represents the amounts, both at bank and on deposit, held in the UK and available to the Corporation to meet operating expenses, including those of overseas operations, excluding any client money balances held in respect of insurance and arbitration activities. Free cash balances during the year ended 31 December 2011 increased by £3m to £78m (2010: £75m).

The liquidity of the Central Fund is monitored separately. Cash balances are managed to meet short-term operational commitments including the payment of drawdowns. Any surplus cash balances are invested in compliance with defined investment parameters approved by the Lloyd's Investment Committee.

CENTRAL FUND INVESTMENT STRATEGY

Central Fund investment strategy is considered in three parts. A prudent estimate of possible net cash flow requirements is used to determine the value of assets to be maintained for liquidity purposes. These are commingled with other liquid assets of Lloyd's group companies and invested in bank deposits and other short-term securities, with maturities of up to 12 months, with the objective to optimise current income, with low risk, while ensuring that all cash flow requirements are met as they arise.

A significant element of Central Fund assets is invested in fixed interest securities of high credit quality. The financial risk exposures represented by debt securities issued by the Society are also considered when determining the disposition of fixed interest investments. The aim is to optimise investment returns in the longer term while maintaining overall financial risk within defined limits.

A proportion of investments is maintained in more volatile asset classes. Here also, the aim is to optimise investment returns in the longer term without exceeding defined risk tolerances. These investments are diversified among different asset classes to help manage risk. Current exposures include global equities, high yield bonds, global property (via property-related equity securities), commodities and hedge funds. Fixed interest assets of high credit quality are managed 'in house' by Lloyd's. Third party investment managers are retained to manage investments in other asset classes.

FINANCIAL RISK MANAGEMENT AND TREASURY POLICIES

OVERVIEW

The Society's principal financial instruments comprise cash and cash equivalents, investments, borrowings and items that arise directly from operations such as trade receivables and payables. These include assets and liabilities of the Central Fund.

The Society's treasury operations and investments are managed by reference to established policies which are reviewed regularly by the Investment Committee. Policies for managing these risks, in particular credit risk, liquidity risk and market risk, are summarised below:

CREDIT RISK

Credit risk represents the risk of financial loss to the Society if a counterparty, or the issuer of a security, fails to meet its contractual obligations.

Trade and other receivables

The Society has established procedures to minimise the risk of default by trade and other receivables, which are mainly in respect of the Lloyd's market, the main source of income. These procedures include minimum standard checks for new market entrants.

Financial investments

A list of permissible bank counterparties, for the purposes of money-market investment, is maintained and restricted to banks having strong balance sheets and credit ratings. Investment parameters exist for all investment assets, controlling overall credit quality and ensuring appropriate risk diversification. Permitted counterparties to capital market transactions are also carefully controlled. All applicable parameters are reviewed regularly by the Lloyd's Investment Committee.

Guarantees

The Society provides certain financial guarantees as security for the underwriting activities of the members of Lloyd's. Further details are provided in note 25 on page 135.

LIQUIDITY RISK

The value and term of short-term assets are carefully monitored against those of the Society's liabilities. The Society maintains sufficient liquid assets to meet liabilities as they fall due.

The liquidity of the Central Fund is monitored separately. Cash balances are managed to meet short-term operational commitments including the payment of drawdowns. Any surplus cash balances are invested in compliance with defined investment parameters approved by the Lloyd's Investment Committee.

The Society had no committed borrowing facilities as at 31 December 2011 (2010: £nil).

MARKET RISK

Market risk represents the risk that movements in financial markets will affect the financial position of the Society. Market risks arising from the disposition of the Society's investments are monitored against defined parameters using Value at Risk (VAR) methodology. The position is reviewed regularly by the Lloyd's Investment Committee. As investments are actively monitored on a fair value basis, all investments are designated as fair value through profit or loss.

FINANCIAL REVIEW
CONTINUED

FINANCIAL RISK MANAGEMENT AND TREASURY POLICIES CONTINUED

FOREIGN CURRENCY RISK

The Society enters into a variety of foreign exchange transactions in response to the foreign currency requirements of Lloyd's group companies. In managing the exposures arising from such foreign exchange activity, which may involve transactions for forward settlement, the net risk arising from all such exposures is considered and the level of this risk is managed within defined parameters. Consequently, while some net foreign exchange exposures may accrue to the Society from time to time as a result of this activity, the level of such exposures is carefully monitored and is not significant in the context of its combined activities.

Foreign currency exposures arising from overseas investments are considered together with foreign currency liabilities of the Society, and net foreign currency exposures arising are managed through the use of forward foreign exchange contracts.

Separately, the Society provides a Currency Conversion Service (CCS) to participating Lloyd's syndicates, converting insurance premiums and claims between pounds sterling and other Lloyd's settlement currencies as required. Foreign exchange exposures arising from the provision of the CCS are again managed on a net basis, within defined parameters. The CCS is operated separately from other foreign exchange activity of the Society because, under the terms of the service, any profit (or loss) arising from CCS exposures is distributed to (or collected from) syndicates participating in the CCS. Currency exposures arising from CCS activity consequently do not, ultimately, represent risks to the Society.

INTEREST RATE RISK

Borrowings from the Lloyd's market for the purpose of funding statutory insurance deposits do not bear a fixed rate of interest. Instead, investment returns earned on the borrowed assets are passed on to lenders. Consequently, no interest rate risk arises on such borrowings.

Short-term assets held by the Society may be significant at certain times but such balances cannot be accurately predicted. These are invested in money market instruments of up to 12 months duration with the objective of maximising current income while meeting liquidity requirements.

Interest rate risk arising from the requirement to make fixed rate coupon payments in respect of the Lloyd's subordinated loan notes and the perpetual subordinated capital securities is considered in conjunction with the market risk arising on the Society's investments. Overall risk is managed within defined limits, specified by the Franchise Board.

CAPITAL MANAGEMENT

The Society monitors its capital to ensure that it maintains sufficient assets for both operational and solvency purposes. Further disclosures with regard to financial instruments are provided in note 21 on pages 132 and 133.

RELATED PARTY TRANSACTIONS

Except for disclosures made in note 24 (see page 135), no related party had material transactions with the Society in 2011.

GOING CONCERN STATEMENT

After making enquiries, the members of the Council of Lloyd's have a reasonable expectation that the Society has adequate resources to continue in operational existence for the foreseeable future. For this reason, they continue to adopt the going concern basis in preparing the Society's financial statements.

STATEMENT AS TO DISCLOSURE OF INFORMATION TO AUDITORS

Having made enquiries, the Council of Lloyd's confirms that:

> To the best of each Council member's knowledge and belief there is no information relevant to the preparation of the Society Report of which the Society's auditors are unaware.
> Each Council member has taken all the steps a Council member might reasonably be expected to have taken to be aware of relevant audit information and to establish that the Society's auditors are aware of that information.

OUTLOOK

Central assets, which exclude subordinated liabilities, are expected to remain stable at £2.4bn in 2012.

On 27 March 2012, the Council of Lloyd's gave further undertakings to certain corporate members to use the New Central Fund to discharge the liability of those members where they have unpaid cash calls and do not have the resources to meet those cash calls. After taking account of the expiry of unutilised undertakings, the net increase in undertakings, which will be reflected as a charge in the 2012 income statement, is £26m (see note 4 on page 113).

The operating expenses for the Corporation and its subsidiaries are budgeted to decrease by £17m to £192m in 2012 reflecting the focus on financial discipline while delivering the Lloyd's strategy.

STATEMENT OF THE COUNCIL OF LLOYD'S RESPONSIBILITIES IN RELATION TO THE FINANCIAL STATEMENTS

The Council of Lloyd's is responsible for preparing the group financial statements in accordance with byelaws made under Lloyd's Act 1982 and International Financial Reporting Standards (IFRS) as adopted by the European Union.

The Council of Lloyd's is required to prepare group financial statements for each financial year which present fairly the financial position of the Society and the financial performance and cash flows of the Society for that period. In preparing those group financial statements, the Council of Lloyd's is required to:

> Select suitable accounting policies and then apply them consistently.
> Present information, including accounting policies, in a manner that provides relevant, reliable, comparable and understandable information.
> Provide additional disclosures when compliance with the specific requirements in IFRS is insufficient to enable users to understand the impact of particular transactions, other events and conditions on the Society's financial position and financial performance.
> State that the Society has complied with IFRS, subject to any material departures disclosed and explained in the group financial statements.

The Council of Lloyd's is responsible for keeping proper accounting records which disclose with reasonable accuracy at any time the financial position of the Society and enable it to ensure that the group financial statements comply with Article 4 of the IAS Regulation. As the Society's subordinated debt and perpetual subordinated capital securities are admitted to trading in a regulated market in the European Union, Council has elected to comply with Article 4, which requires group financial statements to be prepared in conformity with IFRS as adopted by the European Union. The Council of Lloyd's is also responsible for safeguarding the assets of the Society and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

The Council of Lloyd's is responsible for the maintenance and integrity of the corporate and financial information included on the Society's website (www.lloyds.com). Legislation in the United Kingdom governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

INDEPENDENT AUDITOR'S REPORT TO THE MEMBERS OF THE SOCIETY OF LLOYD'S

We have audited the group financial statements of the Society of Lloyd's ('the Society') for the year ended 31 December 2011, which comprise the group income statement, group statement of comprehensive income, group statement of financial position, group statement of changes in equity, group statement of cash flows and the related notes 1 to 25. The financial reporting framework that has been applied in their preparation is applicable law and International Financial Reporting Standards (IFRSs) as adopted by the European Union.

This report is made solely to the members of Lloyd's, as a body, in accordance with the Council of Lloyd's byelaws made under the Lloyd's Act 1982 and our engagement letter dated 13 December 2011. Our audit work has been undertaken so that we might state to the members of Lloyd's as a body those matters we are required to state to them in an auditor's report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Society and the members of Lloyd's as a body, for our audit work, for this report, or for the opinions we have formed.

RESPECTIVE RESPONSIBILITIES OF THE COUNCIL OF LLOYD'S AND AUDITORS

As explained more fully in the Statement of The Council of Lloyd's Responsibilities set out on page 97, The Council of Lloyd's is responsible for the preparation of the group financial statements and for being satisfied that they give a true and fair view. Our responsibility is to audit and express an opinion on the group financial statements in accordance with byelaws made under the Lloyd's Act 1982 and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

The Society has also instructed us to:

> Report to you our opinion as to whether the Report of the Remuneration Committee has been properly prepared in accordance with the basis described therein.
> Report if, in our opinion, the Society has not kept proper accounting records, if we have not received all the information and explanations we require for our audit.

SCOPE OF THE AUDIT OF THE FINANCIAL STATEMENTS

An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of: whether the accounting policies are appropriate to the group's circumstances and have been consistently applied and adequately disclosed; the reasonableness of significant accounting estimates made by The Council of Lloyd's; and the overall presentation of the financial statements. In addition, we read all the financial and non-financial information in the reports listed on page 68 to identify material inconsistencies with the audited financial statements. If we become aware of any apparent material misstatements or inconsistencies we consider the implications for our report.

OPINION ON FINANCIAL STATEMENTS

In our opinion the group financial statements:

> Give a true and fair view, of the state of the Society's affairs as at 31 December 2011 and of its surplus for the year then ended; and
> Have been properly prepared in accordance with IFRSs as adopted by the European Union; and
> Have been prepared in accordance with Council of Lloyd's byelaws made under the Lloyd's Act 1982.

OPINION ON OTHER MATTERS

In our opinion the part of the Report of the Remuneration Committee that has been described as audited has been properly prepared in accordance with the basis of preparation as described therein;

MATTERS ON WHICH WE ARE REQUIRED TO REPORT BY EXCEPTION

We have nothing to report in respect of the following matters where the Society has requested us to report to you if, in our opinion:

> Proper accounting records have not been kept; or
> We have not received all the information and explanations we require for our audit.

Ernst & Young LLP
Statutory Auditor, London

27 March 2012

GROUP INCOME STATEMENT

for the year ended 31 December 2011

	Note	2011 £000	2010 £000
Operating income		**215,085**	210,193
Central Fund contributions		**94,693**	100,858
General insurance net premium income		**523**	1,463
Other group income		**6,598**	215,822
Total income	3b	**316,899**	528,336
Central Fund claims and provisions (incurred)/released	4	**(15,283)**	34,245
Gross insurance claims	13	**22,717**	11,602
Insurance claims recoverable from reinsurers	13	**1,492**	4,864
Other group operating expenses	5	**(248,582)**	(214,483)
Operating surplus		**77,243**	364,564
Finance costs	7	**(64,370)**	(66,143)
Finance income			
– surplus on subordinated debt repurchase	17	**4,248**	1,470
– other	7	**90,369**	131,436
Unrealised exchange gains on borrowings		**5,428**	7,954
Share of profits of associates	12A	**4,927**	5,084
Surplus before tax		**117,845**	444,365
Tax charge	8A	**(28,495)**	(121,752)
Surplus for the year		**89,350**	322,613

GROUP STATEMENT OF COMPREHENSIVE INCOME

for the year ended 31 December 2011

	Note	2011 £000	2010 £000
Surplus for the year		**89,350**	322,613
Other comprehensive income			
Actuarial (loss)/gain on pension liabilities			
– UK	18	**(56,671)**	(1,271)
– overseas	18	**(216)**	(71)
– associates	12A	**(1,273)**	250
Tax credit/(charge) relating to components of comprehensive income	8A	**11,963**	(981)
Net other comprehensive income for the year		**(46,197)**	(2,073)
Total comprehensive income for the year		**43,153**	320,540

GROUP STATEMENT OF FINANCIAL POSITION

as at 31 December 2011

	Note	2011 £000	2010 £000
Assets			
Intangible assets	9	**622**	326
Lloyd's Collection	12B	**12,019**	12,019
Plant and equipment	10	**31,408**	32,143
Deferred tax asset	8C	**2,264**	–
Investment in associates	12A	**5,220**	6,325
Insurance contract assets	13	**40,572**	47,948
Pension asset	18	**9**	25,995
Loans recoverable	14	**45,956**	54,371
Financial investments	15	**2,684,285**	2,548,640
Inventories		**198**	200
Trade and other receivables due within one year		**99,604**	68,341
Prepayments and accrued income		**33,727**	108,677
Forward currency contracts	21	**45,255**	9,746
Cash and cash equivalents	16	**127,282**	145,570
Total assets		**3,128,421**	3,060,301
Equity and liabilities			
Equity			
Accumulated reserve	22	**1,477,740**	1,434,587
Revaluation reserve	22	**12,019**	12,019
Total equity		**1,489,759**	1,446,606
Liabilities			
Subordinated notes and perpetual subordinated capital securities	17	**898,416**	930,173
Insurance contract liabilities	13	**49,479**	81,745
Pension liabilities	18	**25,016**	858
Deferred tax liabilities	8C	**–**	10,977
Provisions	19	**20,460**	21,305
Loans funding statutory insurance deposits		**352,318**	305,805
Trade and other payables	20	**188,328**	116,079
Accruals and deferred income		**45,374**	66,314
Tax payable		**2,632**	56,269
Forward currency contracts	21	**56,639**	24,170
Total liabilities		**1,638,662**	1,613,695
Total equity and liabilities		**3,128,421**	3,060,301

Approved and authorised by the Council of Lloyd's on 27 March 2012 and signed on its behalf by

John Nelson
Chairman

Richard Ward
Chief Executive Officer

GROUP STATEMENT OF CHANGES IN EQUITY

for the year ended 31 December 2011

	Note	Accumulated reserve £000	Revaluation reserve £000	Total equity £000
At 1 January 2010		1,114,045	12,021	1,126,066
Total comprehensive income for the year		320,540	–	320,540
Transfer between reserves		2	(2)	–
At 31 December 2010		1,434,587	12,019	1,446,606
Total comprehensive income for the year		**43,153**	**–**	**43,153**
At 31 December 2011	22	**1,477,740**	**12,019**	**1,489,759**

GROUP STATEMENT OF CASH FLOWS

for the year ended 31 December 2011

	Note	2011 £000	2010 £000
Surplus before tax		**117,845**	444,365
Finance income – surplus on subordinated note repurchase	17	**(4,248)**	(1,470)
Net finance income – other	7	**(25,999)**	(65,293)
Unrealised exchange gains on borrowings		**(5,428)**	(7,954)
Share of profits of associates	12A	**(4,927)**	(5,084)
Operating surplus		**77,243**	364,564
Central Fund claims and provisions incurred/(released)	4	**15,283**	(34,245)
Operating surplus before Central Fund claims and provisions		**92,526**	330,319
Adjustments for:			
Depreciation of plant and equipment	10	**5,938**	5,868
Amortisation of intangible assets	9	**221**	427
Impairment losses	9/10	**716**	1,006
Loss on sale of fixed assets		**1,111**	591
Operating surplus before working capital changes and claims paid		**100,512**	338,211
Changes in pension obligations		**(6,743)**	(48,540)
Decrease/(increase) in receivables		**52,638**	(68,743)
Decrease in inventories		**2**	1
Increase in payables		**18,145**	51,435
Increase/(decrease) in provisions other than for Central Fund claims		**788**	(23,911)
Cash generated from operations before claims paid		**165,342**	248,453
Claims paid in respect of corporate/insolvent members	19	**(16,910)**	(1,432)
Tax and interest payments in respect of corporate/insolvent members	4	**(2)**	(20)
Claims paid in respect of individual members	4	**(2)**	(905)
Claims paid in respect of Limited Financial Assistance Agreements		**(1)**	(352)
Cash generated from operations		**148,427**	245,744
Tax paid		**(83,747)**	(70,970)
Net cash generated from operating activities		**64,680**	174,774
Cash flows from investing activities			
Purchase of plant, equipment and intangible assets		**(7,577)**	(16,102)
Proceeds from the sale of fixed assets		**30**	1
Purchase of financial investments	15A/B	**(3,741,771)**	(4,237,092)
Receipts from the sale of financial investments	15A/B	**3,637,135**	3,897,913
Decrease in short-term deposits	15B	**26,982**	23,661
Dividends received from associates	12A	**5,096**	5,245
Interest received		**40,048**	37,747
Dividends received	7	**3,145**	3,088
Realised (loss)/gain on settlement of forward currency contracts		**(3,206)**	10,329
Net cash used in investing activities		**(40,118)**	(275,210)
Cash flows from financing activities			
Purchase of subordinated notes	17	**(23,120)**	(19,518)
Interest paid on subordinated notes		**(64,381)**	(66,045)
Other interest paid		**(1,025)**	(1,841)
Increase in borrowings for statutory insurance deposits		**46,973**	156,037
Net cash (used)/generated in financing activities		**(41,553)**	68,633
Net decrease in cash and cash equivalents		**(16,991)**	(31,803)
Effect of exchange rates on cash and cash equivalents		**(1,297)**	(843)
Cash and cash equivalents at 1 January	16	**145,570**	178,216
Cash and cash equivalents at 31 December	16	**127,282**	145,570

NOTES TO THE FINANCIAL STATEMENTS
as at 31 December 2011

1. BASIS OF PREPARATION AND CONSOLIDATION
In 1871, by Lloyd's Act 1871, the then existing association of underwriters was incorporated as the Society and Corporation of Lloyd's (the 'Society'). Its activities are accordingly governed by statute and, since 1982, have been managed by the Council of Lloyd's (the 'Council') pursuant to Lloyd's Act 1982.

The Society's main corporate purposes are to facilitate the carrying on of insurance business by members of Lloyd's and the advancement and protection of their interests in this context. The group financial statements of the Society of Lloyd's comprise the financial statements of the Society of Lloyd's and all its subsidiary undertakings, the Lloyd's Central Fund and the group's interest in associates as at each reporting date. Subsidiary undertakings are consolidated from the date of their acquisition, being the date on which the Society obtains control, and continue to be consolidated until the date that such control ceases. The financial statements are prepared using consistent accounting policies. All intra-group balances and transactions are eliminated in full.

The group financial statements have been prepared in accordance with International Financial Reporting Standards (as adopted by the European Union) and on a historic cost basis, except for financial assets and liabilities at fair value through profit or loss and the Lloyd's Collection, which are measured at fair value. Loans and receivables and other financial liabilities are carried at amortised cost. The group financial statements are presented in sterling and all values are rounded to the nearest thousand (£000).

The Society is regulated by the FSA.

2. PRINCIPAL ACCOUNTING POLICIES
GENERAL
In preparing the financial statements significant estimates and judgements are made in respect of some of the items reported. The main accounting policies identified involving such assessments are considered to be:

- Central Fund claims and provisions – undertakings (see note 2Q and note 19).
- Employee benefits – defined benefit pension scheme (see note 2I and note 18).
- Insurance contracts – liabilities and reinsurance assets (see note 2G and note 13).
- Loans recoverable – hardship loans (see note 2J and note 14).

A. Plant and equipment
Plant and equipment are held at cost less accumulated depreciation and any impairment in value.

Depreciation is charged on a straight line basis on the following principal categories:

- Plant, vehicles and equipment are depreciated over 3 to 25 years according to the estimated life of the asset.
- Equipment on hire or lease is depreciated over the period of the lease.

B. Software development
Costs incurred in acquiring and developing computer software are capitalised as intangible assets where the software supports a significant business system and the expenditure leads to the creation of an identifiable asset of value. Software development is held at cost less accumulated depreciation and any impairment in value. Capitalised software is amortised over three years.

C. Lloyd's Collection
Lloyd's Collection represents various paintings, antiques and artefacts which are included at fair value. Any revaluation surplus or deficit is recognised in the group statement of comprehensive income and is reflected in the revaluation reserve within the group statement of changes in equity.

2. PRINCIPAL ACCOUNTING POLICIES CONTINUED

D. INVESTMENT IN ASSOCIATES AND JOINT VENTURE

An associate is an entity in which the Society has significant influence and which is not a subsidiary undertaking or joint venture. A joint venture is a joint arrangement whereby the parties that have joint control of the arrangement have rights to the net assets of the arrangement. The Society's investment in associates and joint venture are accounted for under the equity method of accounting.

Under the equity method, the investment in associates and joint venture are carried in the group statement of financial position at cost plus post-acquisition changes in the Society's share of net assets of the associate and joint venture. Goodwill relating to an associate is included in the carrying amount of the investment and is not amortised. After application of the equity method, the Society determines whether it is necessary to recognise any additional impairment loss with respect to the Society's net investment in an associate and joint venture. The group income statement reflects its share of the results of operations of the associates and joint venture. The Society's share of associates' other comprehensive income is recognised in the group statement of comprehensive income.

E. IMPAIRMENT OF ASSETS

The Society performs annual impairment testing to assess whether there is an indication that an asset may be impaired. If any such indication exists the Society makes an estimate of the asset's recoverable amount. An asset's recoverable amount is the higher of an asset's fair value less costs to sell and its value in use. When the carrying amount exceeds its recoverable amount, the asset is considered impaired and written down to its recoverable amount.

F. FINANCIAL INSTRUMENTS

Financial assets

Initial recognition

Financial assets within the scope of IAS 39 are classified as financial assets at fair value through profit or loss and receivables. The Society determines the classification of its financial assets at initial recognition.

Financial assets are recognised initially at fair value plus, in the case of loans and receivables, directly attributable transaction costs.

Purchases or sales of financial assets that require delivery of assets within a time frame established by regulation or convention in the market place (regular way purchases) are recognised on the settlement date.

The Society's financial assets include loans recoverable, statutory insurance deposits and other investments designated at fair value through profit or loss, trade and other receivables, accrued income, cash and cash equivalents and derivative assets.

Subsequent measurement

The subsequent measurement of financial assets depends on their classification as follows:

(i) Financial assets at fair value through profit or loss include derivative financial assets which are classified as held for trading, and financial assets designated upon initial recognition at fair value through profit or loss. They are carried in the group statement of financial position at fair value. Gains and losses arising from changes in their fair value are included in the group income statement in the period in which they arise. When financial assets are interest-bearing, interest calculated using the effective interest method is recognised in the group income statement.

(ii) Loans and receivables are non-derivative financial assets with fixed or determinable payment that are not quoted in an active market. They arise when the Society provides money, goods or services directly to a debtor with no intention of trading the receivable. These financial assets are carried at amortised cost using the effective interest method. Gains and losses are recognised in the group income statement when the loans and receivables are derecognised or impaired, as well as through the amortisation process.

Financial liabilities

Initial recognition

Financial liabilities within the scope of IAS 39 are classified as financial liabilities at fair value through profit and loss and other financial liabilities. The Society determines the classification of its financial liabilities at initial recognition.

Financial liabilities are recognised initially at fair value and in the case of other financial liabilities, directly attributable transaction costs. The Society's financial liabilities include trade and other payables, accruals, subordinated loan notes and perpetual capital securities and derivative liabilities.

The subsequent measurement of financial liabilities depends on their classification as follows:

(i) Financial liabilities at fair value through profit or loss include derivative financial liabilities which are classified as held for trading. Gains or losses on liabilities held for trading are recognised in the group income statement.

(ii) Other financial liabilities, which include the subordinated loan notes and the subordinated perpetual capital securities, are carried at amortised cost using the effective interest method.

NOTES TO THE FINANCIAL STATEMENTS CONTINUED

as at 31 December 2011

2. PRINCIPAL ACCOUNTING POLICIES CONTINUED

F. FINANCIAL INSTRUMENTS CONTINUED

Fair value of financial instruments

Financial instruments are categorised for disclosure purposes into a hierarchy consisting of three levels depending upon the source of input as required by IFRS 7 (Financial Instruments: Disclosures).

Level 1 – The fair value of financial instruments which are actively traded in organised financial markets is determined by reference to quoted market bid prices at the close of business on the reporting date. The quoted market price used for financial assets held by the Society is the current bid price; the appropriate quoted market price for financial liabilities is the current offer price.

Level 2 – The fair value of financial instruments for which quoted market prices are not used for valuation purposes are derived both directly and indirectly from observable market conditions. The fair value of forward currency contracts is calculated by reference to current forward exchange rates for contracts with similar maturity profiles. The nominal value less estimated credit adjustments of trade receivables and payables are assumed to approximate to their fair values.

Level 3 – The fair value of financial instruments for which there is no observable quoted market price is determined by a variety of methods incorporating assumptions that are based, so far as possible, on market conditions existing at each reporting date.

Amortised cost of financial instruments

Amortised cost is computed using the effective interest method less any allowance for impairment and principal repayment or reduction. The calculation takes into account any premium or discount on acquisition and includes transaction costs and fees that are an integral part of the effective interest rate.

Impairment of financial assets

The Society assesses at each reporting date whether there is an indication that an asset may be impaired. If any such indication exists, the asset is written down to its recoverable amount.

Derecognition of financial instruments

Other investments are derecognised when the right to receive cash flows from the asset have expired or, in the case of a financial liability, when the obligation under the liability is cancelled or discharged.

G. INSURANCE CONTRACTS (LIABILITIES AND REINSURANCE ASSETS)

In accordance with IFRS 4 (Insurance contracts), the Society applies established UK accounting practices for insurance contracts, modified as appropriate to comply with the IFRS framework and applicable standards. This includes the application of the Statement of Recommended Practice (SORP) on accounting for insurance business issued by the Association of British Insurers in December 2005 (amended December 2006).

Insurance contracts are defined as those containing significant insurance risk which arises if, and only if, an insured event could cause an insurer to pay significant additional benefits in any scenario, excluding scenarios that lack commercial substance, at the inception of the contract. Such contracts remain insurance contracts until all rights and obligations are extinguished or expired.

An impairment review is performed on all reinsurance assets when an indication of impairment occurs. Reinsurance assets are impaired only if there is objective evidence that the Society may not receive all amounts due to it under the terms of the contract and this can be measured reliably.

H. INVENTORIES

Inventories are stated at the lower of cost and net realisable value on a first in, first out (FIFO) basis. Net realisable value is the estimated selling price in the ordinary course of business less estimated costs necessary to make the sale.

I. EMPLOYEE BENEFITS

The Society accounts for pensions and similar benefits (principally income protection due to ill-health) under IAS 19 (Employee Benefits). The Society operates a number of defined benefit pension schemes in which obligations are measured at discounted present value using the projected unit credit method, while plan assets are recorded at fair value. The operating and financing income and costs of the scheme are recognised in the group income statement. Service costs, financing income (expected return on plan assets), and costs are recognised in the periods in which they arise. Actuarial gains and losses are recognised in full in the group statement of comprehensive income in the period in which they occur. Costs of discretionary awards in respect of past service are recognised in the group income statement when amounts are committed to be paid or there is a constructive liability to make awards to pensioners.

Payments to separately administered defined contribution schemes are charged to the group income statement as they fall due.

Short-term bonuses are accrued in the period to which they relate, long-term bonuses are recognised over their vesting period.

2. PRINCIPAL ACCOUNTING POLICIES CONTINUED

J. LOANS RECOVERABLE

Recoverable Central Fund loans made to hardship members are managed on a fair value basis and are designated as fair value through profit or loss.

Any gains and losses arising from changes in the fair value are included in the group income statement in the period in which they arise.

Fair values are determined by reference to an estimate of the valuation of the underlying securities at the dates at which they may be exercised and discounted back to present day values. A security can normally only be exercised on the later date of death of the member or of their spouse. This date is assessed using actuarial assumptions.

K. TAXATION

Corporation tax on the surplus or deficit for the periods presented comprises current and deferred tax. Corporation and income tax is recognised in the group income statement except to the extent that it relates to items recognised directly in the group statement of comprehensive income, in which case it is recognised in the group statement of comprehensive income.

Current tax is the expected tax payable on the taxable income for the year, using tax rates enacted or substantially enacted at the reporting date, and any adjustment to tax payable in respect of previous years.

Deferred tax liabilities are recognised for all taxable temporary differences and deferred tax assets are recognised for all deductible temporary differences and unutilised tax losses to the extent that it is probable that taxable profits will be available against which the deductible temporary differences or tax losses can be utilised.

Deferred tax is measured on an undiscounted basis at the rates that are expected to apply in the periods in which timing differences reverse, based on tax rates and laws enacted or substantially enacted at the reporting date.

L. SUBORDINATED NOTES AND PERPETUAL SUBORDINATED CAPITAL SECURITIES

Subordinated debt is initially recognised at fair value, being the fair value of the consideration received net of issue costs associated with the borrowing.

After initial recognition, the subordinated debt is subsequently recorded at amortised cost using the effective interest rate over the period to the earliest option date. Amortised cost is calculated after taking into account issue costs and issue discount.

M. CASH AND CASH EQUIVALENTS

For the purposes of the group statement of cash flows, cash comprises cash at banks and demand deposits, and cash equivalents comprise highly liquid investments, that are convertible into cash with an insignificant risk of changes in value, with original maturities of less than three months.

N. INCOME RECOGNITION

Income, which is stated net of value added tax, comprises the fair value of amounts receivable. Income is recognised as follows:

(i) Members' subscriptions, market charges and other services
Members' subscriptions, market charges and other services are recognised in the period for which the service is provided. They are recognised on a basis that reflects the timing, nature and value of the benefits provided.

(ii) Central Fund contributions
Central Fund contributions from members underwriting in the year are recognised when no significant uncertainty as to collectability exists.

(iii) Interest income
Interest receivable is recognised in the group income statement on a time apportioned basis using the effective interest method. Any unwinding of discount is recognised as interest income.

(iv) Dividend income
Dividend income from equity investments is included in the group income statement on the ex-dividend date.

(v) Other income
Other income is recognised when recoverability is agreed.

O. INSURANCE PREMIUMS

Insurance premiums represent premiums on business incepting during the year, together with adjustments for premiums written in previous accounting periods. Premium income is recognised over the period of cover. Premiums written are stated before deduction of commissions but net of taxes, duties levied on premiums and other similar deductions.

NOTES TO THE FINANCIAL STATEMENTS CONTINUED

as at 31 December 2011

2. PRINCIPAL ACCOUNTING POLICIES CONTINUED

P. INSURANCE CLAIMS

Claims incurred in insurance related activities consist of claims and claims handling expenses paid during the year together with the movement in outstanding claims. Outstanding claims are the estimated final cost of all claims incurred but not settled at the reporting date, including claims incurred but not reported (IBNR). Outstanding claims are not discounted. Subsequent information and events may result in the ultimate liability being less than, or greater than, the amount provided. Any differences between the provision and subsequent settlements are reflected within the group financial statements of later years.

Q. CENTRAL FUND CLAIMS AND PROVISIONS

Central Fund claims and provisions (undertakings) are accounted for when they are approved by the Council and become contractual commitments. These undertakings are granted wholly at the discretion of the Council for a fixed period, normally one year, and therefore are not deemed to be constructive obligations, except for renewals of those commitments previously granted. For those corporate members in provisional liquidation, the Council provides a supporting commitment, which will ensure that in no circumstance will an insurance creditor receive less than the amount it would have received in a winding up commencing on the date of the provisional liquidation. As the supporting undertakings are legally enforceable commitments, an estimate of their value is included within provisions in the group financial statements and changes during the period are reflected in the group income statement.

Recoveries in respect of undertakings previously given are credited to the group income statement when contractually committed to be received.

R. FOREIGN CURRENCY AND DERIVATIVE INSTRUMENTS

Foreign currency translation

(i) Functional and presentation currency
The group financial statements are presented in pound sterling, which is the Society's functional and presentation currency. Items included in the financial statements of each of the Society's entities are measured using the currency of the primary economic environment in which the entity operates (the functional currency).

(ii) Transactions and balances
Transactions in foreign currencies are recorded at the exchange rate prevailing on the date of the transaction. At each reporting date, monetary assets and liabilities denominated in foreign currencies are retranslated at the exchange rate prevailing at the reporting date. Translation differences on monetary items are taken to the group income statement.

Translation differences on non-monetary items measured at fair value are reported as part of the fair value gain or loss and included in the group income statement.

The results and financial position of overseas Society operations are translated into pound sterling as follows:

> Assets and liabilities are translated at the closing rate at the date of that statement of financial position.
> Income and expenses are translated at the average exchange rate for the year.
> Any resulting exchange differences are recognised in the group statement of comprehensive income and accumulated within a separate component of equity.

The Society enters into forward currency contracts to manage exposures to fluctuation in foreign exchange rates, and to provide a service to the Lloyd's market. Where gains and losses are not expected to be refunded or recovered from the Lloyd's market, these amounts are taken to the group income statement.

The principal exchange rates were:

	2011	2010
US$	**1.55**	1.57
Can$	**1.58**	1.56
Euro	**1.20**	1.17

S. LEASES

Payments made under operating leases are charged to the group income statement on a straight-line basis over the period of the lease.

2. PRINCIPAL ACCOUNTING POLICIES CONTINUED

T. NEW STANDARDS AND INTERPRETATIONS NOT APPLIED

The International Accounting Standards Board and International Financial Reporting Interpretations Committee have issued the following standards and interpretations relevant to the Society. At the date these financial statements were approved, the following standards were in issue but not effective:

		Effective date (for accounting periods beginning on or after)
International Accounting Standards		
IAS 1	Presentation of Financial Statements	1 January 2013
IAS 19	Employee Benefits	1 January 2013
IFRS 9	Financial Instruments	1 January 2015
IFRS 10	Consolidated Financial Statements	1 January 2013
IFRS 11	Joint Arrangements	1 January 2013
IFRS 12	Disclosure of Interests in Other Entities	1 January 2013
IFRS 13	Fair Value Measurement	1 January 2013

With the exception of revisions to IAS 19, the Council does not consider that the adoption of the above standards will have a material impact on the Society's financial statements. The impact of changes to IAS 19 Employee Benefits is in the process of being evaluated.

3. SEGMENTAL ANALYSIS

Segment information is presented in respect of the Society's business segments. The primary business segments are based on the Society's management and internal reporting structure.

Intra-segment pricing is determined on an arm's-length basis.

Segment results, assets and liabilities include items directly attributable to a segment as well as those that can be allocated on a reasonable basis.

Segment capital expenditure is the total cost incurred during the year to acquire segment assets that are expected to be used for more than one period.

Segment information in respect of geographical location is not presented. The Society's main source of income is from the Lloyd's market based primarily in the UK, which includes the recovery of costs in respect of overseas operations. The recovery of overseas operating costs is collected in the UK from the Lloyd's market.

The Society's primary business segments are as follows:

(i) Corporation of Lloyd's and non-insurance related subsidiary undertakings: the main corporate purposes are to facilitate the carrying on of insurance business by members of Lloyd's and the advancement and protection of their interests in this context. The activities of authorised insurance company subsidiary undertakings are excluded from this business segment.

(ii) Lloyd's Central Fund: these funds, comprising the New Central Fund and the 'Old' Central Fund, are assets of the Society and are held and administered at the discretion of the Council, primarily as funds available for the protection of policyholders. Unless the approval of members is obtained, the New Central Fund may not be used for the purposes of extinguishing or reducing liabilities which have been reinsured by Equitas.

(iii) Insurance activities: the Society has three insurance company subsidiary undertakings, Centrewrite Limited, Lloyd's Insurance Company (China) Limited and Lioncover Insurance Company Limited. Centrewrite provides Exeat insurance to resigned members participating only on run-off syndicates allowing an early exit from Lloyd's, and Estate Protection Plan insurance to members. Centrewrite has also reinsured the members of Syndicate 535 and 1204 for outstanding claims in respect of certain years of account, these contracts have been successfully novated from 1 January 2012. Lloyd's Insurance Company (China) Limited underwrites onshore reinsurance business in China and direct insurance risks in the Shanghai municipality. Following the completion of Phase 2 of the Equitas-Berkshire Hathaway transaction, Lioncover no longer has reinsurance liabilities to any person nor any entitlement to any reinsurance recoveries.

NOTES TO THE FINANCIAL STATEMENTS CONTINUED

as at 31 December 2011

3. SEGMENTAL ANALYSIS CONTINUED

(a) Information by business agent	Note	2011 Corporation of Lloyd's £000	2011 Lloyd's Central Fund £000	2011 Insurance activities £000	2011 Society total £000
Segment income					
Total income	3b	211,676	99,739	5,484	316,899
Segment operating expenses					
Central Fund claims and provisions incurred	4	–	(15,283)	–	(15,283)
Gross claims released		–	–	22,717	22,717
Claims recoverable from reinsurers		–	–	1,492	1,492
Other group operating expenses:					
Employment (including pension costs)	6	(113,226)	–	(3,189)	(116,415)
Premises		(43,314)	–	(695)	(44,009)
Legal and professional	5	(18,441)	(1,026)	(240)	(19,707)
Systems and communications		(27,602)	–	(363)	(27,965)
Other		(28,334)	(6,755)	(5,397)	(40,486)
Total other group operating expenses		(230,917)	(7,781)	(9,884)	(248,582)
Total segment operating expenses		(230,917)	(23,064)	14,325	(239,656)
Total segment operating surplus		(19,241)	76,675	19,809	77,243
Finance costs	7	(62)	(64,308)	–	(64,370)
Finance income					
surplus on subordinated debt repurchase	17	–	4,248	–	4,248
other	7	1,283	85,937	3,149	90,369
Unrealised exchange losses on borrowings		–	5,428	–	5,428
Share of profits of associates	12A	4,927	–	–	4,927
Segment surplus before tax		(13,093)	107,980	22,958	117,845
Tax charge					(28,495)
Surplus for the year					89,350
Segment assets and liabilities					
Investment in associates		5,220	–	–	5,220
Other assets		535,681	2,355,433	229,823	3,120,937
Segment assets		540,901	2,355,433	229,823	3,126,157
Tax assets					2,264
Total assets					3,128,421
Segment liabilities		(521,995)	(982,941)	(131,094)	(1,636,030)
Tax liabilities					(2,632)
Total liabilities					(1,638,662)
Other segment information					
Capital expenditure	9/10	6,180	–	1,397	7,577
Depreciation	10	5,765	–	173	5,938
Amortisation of intangible assets	9	56	–	165	221
Impairment of long-term assets	9/10	716	–	–	716
Average number of UK employees (permanent and contract)		743	–	3	746
Average number of overseas employees (permanent and contract)		130	–	33	163
Average number of total employees (permanent and contract)		873	–	36	909

Average staff numbers shown above are on a full-time equivalent basis.

3. SEGMENTAL ANALYSIS CONTINUED

(a) Information by business agent continued	Note	2010 Corporation of Lloyd's £000	2010 Lloyd's Central Fund £000	2010 Insurance activities £000	2010 Society total £000
Segment income					
Total income	3b	207,326	315,605	5,405	528,336
Segment operating expenses					
Central Fund claims and provisions released	4	–	34,245	–	34,245
Gross claims released		–	–	11,602	11,602
Claims recoverable from reinsurers		–	–	4,864	4,864
Other group operating expenses:					
Employment (including pension costs)	6	(89,842)	–	(2,622)	(92,464)
Premises		(42,025)	–	(730)	(42,755)
Legal and professional	5	(17,599)	(838)	(398)	(18,835)
Systems and communications		(27,485)	–	(435)	(27,920)
Other		(26,841)	(4,947)	(721)	(32,509)
Total other group operating expenses		(203,792)	(5,785)	(4,906)	(214,483)
Total segment operating expenses		(203,792)	28,460	11,560	(163,772)
Total segment operating surplus		3,534	344,065	16,965	364,564
Finance costs	7	(27)	(66,116)	–	(66,143)
Finance income					
surplus on subordinated debt repurchase	17	–	1,470	–	1,470
other	7	1,040	127,907	2,489	131,436
Unrealised exchange losses on borrowings		–	7,954	–	7,954
Share of profits of associates	12A	5,084	–	–	5,084
Segment surplus before tax		9,631	415,280	19,454	444,365
Tax charge					(121,752)
Surplus for the year					322,613
Segment assets and liabilities					
Investment in associates		6,325	–	–	6,325
Other assets		494,816	2,354,847	204,313	3,053,976
Segment assets		501,141	2,354,847	204,313	3,060,301
Tax assets					–
Total assets					3,060,301
Segment liabilities		(413,212)	(1,007,487)	(125,750)	(1,546,449)
Tax liabilities					(67,246)
Total liabilities					(1,613,695)
Other segment information					
Capital expenditure	9/10	15,247	–	855	16,102
Depreciation	10	5,489	–	379	5,868
Amortisation of intangible assets	9	223	–	204	427
Impairment of long-term assets	9/10	1,006	–	–	1,006
Average number of UK employees (permanent and contract)		718	–	3	721
Average number of overseas employees (permanent and contract)		123	–	24	147
Average number of total employees (permanent and contract)		841	–	27	868

NOTES TO THE FINANCIAL STATEMENTS CONTINUED

as at 31 December 2011

3. SEGMENTAL ANALYSIS CONTINUED

	Corporation of Lloyd's		Lloyd's Central Fund		Insurance activities		Society total	
(b) Income	**2011 £000**	2010 £000	**2011 £000**	2010 £000	**2011 £000**	2010 £000	**2011 £000**	2010 £000
Market charges								
Managing agents and syndicates	**77,767**	75,904	**–**	–	**4,693**	3,929	**82,460**	79,833
Members and members' agents	**10,206**	12,460	**–**	–	**–**	–	**10,206**	12,460
Performance and risk management charge	**14,599**	14,235	**–**	–	**–**	–	**14,599**	14,235
Total market charges	**102,572**	102,599	**–**	–	**4,693**	3,929	**107,265**	106,528
Members' subscriptions	**91,610**	89,017	**–**	–	**–**	–	**91,610**	89,017
Other charges	**15,942**	14,635	**–**	–	**268**	13	**16,210**	14,648
Total operating income	**210,124**	206,251	**–**	–	**4,961**	3,942	**215,085**	210,193
Central Fund contributions	**–**	–	**94,693**	100,858	**–**	–	**94,693**	100,858
General insurance net premium income	**–**	–	**–**	–	**523**	1,463	**523**	1,463
Other group income	**1,552**	1,075	**5,046**	214,747	**–**	–	**6,598**	215,822
Total income	**211,676**	207,326	**99,739**	315,605	**5,484**	5,405	**316,899**	528,336

During the year, members paid to the Corporation of Lloyd's (members' subscriptions) and to the Central Fund (Central Fund contributions from members) at 0.5% of their syndicate forecast written premium (2010: 0.5%). Central Fund contributions in the first three years of membership are charged at 2% of syndicate forecast written premium. The ultimate amounts to be retained by the Corporation of Lloyd's and the Central Fund for 2011 will be based on actual 2011 written premiums, of members, the quantification of which will not be known until 2013. The £94.7m (Central Fund contribution from members) and £91.6m (members' subscriptions) included in the group income statement are based on the present best estimates of the ultimate amounts that will be retained by the Central Fund and the Corporation of Lloyd's respectively.

Other group income includes foreign exchange gains, market settlement recoveries which represent continuing debt recoveries from the 1996 'Reconstruction and Renewal' settlement and recoveries in respect of undertakings given by the Central Fund.

4. CENTRAL FUND CLAIMS AND PROVISIONS

	Note	2011 £000	2010 £000
Net undertakings (granted)/released	19	**(15,515)**	34,818
Provisions released in respect of Limited Financial Assistance Agreements	19	**236**	352
Claims payable in respect of individual members		**(2)**	(905)
Tax and interest payable in respect of insolvent members		**(2)**	(20)
Central Fund claims and provisions (incurred)/released		**(15,283)**	34,245

The Council has given undertakings with financial limits to certain corporate members to use the New Central Fund to discharge the liability of those members where they have unpaid cash calls and do not have the resources to meet those cash calls. The purpose of these undertakings is primarily to allow valid claims made on policies underwritten by those insolvent members to continue to be paid in full. Undertakings are accounted for when they are approved by the Council and become contractual commitments. These undertakings are granted wholly at the discretion of the Council principally on an annual basis and therefore are not deemed constructive obligations (see note 19). Unutilised undertakings as at 31 December 2011 were £8m. Those undertakings have expired and have been replaced by further annual undertakings given on 27 March 2012 that total £34m, a net increase of £26m. No provision has been included in these financial statements in respect of these further undertakings.

For those corporate members in provisional liquidation, the Council has also provided supporting commitments, which will ensure that in no circumstance will an insurance creditor receive less than the amount it would have received in a winding up commencing on the date of the provisional liquidation.

As the supporting undertakings are legally enforceable commitments, an estimate of their value, if applicable, has been included within provisions in the group financial statements and changes during the year are reflected in the group income statement, as shown in the table above.

NOTES TO THE FINANCIAL STATEMENTS CONTINUED

as at 31 December 2011

5. OTHER GROUP OPERATING EXPENSES

	Note	2011 Corporation of Lloyd's £000	2011 Lloyd's Central Fund £000	2011 Insurance activities £000	2011 Total £000
Other group operating expenses include:					
Employment costs	6	**113,226**	**–**	**3,189**	**116,415**
Operating lease rentals – Lloyd's 1986 building		**16,767**	**–**	**–**	**16,767**
Operating lease rentals – other		**7,732**	**–**	**–**	**7,732**
Professional fees, including legal fees and related costs		**17,252**	**797**	**198**	**18,247**
Audit		**357**	**229**	**42**	**628**
Other services pursuant to legislation payable to Ernst & Young LLP		**406**	**–**	**–**	**406**
Actuarial services payable to Ernst & Young LLP		**50**	**–**	**–**	**50**
Tax services payable to Ernst & Young LLP		**55**	**–**	**–**	**55**
Other services payable to Ernst & Young LLP		**321**	**–**	**–**	**321**
Total legal and professional fees		**18,441**	**1,026**	**240**	**19,707**
Charitable donations		**618**	**–**	**–**	**618**

	Note	2010 Corporation of Lloyd's £000	2010 Lloyd's Central Fund £000	2010 Insurance activities £000	2010 Total £000
Other group operating expenses include:					
Employment costs	6	89,842	–	2,622	92,464
Operating lease rentals – Lloyd's 1986 building		16,767	–	–	16,767
Operating lease rentals – other		7,568	–	–	7,568
Professional fees, including legal fees and related costs		16,530	608	307	17,445
Audit		361	230	91	682
Other services pursuant to legislation payable to Ernst & Young LLP		456	–	–	456
Actuarial services payable to Ernst & Young LLP		50	–	–	50
Tax services payable to Ernst & Young LLP		53	–	–	53
Other services payable to Ernst & Young LLP		149	–	–	149
Total legal and professional fees		17,599	838	398	18,835
Charitable donations		1,431	–	–	1,431

Other services pursuant to legislation payable to Ernst & Young LLP includes work undertaken on the Aggregate Accounts, pro forma financial statements and regulatory returns.

6. EMPLOYMENT

	Note	2011 £000	2010 £000
Salaries and wages (including performance-related bonus)		**62,351**	59,465
Lloyd's Performance Plan (excluding social security costs – note 19)		**316**	4,771
Lloyd's Pension Scheme costs	18	**24,511**	4,941
Other pension costs		**1,584**	901
Social security costs		**6,994**	6,994
Severance costs		**5,044**	791
Contract and agency staff		**7,042**	6,033
Other employment costs		**8,573**	8,568
		116,415	92,464

The emoluments of the Chairman, CEO, members of the Council and Franchise Board are included in the report of the Remuneration Committee on page 86.

7. FINANCE

	Note	2011 Corporation of Lloyd's £000	2011 Lloyd's Central Fund £000	2011 Insurance activities £000	2011 Total £000	2010 Total £000
Finance costs						
Interest payable on financial liabilities measured at amortised cost		–	**(63,268)**	–	**(63,268)**	(65,076)
Other interest payable and similar charges		**(62)**	–	–	**(62)**	(27)
Amortisation of issue costs and discount		–	**(1,040)**	–	**(1,040)**	(1,040)
Total interest payable on financial liabilities	3a	**(62)**	**(64,308)**	–	**(64,370)**	(66,143)
Finance income						
Bank interest received		**806**	**576**	**203**	**1,585**	1,729
Dividends received		–	**3,145**	–	**3,145**	3,088
Other returns on investments designated at fair value through profit or loss		**387**	**82,382**	**2,519**	**85,288**	160,755
Unrealised fair value movement of investments designated at fair value through profit or loss		**52**	**4,969**	**427**	**5,448**	(19,861)
Unrealised fair value movement of forward contracts held for trading		**38**	**(10,343)**	–	**(10,305)**	(14,545)
Realised fair value movement of forward contracts held for trading		–	**10,140**	–	**10,140**	(1,400)
(Decrease)/increase in valuation of loans recoverable designated at fair value through profit or loss		–	**(4,932)**	–	**(4,932)**	1,670
Total finance income	3a	**1,283**	**85,937**	**3,149**	**90,369**	131,436

8. TAXATION

A. TAX ANALYSIS OF CHARGE IN THE YEAR

	Note	2011 £000	2010 £000
Current tax:			
Corporation tax based on profits for the year at 26.5% (2010: 28%)		**(30,031)**	(110,456)
Adjustments in respect of previous years		**1,719**	1,914
Foreign tax suffered		**(1,799)**	(210)
Total current tax		**(30,111)**	(108,752)
Deferred tax:			
Origination and reversal of timing differences			
current year		**1,944**	(12,143)
prior year		**(328)**	(857)
Tax charge recognised in the group income statement	8B	**(28,495)**	(121,752)
Analysis of tax charge recognised in the group statement of comprehensive income:			
Deferred tax:			
Tax credit/(charge) on actuarial loss on pension liabilities:			
group		**11,626**	(914)
associates		**337**	(67)
Tax credit/(charge) recognised in the group statement of comprehensive income		**11,963**	(981)
Total tax charge		**(16,532)**	(122,733)

NOTES TO THE FINANCIAL STATEMENTS CONTINUED

as at 31 December 2011

8. TAXATION CONTINUED

B. RECONCILIATION OF EFFECTIVE TAX RATE

	Note	2011 %	2011 £000	2010 %	2010 £000
Surplus on ordinary activities before tax			**117,845**		444,365
Corporation tax at 26.5% (2010: 28%)		**26.5%**	**(31,229)**	28.0%	(124,422)
Expenses not deductible for tax purposes		**2.6%**	**(3,112)**	0.4%	(1,760)
Utilisation of tax credits		**(0.0%)**	**50**	(0.0%)	61
Overseas tax		**0.7%**	**(788)**	0.0%	(210)
Other		**(1.4%)**	**1,700**	(0.4%)	1,845
Deferred tax adjustment relating to change in tax rate		**(3.0%)**	**3,494**	(0.4%)	1,677
Deferred tax prior year adjustments		**0.3%**	**(329)**	0.2%	(857)
Adjustments in respect of previous years		**(1.5%)**	**1,719**	(0.4%)	1,914
Tax charge	8A	**24.2%**	**(28,495)**	27.4%	(121,752)

C. DEFERRED TAX

	2011 Balance at 1 January £000	2011 Income Statement £000	2011 Equity £000	2011 Balance at 31 December £000
Plant and equipment	**5,496**	**(629)**	**–**	**4,867**
Loans recoverable	**(5,808)**	**1,506**	**–**	**(4,302)**
Financial investments	**(4,184)**	**1,654**	**–**	**(2,530)**
Pension (assets)/liabilities	**(5,996)**	**290**	**11,626**	**5,920**
Other employee benefits	**2,760**	**(1,444)**	**–**	**1,316**
Other items	**(3,245)**	**238**	**–**	**(3,007)**
	(10,977)	**1,615**	**11,626**	**2,264**

In 2011, there were no unrecognised deductible temporary differences (2010: nil).

The Finance Act 2011, enacted on 19 July 2011, included legislation to reduce the corporation tax rate to 26% from 1 April 2011, and then to 25% from 1 April 2012. This change was therefore substantively enacted at 31 December 2011 and has been reflected in the amounts recognised as at that date.

Further reductions are proposed to reduce the rate by an additional 1% down to 24% from April 2012, followed by further redcutions of 1% each year down to 22% in April 2014. These reductions were not substantively enacted at 31 December 2011 and therefore have not been reflected in the amounts recognised as at that date. It is estimated that these future changes will decrease the net deferred tax asset by £406k.

	2010 Balance at 1 January £000	2010 Income Statement £000	2010 Equity £000	2010 Balance at 31 December £000
Plant and equipment	4,549	947	–	5,496
Loans recoverable	(7,228)	1,420	–	(5,808)
Financial investments	(1,812)	(2,372)	–	(4,184)
Pension liabilities/(assets)	5,962	(11,044)	(914)	(5,996)
Other employee benefits	3,428	(668)	–	2,760
Other items	(1,962)	(1,283)	–	(3,245)
	2,937	(13,000)	(914)	(10,977)

9. INTANGIBLE ASSETS – SOFTWARE DEVELOPMENT

	£000
Cost:	
At 1 January 2010	5,043
Additions	694
Disposals	(1,226)
At 31 December 2010	4,511
Additions	**1,086**
Disposals	**(664)**
At 31 December 2011	**4,933**
Amortisation:	
At 1 January 2010	4,984
Charge for the year	427
Impairment losses	–
Disposals	(1,226)
At 31 December 2010	4,185
Charge for the year	**221**
Impairment losses	**3**
Disposals	**(98)**
At 31 December 2011	**4,311**
Net book value at 31 December 2011	**622**
Net book value at 31 December 2010	326

IMPAIRMENT LOSSES

As part of an assessment of the carrying value of assets, £3,000 was written off in 2011 (2010: nil). The impairment and amortisation charges are included within other group operating expenses.

10. PLANT AND EQUIPMENT

	£000
Cost:	
At 1 January 2010	58,028
Additions	15,408
Disposals	(3,180)
At 31 December 2010	70,256
Additions	**6,491**
Disposals	**(7,065)**
At 31 December 2011	**69,682**
Depreciation and impairment:	
At 1 January 2010	33,829
Depreciation charge for the year	5,868
Impairment losses	1,006
Disposals	(2,590)
At 31 December 2010	38,113
Depreciation charge for the year	**5,938**
Impairment losses	**713**
Disposals	**(6,490)**
At 31 December 2011	**38,274**
Net book value at 31 December 2011	**31,408**
Net book value at 31 December 2010	32,143

NOTES TO THE FINANCIAL STATEMENTS CONTINUED

as at 31 December 2011

10. PLANT AND EQUIPMENT CONTINUED

IMPAIRMENT LOSSES

Impairment reviews are undertaken annually in which assets within plant and other assets have their recoverable amounts reassessed. As part of this assessment of the carrying value of assets, £713,000 was written off in 2011 (2010: £1,006,000). The charge is included within other group operating expenses.

11. INVESTMENTS IN SUBSIDIARY UNDERTAKINGS AND ASSOCIATES

Entity	Nature of business	Proportion of equity capital held
Principal subsidiary undertakings		
Additional Securities Limited	Provision of deposits overseas on behalf of Lloyd's underwriters to comply with local insurance regulations	100%
Centrewrite Limited	Authorised UK insurance company	100%
Lioncover Insurance Company Limited	Authorised UK insurance company	100%
Lloyd's Insurance Company (China) Limited	Authorised insurance company in China (incorporated in 2007 with a share capital of Rmb 200,000,000)	100%
Associates and Joint Venture		
Ins-sure Holdings Limited	Provision of premiums and claims accounting and settlement, policy production and ancillary insurance services principally to the London insurance market	25%
Xchanging Claims Services Limited	Provision of claims and recoveries services	50%
The Message Exchange Limited	Provision of messaging infrastructure to the London insurance market	Limited by Guarantee 25%

The issued share capital of Ins-sure Holdings Limited is £4,000. There are three classes of shares. The Society holds 1,000,000 B shares of 0.1p each that have the right to participate in 25% of any profits available for distribution.

The issued share capital of Xchanging Claims Services Limited is £4,001. There are three classes of shares. The Society holds 1,000 A shares of £1 each and 2,001 C shares of £1 each. The A and C shares have the following rights with respect to dividends:

(a) The C shares carry a right to a fixed cumulative preference dividend of 5% calculated on the nominal capital and a variable participating dividend calculated by reference to trading profits.

(b) The A shares participate in 50% of any profits available for distribution after taking account of the dividend rights outlined above.

The Society entered into a joint venture agreement with three Lloyd's Market associations namely International Underwriting Association; London and International Brokers' Association; and Lloyd's Market Association for an equal participation in The Message Exchange Limited (TMEL) which was incorporated on 27 August 2010.

TMEL operates The Exchange – a simple messaging hub provided to the London insurance market to support its efforts to extend the use of electronic processing of business. As a 31 December 2011, net assets of TMEL have no material impact on the Society accounts.

12. INVESTMENTS

A. INVESTMENTS IN ASSOCIATES

	2011 Goodwill £000	2011 Share of other net assets £000	2011 Total £000	2010 Total £000
At 1 January	**861**	**5,464**	**6,325**	6,303
Share of operating profits	**–**	**6,712**	**6,712**	7,003
Share of interest income	**–**	**66**	**66**	66
Share of tax on profit on ordinary activities	**–**	**(1,851)**	**(1,851)**	(1,985)
Total share of profits of associates	**–**	**4,927**	**4,927**	5,084
Share of actuarial (loss)/gain on pension liability	**–**	**(1,273)**	**(1,273)**	250
Share of tax on items taken directly to equity	**–**	**337**	**337**	(67)
Dividends received	**–**	**(5,096)**	**(5,096)**	(5,245)
At 31 December	**861**	**4,359**	**5,220**	6,325

Summary financial information for associates – 100%:

	Assets £000	Liabilities £000	Revenues £000	Profit after tax £000
2011				
Ins-sure Holdings Limited	**28,162**	**(18,540)**	**73,809**	**10,485**
Xchanging Claims Services Limited	**17,386**	**(11,754)**	**43,677**	**5,445**
	45,548	**(30,294)**	**117,486**	**15,930**
2010				
Ins-sure Holdings Limited	30,227	(17,588)	72,320	10,139
Xchanging Claims Services Limited	18,596	(12,265)	42,617	5,959
	48,823	(29,853)	114,937	16,098

B. LLOYD'S COLLECTION

The Lloyd's Collection represents various paintings, antiques and artefacts. The collection was valued at £12.0m by Gurr Johns Limited, valuers and fine art consultants in November 2009, on the basis of open market auction value assuming all items are not sold at the same time taking into account the nature, age, condition and quality of each chattel. This resulted in a revaluation gain of £1.2m in 2009. In 2011 and 2010 it has been assessed that there is no change in valuation.

NOTES TO THE FINANCIAL STATEMENTS CONTINUED

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13. INSURANCE ACTIVITIES

For insurance contracts, claims provisions (comprising provisions for claims reported by policyholders and claims incurred but not reported) are established to cover the ultimate cost of settling the liabilities in respect of claims that have occurred and are estimated based on known facts at the reporting date. Outstanding claims provisions are not discounted for the time value of money.

	2011 £000	2010 £000
Insurance claims		
Gross claims:		
Claims paid	**(13,762)**	(3,637)
Change in provisions for claims	**36,479**	15,239
	22,717	11,602
Claims recoverable from reinsurers:		
Claims recovered from reinsurers	**13,002**	4,650
Change in reinsurance contract assets	**(11,510)**	214
	1,492	4,864

CENTREWRITE LIMITED

Centrewrite Limited's principal activities in 2011 were to underwrite the Lloyd's Members' Estate Protection Plan, to reinsure individual members of Lloyd's participations on syndicates for underwriting years of account which have not been closed and to provide reinsurance to close to syndicates with no successor syndicate.

Centrewrite has a structured approach to pricing, which is approved by the Centrewrite board in respect of the insurance contracts it underwrites. For reinsurance to close contracts, prior to the contract being quoted Centrewrite considers and does actuarial analysis upon the underlying historical data in respect of the performance of the syndicate. This data includes that in respect of claims development, major claims outstanding, exposure to further claims development, future run-off costs and reinsurance cover. The reinsurance to close contracts mainly relate to liability and energy risks written between 1993 and 2001.

Centrewrite regularly monitors the performance of its business, including that in respect of outstanding claims exposure and reinsurance recoveries through a sub-committee of the Board.

Due to the uncertainty in the timing of large claims payments, Centrewrite invests in assets that can be readily realised to meet these liabilities as they fall due. Centrewrite regularly reviews the security of its reinsurance assets and makes provision for amounts which are not considered to be recoverable, based on default rates used by the Lloyd's market.

LLOYD'S INSURANCE COMPANY (CHINA) LIMITED

Lloyd's Insurance Company (China) Limited (LICCL) is a wholly owned subsidiary undertaking of the Society of Lloyd's. The company's principal activity during 2011 was the reinsurance of non-life business in the China insurance market and direct non-life insurance in the Shanghai municipality. Lloyd's syndicates participate in LICCL's reinsurance business by means of retrocession agreements which allow a 100% risk transfer.

Insurance contract liabilities may be analysed as follows:

	2011 Insurance contract liabilities £000	2011 Reinsurer's share of liabilities £000	2011 Net £000	2010 Insurance contract liabilities £000	2010 Reinsurer's share of liabilities £000	2010 Net £000
Provision for claims reported	**45,460**	**(34,194)**	**11,266**	59,087	(35,393)	23,694
Provision for IBNR claims	**(3,677)**	**1,300**	**(2,377)**	18,114	(8,237)	9,877
	41,783	**(32,894)**	**8,889**	77,201	(43,630)	33,571
Unearned premiums	**7,696**	**(7,678)**	**18**	4,544	(4,318)	226
Insurance contract liabilities	**49,479**	**(40,572)**	**8,907**	81,745	(47,948)	33,797

13. INSURANCE ACTIVITIES CONTINUED

The movement in provision for insurance claims can be analysed as follows:

	2011 Insurance contract liabilities £000	2011 Reinsurer's share of liabilities £000	2011 Net £000	2010 Insurance contract liabilities £000	2010 Reinsurer's share of liabilities £000	2010 Net £000
At 1 January	**77,201**	**(43,630)**	**33,571**	89,739	(42,230)	47,509
Claims released	**(22,717)**	**(1,492)**	**(24,209)**	(11,602)	(4,864)	(16,466)
Claims paid (see below)	**(13,762)**	**13,002**	**(760)**	(3,637)	4,650	1,013
Effect of exchange rates	**1,061**	**(774)**	**287**	2,701	(1,186)	1,515
At 31 December	**41,783**	**(32,894)**	**8,889**	77,201	(43,630)	33,571

Claims incurred consist of claims and claims handling expenses paid during the year, together with the movement in outstanding claims. Full provision is made, on the basis of available information, for the estimated ultimate cost of claims notified but not settled as at the date of the statement of financial position, after taking into account handling costs and settlement trends. A provision for claims incurred but not notified is also established as at that date on a statistical basis. The provision also reflects claims settlement expenses and anticipated reinsurance and other recoveries. The provision for outstanding claims is based on information available at the reporting date. Subsequent information and events may result in the ultimate liability being less than, or greater than, the amount provided. Any differences between the provision and subsequent settlements are dealt with in the group income statements of later years.

CLAIMS DEVELOPMENT TABLE

The table below shows the development of claims over a period of time on a gross basis. The claims development table shows the cumulative incurred claims, including both notified and IBNR claims for each successive year, together with cumulative claims at the current reporting date.

	2007 and prior £000	2008 £000	2009 £000	2010 £000	2011 £000	Total £000
At end of underwriting year	76,534	104,754	9,498	16,604	**21,367**	
One year later	75,135	93,896	8,909	18,259		
Two years later	71,080	77,095	2,744			
Three years later	70,718	41,331				
Four years later	64,032					
Current estimate of cumulative claims	64,032	41,331	2,744	18,259	**21,367**	
Cumulative payments to date	(62,284)	(25,835)	(1,671)	(12,831)	**(3,329)**	
Insurance contract liabilities	1,748	15,496	1,073	5,428	**18,038**	**41,783**

The incurred claims from 2008 include amounts relating to the reinsurance of members of Syndicate 535. The incurred claims from 2009 include amounts relating to the reinsurance of members of Syndicate 1204.

NOTES TO THE FINANCIAL STATEMENTS CONTINUED

as at 31 December 2011

14. LOANS RECOVERABLE

	2011 £000	2010 £000
At 1 January	**54,371**	54,614
Recoveries during the year	**(3,483)**	(1,913)
Fair value movements recognised during the year	**(4,932)**	1,670
At 31 December	**45,956**	54,371

None of the change in valuation of loans recoverable during 2011 or 2010 relates to changes in credit risk. The Society's loans recoverable are categorised as fair value Level 3 for disclosure purposes. All fair value movements are recognised as finance income or finance costs in the group income statement and relate solely to the revaluation of hardship and LFAA assets.

15. FINANCIAL INVESTMENTS

	Note	2011 £000	2010 £000
Statutory insurance deposits	15A	**361,817**	311,756
Other investments	15B	**2,322,468**	2,236,884
		2,684,285	2,548,640

A. STATUTORY INSURANCE DEPOSITS

	2011 Securities £000	2011 Deposits £000	2011 Total £000	2010 Total £000
Market value at 1 January	**146,416**	**165,340**	**311,756**	175,248
Additions at cost	**478,952**	**287,342**	**766,294**	547,235
Disposal proceeds	**(499,288)**	**(224,986)**	**(724,274)**	(430,158)
Surplus on the sale and revaluation of investments	**5,936**	**2,105**	**8,041**	19,431
Market value at 31 December	**132,016**	**229,801**	**361,817**	311,756

Analysis of securities at year end:	2011 Cost £000	2011 Valuation £000	2010 Cost £000	2010 Valuation £000
Government	**135,383**	**132,016**	136,468	144,700
Corporate securities (see below)	**–**	**–**	1,127	1,716
Market value at 31 December	**135,383**	**132,016**	137,595	146,416
Analysis of corporate securities:				
AAA		**–**		1,716
AA		**–**		–
		–		1,716

Finance is arranged by advances from syndicates in the Lloyd's market. These advances are renewed annually. By agreement with the lenders, investment returns earned on these assets are paid, in appropriate proportions, to the lenders. In this way, the Society avoids any risk arising from a mismatch between borrowing and lending terms. Book cost is stated at historical exchange rates, market value is quoted at year end exchange rates.

The provision of funds by members in respect of the establishment and maintenance of overseas deposits is a condition of permission to underwrite insurance business at Lloyd's.

15. FINANCIAL INVESTMENTS CONTINUED

B. OTHER INVESTMENTS

	2011 Corporation of Lloyd's £000	2011 Central Fund £000	2011 Insurance activities £000	2011 Total £000	2010 Total £000
Market value at 1 January	33,590	2,133,729	69,565	2,236,884	1,966,482
Additions at cost	–	2,808,764	166,713	2,975,477	3,689,857
(Decrease)/increase in short-term deposits	(20,269)	(6,726)	13	(26,982)	(23,661)
Disposal proceeds	–	(2,756,095)	(156,766)	(2,912,861)	(3,467,755)
Surplus on the sale and revaluation of investments	–	35,221	14,729	49,950	71,961
Market value at 31 December	13,321	2,214,893	94,254	2,322,468	2,236,884
Analysis of securities at year end:					
Listed securities					
Fixed interest:					
Government	–	982,036	75,954	1,057,990	673,658
Corporate securities	–	801,060	13,822	814,882	1,077,802
Emerging markets	–	46,172	–	46,172	30,612
High yield	–	39,280	–	39,280	40,878
	–	1,868,548	89,776	1,958,324	1,822,950
Equities:					
Global	–	152,068	–	152,068	209,060
Emerging markets	–	37,354	–	37,354	41,574
	–	189,422	–	189,422	250,634
Total listed securities	–	2,057,970	89,776	2,147,746	2,073,584
Unlisted securities					
Hedge funds	–	75,453	–	75,453	78,704
Commodities	–	41,655	–	41,655	–
Short-term deposits	13,321	19,815	4,478	37,614	64,596
Security deposits (see below)	–	20,000	–	20,000	20,000
Total unlisted securities	13,321	156,923	4,478	174,722	163,300
Market value	13,321	2,214,893	94,254	2,322,468	2,236,884
Analysis of corporate securities:					
AAA	–	319,972	7,899	327,871	599,530
AA	–	323,191	4,958	328,149	324,964
A	–	154,865	965	155,830	150,271
Other	–	3,032	–	3,032	3,037
	–	801,060	13,822	814,882	1,077,802

SECURITY DEPOSITS

Tutelle Limited

In 1996 the Council set aside, under a Lloyd's special account, £20m of the 'Old' Central Fund to secure the Society's obligations under staff indemnities and certain indemnities which have been given by Lloyd's to certain individuals and advisers in respect of the 'Reconstruction and Renewal' plan. These include members of the Reserve Group, directors and officers of Equitas, members of the Council, Lloyd's Regulatory Board, Lloyd's Market Board (the latter two boards ceased during 2002) and of their respective sub-committees and Corporation staff.

Unless and until there is any default under the security documentation, interest earned on the trust fund is paid to the 'Old' Central Fund. The security was deposited for an initial period of two years and the Council exercised its discretion to renew this in June 1998. The Council further amended the period of the deposit, in November 1998, so that the security could only be released if the Council was satisfied that there was no reasonable prospect of a claim being made under these indemnities. Tutelle's position is under biennial review and, having been reviewed in July 2010, will be reviewed again in July 2012. The security may continue for a period of up to 80 years. Any of the funds remaining after this period will be repaid to the 'Old' Central Fund.

NOTES TO THE FINANCIAL STATEMENTS CONTINUED

as at 31 December 2011

15. FINANCIAL INVESTMENTS CONTINUED

C. FAIR VALUE HIERARCHY

	Notes	2011 Level 1 £000	2011 Level 2 £000	2011 Level 3 £000	2011 Total £000
Financial investments at fair value through profit or loss					
Statutory insurance deposits	15A				
Listed securities		–	2,869	–	2,869
Unlisted securities		–	129,147	–	129,147
Deposits with credit institutions		–	229,801	–	229,801
Other investments	15B				
Listed securities		1,143,442	814,882	–	1,958,324
Equity investments		189,422	–	–	189,422
Unlisted securities		–	117,108	–	117,108
Deposits with credit institutions		57,614	–	–	57,614
Market value at 31 December		1,390,478	1,293,807	–	2,684,285

	Notes	2010 Level 1 £000	2010 Level 2 £000	2010 Level 3 £000	2010 Total £000
Financial investments at fair value through profit or loss					
Statutory insurance deposits	15A				
Listed securities		–	9,831	–	9,831
Unlisted securities		–	136,585	–	136,585
Deposits with credit institutions		–	165,340	–	165,340
Other investments	15B				
Listed securities		826,589	996,361	–	1,822,950
Equity investments		250,634	–	–	250,634
Unlisted securities		–	78,704	–	78,704
Deposits with credit institutions		84,596	–	–	84,596
Market value at 31 December		1,161,819	1,386,821	–	2,548,640

Level 1

Inputs to Level 1 fair values are quoted prices in active markets for identical assets. An active market is one in which transactions for the asset occur with sufficient frequency and volume to provide pricing information on an ongoing basis. Examples are listed debt securities in active markets, listed equities in active markets, listed deposits held with credit institutions in active markets.

Level 2

Inputs to Level 2 fair values are inputs other than quoted prices included within Level 1 that are observable for the asset, either directly (ie as prices) or indirectly (ie derived from prices) and fair value is determined through the use of models or other valuation methodologies. Level 2 inputs include; quoted prices for similar (ie not identical) assets in active markets, quoted prices for identical or similar assets in markets that are not active or in which little information is released publicly, unlisted deposits held with credit institutions in active markets, low volatility hedge funds where tradeable NAVs are published.

The fair value movements during the year are recognised as finance income or finance cost in the group income statement.

16. CASH AND CASH EQUIVALENTS

	2011 £000	2010 £000
Cash at banks	53,412	48,588
Short-term deposits	73,870	96,982
	127,282	145,570

Cash at banks earns interest at floating rates based on daily bank deposit rates. Short-term deposits are made for varying periods of between one day and three months, depending on the immediate cash requirements of the Society and earn interest at the respective short-term deposit rates. The fair value of cash and cash equivalents is £127.3m (2010: £145.6m).

17. SUBORDINATED NOTES AND PERPETUAL SUBORDINATED CAPITAL SECURITIES

	2011 £000	2010 £000
Details of loans payable wholly or partly after more than five years:		
6.875% subordinated notes of £300m maturing 17 November 2025	**300,000**	300,000
5.625% subordinated notes of €253m maturing 17 November 2024	**211,063**	216,507
7.421% perpetual subordinated capital securities of £392m redeemable on 21 June 2017	**392,013**	419,381
	903,076	935,888
Less issue costs to be charged in future years	**(3,880)**	(4,690)
Less discount on issue to be unwound in future years	**(780)**	(1,025)
	898,416	930,173

SUBORDINATED DEBT ISSUED IN 2004

The Sterling Notes mature on 17 November 2025, although the Society may redeem them on 17 November 2015 and 17 November 2020. In the event that the Society does not redeem the Sterling Notes on 17 November 2015, the rate of interest payable will be the rate per annum which is the aggregate of the Gross Redemption Yield on the relevant Benchmark Gilt (a UK government security having a maturity date on or nearest to the next reset date) plus a margin of 3.07%.

The Euro Notes mature on 17 November 2024, although the Society may redeem them on 17 November 2014 or on any interest payment date thereafter.

In the event that the Society does not redeem the Euro Notes on 17 November 2014, the rate of interest payable will be three month Euribor plus a margin of 2.72%.

The Notes are subordinated obligations of the Society. Each tranche of the Notes will rank pari passu with the other in a winding-up of the Society. Upon the occurrence of any winding-up proceedings of the Society, payments on the Notes will be subordinated in right of payment to the prior payment in full of all other liabilities of the Society, except for liabilities which rank equally with or junior to the Notes. Payments on the Notes will also be subordinated to certain payments which may be made out of central assets including payments made to discharge the liabilities of an insolvent member to any person (including any policyholders) arising out of or, in connection with insurance business carried on at Lloyd's by that insolvent member and payments made in respect of the costs required by or under any insolvency procedure to which the Society or the Lloyd's market may be subject. However, in the event of a winding-up of the Society, the claims of the holders of the Notes rank senior to the distribution of any central assets to members of Lloyd's generally (other than payments made to members in their capacity as senior creditors of the Society).

SUBORDINATED DEBT ISSUED IN 2007

The perpetual subordinated capital securities ('capital securities') are perpetual securities and have no fixed redemption date. However, they are redeemable in whole on 21 June 2017 at the option of the Society or on any interest payment date thereafter provided certain conditions have been met by the Society. The capital securities bear interest at a rate of 7.421% per annum until 20 June 2017, payable annually in arrears on 21 June in each year, and thereafter at a rate per annum reset semi-annually of 2.41% per annum above the London interbank offered rate for six-month sterling deposits, payable semi-annually in arrears on the interest payment dates falling on 21 June and 21 December in each year.

The capital securities are subordinated obligations of the Society. Upon the occurrence of any winding-up proceedings of the Society, the claims of the holders of the capital securities will rank junior to all other claims of creditors of the Society (including any creditor who is the holder of any of the Sterling or Euro Notes issued by the Society in 2004) except for those creditors having claims which rank equally with or junior to the claims of the holders of the capital securities. The claims of the holders of the capital securities will also rank junior to any payments made to discharge the liabilities of a member in connection with insurance business carried on at Lloyd's by that member and also to the claims of any person in respect of whom a New Central Fund undertaking has been made. However, in the event of a winding-up of the Society, the claims of the holders of the capital securities rank senior to the distribution of any central assets to members of Lloyd's generally (other than payments made to members in their capacity as senior creditors of the Society).

Subordinated debt repurchases

During 2011, the Society of Lloyd's repurchased a principal amount of £27,368,000 of its 2007 perpetual subordinated capital securities at a cost of £23,120,000. The Society additionally paid accrued interest on the purchased securities. The profit on the repurchase was £4,248,000.

During 2010, The Society of Lloyd's repurchased £20,988,000 of its outstanding debt securities at a cost of £19,518,000. The Society additionally paid accrued interest on the purchased securities. The profit on the repurchase was £1,469,800.

NOTES TO THE FINANCIAL STATEMENTS CONTINUED

as at 31 December 2011

18. PENSION SCHEMES

The Society operates a number of defined benefit and defined contribution pension schemes. The principal scheme is the Lloyd's Pension Scheme which is a defined benefit scheme. Other schemes have been established for certain employees based overseas.

These schemes are generally funded by the payment of contributions to separately administered funds.

DEFINED BENEFIT PLANS

The pension surplus/(deficits) of the schemes at 31 December 2011 are as follows:

	2011 £000	2010 £000
Schemes in surplus:		
Lloyd's Pension Scheme	–	25,913
Overseas pension schemes	9	82
	9	25,995
Schemes in deficit:		
Lloyd's Pension Scheme	(23,679)	–
Overseas pension schemes	(1,337)	(858)
	(25,016)	(858)

The amounts charged to the group income statement and group statement of comprehensive income, in respect of defined benefit plans are as follows:

	2011 £000	2010 £000
Group income statement:		
Lloyd's Pension Scheme	24,511	4,941
Overseas pension schemes	1,584	901
	26,095	5,842
Group statement of comprehensive income:		
Lloyd's Pension Scheme	56,671	1,271
Overseas pension schemes	216	71
	56,887	1,342

Lloyd's Pension Scheme

The Lloyd's Pension Scheme is a defined benefit pension scheme with assets held in a separately administered fund. For the purposes of determining the funding position of the scheme and future contributions, a formal actuarial valuation of the scheme was carried out by Towers Watson, actuaries and consultants, as at 30 June 2010 using the projected unit credit method. The principal actuarial assumptions adopted in the valuation were:

- Assumed future price inflation of 3.5% per annum.
- Pensions would increase in payment at 3.5% per annum (relating to benefits accrued between 6 April 1997 and 5 April 2005) or 2.5% per annum (benefits accrued post 5 April 2005).
- Total pensionable remuneration would increase by 4.5% per annum.
- The rate of return on investments held at the valuation date and on future contributions receivable after the valuation date was assumed to be 6.8% per annum for periods before benefits come into payment and 4.7% per annum for periods after benefits come into payment.
- Mortality assumptions were based on 110% of SAPS light tables for males/105% SAPS light tables for females, with allowance for future improvements in line with CMI 2009 core projects with a trend improvement of 1.5% per annum.
- An allowance was made for commutation at retirement, assuming 20% of member pension commuted at retirement, on terms mid-way between current actual terms and 'cost neutral' on TP basis.

The next formal actuarial valuation will be carried out as at 30 June 2013.

The total market value of the scheme's assets at the date of valuation was £418m, and the total value of accrued liabilities was £488.3m showing a shortfall of £70.3m. These figures exclude both liabilities and the related assets in respect of money purchase AVCs. To eliminate the funding shortfall, the Trustees have agreed a Recovery Plan with Lloyd's. Lloyd's paid additional contributions of £45m to the Scheme in December 2010, and will make fixed additional monthly contributions from July 2014 to June 2020 inclusive to eliminate the remaining deficit.

18. PENSION SCHEME CONTINUED

DEFINED BENEFIT PLANS CONTINUED

No allowance was made for discretionary increases to pre 6 April 1997 benefits when in payment. In 2003, the Society instructed Towers Watson not to allow for such increases in calculating the scheme's liabilities for future actuarial valuations. Such increases have always been payable at the discretion of the Society and will continue to be considered on the basis of affordability, but are not taken into account by the actuary in determining the funding level.

In recent years, in order to mitigate exposure to pension scheme liabilities several changes have been made to the Lloyd's Pension Scheme. From February 2005 the senior management section of the scheme was closed to new entrants and the normal retirement age for joiners was increased from 60 to 65. The final salary scheme was closed to new joiners at the end of June 2006. New entrants from July 2006 have been eligible to join the Lloyd's Pension Scheme but accrue benefits on an 80ths career average basis and are contracted-in to the State Second Pension.

Employee contributions at 5%, or 10% for members of the senior management section, of pensionable earnings up to the Scheme earnings cap where applicable, have been introduced from July 2006. Normally, instead of making an employee contribution, employees make a salary sacrifice of the appropriate percentage of their salary and Lloyd's make an additional employer contribution of the same amount. Following the 2010 actuarial valuation employer contributions as a percentage of basic salaries are 21.7% for pre-February 2005 final salary members, 12.9% for post-January 2005 entrants and 6.5% for members accruing benefits on a career average basis.

Principal actuarial assumptions in respect of IAS 19

The demographic assumptions which are the most financially significant are those relating to the longevity of retired members. The assumptions for the purposes of the IAS 19 valuation as at 31 December 2010 are as applied in the triennial actuarial valuation as at 30 June 2010.

These assumptions are equivalent to expected longevity at age 60 approximately as follows:

> For pensioners currently aged 60: ranging from 28 years to 30 years (2010: 28 years to 30 years).
> For non-pensioners currently aged 45: ranging from 30 years to 32 years (2010: 30 years to 32 years).

The other major financial assumptions used by the actuary as at 31 December 2011 for the purposes of IAS 19 were:

	2011 % per annum	2010 % per annum	2009 % per annum	2008 % per annum	2007 % per annum
General salary and wage inflation	**4.1%**	4.5%	4.6%	4.9%	5.2%
Rate of increase in pensions in payment					
pre 6 April 1997 (in excess of GMP's)	**–**	–	–	–	–
6 April 1997 to 5 April 2005	**3.1%**	3.5%	3.6%	3.0%	3.4%
post 5 April 2005	**2.5%**	2.5%	2.5%	2.5%	2.5%
Increases to deferred pensions	**2.1%**	3.0%	3.6%	3.0%	3.4%
Discount rate	**4.9%**	5.5%	5.7%	6.4%	5.9%
Price inflation	**2.1%**	3.0%	3.6%	3.0%	3.4%
Expected rate of return					
Bonds	**4.4%**	5.0%	5.1%	5.8%	5.2%
Equities	**7.1%**	8.0%	8.1%	8.1%	8.1%

An allowance is made for members commuting 20% (2010: 20%) of their pension on retirement.

The expected rate of return on assets is determined based on market prices prevailing on the valuation date, applicable to the period over which the obligation is to be settled.

SENSITIVITY OF PENSION OBLIGATION TO CHANGES IN ASSUMPTIONS

The actuarial valuation of liabilities under IAS 19 is particularly sensitive to changes in market conditions, which determine the rate at which pension liabilities are discounted.

A change of 0.1% pa in the discount rate as at 31 December 2011 would result in a change to the pension liabilities at that date of around 2%, or approximately £10m.

A change in the mortality assumptions could have a significant impact on the pension liability. For instance, use of the core projection model with 2% p.a. long-term improvement for future mortality improvements could add around another 2% to the balance sheet liabilities.

NOTES TO THE FINANCIAL STATEMENTS CONTINUED

as at 31 December 2011

18. PENSION SCHEMES CONTINUED

SENSITIVITY OF PENSION OBLIGATION TO CHANGES IN ASSUMPTIONS CONTINUED

Amounts for the current and previous years were:

Asset/(liability) analysis of the scheme	2011 Fair value £000	2010 Fair value £000	2009 Fair value £000	2008 Fair value £000	2007 Fair value £000
Bonds	**181,293**	161,806	147,066	127,304	162,611
Equities	**251,898**	292,533	268,347	198,037	238,734
Property	**66,555**	15,368	–	–	–
Cash and net current assets	**38,727**	46,249	20,195	22,306	22,569
Total market value of assets	**538,473**	515,956	435,608	347,647	423,914
Actuarial value of scheme liabilities	**(562,152)**	(490,043)	(456,899)	(379,632)	(407,414)
(Deficit)/surplus in the scheme	**(23,679)**	25,913	(21,291)	(31,985)	16,500

Changes in the present value of the defined benefit obligations are:

	2011 £000	2010 £000
Actuarial value of scheme liabilities at 1 January	**490,043**	456,899
Interest cost on pension scheme liabilities	**26,718**	25,536
Current service cost (net of employee contributions)	**6,291**	5,489
Past service cost	**30,233**	–
Employee contributions	**2,700**	2,346
Benefits paid	**(18,724)**	(18,213)
Experience losses arising in scheme liabilities	**4,852**	2,249
Change in assumptions underlying the present value of the scheme liabilities	**20,039**	15,737
Actuarial value of scheme liabilities at 31 December	**562,152**	490,043

Changes in fair value of plan assets were:

	2011 £000	2010 £000
Fair value of scheme assets at 1 January	**515,956**	435,608
Expected return on pension scheme assets	**35,031**	29,784
Employer contributions		
normal	**4,790**	4,716
special	**30,500**	45,000
Employee contributions	**2,700**	2,346
Benefits paid	**(18,272)**	(17,781)
Actuarial (loss)/gain on scheme assets	**(31,780)**	16,715
Administrative expenses	**(452)**	(432)
Fair value of scheme assets at 31 December	**538,473**	515,956

The special contribution of £30.5m was made to the pension scheme to meet future discretionary increases, the contribution in 2010 was made to improve the funding position. The Society expects to contribute approximately £4.8m in normal contributions to the pension scheme in 2012.

18. PENSION SCHEMES CONTINUED

ANALYSIS OF THE AMOUNT RECOGNISED IN THE GROUP STATEMENT OF COMPREHENSIVE INCOME

	2011 £000	2010 £000
Actual return on pension scheme assets	**3,251**	46,499
Less expected return on pension scheme assets	**(35,031)**	(29,784)
Actual return less expected return on pension scheme assets	**(31,780)**	16,715
Experience losses arising on scheme liabilities	**(4,852)**	(2,249)
Changes in the assumptions underlying the present value of the scheme liabilities	**(20,039)**	(15,737)
Actuarial loss recognised in the group statement of comprehensive income	**(56,671)**	(1,271)

The cumulative actuarial loss recognised in the group statement of comprehensive income since 1 January 2004 is £89.0m (2010: £32.3m actuarial loss).

ANALYSIS OF THE AMOUNT CHARGED TO THE GROUP INCOME STATEMENT (RECOGNISED IN OTHER GROUP OPERATING EXPENSES)

	2011 £000	2010 £000
Current service cost	**6,291**	5,489
Past service accrual	**26,533**	3,700
Expected return on pension scheme assets	**(35,031)**	(29,784)
Interest on pension scheme liabilities	**26,718**	25,536
Total operating charge	**24,511**	4,941

The Society recognises the cost of discretionary increases to pre 6 April 1997 benefits in payment when there is a constructive liability to make such increases. In 2007 the Society provided £10.0m to meet future discretionary increases, this amount has been notionally segregated from the scheme's other assets (the 'notional fund') and its investment performance will be tracked on the assumption that it is invested in the same way as the scheme's other assets. The notional fund will be used to facilitate the award of future discretionary pension increases when the Society carries out its annual review of pensions in accordance with the Scheme's Definitive Trust Deed. As long as there is a notional fund set aside for this purpose, discretionary increases will continue to be made. Past service costs of £26.5m represent the costs of an increase for 2012 of £6.5m and a further £20.0m to meet future discretionary increases which was paid into the notional fund in December 2011. As at 31 December 2011 the value of the notional fund was £31.2m.

The measurement bases set by IAS 19 are likely to give rise to significant fluctuations to the scheme's assets and liabilities. However, this may not necessarily require changes to the contribution rate, as recommended by the independent actuary, which is based on expected long-term rates of return.

HISTORY OF EXPERIENCE GAINS AND LOSSES

	2011 £000	2010 £000	2009 £000	2008 £000	2007 £000
Difference between the expected and actual return on scheme assets:					
Amount	**31,780**	16,715	54,517	(116,429)	5,744
Percentage of scheme assets	**5.9%**	3.2%	12.5%	(33.5%)	1.4%
Experience (losses)/gains on scheme liabilities:					
Amount	**(4,852)**	(2,249)	3,850	(2,170)	(12,070)
Percentage of the present value of the scheme liabilities	**(0.9%)**	(0.5%)	0.8%	(0.6%)	(3.0%)
Total amount recognised in the group statement of comprehensive income:					
Amount	**(56,671)**	(1,271)	(10,552)	(67,855)	52,452
Percentage of the present value of the scheme liabilities	**(10.1%)**	(0.3%)	(2.3%)	(17.9%)	12.9%

NOTES TO THE FINANCIAL STATEMENTS CONTINUED

as at 31 December 2011

18. PENSION SCHEMES CONTINUED

Overseas pension schemes

The Society operates a number of defined benefit plans for qualifying employees based overseas. The actuarial valuations of these pension schemes at 31 December 2011 was a deficit of £1.3m (2010: £0.8m). The total expense recognised in other operating expenses of £0.3m (2010: £0.1m) represents the related current service cost of these schemes. An actuarial loss of £0.2m has been recognised in the group statement of comprehensive income (2010: actuarial loss of £0.07m).

Defined contribution plans

The Society operates a number of defined contribution retirement benefit plans for qualifying employees based overseas. The assets of the plans are held separately from those of the Society in funds under the control of the trustees.

In some countries, employees are members of state-managed retirement benefit plans. The Society is required to contribute a specified percentage of payroll costs to fund these benefits. The only obligation of the Society with respect to the retirement benefit plan is to make the specified contributions.

The total expense recognised in the group income statement of £0.3m (2010: £0.1m) represents contributions payable to these plans by the Society at rates specified in the rules of these plans.

19. PROVISIONS

	2011 Undertakings given to insolvent members £000	2011 Limited Financial Assistance Agreements £000	2011 Income support schemes £000	2011 Lloyd's performance plan £000	2011 Restructuring £000	2011 Total £000	2010 Total £000
Balance at 1 January	**9,060**	**283**	**4,612**	**7,350**	**–**	**21,305**	82,172
Charged in the year	**15,515**	**(236)**	**–**	**357**	**6,644**	**22,280**	(29,729)
Utilised in the year	**(16,910)**	**–**	**(367)**	**(5,848)**	**–**	**(23,125)**	(31,138)
Balance at 31 December	**7,665**	**47**	**4,245**	**1,859**	**6,644**	**20,460**	21,305

PROVISION FOR UNDERTAKINGS GIVEN TO INSOLVENT MEMBERS

The Council has given undertakings with financial limits to certain corporate members to use the New Central Fund to discharge the liability of those members where they have unpaid cash calls and do not have the resources to meet those cash calls.

The purpose of these undertakings is primarily to allow valid claims made on policies underwritten by those insolvent members to continue to be paid in full. For those corporate members in provisional liquidation, the Council has also provided a supporting commitment, which will ensure that in no circumstance will an insurance creditor receive less than the amount it would have received in a winding-up commencing on the date of the provisional liquidation.

	Note	2011 £000	2011 £000	2010 £000	2010 £000
Provisions for amounts payable at 1 January			**9,060**		45,310
Undertakings granted/(released) in the year	4		**15,515**		(34,818)
Analysis of paid undertakings by member:					
Flectat Limited		**(7,450)**		–	
Kite Dedicated Capital Limited (formerly Goshawk Dedicated (No 2) Limited)		**(9,456)**		(355)	
Margent Capital Management		**–**		(1)	
Standfast		**–**		(1,010)	
Other corporate members		**(4)**		(66)	
Paid during the year			**(16,910)**		(1,432)
Undertakings given to insolvent members at 31 December			**7,665**		9,060

The cumulative aggregate amount of all undertakings (excluding the supporting commitments) given by the Council at 31 December 2011 was £1.2bn of which £0.4bn has been recognised as recoveries by that date resulting in a net cost to the Central Fund of £0.8bn.

19. PROVISIONS CONTINUED

LIMITED FINANCIAL ASSISTANCE AGREEMENTS (LFAAs)

The first LFAAs were provided to individual members in 2005 to meet their outstanding underwriting liabilities. Further LFAAs were provided in 2010. Assistance is provided to individuals who are reliant on their funds at Lloyd's (FAL) either because it is in the form of a bank guarantee secured on their sole residence or because they are reliant on the income generated by their FAL. All costs are funded by the New Central Fund.

INCOME SUPPORT SCHEMES

Hardship income top-up scheme

The Hardship Scheme was created in 1989 to assist individual members who had reduced means as a result of high underwriting losses. Members in the Scheme are eligible to receive ex-gratia top-up income payments from Lloyd's by virtue of having a Hardship Trust Fund (HTF) or having been awarded litigation recoveries used in 'Reconstruction and Renewal' to pay Equitas premiums. The Hardship Scheme is permanent and non-discretionary, but the granting of Hardship Income Top-up payments is at Lloyd's discretion. All costs are currently funded by the 'Old' Central Fund.

Income and Housing Support Scheme (IHSS Scheme)

The IHSS Scheme was established in 1996 to provide financial assistance to individual members who accepted the 'Reconstruction and Renewal' Settlement offer, to ensure that their housing and income requirements were maintained at a reasonable level. The payments under the scheme are discretionary and are currently funded by the 'Old' Central Fund.

Income Assistance Scheme

The Income Assistance Scheme is effective from 1 January 2010 and replaces both the Hardship Income Top-up payments and the IHSS. The Income Assistance Scheme is permanent, replacing the discretionary nature of the previous schemes, and guarantees ongoing payment other than in the event that Lloyd's faces severe financial stress.

LLOYD'S PERFORMANCE PLAN (LPP)

The Society introduced a performance plan for all employees, effective from 1 January 2008 that is related to the results of the Lloyd's market. Details of the plan and the transitional arrangements for executive directors and senior employees are outlined in the report of the Remuneration Committee on pages 81 to 88. Included within the charge for the year and provision utilised are National Insurance contributions of £0.5m (2010: £0.8m).

RESTRUCTURING PROVISIONS

The provision is mainly in respect of obligations towards former employees arising from the restructuring programme.

20. TRADE AND OTHER PAYABLES

	2011 £000	2010 £000
Due within one year:		
Trade and other creditors	**115,523**	52,270
Members' subscriptions and contributions repayable	**47,290**	37,104
Taxation and social security	**2,361**	2,559
Arbitration awards	**3,567**	3,446
Interest payable on subordinated loan notes	**19,587**	20,700
	188,328	116,079

NOTES TO THE FINANCIAL STATEMENTS
CONTINUED
as at 31 December 2011

21. FINANCIAL INSTRUMENTS
Explanations of the Society's financial instrument risk management objectives, policies and strategies are set out in the discussion of the Society's financial risk management and treasury policies on pages 95 and 96 of the Financial Review.

FAIR VALUES AND CREDIT RISK
The methods and assumptions used in estimating the fair value of financial instruments are detailed in note 2F on pages 105 and 106.

The fair value (based on the quoted offer prices) of subordinated debt is £839.5m (2010: £926.0m) against a carrying value measured at amortised cost of £898.4m (2010: £930.2m). All other financial instruments are either held at fair value or at an amount that approximates fair value.

At the reporting date there were no significant concentrations of credit risk. The maximum exposure to credit risk is represented by the carrying value of each financial asset, including derivative financial instruments, in the group statement of financial position. Exposures under guarantees entered into by the Society are detailed in note 25.

IMPAIRMENT LOSSES
Trade receivables
The ageing of trade receivables as at 31 December 2011 was as follows:

	2011 Gross £000	2011 Impairment £000	2011 Net £000	2010 Gross £000	2010 Impairment £000	2010 Net £000
Not past due	**164**	**–**	**164**	17,164	–	17,164
Past due 31-120 days	**393**	**–**	**393**	1,533	–	1,533
More than 120 days	**582**	**(487)**	**95**	738	(630)	108
Total	**1,139**	**(487)**	**652**	19,435	(630)	18,805

Trade receivables of £0.7m (net of allowance for impairment of £0.5m) are included within trade and other receivables in the balance sheet.

The Society's normal credit terms are 30 days. Receivables of more than 120 days represent amounts due from members no longer underwriting in respect of Society charges.

The movement in the allowance for impairment in respect of trade receivables during the year was as follows:

	2011 £000	2010 £000
Balance at 1 January	**630**	828
Additional allowances during the year charged to the group income statement	**52**	136
Allowances released during the year credited to the group income statement	**–**	(54)
Recoveries during the year	**(195)**	(280)
Balance at 31 December	**487**	630

SENSITIVITY ANALYSIS
Foreign currency exposure
Currency risk is the risk that the sterling value of the Society's assets and liabilities will fluctuate due to changes in foreign exchange rates. The Society's exposure to the risk of changes in the foreign exchange rates relates primarily to retranslating foreign currency subordinated notes, revaluation of loans recoverable and changes in the fair value of foreign currency denominated investments and forward contracts.

SENSITIVITY ANALYSIS
Debt securities sensitivities
The value of the Society's investments in debt securities is affected by changes in the level of yields, as determined by the financial markets.

As at 31 December 2011, a consistent increase of 100 basis points in the yields applicable to all relevant securities would have reduced the surplus before tax by approximately £69m (2010: £52m). This analysis assumes that all other variables, in particular foreign currency exchange rates, remain constant. In practice, actual results may differ.

Equity price risk
Equity price risk is the risk that the market values of equity investments fall. At 31 December 2011, a 15% fall in the value of all the Society's equity investments would have reduced the surplus before tax by approximately £28m (2010: £37m). This analysis assumes that all other variables, in particular foreign currency exchange rates, remain constant. In practice, actual results may differ.

21. FINANCIAL INSTRUMENTS CONTINUED

LIQUIDITY RISK

The table below summarises the maturity profile of the Society's non-derivative financial liabilities as at 31 December 2011 based on undiscounted contractual cash flows:

As at 31 December 2011	Carrying amount £000	Contractual cash flows £000	Within 1 year £000	1-2 years £000	2-5 years £000	More than 5 years £000
Subordinated loan notes	**508,860**	**(954,153)**	**(32,497)**	**(32,497)**	**(97,492)**	**(791,667)**
Perpetual subordinated capital securities	**389,556**	**(566,561)**	**(29,091)**	**(29,091)**	**(87,274)**	**(421,105)**
Loans funding statutory insurance deposits	**352,318**	**(352,318)**	**(352,318)**	**–**	**–**	**–**
Trade and other payables	**188,328**	**(188,328)**	**(188,328)**	**–**	**–**	**–**
	1,439,062	**(2,061,360)**	**(602,234)**	**(61,588)**	**(184,766)**	**(1,212,772)**

As at 31 December 2010	Carrying amount £000	Contractual cash flows £000	Within 1 year £000	1-2 years £000	2-5 years £000	More than 5 years £000
Subordinated loan notes	513,698	(996,381)	(32,804)	(32,804)	(98,410)	(832,363)
Perpetual subordinated capital securities	416,475	(637,237)	(31,122)	(31,122)	(93,367)	(481,626)
Loans funding statutory insurance deposits	305,805	(305,805)	(305,805)	–	–	–
Trade and other payables	116,079	(116,079)	(116,079)	–	–	–
	1,352,057	(2,055,502)	(485,810)	(63,926)	(191,777)	(1,313,989)

Forward currency contracts are settled gross; notional amounts are a close proxy for gross cash flow amounts. Further details regarding the subordinated loan notes and the perpetual subordinated capital securities can be found in note 17 on page 125. Information regarding financial guarantees, all of which could theoretically be called on within one year, can be found in note 25 on page 135.

DERIVATIVE FINANCIAL INSTRUMENTS

The Society enters into forward currency contracts to manage exposures to fluctuation of exchange rates and to provide a service to the Lloyd's market. The Society's derivative financial instruments are categorised as fair value Level 2 for disclosure purposes.

Analysis of forward currency contracts:	2011 £000	2010 £000
Outstanding forward foreign exchange gains	**45,255**	9,746
Outstanding forward foreign exchange losses	**(56,639)**	(24,170)

The fair value and notional amounts of forward currency contracts, all of which mature within one year, are analysed as follows:

	2011 Assets		2011 Liabilities	
As at 31 December 2011	Fair value £000	Notional £000	Fair value £000	Notional £000
Currency Conversion Service (CCS)	**18,434**	**276,773**	**(19,528)**	**(278,258)**
Other forward foreign exchange contracts	**26,821**	**1,621,307**	**(37,111)**	**(1,620,972)**
	45,255	**1,898,080**	**(56,639)**	**(1,899,230)**

	2010 Assets		2010 Liabilities	
As at 31 December 2010	Fair value £000	Notional £000	Fair value £000	Notional £000
Currency Conversion Service (CCS)	5,742	213,750	(5,622)	(213,902)
Other forward foreign exchange contracts	4,004	1,007,053	(18,548)	(1,021,596)
	9,746	1,220,803	(24,170)	(1,235,498)

NOTES TO THE FINANCIAL STATEMENTS CONTINUED

as at 31 December 2011

22. EQUITY

ACCUMULATED RESERVES

	2011 £000	2010 £000
Attributable to:		
Corporation of Lloyd's and non-insurance related subsidiary undertakings	**33,357**	84,270
Central Fund	**1,361,110**	1,281,070
Insurance related subsidiary undertakings	**78,053**	62,922
Associates	**5,220**	6,325
	1,477,740	1,434,587

REVALUATION RESERVE

The revaluation reserve is used to record increases in the fair value of the Lloyd's Collection and decreases to the extent that such decreases relate to the amount previously recognised in the group statement of comprehensive income.

23. COMMITMENTS

A. CAPITAL EXPENDITURE COMMITMENTS

Capital expenditure commitments contracted but not provided in the accounts totalled £3,536,000 (2010: £1,132,000).

B. OPERATING LEASE COMMITMENTS

	2011 £000	2010 £000
Non-cancellable operating lease rentals are payable as follows:		
Within one year	**25,797**	24,595
After one year but not more than five years	**87,529**	75,416
More than five years	**88,698**	105,458

Commitments outstanding under the terms of the lease for the Lloyd's 1986 building have been included at the current rental value (£16.8m per annum) to the first break of the lease in 2021. The lease was subject to a rent review in March 2006, a rent review is currently underway. The Lloyd's Chatham building is included at the current rental value (£0.4m per annum) to the first break in the lease in 2016. A rent review is currently underway.

Subsidiary undertakings are party to a number of small operating leases mainly for property rental and small machinery. The commitments outstanding have been included at the current rental value to the first break in the lease. These arrangements do not impose any significant restrictions on the Society.

During the year ended 31 December 2011, £24.5m (2010: £24.3m) was recognised as an expense in the group income statement in respect of operating leases.

24. DISCLOSURE OF RELATED PARTY TRANSACTIONS

The group financial statements include the financial statements of the Society and all of its subsidiary undertakings, the Lloyd's Central Fund and the group's interests in its associates and joint venture as listed in note 11.

Services provided to Ins-sure Holdings Limited group in the year ended 31 December 2011 included operating systems support and development, premises and other administrative services. The total value of the services provided was £293,000 (2010: £274,000). In addition, Ins-sure Holdings Limited group charged the Society £922,000 for services provided in the same year (2010: £1,063,000).

At 31 December 2011, there was a balance of £21,000 (2010: £24,000) owing from Ins-sure Holdings Limited group to the Society.

Services provided to Xchanging Claims Services Limited group in the year ended 31 December 2011 included premises and other administrative services.

The total value of the services provided was £74,000 (2010: £76,000).

At 31 December 2011, there was a balance of £8,000 (2010: £3,000) owing from Xchanging Claims Services Limited group to the Society. In addition, Xchanging Claims Services Limited group have charged the Society £307,000 for services provided in the same year (2010: £223,000).

The Message Exchange Limited have charged the Society £541,000 for services provided in the year ended 31 December 2011 (2010: £nil).

At 31 December 2011, there was a balance of £35,000 (2010: £nil) owing from the Society to The Message Exchange Limited.

Transactions with associates and joint venture arrangements are priced on an arm's-length basis.

A member of Council, Rupert Atkin, is also a Director of Shrewsbury Underwriting Capital (Bermuda) Limited and Shrewsbury Underwriting Capital Limited. During the period the Society received no other income relating to undertakings previously paid out in respect of these companies (2010: £188m).

In the normal course of business, the Society may enter into transactions with Lloyd's market businesses in which members of Council and the Franchise Board may have an interest. Such transactions are on an arm's-length basis.

25. CONTINGENT LIABILITIES

(a) General average guarantees have been given on behalf of, and secured by, Lloyd's underwriters. It is estimated that the aggregate of the liabilities attaching to these guarantees at 31 December 2011 amounted to £24.3m (31 December 2010: £24.9m).

(b) The Society has taken on the responsibilities of some individual members under hardship and other agreements.

In connection with the statutory transfer to Equitas Insurance Limited on 30 June 2009 of the non-life business underwritten at Lloyd's and allocated to 1992 or prior years of account, the Society has entered into undertakings for the benefit of certain policyholders of Equitas Insurance Limited (former policyholders of PCW syndicates or of members who at the material time still have the benefit of hardship or other agreements with the Society), under which the Society would meet any shortfall in recoveries by such policyholders from Equitas Insurance Limited on the occurrence of an 'Equitas Insolvency Event'.

The Society has also given an unlimited undertaking to its subsidiary undertaking Centrewrite Limited to meet any shortfall in its cashflow or assets (including any shortfall arising from an insufficiency of recoveries from Equitas Reinsurance Limited under its reinsurance of the obligations of Centrewrite to Equitas Insurance Limited).

(c) Uncollateralised bank guarantees and other arrangements have been entered into by the Society to provide security in connection with the underwriting activities of the members of Lloyd's in the countries shown:

	2011 £000	2010 £000
Guarantees provided by the Society:		
USA: US$1,500,000 (2010: US$1,500,000)	**965**	958

In respect of all contingent liabilities disclosed as at 31 December 2011, no provision has been made in the Society financial statements.

FIVE YEAR SUMMARY

	2011 £000	2010 £000	2009 £000	2008 £000	2007 £000
Operating income	**215,085**	210,193	195,043	177,542	177,853
Central Fund contributions	**94,693**	100,858	99,687	84,294	168,346
General insurance net premium income	**523**	1,463	6,992	37,937	2,046
Other group income	**6,598**	215,822	52,048	32,397	81,478
Total income	**316,899**	528,336	353,770	332,170	429,723
Central Fund claims and provisions (incurred)/released	**(15,283)**	34,245	19,586	6,349	18,208
Contribution to Equitas – Berkshire Hathaway transaction	**–**	–	–	–	(90,000)
Gross insurance claims released/(incurred)	**22,717**	11,602	(6,714)	(77,314)	16,330
Insurance claims recoverable from/(payable to) reinsurers	**1,492**	4,864	302	42,806	(17,041)
Other group operating expenses:					
Employment (including pension costs)	**(116,415)**	(92,464)	(92,030)	(86,491)	(82,752)
Premises	**(44,009)**	(42,755)	(39,056)	(36,637)	(35,371)
Legal and professional	**(19,707)**	(18,835)	(19,089)	(16,944)	(16,580)
Systems and communications	**(27,965)**	(27,920)	(21,936)	(21,267)	(19,293)
Other	**(40,486)**	(32,509)	(67,951)	(26,364)	(33,827)
Total other group operating expenses	**(248,582)**	(214,483)	(240,062)	(187,703)	(187,823)
Surplus before finance, associates and tax	**77,243**	364,564	126,882	116,308	169,397
Finance costs	**(64,370)**	(66,143)	(69,345)	(74,405)	(53,752)
Finance income – surplus on subordinated debt repurchase	**4,248**	1,470	36,205	–	–
Finance income – other	**90,369**	131,436	79,555	165,008	128,468
Unrealised exchange gains/(losses) on borrowings	**5,428**	7,954	23,003	(69,233)	(18,059)
Share of profits of associates	**4,927**	5,084	3,363	3,930	4,395
Surplus before tax	**117,845**	444,365	199,663	141,608	230,449
Tax charge	**(28,495)**	(121,752)	(56,596)	(39,620)	(65,994)
Surplus for the year	**89,350**	322,613	143,067	101,988	164,455

MANAGING AGENTS AND SYNDICATES

The table shows the key characteristics for managing agents and syndicates active as at 31 December 2011. In 2011, Lloyd's wrote gross premiums of £23,477m.

Managing agent	Managed syndicate(s)	2011 GWP* £m	2010 GWP* £m	Owned share of syndicate(s) %
ACE Underwriting Agencies Limited	2488	371	390	100
Advent Underwriting Limited	0780	204	186	100
AEGIS Managing Agency Limited	1225	330	286	100
Alterra at Lloyd's Limited	1400	167	118	100
Amlin Underwriting Limited	2001	1,303	1,212	100
	6106	40	43	0
Antares Managing Agency Limited	1274	175	189	100
Arch Underwriting at Lloyd's Limited	2012	142	113	100
Argenta Syndicate Management Limited	1110	45	28	0
	1965	55	32	0
	2121	222	179	27
Argo Managing Agency Limited	1200	337	308	83
Ark Syndicate Management Limited	4020	312	329	91
	6105	8	24	0
Ascot Underwriting Limited	1414	563	573	100
Aspen Managing Agency Limited	4711	227	189	100
Atrium Underwriters Limited	0570	144	133	25
	0609	238	230	26
Barbican Managing Agency Limited	1955	199	201	100
Beaufort Underwriting Agency Limited	0318	157	156	85
	1318	23	24	100
	2318	1	8	100
Beazley Furlonge Limited	0623	217	228	6
	2623	922	970	100
	3622	9	11	100
	3623	111	124	100
	6107	11	11	0
Brit Syndicates Limited	2987	940	896	100
Canopius Managing Agents Limited	0260	40	52	81
	4444	614	582	93
Capita Managing Agency Limited	2232	56	16	0
	2255	57	–	0
Cathedral Underwriting Limited	2010	279	277	58
	3010	24	22	100
Catlin Underwriting Agencies Limited	2003	1,726	1,684	100
	3002	6	2	100
Chaucer Syndicates Limited	1084	884	863	96
	1176	26	27	55
	1301	91	105	0
	4242	67	67	0
Chubb Managing Agent Limited	1882	78	22	100
Equity Syndicate Management Limited	0218	545	528	64
Faraday Underwriting Limited	0435	288	222	100
Flagstone Syndicate Management Limited	1861	116	122	100
	1969	88	64	0
Hardy (Underwriting Agencies) Limited	0382	289	280	93
HCC Underwriting Agency Limited	4141	105	93	100
Hiscox Syndicates Limited	0033	786	872	73
	3624	190	110	100
	6104	31	33	0

* See Glossary on page 139.

MANAGING AGENTS AND SYNDICATES CONTINUED

Managing agent	Managed syndicate(s)	2011 GWP* £m	2010 GWP* £m	Owned share of syndicate(s) %
Jubilee Managing Agency Limited	0779	26	27	18
	5820	113	132	66
Liberty Syndicate Management Limited	4472	1,080	1,035	100
Managing Agency Partners Limited	2791	242	281	21
	6103	19	20	0
Markel Syndicate Management Limited	3000	352	316	100
Marketform Managing Agency Limited	2468	179	175	61
Mitsui Sumitomo Insurance Underwriting at Lloyd's Limited	3210	258	272	100
Montpelier Underwriting Agencies Limited	5151	145	149	100
Munich Re Underwriting Limited	0457	465	339	100
Navigators Underwriting Agency Limited	1221	200	208	100
Newline Underwriting Management Limited	1218	121	105	100
Novae Syndicates Limited	2007	624	581	100
Omega Underwriting Agents Limited	0958	266	325	41
Pembroke Managing Agency Limited	4000	183	170	100
QBE Underwriting Limited	0386	443	458	70
	2999	1,117	1,013	100
R&Q Managing Agency Limited	1897	22	–	8
R. J. Kiln & Co. Limited	0308	24	26	50
	0510	950	897	53
	0557	33	37	0
	0807	138	131	52
	1880	231	179	100
Renaissance Re Syndicate Management Limited	1458	70	43	100
RITC Syndicate Management Limited	5678	2	2	100
Riverstone Managing Agency Ltd	3500	73	–	100
S.A. Meacock & Company Limited	0727	83	72	12
Sagicor at Lloyd's Limited	0044	6	2	100
	1206	280	291	100
Shelbourne Syndicate Services Limited	2008	64	89	100
Sportscover Underwriting Limited	3334	63	52	86
Starr Managing Agents Limited	1919	322	383	100
	2243	59	56	0
Talbot Underwriting Limited	1183	632	633	100
Travelers Syndicate Management Limited	5000	331	365	100
Whittington Capital Management Limited	1910	64	101	0
	1945	5	–	0
	1967	92	54	0
	2015	25	–	0
	2525	34	37	0
	2526	49	38	0
XL London Market Limited	1209	328	340	100
All Other syndicates and RITC adjustment		(195)	(76)	
Total		23,477	22,592	

* See Glossary on page 139.

Name changes and managing agent changes during 2011 or after:
Syndicate 1955, previously managed by Whittington Capital Management Limited, transferred to Barbican Managing Agency Limited
Syndicates 2525 & 2526, previously managed by Alterra at Lloyd's Limited, transferred to Whittington Capital Management Limited
The following syndicates merged:
R J Kiln & Co Limited 510 and 807
Atrium Underwriters Limited 570 and 609

The following syndicates ceased trading at 31 December 2011
Argenta Syndicates Management Limited 1965
Beaufort Underwriting Agency Limited 2318

As at 27 March 2012 the following syndicates commenced trading for the 2012 year of account:
Catlin Underwriting Agencies Limitd 2088, 6111, 6112
Pembroke Managing Agency Limited 6110

GLOSSARY OF TERMS

Set out below is a guide to insurance and Lloyd's-related terms. These are not precise definitions but are included to provide assistance to readers as to the general meaning of terms commonly used in the Lloyd's market. Formal definitions are set out in the Definitions Byelaw.

ACCIDENT YEAR RATIO
The accident year ratio is calculated as expenses and incurred losses (paid and reserves) for claims occurring in the year as a proportion of net premiums earned during the year. It excludes movements during the calendar year on claims, expenses and premium estimates for previous years.

ACTIVE UNDERWRITER
A person employed by a managing agent with principal authority to accept insurance and reinsurance risks on behalf of the members of a syndicate.

BINDING AUTHORITY
An agreement between a Lloyd's managing agent and a coverholder under which the Lloyd's managing agent delegates its authority to enter into a contract or contracts of insurance to be underwritten by the members of a syndicate.

CALENDAR YEAR RATIO
This is the combined ratio (see below) and is the sum of the accident year ratio (see above) and the prior years' reserve movements (see below).

CALLABLE LAYER
Central Fund assets may be supplemented by a 'callable layer' of up to 3% of members' overall premium limits in any one calendar year. These funds would be drawn from premium trust funds.

CAPACITY
In relation to a member, it is the maximum amount of insurance premiums (gross of reinsurance but net of brokerage) which a member can accept. In relation to a syndicate it is the aggregate of each member's capacity allocated to that syndicate.

CENTRAL ASSETS
The net assets of the Society including the Central Fund, but excluding the subordinated debt liability and the callable layer.

CENTRAL FUND
The fund financed by (among other things) contributions from Lloyd's members and administered by the Council primarily as a fund for the protection of policyholders, and includes both the 'Old' Central Fund and the New Central Fund.

COMBINED RATIO
A measure of an insurer's underwriting profitability based on the ratio of net incurred claims plus net operating expenses to net earned premiums. A combined ratio of 100% is break even (before taking into account investment returns). A ratio less than 100% is an underwriting profit.

CORPORATE MEMBER
A company incorporated with limited liability, a Scottish limited partnership or a limited liability partnership, admitted to membership of the Society.

COUNCIL
Created by Lloyd's Act 1982, the Council has the management and superintendence of the affairs of the Society and the power to regulate and direct the business of insurance at Lloyd's.

COVERHOLDER
A firm either in the UK or overseas that is authorised by a managing agent under the terms of a binding authority to enter into contracts of insurance to be underwritten by members of a syndicate managed by the managing agent. A Lloyd's broker may act as a coverholder.

FINANCIAL SERVICES AUTHORITY (FSA)
The body that regulates the financial services industry in the UK.

FRANCHISE BOARD
The board established by the Council with responsibility for creating and maintaining a commercial environment at Lloyd's in which the long-term return to all capital providers is maximised. This includes setting the Risk Management Framework and profitability targets for the market.

FUNDS AT LLOYD'S (FAL)
Capital lodged and held in trust at Lloyd's as security for the policyholders and to support a member's overall underwriting business.

GROSS WRITTEN PREMIUMS (GWP)
Written insurance premiums, gross of reinsurance and acquisition costs.

INTEGRATED LLOYD'S VEHICLE (ILV)
An arrangement in which a syndicate's capital is wholly provided by corporate members that are under the same ownership and control as the syndicate's managing agent.

MANAGING AGENT
An underwriting agent responsible for managing a syndicate, or multiple syndicates.

MEMBER (OF THE SOCIETY)
A person admitted to membership of the Society.

NAME
A member of the Society who is an individual and who trades on an unlimited basis.

NEW CENTRAL FUND
The New Central Fund constituted by and governed by the New Central Fund Byelaw (No. 23 of 1996).

PREMIUMS TRUST FUNDS (PTF)
The premiums and other monies that members receive in respect of their underwriting at Lloyd's are held by their managing agents in trust for them subject to the discharge of their underwriting liabilities.

The premiums trust funds comprise a sterling fund, Lloyd's American Trust Fund, Lloyd's Dollar Trust Funds, Lloyd's Canadian Trust Fund and the Lloyd's Asia trust funds (which cover general business written through coverholders in Singapore). These premiums trust funds are available to fund overseas regulatory deposits, claims, return premiums, underwriting expenses and any profit that is payable to the member after providing for all future liabilities.

PRIOR YEARS' RESERVE MOVEMENTS
This is calculated as movements in reserves established for claims that occurred in previous accident years as a proportion of net premiums earned during the year.

REALISTIC DISASTER SCENARIOS (RDS)
A series of scenarios, both natural and man-made, which are used to assess the market's risk profile to a variety of different catastrophes to enable better risk management practices within Lloyd's.

GLOSSARY OF TERMS
CONTINUED

REINSURANCE TO CLOSE (RITC)
A reinsurance agreement under which members of a syndicate for a year of account to be closed are reinsured by members who comprise that or another syndicate for a later year of account against all liabilities arising out of insurance business written by the reinsured syndicate.

REINSURANCE TO CLOSE (RITC) SYNDICATE
A syndicate set up solely to underwrite the Reinsurance to Close of other syndicates.

SERVICE COMPANY
A service company means an approved coverholder that (a) is associated with a managing agent by reason of it being a wholly owned subsidiary of the managing agent; or being a wholly owned subsidiary of the managing agent's holding company; or such other matters as the Franchise Board may determine in any particular case or generally; and (b) will be authorised by its associated managing agent to enter into contract(s) of insurance to be underwritten only by members of a syndicate managed by the associated managing agent or an insurance company which is a member of the same corporate group.

SPECIAL PURPOSE SYNDICATE (SPS)
A syndicate set up solely to underwrite a quota share reinsurance of another syndicate's business for a year of account.

SPREAD SYNDICATE
A syndicate whose capital is provided by a number of different members, including members that have separate ownership and control, to the syndicate's managing agent.

SPREAD VEHICLE
A corporate member underwriting on a number of different syndicates.

SYNDICATE
A member, or group of members, underwriting insurance business at Lloyd's through the agency of a managing agent.

TIER 1 CAPITAL
The core measure of an insurer's financial strength from the viewpoint of the FSA. It consists of the most reliable and liquid assets. The perpetual securities issued in 2007 qualify as tier 1 capital as the proceeds of the debt issue are fully paid and immediately available; debt holders are sub-ordinate to payment of claims.

TRADITIONAL SYNDICATE
A syndicate whose members underwrite insurance business at Lloyd's for the current year of account and which is neither an SPS syndicate or an RITC syndicate.

YEAR OF ACCOUNT
The year to which a risk is allocated and to which all premiums and claims in respect of that risk are attributed. The year of account of a risk is usually determined by the calendar year in which the risk incepts. A year of account is normally closed by reinsurance at the end of 36 months.

Since merchants first met to insure their ships at Edward Lloyd's coffee shop over 300 years ago, nearly every aspect of the way we do business has changed. But one constant is the bold confidence proclaimed by our motto, reflected in both our unique appetite for risk and our worldwide reputation for settling valid claims.

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