LLOYD'S

EXTREME RISK, EXCEPTIONAL RESILIENCE

ANNUAL REPORT 2005

2005 WAS AN EVENTFUL YEAR FOR THE WORLD BY ANY STANDARDS. ALL OF THEM DEMANDING AN URGENT, YET PROPORTIONATE, RESPONSE FROM THE WORLD'S LEADING SPECIALIST INSURANCE MARKET

Peter Levene, Chairman 5 April 2006

The events of last year yet again demonstrated the value of insurance and the value of Lloyd's. In the aftermath of hurricanes Katrina, Rita and Wilma, we upheld our reputation as the world's leading specialist insurance market, and reinforced our commitment to help a devastated region to rebuild.

In a year in which the industry saw record claims from natural catastrophes, and the biggest single catastrophic event in its history, Lloyd's was able to cope with these events in the normal course of business and emerge with a small market loss. This was a significant achievement.

Despite the large hurricane claims, we avoided any significant impact on the Central Fund. Lloyd's further strengthened its central resources, and the rating agencies reaffirmed the market's 'A' ratings.

This demonstration of our strength was the result of a team effort across the market. I would, however, like to mention the contribution of the Franchise Performance directorate. The value of their work within the Lloyd's market has now been clearly proven.

The market's performance was further evidence of the changes we have implemented in recent years to rebuild on firm foundations in the wake of 9/11. Since that time, we have implemented a new franchise structure, introduced a new flexible capital structure and put a clear focus on profitable underwriting.

And this is just the start.

A strategic plan to ensure our competitiveness

In January, we published a three-year plan which encapsulated the various initiatives we have undertaken and that we are planning to ensure Lloyd's future competitiveness. In a nutshell, it is about working with the market to develop a modern, efficient, profitable place to do business.

We are under no illusions about the challenges that we face in the future, but our recent record and ability to adapt to new circumstances make us confident that we can deliver this plan. Much has been achieved during the course of 2005 but, as the plan makes clear, there is still more to do. Top of our agenda for the year ahead is the reform of our business processes, which must be modernised if the Lloyd's market is to remain competitive in future.

Ultimately, the success of this market will be based on a partnership. We have worked closely with the market to develop the three-year plan, and it will take a joint effort to make sure that Lloyd's is the marketplace of choice for insurers, policyholders and capital providers.

Global development: a foothold in China

Lloyd's global brand and network of licences remain the jewels in our crown. The brand was significantly enhanced in November last year when we received the go-ahead to establish an onshore reinsurance operation in China. The licence will give Lloyd's access to one of the world's fastest developing economies.

> Left – Lloyd's Chairman, Lord Levene greeting Chinese President, Hu Jintao at Downing Street with Prime Minister, Tony Blair and Deputy Prime Minister, John Prescott.

> Right – Lord Levene with new CEO Richard Ward.

Arrivals and departures

We move into this critical phase with strong management, and we welcome a new CEO, Richard Ward, who comes with a track record of building consensus and driving change. The task for Richard and his colleagues is to create a successful platform for insurers, in the face of increasing competition for the business. That means making sure Lloyd's raises its game, to deliver the best service with openness and transparency.

Much of the regained strength and confidence of Lloyd's was developed under the leadership of Nick Prettejohn, through the personal input he made. In thanking him for all he did, I would also like to wish him every success in his new role at Prudential.

I am very grateful to Luke Savage for his hard work as Acting CEO over the past four months. He will now be able to concentrate his efforts, once again, on finance and risk management. I would also like to express my particular thanks to John Coldman who completed his term of office as Deputy Chairman earlier this year and who has always given me the greatest encouragement and assistance.

Strongly placed to meet the challenges ahead

Lloyd's remains in a strong competitive position with a powerful global brand and strong market-wide security ratings. The marketplace remains a centre of expertise, capable of underwriting complex risks that others simply cannot cover. It is critical that we build on these foundations and deliver the three-year plan to ensure the future of the market.

I would like to thank my Deputy Chairmen and my colleagues on the Lloyd's Council and Franchise Board for their commitment and hard work during a notably demanding year. It is also a credit to the staff in the Corporation and the businesses in the market that we were able to meet the challenges of the past year and deliver a particularly tough agenda.

Peter Levene, Chairman 5 April 2006

IF EVER THERE WAS A YEAR IN WHICH LLOYD'S DEMONSTRATED STRENGTH IN THE FACE OF ADVERSITY, IT WAS 2005

Luke Savage, Acting CEO 5 April 2006

2005 key financials

2005 net loss before tax

£103m

2005 combined ratio

111.8%

2005 capital, reserves and subordinated loan notes

£11.0bn

In 2005, faced with the most expensive year for natural catastrophes in the history of our industry, the Lloyd's market proved its resilience and financial strength, once again reinforcing our reputation for paying valid claims.

Hurricanes Katrina, Rita and Wilma were three of the ten largest storms in US history, with an insured loss estimated at over $65bn. Inevitably, they had a significant impact on the financial result of the market; but the ability of all syndicates to handle the hurricanes without calling on the Central Fund is clear evidence of the progress we have made in recent years.

We made further progress in our continuous efforts to create a modern, transparent and efficient platform. Key achievements included gaining our China licence, improvement in our risk management capability, the implementation of a new capital regime and exceeding our targets on contract certainty.

These achievements have not gone unnoticed. In an atmosphere of frequent and widespread downgrades, Lloyd's ratings were reaffirmed by all three rating agencies with whom we have an interactive relationship.

Despite recording a strong performance in the first half of 2005, the combined impact of hurricanes Katrina, Wilma and Rita, totalling £3.3bn net, resulted in the market reporting a small overall loss of £103m and a combined ratio of 111.8%.

The industry continues to see good opportunities at Lloyd's and many of our biggest insurers have expanded their businesses here in 2006. Capital providers responded in a disciplined way to limited opportunities for rate increases, putting £1.2bn of new money into the market. Capacity also increased in line with new business opportunities to £14.8bn, a 7% rise on the previous year.

Franchise performance: a focus on underwriting profit

Over the course of last year, we continued to invest in the development of the market's risk management capability. The series of Realistic Disaster Scenarios were further developed, and two new events were created. This included a $60bn Gulf of Mexico loss exercise which forced the market to look at their exposure and where necessary adjust their underwriting and reinsurance programmes. Without this exercise our Katrina losses would have been greater. Nevertheless, the hurricanes were a harsh reminder of the importance of exposure management and that catastrophe models are only as good as the assumptions that lie behind them.

The Franchise Performance directorate continued their mandate to improve the professionalism of underwriting in the market through performance management and a focus on underwriting for profit.

We have seen a measured market response, with syndicates taking advantage of business opportunities where rates have improved after the hurricanes, while cutting back in unaffected lines where rates are softening.

We remain committed to improving the market's exposure management and monitoring and preserving the integrity of the risk management framework.

Reinsurance and Open Years: reducing risks
Further work was undertaken during 2005 to reduce the risks facing Lloyd's. The small reduction in the number of Open Years saw the closure of seven years of account allowing capital providers on old years to leave the market.

We also continued to make progress in the area of reinsurance asset management, significantly improving the age and quality of debt.

Claims: big steps towards more efficient management
During the year, we came closer to realising our vision of the Lloyd's market being recognised globally for best practice in claims management. We maintained the momentum that built up in 2004 to establish standards for claims management and to streamline claims handling, with the introduction of Claims Management Principles and initial minimum standards throughout the market.

The work of the claims team took on a new focus in the aftermath of hurricane Katrina. In order to respond to the thousands of policyholders who were made homeless or whose properties suffered damage from the storm we set up a team of claims experts on hand 24/7 to deal with policyholders' enquiries, handling over 5,000 calls from US residents.

Capital advantages
Over recent years, we have worked to reform our distinctive structures and processes to bring them in closer alignment with our peers. In 2005 this work continued, as we implemented a new risk-based capital regime, in line with the FSA's new Individual Capital Adequacy Standards (ICAS). Capital for each member or syndicate is now based on the unique risk characteristics of the business, rather than market average assumptions. This means significant benefits: capital is better aligned with risk, our central assets are protected, a competitive return on capital is achievable and we provide a level of security well beyond the requirements of our current rating level.

Making the Lloyd's brand work harder for us
In the aftermath of the Spitzer investigations, two successive years of record natural catastrophes and a spate of rating downgrades, it was essential to continue the work to maximise the benefits we derive from the Lloyd's brand.

We carried out our own global brand tracking which showed that we remain the top brand in the specialist insurance sector. We also conducted a customer satisfaction survey to help ensure our thinking continues to reflect the needs of our key stakeholders.

This helped us define the Lloyd's brand and we moved to implement the new identity across the Corporation and market. We also identified ways to deliver our brand vision more effectively through the working environment, our customer service, staff behaviour and communications.

Business process reform: much achieved, much to do
Although the market has long agreed on the need to improve its service standards and business processes, 2005 was the year when contract certainty moved to the top of boardroom agendas.

The definition of contract certainty and measurement targets were agreed; and practical help was provided in the form of a code of practice and contract certainty checklist. This enabled us to achieve a success rate of more than double the year end target of 30%. The average quality of the LMP Slip, the document that records the detail of risks and forms the basis of a contract, also rose from 70% to 97%.

During 2005, the drive to introduce electronic data placement changed direction. The technological landscape has evolved, and market requirements have changed. This has led to the development of alternative solutions and negated the need for Lloyd's to build central infrastructure. Indeed there was a growing consensus that the market was better equipped to solve the problem of electronic data placement and that the franchisor's role should be standard setting. In light of this, we took the decision to close Kinnect.

Lloyd's remains committed to the introduction of electronic data placement and will continue to encourage and support the development of electronic trading platforms, business-to-business systems and the use of data transfer standards.

We achieved a lot during 2005 but the clock is ticking and challenges remain. Improving our business processes remains a top priority for Lloyd's and our businesses. We simply cannot afford not to do it.

Operating costs: maintaining discipline
Cost discipline and ensuring value for money remained priorities during 2005. Our cost base remained at a stable level with Society operating expenses of £172m. This stability masks a positive underlying trend, with less resources focused on running the current Lloyd's platform and more available to invest in Lloyd's future.

Changes, challenges and the future
In 2005, we worked closely with the market to develop a three-year Strategic Plan. Building on our recent achievements, this is designed to take the market to the next level in terms of performance, by ensuring:

> a clear and transparent performance framework;

> a strong capital framework;

> a secure, highly-rated market;

> outstanding market access; and

> efficient business processes.

LLOYD'S POSITION IS STRONG, BUT THERE IS NO ROOM FOR COMPLACENCY

Our vision is to be the platform of choice for insurers and reinsurers. Although Lloyd's is in a strong position, there is no room for complacency. We must act now to ensure that the Lloyd's platform is as competitive as possible.

A number of organisational changes were implemented during 2005 to ensure we have the best structure to deliver on our plan. These included the rationalisation of Corporation directorates and the creation of a Franchisee Relations department.

As I come to the end of my brief tenure as Acting CEO, I would like to thank everyone within the Corporation and market for their hard work in what has been an exceptionally challenging year.

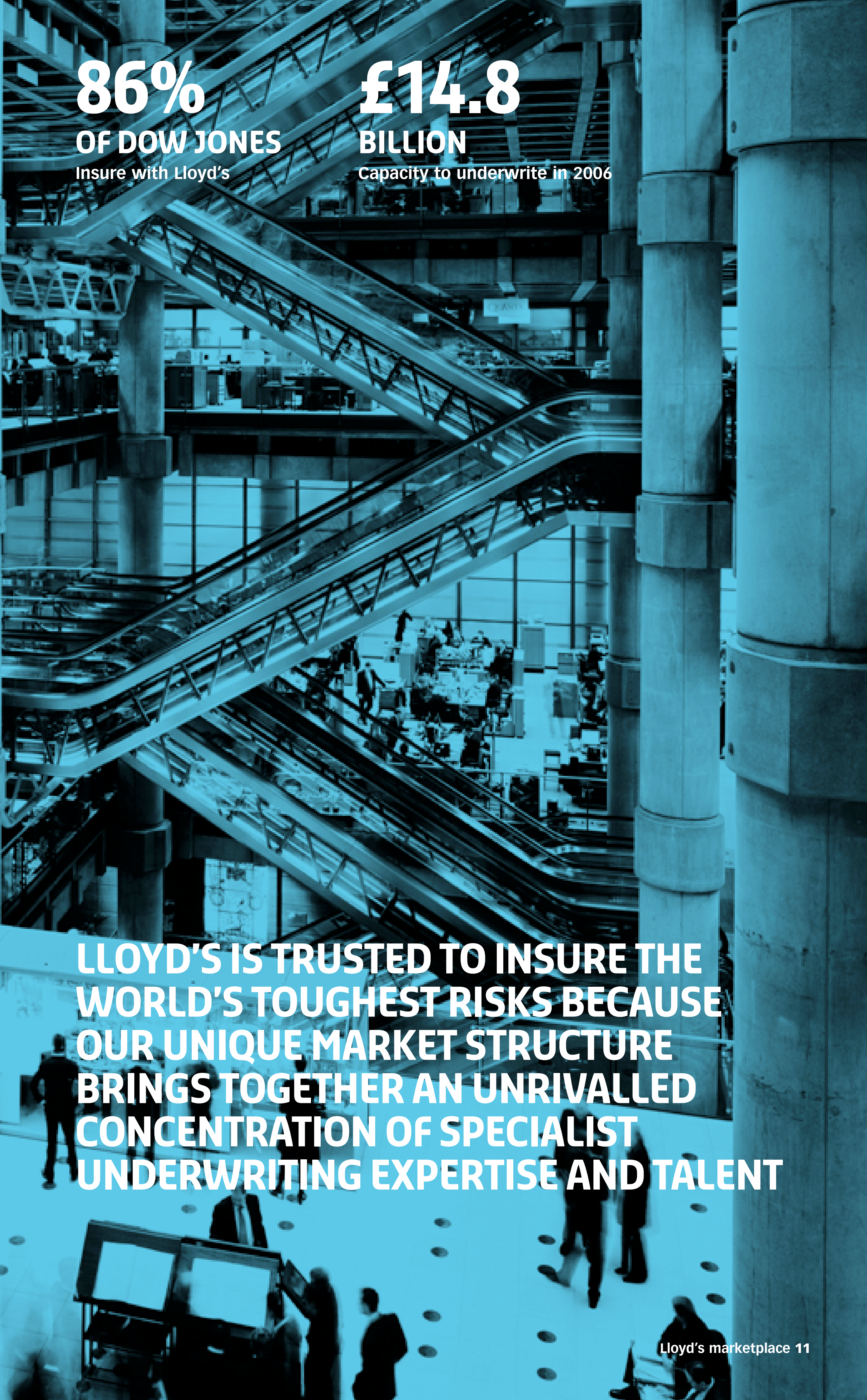
Luke Savage, Acting CEO 5 April 2006

62
SYNDICATES
Provide specialist insurance

200
TERRITORIES
A leading global insurer and reinsurer

89%
OF FTSE 100
Insure with Lloyd's

THE WORLD'S LEADING SPECIALIST INSURANCE MARKET



86%
OF DOW JONES
Insure with Lloyd's

£14.8
BILLION
Capacity to underwrite in 2006

LLOYD'S IS TRUSTED TO INSURE THE WORLD'S TOUGHEST RISKS BECAUSE OUR UNIQUE MARKET STRUCTURE BRINGS TOGETHER AN UNRIVALLED CONCENTRATION OF SPECIALIST UNDERWRITING EXPERTISE AND TALENT

ENDURING ENTREPRENEURSHIP, CREATIVE, AGILE. DEMONSTRATING SUSTAINED ABILITY TO SURMOUNT THE GREATEST CHALLENGES. LLOYD'S IN 2005.

**Peter Middleton, Managing Director,
Specialty Division, Markel International**

ABACUS . ACE . ADVENT . AEGIS . AMLIN . ARGENTA . ASCOT . ATRIUM BEAUFORT . BEAZLEY FURLONGE . BRIT . CANOPIUS . CATHEDRAL CATLIN . CHAUCER . CREECHURCH . DANISH RE . EQUITY . FARADAY GERLING . HARDY . HERITAGE . HISCOX . ILLIUM . IMAGINE . JUBILEE KGM . KILN . LIBERTY . LIMIT . MAP . MARKEL . MARKETFORM MARLBOROUGH . MUNICH RE . NAVIGATORS . NEWLINE . OMEGA S. A. MEACOCK . ST PAUL TRAVELERS . SVB . TALBOT . WELLINGTON . XL

A RECORD YEAR OF NATURAL CATASTROPHES, A CHANCE FOR LLOYD'S TO SHOW ITS STRENGTH

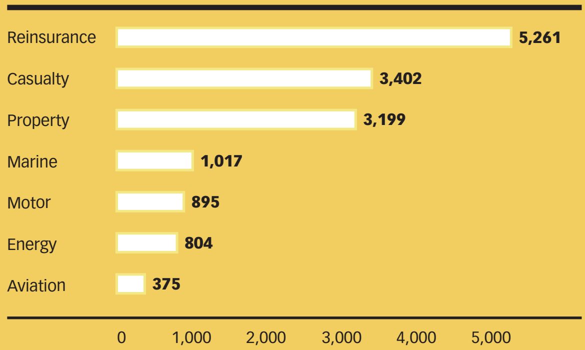
2005 highlights

- Hurricane Katrina causes over $130bn of damage
- Lloyd's results demonstrate underwriting discipline and robust financial strength
- Critical importance of managing exposures and assessment of risk
- Prior year reserves movement shows encouraging stability

Lloyd's business by class

Lloyd's business by region

Lloyd's gross written premium £m



Annual Report

This Market Commentary on pages 14 to 17, 20, 21, 24, 25, 28 and 29 forms the Annual Report required under the Insurance Accounts Directive (Lloyd's Syndicate and Aggregate Accounts) Regulations 2004 and was approved by the Council of Lloyd's on 5 April 2006.

Lord Levene of Portsoken, Chairman

2005 was an eventful year for the world by any standards, beginning with Northern Europe's winter storm Erwin and ending with the earthquake in Pakistan. For Lloyd's, the greatest test was our response to the three major US hurricanes, Katrina, Rita and Wilma. By meeting the challenge head-on the market was able to build on its long and established reputation for paying valid claims and demonstrate its financial robustness and strength in adversity.

Hurricane Katrina brought with it a storm surge and subsequent flooding after the levees protecting New Orleans failed, causing more than 1,000 deaths and damage valued at over $130bn, not all of which was insured. Both Katrina and Rita caused substantial damage to the offshore oil and gas installations in the Gulf of Mexico; and Wilma, after hitting the Yucatan province of Mexico, reached Florida as a diminished but still powerful category two hurricane.

Standing firm in the face of catastrophe

The cost to the insurance and reinsurance industry was vast, with many companies consequently suffering credit rating downgrades, and a small number ceasing trading.

For Lloyd's, the hurricanes inevitably had a major impact on the market level result with a small loss of £103m recorded in the Pro Forma Financial Statements (PFFS) and a combined ratio of 111.8%. The PFFS aggregates the results of the syndicate annual accounts, notional investment return on funds at Lloyd's and the Society of Lloyd's financial statements. The syndicate annual accounts reported an aggregate loss of £871m. The gross loss at market level was substantial in surplus lines property insurance, offshore energy insurance and property per risk and catastrophe reinsurance. It was the first real test of the restructuring implemented in 2002 and 2003 following the Chairman's Strategy Group. The Franchise Performance management process and market capital structures both emerged with credit. All of the syndicates impacted by the hurricanes continue to trade forward.

All three major ratings agencies, with whom Lloyd's has an interactive relationship, affirmed an 'A' rating for the Lloyd's market, and after thorough analysis reconfirmed a 'stable' outlook, which is a reflection of Lloyd's improved market discipline and robust financial strength.

Investment review 2005

Syndicate investment returns continue to be driven by the performance of fixed interest markets. Returns on pound sterling fixed interest assets were solid, if unexceptional but yields on US dollar fixed interest investments remained relatively low for a second consecutive year. Consequently, syndicate investment returns overall were modest with an average annual return of 3.2%. The overall return in 2005 of £709m was a third higher than in 2004 due to a marginally higher rate of return and the increased size of syndicate investment portfolios. Equity markets performed well, with returns of more than 20% in the UK, but this continues to have little impact on Lloyd's investments.

In view of the concentration of investments in fixed interest markets, the major risks for syndicate investment assets are increase in yields in pound sterling and US dollar, perhaps driven by significant inflationary pressures, or significant rise in the yield margins demanded by investors in corporate credit instruments. Whilst rising yields may reduce the level of return, as in 2005, the risk that significant loss may result is low in view of the relatively conservative investment strategies.

Prior year surplus

There are two major factors driving the marginal aggregate prior year surplus of £14m. These are the surpluses of over £300m recognised on claims reserves established for the 2002 to 2004 accident years and deficiencies of approximately £300m arising on reserves for professional liability classes, particularly in respect of the 1999 to 2001 accident years.

The claims development for short-tail classes has been relatively benign and surpluses have arisen in the absence of adverse experience.

The deficiency of professional liability reserves has been caused by deterioration on existing claims and the continuing emergence of new claims as the major years of exposure develop towards maturity. A key contributor to this development has been the impact of WorldCom and Enron, involving the major investment banks. The underwriting environment has improved since 2002, but this area of business continues to be recognised as inherently volatile and has a development period of several years to reach full maturity.

Improving cross-cycle performance

Lloyd's must continue to focus on underwriting fundamentals in order to ensure improved performance in 2006. We remain determined to manage the worst effects of the underwriting cycle through disciplined underwriting and pricing risk adequately. Market capacity has increased overall for 2006 to reflect business opportunities in the aftermath of the hurricanes, although businesses not impacted by the hurricanes have cut back. Prior to the hurricanes, capacity had been expected to reduce by between 10% and 15%.

Our recently published plan for an Optimal Platform recognises the need for stable market performance, which delivers better operating returns. To achieve this aim, Lloyd's is developing a performance management framework. This will lay down principles of underwriting management and enforceable minimum standards which will be in place in time for the 2007 business plan process.

With a third successive year of major windstorms predicted, Lloyd's cannot afford to be complacent – especially given the contraction in retrocessional capacity and the reduction in underwriters' reinsurance protection. Lloyd's businesses exposure management and focus on underwriting for gross profit is at the forefront of the Franchise Performance framework and an intelligent and disciplined approach will continue to be critical to Lloyd's success.

REINSURANCE THE 2005 HURRICANES HIGHLIGHTED THE CRITICAL IMPORTANCE OF UNDERWRITING DISCIPLINE AND PRICING ADEQUACY

Lloyd's reinsurance sector reported gross premium income written of £5.3bn in 2005. This book of business covers a wide range of classes, both long and short tail, and is underwritten on both proportional and non-proportional bases.

The largest class of business within this sector is property non-proportional per risk and catastrophe excess of loss reinsurance with a limited amount of retrocessional business. A large proportion of this business is cover for US insurance and reinsurance companies.

Reinsurance market conditions were stable in 2004 but, as global capacity expanded, rates in a number of lines started to come under pressure. US hurricanes Charley, Frances, Ivan and Jeanne had a further, more significant impact on short-tail reinsurance classes. The majority of the losses were retained by the insurers enabling the reinsurance sector as a whole to still return a small profit for 2004.

2005: a different story
In contrast, the reinsurance market bore a major share of 2005's catastrophe losses and for many of Lloyd's competitors, capital was severely impaired. The scale and geographical footprint of hurricane Katrina meant that over 50% of the losses were incurred by reinsurers. For Lloyd's, as a leading reinsurance market in property, marine and energy, the significant loss of £1,307m and a combined ratio of 135.1% were inevitable.

Rethinking reinsurance
After the losses caused by hurricane Ivan in 2004, the global marine reinsurance market reacted weakly with relatively modest rating increases and little change to terms and conditions.

In contrast, reinsurers are now imposing substantial rate rises and changing the structure of reinsurance programmes to separate Gulf of Mexico windstorm coverage.

Managing exposures
For reinsurers, management of aggregates remains a critical issue, ahead of price and capacity. Last year's losses have highlighted the requirement for recalibration of models developed by catastrophe modelling companies, as well as those used by rating agencies, which are primary drivers of behaviour in the reinsurance market.

The hurricanes have sharpened the focus of the rating agencies and the catastrophe modelling companies and reinsurers have responded quickly, increasing rates and tightening conditions, particularly for reassureds with peak catastrophe exposure.

2005 combined ratio

Accident year

133.6%

Prior year reserve movement

1.5%

Calendar year

135.1%

2005 highlights

> Lloyd's is one of the world's largest writers of reinsurance risk

> As a leading reinsurer in property, marine and energy, the impact of the US hurricanes was inevitable

> Managing peak catastrophe exposures is a key challenge

Making landfall at 06:10 local time on 29 August, hurricane Katrina devastated a massive area of the US Gulf Coast, leaving over 1,000 people dead and around 300,000 without homes.

Naturally, in the immediate aftermath of the disaster, the world's attention was seized by this terrible human tragedy. But, as thoughts turned to reconstruction, the scale of Katrina's economic and commercial impact became clear.

Over $40bn of insured losses, and a threat to business survival

In particular, the oil industry – a hugely important contributor to the local and national economy – had suffered heavy losses. A number of oil and gas platforms in the Gulf of Mexico had been completely destroyed, and very many more had sustained damage serious enough to put them out of action.

In total, the cost to the offshore industry was over $5bn, most of which was a loss for Lloyd's, since we're clear market leader in this class of business.

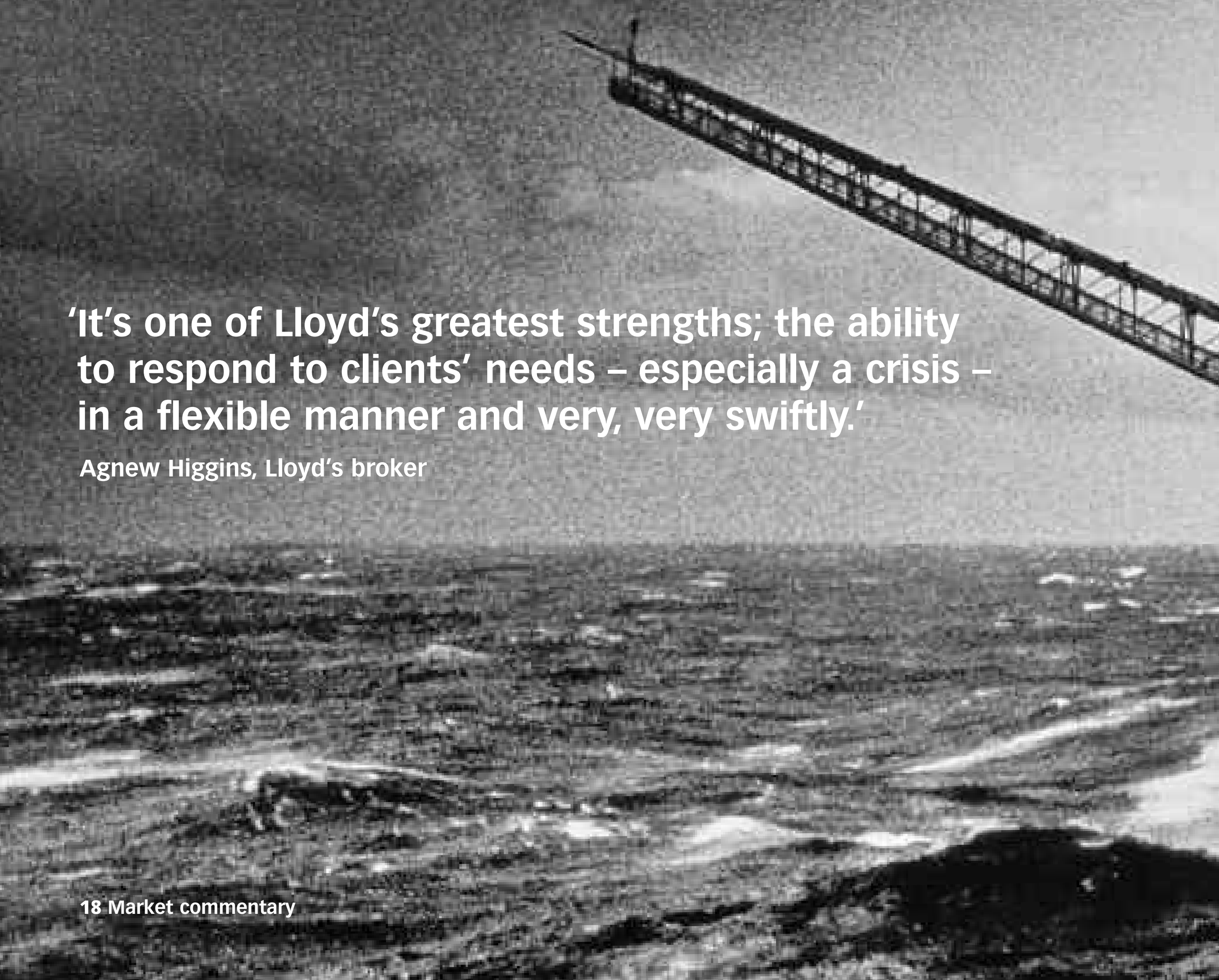
It hurt, of course. But we made our reputation in the US by the promptness of our response and our willingness to settle all valid claims in the wake of the 1906 San Francisco earthquake; and, a century on, we had no intention of letting anything tarnish that reputation.

This determination was crucial for the market's offshore energy clients in the area. Many of them are small operators without the resources to withstand a major interruption to their business, and so the speed and reliability of their insurers can make or break them.

Moving fast to keep a client afloat

A case in point? Palm Energy Partners' single installation in the Mississippi delta survived Katrina, but only just. To get production back online, they urgently needed to buy new pipeline – without which, of course, they would have no revenue.

While some insurers might have wasted weeks or even months disputing the terms of a very complex policy, Lloyd's settled the claim fast; the company was able to pay for the replacement pipeline; production resumed... and a business that could easily have been destroyed by Katrina is alive and well.



'It's one of Lloyd's greatest strengths; the ability to respond to clients' needs – especially a crisis – in a flexible manner and very, very swiftly.'

Agnew Higgins, Lloyd's broker

SURVIVING THE BIGGEST BLOW

WHEN 140 MPH WINDS DEVASTATE THE OFFSHORE OIL INDUSTRY, IT CALLS FOR A RAPID REACTION

CASUALTY A YEAR OF IMPROVED PERFORMANCE OVERCOMING LEGACY ISSUES

2005 combined ratio

Accident year

89.8%

Prior year reserve movement

4.1%

Calendar year

93.9%

2005 highlights

- Specialist mix of business led to improved performance in 2005
- Improving trend in required reserve additions as soft market years approach maturity
- Maintained discipline to manage exposures as rates and coverage come under pressure

In 2005, £3.4bn of Lloyd's total gross premium income was written in the casualty classes. Professional indemnity remains the largest line of business. Medical malpractice, accident and health, directors' and officers', financial institutions, general and employers' liability are also significant lines of business.

These are particularly specialist and complex risks, subject to the vagaries of tort systems and legal processes around the world. In the US, the cost of the tort system is causing grave concern and plaintiffs in other countries are seeking to emulate the success of their US peers. Reserving and pricing decisions require detailed knowledge of the factors driving claims inflation, as well as expertise in claims settlement and loss development patterns.

Cyclical trends

The US market has seen severe underwriting losses in casualty in recent years. This has been driven in part by litigation brought by investors as a reaction to falls in the stock market, particularly from 1998 to 2002. Our relatively modest exposure to general liability written on an occurrence form has meant that prior year deterioration has been less severe than for many of our competitors.

Premium rates rose sharply from 2000 to 2003 and the mix of business written in the market changed, with a shift of emphasis from financial institutions, other large account errors and omissions, and directors' and officers' liability business to medical malpractice and smaller, more specialist errors and omissions risks. These changes are reflected in improving underwriting year figures, although softening rates have followed as an immediate consequence of profitable underwriting. In 2005, casualty produced an overall profit of £179m and a combined ratio of 93.9% despite continued reserve strengthening.

World markets have reacted to major property insurance and reinsurance losses, with changes to coverage and rate increases in areas that sustained losses. There has been little or no knock-on effect in the casualty market so far. The market will need to keep its discipline and manage its exposures as rates and margins fall.

PROPERTY WITH ANOTHER RECORD YEAR OF NATURAL CATASTROPHES, LOSSES WERE INEVITABLE. BUT IS THIS A FREAK YEAR OR THE START OF A NEW TREND?

Property, direct and reinsurance business, is the largest market sector at Lloyd's. Direct property gross premium income written in 2005 totalled £3.2bn with the US the biggest market by far.

The strong profits we achieved in 2002 and 2003 reflected a vastly improved underwriting landscape post 9/11 and the benign claims experience. Global competition increased across most property lines during 2004 and this continued in the first half of 2005.

Three major hurricanes, $170bn economic cost
For the second year running, experts' predictions of an active Atlantic storm season proved accurate. In 2004, four major hurricanes made US landfall; and in 2005, there were three more – Katrina, Rita and Wilma. There had never before been more than five major hurricanes in a two year period and the 15 storms categorised as hurricanes in 2005 broke the previous record of 12 in 1969.

Current estimates indicate that the total economic cost of the 2005 Atlantic storm season will equal $170bn, nearly four times the previous record of $45bn in 2004. Hurricane Katrina alone is likely to cost in excess of $130bn, surpassing the previous record of $26.5bn held by hurricane Andrew in 1992.

Given Lloyd's material exposure to natural catastrophes, it is not surprising the property sector suffered a loss of £457m in 2005 with a combined ratio of 118.5%.

Preparing for the future
Inevitably, these losses have had a major influence on the rating environment, particularly on business lines exposed to catastrophe risk in the US. The rating environment for all insurers has to take into account the risk/reward profile for providing coverage for these peak exposures.

The hurricanes highlighted the industry's need to better understand, capture, aggregate and ultimately model exposure to natural catastrophes.

2005 combined ratio

Accident year

119.5%

Prior year reserve movement

(1.0)%

Calendar year

118.5%

2005 highlights

- US hurricane season impacted results for second successive year
- Stable prior years including reserves established for 2004 hurricane claims
- Opportunities to achieve excellent returns for providing coverage for peak exposures and managing volatility

As it does every year, the sports-loving world turned its eyes to London SW19. More than 450,000 spectators watched top players from over 60 nations compete, while an audience of countless millions followed the action on TV, all over the world.

As ever, plenty of strawberries and cream were consumed; and, just as predictably, play was interrupted on a number of occasions by rain.

Nevertheless, the tournament ran like clockwork, with Roger Federer and Venus Williams eventually emerging victorious, each becoming Wimbledon champion for the third time.

A tailor-made policy: advantage Wimbledon

For Lloyd's, it was another year working with the tournament organisers – The All England Lawn Tennis Club (AELTC) – to provide cover against any kind of disruption, cancellation or curtailment.

That represents a major challenge for the insurer because, as with any major sporting event televised throughout the world, so much can go wrong. The risks range from game cancellation to physical damage which in turn takes the tournament off the airwaves.

Naturally, our long experience at Wimbledon gives us a real advantage. But, as Federer or Williams would agree, it's a different tournament each year; and, as the nature of the risk continues to evolve, we have to be flexible in our thinking about how to provide precisely the protection the client needs.

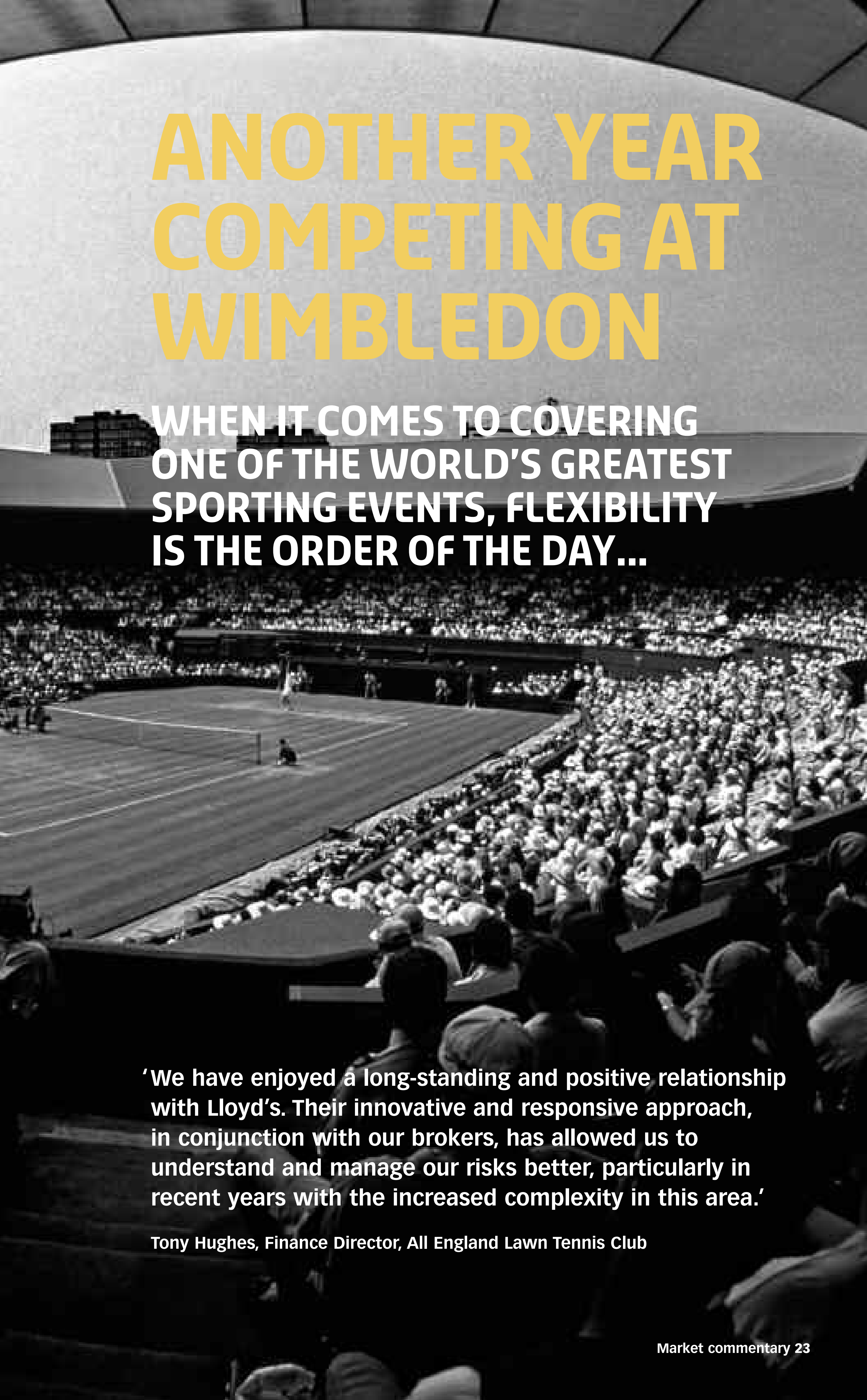
In 2003, our tailor-made policy included cover against disruption caused by an outbreak of SARS and for 2006, cover is specifically provided for Avian Influenza, for the first time.

Outstanding service (no pun intended)

For Lloyd's, the long-term relationship between insurer and insured is also extremely important. The market's brokers and underwriters work closely with the organisers of Wimbledon to ensure they have the right risk management in place. This involves seeing how risks can be prevented or prepared for, before deciding exactly what needs to be insured.

Federer and Williams to win yet again in 2006? Or Britain's Andy Murray to make his big breakthrough, perhaps?

Whatever happens, Lloyd's will be there helping to ensure that the AELTC is appropriately protected, and that Wimbledon retains its title as the world's greatest tennis tournament.



ANOTHER YEAR COMPETING AT WIMBLEDON

WHEN IT COMES TO COVERING ONE OF THE WORLD'S GREATEST SPORTING EVENTS, FLEXIBILITY IS THE ORDER OF THE DAY...

'We have enjoyed a long-standing and positive relationship with Lloyd's. Their innovative and responsive approach, in conjunction with our brokers, has allowed us to understand and manage our risks better, particularly in recent years with the increased complexity in this area.'

Tony Hughes, Finance Director, All England Lawn Tennis Club

MARINE SOLID PERFORMANCE DESPITE US HURRICANES AND INTENSE COMPETITIVE PRESSURES

2005 combined ratio

Accident year

98.8%

Prior year reserve movement

(7.4)%

Calendar year

91.4%

2005 highlights

> Competition remains intense across marine lines of business

> Marine liability and specie account performed well during 2005

> Limited direct hurricane losses

Lloyd's remains an influential lead market for marine business, with gross premium income written of £1bn. The principal components of the class are hull, cargo, specie and marine liabilities.

Although rates were generally stable across the marine market in the first half of 2005, competition for business in the two largest marine classes, hull and cargo, remained intense. As a result, pricing came under sustained pressure in the first half of the year.

The poor claims experience for hull business written in 2004 deteriorated further in 2005. Marine liability faced less competitive pressure during the year, and continues to return good results. The International Group of P&I Clubs programme remains a significant part of this book. While 2005 looks likely to be a profitable year for the Group programme, 2004 suffered some significant deterioration during the last 12 months.

The specie market, the insurance of highly valued items such as gold bullion, remained as competitive as ever but continues to return good results.

Overall, the marine market returned a profit of £73m and a combined ratio of 91.4% assisted by reserve releases from previous accident years.

After the hurricanes: easing pressure, rising rates
The competitive pressure eased in the second half as the hurricane season developed. In the aftermath of the storms, the market was successful in targeting across the board rate rises in anticipation of both the losses and increased reinsurance costs.

Lloyd's direct marine losses from the hurricanes were limited and less than anticipated, with the majority being retained in the domestic US market.

MOTOR INCREASED FOCUS ON SPECIALIST RISKS AND COMPANY FLEETS PRODUCED EXCELLENT RESULTS

It is over a century since the first Lloyd's motor policy was written, and historically Lloyd's has held a major share of the UK market, with many managing agents including a motor insurance syndicate in their group.

Today, this class of business is less prominent in the market but remains an important part of our overall business. The entry of supermarket and online businesses into the private car market has led to increasing competition, and therefore Lloyd's focus has shifted to non-standard and company fleet business, both in volume terms and as a proportion of the total motor income. Of the total gross premium income written of £0.9bn, less than 50% derives from private car insurance.

This balance in the motor portfolio has produced excellent results with a profit for the year of £82m and a combined ratio of 91.2% assisted by reserve releases from previous accident years.

Motor insurers continue to focus on the key risk to their business from claims inflation, including levels of court awards.

Non-standard: playing to Lloyd's strengths
In particular, Lloyd's specialises in covering high performance vehicles, classic cars and drivers with serious convictions. These exposures are more complex and require a higher level of underwriting skill and experience with terms set for individual risks. The same applies to providing appropriate cover for large company vehicle fleets.

Overseas motor: improving performance
Around 20% of our motor business originates outside the UK. The performance of this portfolio improved significantly in 2005 following the corrective measures taken in 2003 and 2004.

2005 combined ratio

Accident year

97.3%

Prior year reserve movement

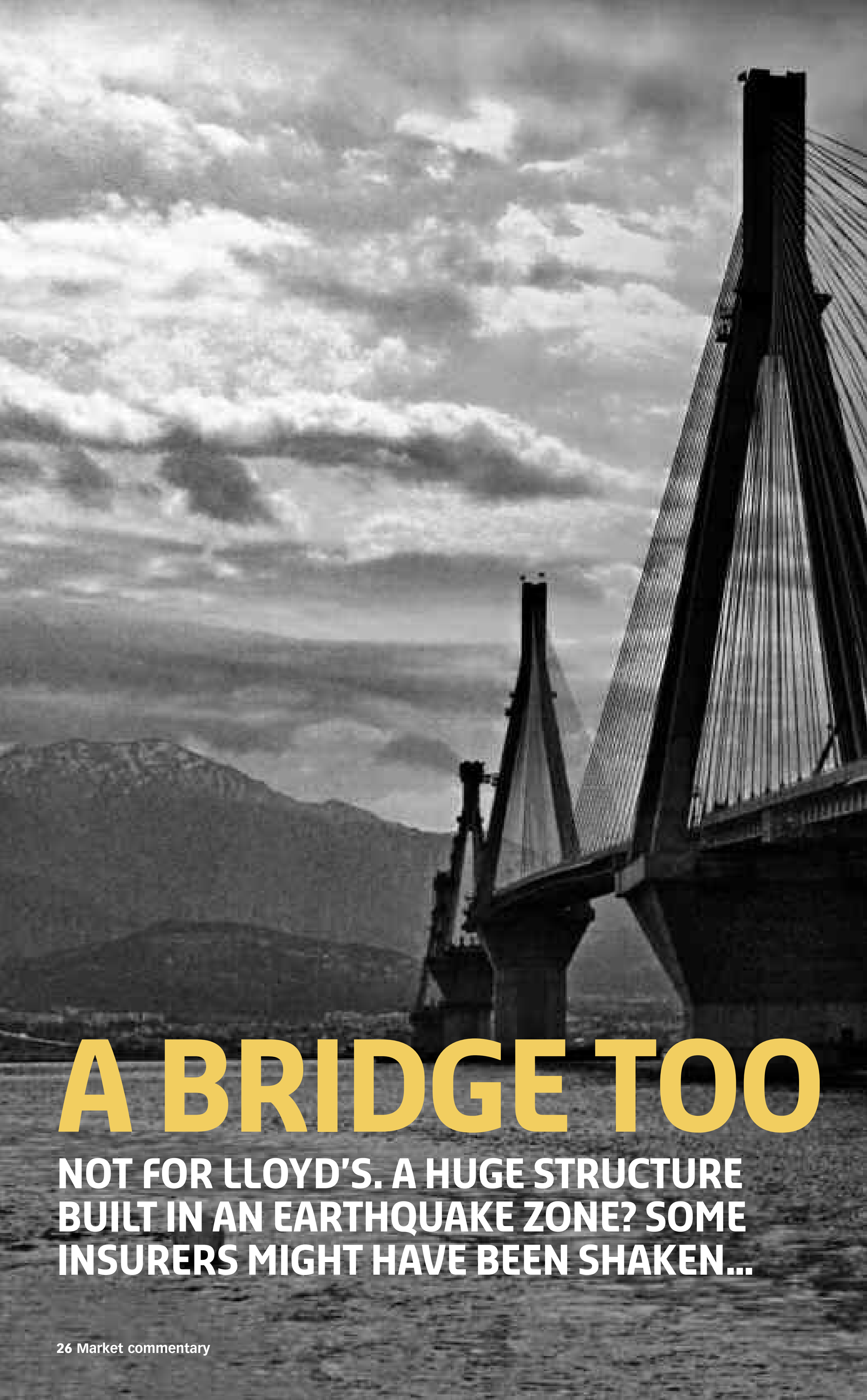
(6.1)%

Calendar year

91.2%

2005 highlights

- Lloyd's strength in specialist lines produced excellent results
- Motor provides diversity in the Lloyd's market and is an important part of the overall business



A BRIDGE TOO

NOT FOR LLOYD'S. A HUGE STRUCTURE BUILT IN AN EARTHQUAKE ZONE? SOME INSURERS MIGHT HAVE BEEN SHAKEN...

> ‘After the lightning strike in January it took two months to fully repair the damage. Whenever we have needed help from our brokers, they have responded very promptly.’
>
> **Stavros Stavris, Financial Director, Gefyra S.A.**

Fulfilling a century-old national dream, the Rion-Antirion Bridge links the Peloponnese to mainland Greece, across the Gulf of Corinth. Over 2,500 metres from end to end, it's the longest bridge of its kind in the world.

Its colossal size apart, what makes it such a stunning feat of modern engineering is the exceptionally adverse conditions in which it was built. Not only is the water up to 65 metres deep, but the sea bed is notably unstable.

More challenging still, this is an area of high seismic activity, with the two ends of the bridge actually founded on different tectonic plates. So it was a huge achievement on the part of the construction team (built by Vinci with the co-operation of five Greek construction companies) that the bridge opened on schedule in August 2004, just in time for the Athens Olympics.

The bridge's sheer size, with a total value of €800m, was a real test of the market's capacity. This was a very unusual risk, large in size and complexity, that other insurance firms may have found too difficult. But Lloyd's underwriters pride themselves on insuring the world's toughest risks so this was definitely one for the market.

Lightning never strikes twice (we hope)

In fact, during the first year, there was a claim – when a lightning strike damaged cables at a cost of €750,000.

But, having settled the claim promptly, we trust that the proverb is correct and there won't be any repetition.

For Greece, the Rion-Antirion Bridge is not just an engineering marvel and a vitally important new transport link, but also a symbol of national pride. So it's a real testament to Lloyd's international standing that yet another of the world's biggest and most unusual risks has been entrusted to us.

FAR?

ENERGY AFTER THREE PROFITABLE YEARS, A SEQUENCE OF MAJOR LOSSES DEMANDS A RETHINK IN UNDERWRITING STRATEGY

2005 combined ratio

Accident year

148.5%

Prior year reserve movement

(1.6)%

Calendar year

146.9%

2005 highlights

> Katrina and Rita hit the Gulf of Mexico leading to record offshore energy losses

> Radical changes to pricing and structure to manage aggregates and reduce volatility

Lloyd's is a leading global market for energy with gross premium income written of £0.8bn. This includes a variety of onshore and offshore property and liability classes, ranging from construction to exploration and production, refinery and distribution.

Offshore energy business has always formed the larger part of Lloyd's energy portfolio and a large proportion of this is located in the Gulf of Mexico.

2002 to 2004: a profitable period

Following a period of very poor results in the late 1990s and beyond, 2002 and 2003 were exceptionally profitable. This reflected a vastly improved underwriting environment, combined with low frequency and severity of loss. In 2004, pricing pressure re-emerged in several energy lines, before hurricane Ivan hit the Gulf of Mexico – resulting in the offshore energy sector's largest ever loss from a single event. Post-Ivan, price stability returned to the offshore market and continued into early 2005.

2005: a year of major losses

2005 was marked by even greater major loss activity. This started in January, with a loss at the Suncor refinery in Canada (onshore); continued in July with substantial damage to one of India's ONGC platforms (offshore); and culminated in August and September, with Katrina and Rita hitting the Gulf of Mexico (principally offshore). In aggregate, these events have contributed to the sector's significant overall loss of £238m and a combined ratio of 146.9%.

The size of these single-risk natural catastrophe losses, and the rapidity with which they followed one another, has prompted significant changes to the price and structure of the product offered by energy insurers. More restricted windstorm limits have been introduced, substantial price increases have been achieved and the practice of offering certain forms of business interruption insurance has largely ended.

Working to reduce volatility in future

Energy market underwriters have been forced to rethink their underwriting strategy, with most deciding to reduce substantially their aggregate exposure to Gulf of Mexico windstorms. The reinsurance market has been a critical driver of strategy change for energy insurers, but many Lloyd's businesses had already sought actively to reduce the volatility traditionally tolerated within this class.

The market must maintain its pricing and aggregate exposure discipline and continue to develop a more sophisticated approach to pricing catastrophe risk, in order to produce less volatile results in future.

AVIATION EXCELLENT RESULTS RECORDED IN A YEAR OF LOW LOSSES AND HIGH DEMAND FOR CAPACITY

Lloyd's is a major provider of capacity in the global aviation market with gross premium income written of £0.4bn, leading business in all sectors of this specialist class, including airline, general aviation, products, air traffic control, war and terrorist coverage, airports and satellite business.

This balance in the portfolio has produced excellent results with a profit of £96m and a combined ratio of 70.6%. This has been assisted by reserve releases from previous accident years, in view of the benign loss development during 2005.

The aviation market has made a strong recovery since the heavy losses of 2001, namely 9/11 and Queens, with relatively benign loss activity over the last three years. The resultant profitability has inevitably led to increased competition. Airline rates have fallen further in 2005, but rates for other classes of aviation business have remained stable or seen small increases. Offsetting this has been the growth of the aviation industry.

A fast growing demand for capacity
Worldwide air passenger traffic volumes continue to grow, particularly in the leisure market, with much of the increased capacity provided by the emerging low-cost carriers.

Growing demand, combined with the increase in aviation fuel prices, has led all the major airlines to re-equip their fleets with the latest energy-efficient aircraft, in order to remain competitive. But, as these more expensive aircraft have come into service, demand for hull insurance has been met by the capacity available. The capacity demand and supply equation will be further tested shortly when the new Airbus A380 enters commercial service: Lloyd's is prepared for this challenge.

Generally, the industry's continuing investment in new aircraft and safety systems and infrastructure at airports is contributing to a historically low loss frequency.

The returns achieved in this class for 2002 to 2005 reflect its catastrophe risk and inherent volatility.

Specialist risks: Lloyd's natural arena
In addition to hull and liability exposures from the major airlines, the Lloyd's market insures a variety of very complex risks from right across the aviation industry. We provide cover for product liability of aircraft and aircraft component manufacturers; the launch of satellites; helicopters; refuelling risks; and airport operators, among others. Given their loss potential, all these risks demand the highest levels of underwriting skill and risk management expertise from Lloyd's.

2005 combined ratio

Accident year

80.4%

Prior year reserve movement

(9.8)%

Calendar year

70.6%

2005 highlights

- Loss activity at record low
- Airline book remains under pressure and requires adequate returns for the catastrophe risk and volatility

ON BOARD FROM THE START

CHINA'S CIVIL AVIATION INDUSTRY HAS TAKEN OFF

Back in 1974, China's great economic renaissance was yet to begin. So, when Lloyd's first covered four Boeing 707s belonging to Chinese airlines, we little suspected how our capacity would be tested over the next three decades.

Today, the Chinese fleet consists of over 750 aircraft, with an insurance value of around $32bn. And we're pleased to say we are still very much on board, working closely with the People's Insurance Company of China (PICC) to provide the highly specialised hull war cover that enables the country's airlines to keep flying.

A relationship built on adaptability and performance

Relationships as long as this are by no means unusual for Lloyd's. But what makes this one exceptional is the enormous change and extraordinarily rapid growth that have taken place over the last 30 years.

The market's adaptability, dynamism and performance over time have enabled it to maintain continuity and keep pace with the client's changing needs.

One way, as the lead underwriter for the risk explained, is to offer expertise to others in the market, who don't normally participate in the class of business. That gives them the opportunity to join forces and meet the client's coverage needs. 'Syndication of risk is what Lloyd's does well,' he says.

The challenge for Lloyd's, in an ever more uncertain world, is continually to offer a competitive product while meeting the stringent requirements of the Chinese carriers, making informed decisions on the scope of coverage.

That challenge is about to get even bigger – as the massive new Airbus A380 comes into service very shortly. With 555 seats and a wingspan equivalent to a football pitch, each of these monstrous machines will have an insurance value of up to $300m. Faced with this, some insurers might pack their bags. But at Lloyd's, we've always taken the world's biggest and toughest risks in our stride. And that includes the super-jumbo kind.

RISK AND RESPONSIBILITY

THE LLOYD'S MARKET BRINGS TOGETHER AN UNRIVALLED CONCENTRATION OF RISK-TAKING UNDER ONE ROOF. BUT WE ARE NOT BLINDED TO OUR WIDER RESPONSIBILITIES.

WE HAVE A REAL COMMITMENT, BOTH AS AN ORGANISATION AND AS INDIVIDUALS, TO HELP PEOPLE WHO FACE ADVERSITY, BOTH AT HOME AND ABROAD.

The Lloyd's market has a history of social responsibility spanning two centuries. Today, as you will see below and on the following pages, this is reflected in a wide range of charitable initiatives. But the common thread which runs through everything we report on here – from helping an ex-serviceman get back on his feet, through mentoring young businesses, to helping provide loving homes for African war orphans – is our desire to make a real difference to the lives of people facing deprivation, hardship or lack of opportunity.

Lloyd's Community Programme

Set up in 1989, Lloyd's Community Programme mobilises the time, skills and resources of individuals and companies in the Lloyd's market. Together we help to improve the opportunities and environment of our neighbouring East London boroughs, with a particular focus on Tower Hamlets, an area which has the second lowest employment rate of all local authorities in England.

In 2005, over 700 volunteers from the Lloyd's market took part in the Community Programme's activities. Lloyd's works in partnership with 32 local schools to improve literacy and numeracy, as well as offering career advice. There is also a Social Enterprise Mentoring Programme which helps local regeneration (see page 36) and team challenges involving staff taking part in a day's practical activity, such as painting a community centre or mucking in at a local farm.

The Police Mentoring Programme went from strength to strength in 2005, winning two more prestigious awards. The scheme involves matching senior members of the Lloyd's market with senior police officers who work in the challenging boroughs of Tower Hamlets, Hackney and Newham – helping them develop their management skills, and also enabling a valuable exchange of ideas.

Lloyd's Charities Trust

Through Lloyd's Charities Trust, we support independent charities working in key areas of concern to us, including children and young people; health and disability; and social welfare. Over a three-year period, we provide financial support for three designated charities, currently Hope and Homes for Children, Macmillan Cancer Relief and St Giles Trust.

You can read on pages 34 and 35 how Hope and Homes for Children are helping to rebuild shattered lives and build a new future for thousands of children in war-ravaged Sierra Leone.

Macmillan Cancer Relief helps people living with cancer by providing practical and emotional support. Lloyd's has supported the charity's crucial expansion and relocation of their CancerLine Service. This service benefits young people and those for whom English is a second language living with cancer across the UK.

St Giles Trust helps disadvantaged offenders and the homeless. Lloyd's is supporting the charity's Peer Advisors Scheme in seven prisons and a Young Offenders Institution in Kent. This innovative scheme offers training to prisoners on short sentences – which is not only of direct benefit to them, but also enables them to provide advice to fellow inmates, helping them break out of the cycle of homelessness and re-offending.

Lloyd's Tercentenary Foundation
Established in 1988, Lloyd's Tercentenary Foundation is a charitable trust which provides funding for research in fields such as medicine, science, and the environment. Since its creation, the Trustees have awarded 58 Lloyd's Fellowships and 15 business scholarships to promising research students.

Lloyd's Patriotic Fund
Established in 1803 to raise funds for victims during the Napoleonic War, Lloyd's Patriotic Fund is the oldest naval and military fund of its kind. Today, the Fund provides financial assistance to ex-servicemen and women, their widows and dependants.

The plight of ex-serviceman Carl Lee and his family illustrates the continuing need for the Lloyd's Patriotic Fund. Since 1999, Carl had served with the Queen's Lancashire Regiment in a number of countries, including Iraq and Northern Ireland. But when he came to leave the army, Carl discovered that he was not eligible for the normal leave of service grant because he was six months short of completing five years of service over the age of 18.

With his wife and young son, Carl returned to the UK to be near his family and they were eventually offered temporary housing. During this time, Lloyd's Patriotic Fund provided a grant for much needed household furnishings and furniture.

The family are now living in a house that they can call home, and Carl and his wife have managed to find work. 'I cannot tell you how grateful we are to all who helped us, including the Lloyd's Patriotic Fund,' says Carl. 'We wrote to every one to say thank you and we say it again.'

1. Volunteering
Staff from Lloyd's IT department spent a day with pupils from Craven Park Primary School, in Hackney. They put together 'story sacks' which help to make books more meaningful to children by using engaging games, puzzles and toys.

2. Coaching
Denis Vangelatos, Finance Manager, of Lloyd's subsidiary company, Centrewrite, coached pupils from Columbia Primary School, Bethnal Green. The RFU qualified coach, taught 14 pupils every week for two seasons in the basic skills of rugby.

3. Donating
In the aftermath of the tragic events of the Indian Ocean Tsunami, the Lloyd's market donated £400,000 to help fund the critical relief effort and long-term rebuilding of local communities.

REBUILDING YOUNG LIVES

'As the media spotlight shifts from one area of devastation to another, many children are left orphaned, homeless, forgotten. One country that has experienced this first hand is war-torn Sierra Leone. Through Lloyd's Charities Trust and the market's support of the charity Hope and Homes for Children, shattered lives are being pieced together and brighter futures secured for these vulnerable children.'

Nick Gooding, Chairman, Lloyd's Charities Trust and Cargo Underwriter, XL syndicate 1209.

HAVING EMERGED FROM THE DEVASTATION OF A DECADE OF CIVIL WAR IN 2002, SIERRA LEONE IS ONE OF THE TOUGHEST PLACES ON EARTH FOR CHILDREN TO GROW UP

Having emerged from the devastation of a decade of civil war in 2002, Sierra Leone is one of the toughest places on earth for children to grow up. Many don't: with infant mortality the highest in the world, only one child in three reaches the age of five. And for those who survive, the outlook is bleak, with thousands having been orphaned, abandoned or recruited as child soldiers during the war. Supported by Lloyd's Charities Trust since 2004, Hope and Homes for Children (HHC) is doing invaluable work to give a new future to Sierra Leone's children.

Transforming lives, securing futures

Since it was founded in 1994, HHC has transformed the lives and secured the future of over 2,000 children in Sierra Leone. The charity's mission in Sierra Leone is to provide the country's poorest children – those worst affected by the civil war or the HIV/AIDS epidemic – with the love of a family and the security of a home.

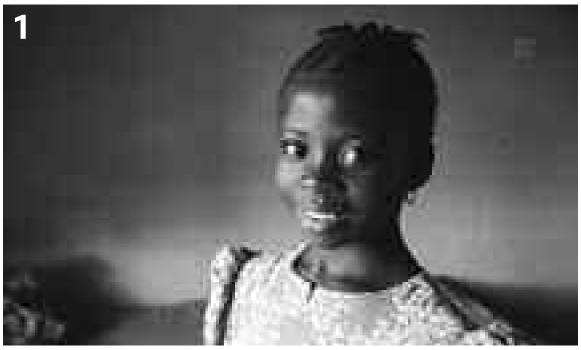
THE CHARITY'S MISSION IN SIERRA LEONE: TO PROVIDE THE COUNTRY'S POOREST CHILDREN WITH THE LOVE OF A FAMILY AND THE SECURITY OF A HOME

Lloyd's Charities Trust has supported HHC as one of its three partner charities since 2004 and will provide a total of £225,000 over three years. The donation so far has funded a range of vitally important childcare services in the capital of Sierra Leone, Freetown, and the Southern district of Bonthe.

A model fostering programme

The HHC/Lloyd's partnership supports a significant number of children who are currently cared for by the charity in Sierra Leone. HHC has successfully developed and implemented a Foster Care Programme for children who have no locatable family. The aim is to find suitable families that can offer a loving, stable environment, enabling each child to reach their full potential.

The programme includes a thorough selection process, training, monitoring and a support system for all carers and children. The HHC system has inspired other agencies to help address the desperate issue of orphaned children that is facing Africa. The Lloyd's Project has already helped 378 orphaned children in Sierra Leone to receive family-based care and support, and it hopes to help hundreds more.



Providing short-term emergency care
Where Foster Care Programmes are not appropriate or immediately available, the partnership also offers emergency interim care support for children. Interim Care Centres provide short-term residential care as well as counselling and support for children until long-term, family-based solutions are found. These Centres are integrated into local communities to ensure these children have access to education, healthcare and other social activities.

Eight year old Marie is one of the young children who is being supported by an HCC Interim Care Centre. The support she has received has been life-changing and has given her a future. For the first time in four years, she has been able to attend school, an opportunity that she cherishes and wants to extend to others:

'I'm so happy to be back at school' says Marie. 'I will work hard as I want to become a teacher and help other children to learn.'

A safe place for vulnerable young mothers
Young single mothers are also being given a helping hand so they can raise their children within their own community. The Mother and Baby Units give vulnerable mothers and their newly born babies a secure and safe place for the first few months after birth. This is a crucial period as it allows mother and child to form a strong bond, helping to prevent the likelihood of future abandonment. This programme provides access to education, advice, training, medical assistance and counselling.

The work of HCC in Sierra Leone, which is in part made possible by Lloyd's Charities Trust and the enduring support of the market, is making an enormous impact on individual lives. These various initiatives are not only providing children with the love of a family and the security of a home, but also the opportunity to unlock their potential and secure a brighter future.

1. Marie
One of the 378 orphaned children helped by the Lloyd's Project in Sierra Leone.
(Image courtesy of HHC.)

2. Nick Gooding, Chairman, Lloyd's Charities Trust
The Trust has been supporting a wide range of charities on behalf of the Lloyd's market for over 50 years.

3. Careworker and child
The Interim Care Centres, part funded by Lloyd's, help to provide short-term residential care and counselling as well as education, healthcare and social activities.
(Image courtesy of HHC.)

4. Child soldiers
During Sierra Leone's decade of civil war, thousands of children were orphaned, abandoned or recruited as child soldiers. Together, Lloyd's and HHC are giving a new future to the children of Sierra Leone.

Lloyd's Community Programme member companies

- ACE European Group
- Advent Underwriting Limited
- Alexander Forbes
- Amlin plc
- Aon Limited
- Ascot Underwriting Limited
- Atrium
- BMS Group Limited
- Barlow, Lyde & Gilbert
- Beazley Furlonge Limited
- Benfield
- Bowood Partners Limited
- Brit Insurance Holdings plc
- Catlin Underwriting Agencies Limited
- Canopius Managing Agencies Limited
- Capita Insurance Services
- Chaucer Syndicates Limited
- CMGL
- Denis M Clayton & Co. Limited
- Ernst & Young
- Faraday Underwriting Limited
- Hardy Underwriting Group plc
- Heath Lambert Group
- Hiscox plc
- HSBC Insurance Brokers Limited
- Ince & Co.
- JLT Risk Solutions
- Kendall Freeman
- Kiln plc
- LeBoeuf, Lamb, Greene & McRae
- Liberty Syndicates
- Limit Underwriting Limited
- Lloyd's
- Marketform Group
- Marsh Limited
- Mazars
- Miller Insurance Services Limited
- Munich Re Underwriting Limited
- Navigators Underwriting Agency Limited
- Omega Underwriting Agents Limited
- PricewaterhouseCoopers
- R. K. Carvill & Co. Limited
- St Paul Travelers
- Talbot Underwriting Limited
- Wellington Underwriting plc
- Xchanging Claims Services
- Xchanging Ins-sure Services
- XL London Market Limited

PULLING TOGETHER

The ongoing success of Lloyd's charitable and community initiatives is testament to the generous support of the Lloyd's market. Without their dedicated time and energy Lloyd's Community Programme (see left for member companies) and the Lloyd's Charities Trust simply wouldn't exist. As the examples below demonstrate, it's about far more than the financial support.

Inspirational support

Torquil McLusky, Business Development Manager at Ascot Underwriting Limited, was inspired to take up voluntary work as a result of a presentation given by the Lloyd's Community Programme in 2004. Since last year, he's been working with Indymedia3 Productions, a video production company and social enterprise in Tower Hamlets, an area which has the second lowest employment rate of all local authorities in England despite its proximity to the City of London.

The company specialises in documentaries with Asian/English themes, and offers complete production services. As a social enterprise, it offers website design and multimedia training to encourage young and aspiring talent.

Torquil meets with the team monthly, providing advice on commercial matters and acting as a sounding board for new ideas. He strongly believes that it's not just the company that benefits from his involvement: 'Mentoring is an invaluable experience for both myself and Indymedia3. It enables me to give something back to the community and inspires me in my work.'

Shoulder to shoulder

In 2005, Randi Cigelnik, General Counsel for ACE European Group, joined 15 women from across the Lloyd's market to take part in the Women's Challenge 5km Run in Hyde Park to raise money for Macmillan Cancer Relief's CancerLine Service, one of the partner projects of Lloyd's Charities Trust.

Macmillan's work struck a personal chord with Randi; a family member and close friend had suffered from cancer and received support from the charity.

Running with her daughter and a colleague, Randi helped to raise over £1,500, which was matched by her employer, making ACE European Group the biggest team fundraiser.

Randi found it: 'an emotional experience running alongside 20,000 other women and there was a great feeling of contributing to such a worthwhile charity which affects people from all walks of life.'

LLOYD'S

LLOYD'S NUMBERS

LLOYD'S MARKET RESULTS

The Lloyd's Annual Report presents the financial results of the Society of Lloyd's and its members. 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 and individual members, underwriting severally for their own account. In view of Lloyd's unique structure, this report includes three sets of financial statements:

- Pro forma financial statements;
- Aggregate Accounts; and
- Society of Lloyd's report and financial statements.

The reason for each of these sets of accounts and the relationship between them is explained below.

Pro forma financial statements (pages 39 to 45)
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 Accounts (as below), members' funds at Lloyd's (FAL) and the Society of Lloyd's financial statements (as below).

The Aggregate Accounts report the results for all syndicates which transacted business during the year and include the syndicate level assets, which represent the first link in the Lloyd's chain of security, as described in detail in the 'Security underlying policies issued at Lloyd's' section on pages 58 to 62.

The capital provided by members is held centrally as FAL, not at syndicate level, and is not, therefore, reported in the Aggregate Accounts. FAL represent 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 financial statements report the central resources of the Society, which form the third link in Lloyd's chain of security. The Aggregate Accounts are prepared using UK GAAP, and, therefore, the central resources of the Society within the PFFS are also presented this way for consistency. The Society financial statements are prepared using IFRS and the financial effects of the differences between the two bases of presentation are reflected in the PFFS.

The profit and loss account in the PFFS, therefore, aggregates the syndicate underwriting 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, therefore, the PFFS aggregate the results and resources of the Society and its members and reflect all the links in Lloyd's chain of security. The PFFS may, therefore, be used as a reasonable presentation of the pre-tax results and state of affairs of the Lloyd's market on a basis that is broadly comparable with general insurance companies.

Aggregate Accounts (pages 47 to 57)
The Aggregate Accounts represent the total of the accounts reported by syndicates in their own audited financial statements.

Lloyd's is required to present this aggregation in accordance with the Insurance Accounts Directive (Lloyd's Syndicate and Aggregate Accounts) Regulations 2004. The syndicate annual accounts are prepared on an annual accounting basis, in accordance with UK GAAP.

The Aggregate Accounts replace the global accounts on a three-year basis which are no longer prepared. The aggregation also reflects the restated 2004 comparative figures as reported in syndicate annual accounts. The change in presentation from using three-year accounting to annual accounting has no impact on the result ultimately attributable and distributable to members.

Society of Lloyd's report and financial statements (pages 93 to 140)
The group financial statements of the Society of Lloyd's (the 'Society') comprise 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.

Byelaws made under Lloyd's Act 1982 require that the financial statements of the Society are prepared and approved by the Council of Lloyd's, and are subsequently approved by the members of Lloyd's in a general meeting.

Following the issue by the Society of subordinated loan notes, which are listed on the London Stock Exchange, the Society has been admitted to trading on a regulated market within the European Union and has adopted International Financial Reporting Standards (IFRS) from 1 January 2005. The Society previously used UK GAAP as its basis for accounting and the 2004 comparative figures have been restated on an IFRS basis.

REPORT OF ERNST & YOUNG LLP TO THE COUNCIL OF LLOYD'S ON THE 2005 LLOYD'S PRO FORMA FINANCIAL STATEMENTS

We have examined the Lloyd's pro forma financial statements ('PFFS') for the year ended 31 December 2005, 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 12, 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 its instructions to us. Our work 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 Council's 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 addressee 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 examine the PFFS and to report to you whether the PFFS have been properly prepared in accordance with the basis of preparation set out in note 2.

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 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. We have not audited those extractions. Our work is solely intended to enable us to make this report.

Our work, 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 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 properly prepared in accordance with the basis of preparation set out in note 2.

However, our work provides less assurance than an audit or a review in accordance with International Auditing Standards. We have not performed an audit and, consequently, we do not express an audit opinion on the financial information set out in the PFFS.

Conclusion
In our opinion, the PFFS for the financial year ended 31 December 2005 have been properly prepared in accordance with the basis of preparation set out in note 2.

Ernst & Young LLP

Ernst & Young LLP, London
5 April 2006

PRO FORMA PROFIT AND LOSS ACCOUNT

for the year ended 31 December 2005

Technical account	Note	2005 £m	2005 £m	2004 Restated £m	2004 Restated £m
Gross premiums written – continuing operations		**14,979**		14,268	
– discontinued operations	5	**3**		346	
			14,982		14,614
Outward reinsurance premiums			**(3,212)**		(2,880)
Premiums written, net of reinsurance			**11,770**		11,734
Change in the gross provision for unearned premiums		**230**		380	
Change in provision for unearned premiums, reinsurers' share		**(215)**		(317)	
			15		63
Earned premiums, net of reinsurance			**11,785**		11,797
Allocated investment return transferred from the non-technical account			**705**		532
			12,490		12,329
Claims paid					
Gross amount		**10,181**		8,387	
Reinsurers' share		**(3,418)**		(2,967)	
			6,763		5,420
Change in provision for claims					
Gross amount		**6,726**		1,388	
Reinsurers' share		**(3,984)**		838	
			2,742		2,226
Claims incurred, net of reinsurance			**9,505**		7,646
Net operating expenses	10		**3,668**		3,755
Balance on the technical account for general business			**(683)**		928
Attributable to – continuing operations			**(538)**		1,652
– discontinued operations	5		**(145)**		(724)
Total			**(683)**		928
Non-technical account					
Balance on the technical account for general business			**(683)**		928
Syndicate investment return		**705**		532	
Notional investment return on funds at Lloyd's		**602**		487	
Investment return and other income on Society assets		**191**		148	
		1,498		1,167	
Allocated investment return to the technical account		**705**		532	
			793		635
Other expenses			**(213)**		(196)
Result for the financial year before tax	8		**(103)**		1,367

Statement of total recognised gains and losses	Note	2005 £m	2004 Restated £m
Result for the financial year		**(103)**	1,367
Other recognised gains and losses		**42**	(22)
Total recognised gains and losses	8	**(61)**	1,345

PRO FORMA BALANCE SHEET

as at 31 December 2005

	Note	2005 £m	2005 £m	2004 Restated £m	2004 Restated £m
Investments					
Financial investments	11		**25,523**		22,068
Deposits with ceding undertakings			**14**		15
Reinsurers' share of technical provisions					
Claims outstanding		**14,450**		9,678	
Unearned premiums		**696**		872	
			15,146		10,550
Debtors					
Debtors arising out of direct operations		**3,853**		3,444	
Debtors arising out of reinsurance operations		**3,629**		3,411	
Other debtors		**685**		687	
			8,167		7,542
Other assets					
Tangible assets		**17**		16	
Cash at bank and in hand	12	**8,045**		8,105	
Overseas deposits		**1,444**		1,239	
Other		**10**		12	
			9,516		9,372
Prepayments and accrued income					
Accrued interest and rent		**93**		63	
Deferred acquisition costs		**1,503**		1,444	
Other prepayments and accrued income		**91**		111	
			1,687		1,618
Total assets			**60,053**		51,165
Capital, reserves and subordinated loan notes					
Members' funds at Lloyd's		**10,206**		9,622	
Members' balances		**(408)**		1,426	
Central reserves		**693**		615	
Capital and reserves	8	**10,491**		11,663	
Subordinated loan notes		**501**		506	
			10,992		12,169
Technical provisions					
Provision for unearned premiums		**6,829**		6,780	
Claims outstanding		**37,719**		28,849	
			44,548		35,629
Deposits received from reinsurers			**142**		37
Creditors					
Creditors arising out of direct insurance operations		**884**		458	
Creditors arising out of reinsurance operations		**2,228**		1,894	
Other creditors including taxation		**1,113**		758	
			4,225		3,110
Accruals and deferred income			**146**		220
Total liabilities			**60,053**		51,165

Signed on behalf of the Council of Lloyd's on 5 April 2006

Lord Levene of Portsoken, Chairman

Luke Savage, Director, Finance and Risk Management and Acting CEO

PRO FORMA CASH FLOW STATEMENT

for the year ended 31 December 2005

	2005 £m	2004 Restated £m
Result on ordinary activities before tax	**(103)**	1,367
Depreciation	**2**	3
Realised and unrealised (gains)/losses and foreign exchange	**(1,060)**	690
Net purchase of investments	**(2,212)**	(4,302)
Notional return on funds at Lloyd's	**(602)**	(487)
Increase in technical provisions	**4,314**	1,774
(Increase)/decrease in debtors	**(519)**	1,369
Increase/(decrease) in creditors	**1,031**	(501)
Cash generated from operations	**851**	(87)
Income taxes received/(paid)	**82**	(58)
Net cash from operating activities	**933**	(145)
Cash flows from financing activities		
Net (profits)/losses (paid to)/received from members	**(994)**	510
Increase in loans	**40**	–
Interest paid	**(39)**	–
Issue of subordinated loan notes	**–**	504
Net (decrease)/increase in cash holdings	**(60)**	869
Cash holdings at 1 January	**8,105**	7,236
Cash holdings at 31 December	**8,045**	8,105

NOTES TO THE PRO FORMA FINANCIAL STATEMENTS
for the year ended 31 December 2005

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 Accounts (pages 47 to 57), members' funds at Lloyd's (FAL) and the financial statements of the Society of Lloyd's, also known as the Corporation of Lloyd's, (pages 93 to 140).

The Aggregate Accounts report the audited results for calendar year 2005 and the financial position at 31 December 2005 for all syndicates which transacted business during the year. The Aggregate Accounts include the syndicate level assets, which represent the first link in the chain of security (see pages 58 to 62).

The capital provided by members is held centrally as FAL, not at syndicate level, and is not, therefore, reported in the Aggregate Accounts. FAL represent 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 form the third link in Lloyd's chain of security.

The profit and loss account in the PFFS, therefore, aggregates the syndicate underwriting 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 funds at Lloyd's and the central resources of the Society. Overall, therefore, 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 58 to 62. 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.

Comparative figures for calendar year 2004
The comparative figures for calendar year 2004 have been restated. This is necessary for two reasons:

- The pro-forma annual accounting statements in the 2004 Annual Report were compiled from syndicate returns prepared by managing agents in accordance with instructions issued by Lloyd's. The agents were required to follow relevant accounting policies as set out in the instructions. With effect from 1 January 2005, syndicates prepare their annual accounts in accordance with UK GAAP and each business applies the accounting policies appropriate to their business. The restated figures for 2004 in the PFFS are based on the comparative figures for calendar year 2004, included in the Aggregate Accounts and reflect the differences arising now that full annual accounting has been adopted by syndicates. The comparative figures also include the results and net assets of ten syndicates which closed by reinsurance in 2004;

- The Society's financial statements have been restated to include the results of its two insurance subsidiary undertakings, Centrewrite Limited and Lioncover Insurance Company Limited, and the adoption of FRS 17 'Retirement Benefits' as required under UK GAAP from 1 January 2005.

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, therefore, 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
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 been included in the pro forma balance sheet.

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 held under the terms of the premiums trust deed. These are each available to meet cash calls made on the member in respect of a syndicate. The assets in funds at Lloyd's 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 members' net funds at Lloyd's requirement and certain liabilities in respect of its underwriting business. Each member's net funds at Lloyd's requirement 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. The notional investment return is calculated on the average value of FAL during the year, based on indices yields on 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.

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.

In order to present the Society financial information on a basis consistent with the Aggregate Accounts, the Society financial information is presented on a UK GAAP basis within the PFFS. The effect of restating the Society financial statements is shown in note 8, and described in the conversion to IFRS document set out in note 30 to the Society financial statements.

Transactions between syndicates and the Society
(1) 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.

(2) 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 other income includes recoveries from insolvent members. The Aggregate Accounts for calendar year 2005 and earlier years include those members' results and balances.

(3) Syndicate loans to the Central Fund (and annual interest payments on the loans) are reported as assets (and accrued income) within the Aggregate Accounts. The Society financial statements report the loans as equity and account for interest payable when the Council formally approves interest payments.

(4) 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 Aggregate Accounts and the Society financial statements have been eliminated (note 8).

Intra-syndicate loans
The Aggregate Accounts report debtor and creditor balances for intra-syndicate loans totalling £315m (2004: £245m). 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 loan notes
In late 2004, Lloyd's raised capital by issuing £500m of subordinated loan notes. In accordance with the terms of these notes, the capital raised is available for payment to policyholders in advance of repayment to the note holders. Accordingly, the amount of the notes is included in the 'capital, reserves and subordinated loan notes' as reported in the pro forma balance sheet.

3. Accounting policies notes

A. Aggregate Accounts
The accounting policies adopted in respect of the syndicate annual accounts are set out on pages 50 to 52 of the Aggregate Accounts.

B. Funds at Lloyd's
Funds at Lloyd's are valued in accordance with their market value at the year end, and using year end exchange rates.

C. Society of Lloyd's
The accounting policies adopted in the Society of Lloyd's financial statements in accordance with IFRS are set out on pages 96 to 103.

4. Variability
Calendar year movements in reserves are based upon best estimates as at 31 December 2005 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.

The effect of claims from hurricanes Katrina, Rita and Wilma are included in the PFFS based on the disclosures reported in the Aggregate Accounts (see note 6 on page 53).

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.

Where business has been reported as discontinued in 2005, the results for that business have also been reported as discontinued in the 2004 comparative figures.

6. Members' funds at Lloyd's

The valuation of members' funds at Lloyd's (FAL) in the balance sheet totals £10,206m (2004: £9,622m).

The notional investment return on FAL included in the non-technical profit and loss account totals £602m (2004: £487m).

7. Society of Lloyd's

The results of the group financial statements of the Society included in the profit and loss account are a net profit of £183m (2004: £2m loss) in the technical account and a net loss of £13m (2004: £36m loss) 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 Aggregate Accounts, members' funds at Lloyd's and the Society financial statements is set out below:

	2005 £m	2004 Restated £m
Result per aggregate financial statements	**(871)**	975
Result per Society financial statements under IFRS	**(28)**	123
Central Fund claims and provisions in Society financial statements	**224**	153
Central Fund recoveries from insolvent members	**(12)**	(20)
Adjustments arising due to pre-tax differences between IFRS and UK GAAP in Society financial statements	**3**	(333)
Taxation (credit)/charge in Society financial statements	**(17)**	39
Interest receivable on syndicate loans to Central Fund accrued in Aggregate Accounts	**(4)**	–
Results of syndicates closed by reinsurance in 2004	**–**	(57)
Notional investment return on members' funds at Lloyd's	**602**	487
PFFS result on ordinary activities pre-tax	**(103)**	1,367

	2005 £m	2004 Restated £m
Result for the financial year	**(103)**	1,367
Other recognised gains and losses per Aggregate Accounts	**(14,832)**	(212)
Other recognised gains and losses per Society financial statements	**(1)**	2
Elimination of prior year adjustment in Aggregate Accounts	**14,875**	188
Total recognised gains and losses	**(61)**	1,345

	2005 £m	2004 Restated £m
Net assets per Aggregate Accounts	**(463)**	1,385
Net assets of syndicates closed by reinsurance in 2004	**–**	(51)
Equity per Society financial statements under IFRS	**765**	690
Central Fund claims and provisions in Society financial statements	**166**	92
Adjustments arising due to differences between IFRS and UK GAAP in Society financial statements	**(72)**	(75)
Members' funds at Lloyd's	**10,206**	9,622
Syndicate loans to Central Fund in Aggregate Accounts	**(107)**	–
Interest receivable on syndicate loans to Central Fund accrued in Aggregate Accounts	**(4)**	–
Capital and reserves per PFFS	**10,491**	11,663

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

9. Segmental analysis

A segmental analysis of the insurance operations of Lloyd's syndicates is reported in the Aggregate Accounts (note 4 on pages 52 and 53). The Society financial statements include a segmental analysis of the activities of the Corporation's insurance subsidiary undertakings, Centrewrite Limited and Lioncover Insurance Company Limited (note 3 on pages 103 to 106). These disclosures have not been repeated in the PFFS.

10. Net operating expenses	2005 £m	2004 Restated £m
Acquisition costs	**2,921**	2,803
Change in deferred acquisition costs	**(8)**	2
Administrative expenses	**872**	880
(Profit)/loss on exchange	**(117)**	70
	3,668	3,755

	Market value	
11. Financial Investments	2005 £m	2004 Restated £m
Shares and other variable yield securities and units in unit trusts	**2,398**	2,498
Debt securities and other fixed income securities	**20,279**	17,095
Participation in investment pools	**564**	704
Loans and deposits with credit institutions	**2,275**	1,737
Other	**7**	34
	25,523	22,068

12. Cash at bank and in hand

Cash at bank and in hand includes letters of credit and bank guarantees held in trust within members' funds at Lloyd's to meet policyholder claims as required, totalling £5,595m (2004: £5,712m).

AGGREGATE ACCOUNTS

Statement of Council's responsibilities

The Insurance Accounts Directive (Lloyd's Syndicate and Aggregate Accounts) Regulations 2004 ('the Regulations') require the Council of Lloyd's to prepare Aggregate Accounts in respect of the financial year by totalling all the syndicate annual accounts prepared in accordance with Regulation 3 of the Regulations.

The Regulations also require the Council to prepare an Annual Report on the insurance business carried on by the members of Lloyd's during the financial year. The Annual Report is set out in the Market Commentary on pages 14 to 17, 20, 21, 24, 25, 28 and 29.

Report of Ernst & Young LLP to the Council of Lloyd's on the 2005 Lloyd's Aggregate Accounts

We have examined the Lloyd's Aggregate Accounts for the year ended 31 December 2005, which comprise an aggregate profit and loss account, aggregate statement of total recognised gains and losses, aggregate balance sheet and aggregate statement of cash flows and the related notes 1 to 23, together with the Annual Report which have been prepared in accordance with The Insurance Accounts Directive (Lloyd's Syndicate and Aggregate Accounts) Regulations 2004 ('the Regulations') on the basis set out in note 1.

This report is made solely to the Council of Lloyd's in accordance with the Regulations. Our work 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 Regulations 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 addressee 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

As described in the Statement of Responsibilities, the Council of Lloyd's is responsible for the preparation and approval of the Aggregate Accounts and the Annual Report in accordance with the Regulations.

Our responsibility is to examine the Aggregate Accounts and the Annual Report and to report to you whether the Aggregate Accounts and the Annual Report have been properly prepared and correctly aggregated in accordance with the Regulations. We also report to you if the Aggregate Accounts are not consistent with the syndicate information which has been aggregated to prepare the Aggregate Accounts, if the Annual Report is not consistent with the Aggregate Accounts or if we have not received all the information and explanations we require for the purposes of our work. We read the Annual Report and consider whether it is consistent with the Aggregate Accounts. We consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the Aggregate Accounts. Our responsibilities do not extend to any other information.

Basis of conclusion

The Aggregate Accounts have been compiled from an aggregation of financial information extracted from the balance sheet and profit and loss account included in syndicate 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. We have not audited those extractions. Our work is solely intended to enable us to make this report.

Our work, 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 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 Aggregate Accounts and the Annual Report. 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 Aggregate Accounts and the Annual Report have been properly prepared and correctly aggregated in accordance with the Regulations.

However, our work provides less assurance than an audit or a review in accordance with International Auditing Standards. We have not performed an audit and, consequently, we do not express an audit opinion on the financial information set out in the Aggregate Accounts or the Annual Report.

Conclusion

In our opinion, the Aggregate Accounts and the Annual Report for the financial year ended 31 December 2005 have been properly prepared and correctly aggregated in accordance with the Regulations.

Ernst & Young LLP

Ernst & Young LLP, London
5 April 2006

AGGREGATE PROFIT AND LOSS ACCOUNT

for the year ended 31 December 2005

Technical account	Notes	2005 £m	2005 £m	2004 Restated £m	2004 Restated £m
Gross premiums written – continuing operations		**14,997**		14,319	
– discontinued operations		**3**		368	
	4		**15,000**		14,687
Outward reinsurance premiums			**(3,212)**		(2,872)
Premiums written, net of reinsurance			**11,788**		11,815
Change in the provision for unearned premiums					
Gross amount		**230**		367	
Reinsurers' share		**(215)**		(315)	
Change in the net provision for unearned premiums			**15**		52
Earned premiums, net of reinsurance			**11,803**		11,867
Allocated investment return transferred from the non-technical account			**709**		524
			12,512		12,391
Claims paid					
Gross amount		**10,073**		8,041	
Reinsurers' share		**(3,310)**		(2,829)	
			6,763		5,212
Change in provision for claims					
Gross amount		**6,674**		1,839	
Reinsurers' share		**(3,911)**		295	
			2,763		2,134
Claims incurred, net of reinsurance			**9,526**		7,346
Net operating expenses	9		**3,848**		4,058
Balance on the technical account for general business			**(862)**		987
Attributable to – continuing operations		**(717)**		1,347	
– discontinued operations		**(145)**		(360)	
Total			**(862)**		987
Non-technical account					
Balance on the technical account for general business			**(862)**		987
Investment income	10	**942**		754	
Unrealised gains on investments		**(80)**		(25)	
Investment expenses and charges	11	**(153)**		(205)	
Allocated investment return transferred to the technical account		**(709)**		(524)	
Other charges	12	**(9)**		(12)	
Balance on the non-technical account			**(9)**		(12)
Result for the financial year			**(871)**		975

Statement of total recognised gains and losses	Notes	2005 £m	2004 Restated £m
Result for the financial year		**(871)**	975
Exchange differences on translating foreign operations		**43**	(24)
Prior year adjustment	7	**(14,875)**	(188)
Total recognised gains and losses		**(15,703)**	763

AGGREGATE BALANCE SHEET

as at 31 December 2005

	Notes	2005 £m	2005 £m	2004 Restated £m	2004 Restated £m
Investments					
Financial investments	13		**19,650**		16,817
Deposits with ceding undertakings			**14**		15
Reinsurers' share of technical provisions					
Claims outstanding		**13,929**		9,090	
Unearned premiums		**696**		872	
			14,625		9,962
Debtors					
Debtors arising out of direct operations	14	**3,853**		3,433	
Debtors arising out of reinsurance operations	15	**3,650**		3,371	
Other debtors		**937**		773	
			8,440		7,577
Other assets					
Cash at bank and in hand		**2,386**		2,268	
Other		**1,454**		1,523	
			3,840		3,791
Prepayments and accrued income					
Accrued interest and rent		**92**		62	
Deferred acquisition costs		**1,503**		1,444	
Other prepayments and accrued income		**81**		92	
			1,676		1,598
Total assets			**48,245**		39,760
Capital and reserves					
Members' balances	16		**(463)**		1,385
Technical provisions					
Provision for unearned premiums		**6,829**		6,780	
Claims outstanding		**37,202**		28,243	
			44,031		35,023
Deposits received from reinsurers			**142**		37
Creditors					
Creditors arising out of direct insurance operations	17	**884**		454	
Creditors arising out of reinsurance operations	18	**2,228**		1,812	
Other creditors		**1,317**		870	
			4,429		3,136
Accruals and deferred income			**106**		179
Total liabilities			**48,245**		39,760

Signed on behalf of the Council of Lloyd's on 5 April 2006

Lord Levene of Portsoken, Chairman

Luke Savage, Director, Finance and Risk Management and Acting CEO

AGGREGATE STATEMENT OF CASH FLOWS

for the year ended 31 December 2005

	Notes	2005 £m	2004 Restated £m
Net cash inflow from operating activities	19	**2,948**	3,976
Transfer (to)/from members in respect of underwriting participations		**(994)**	370
Financing			
Increase in bank/inter-syndicate loans		**50**	164
Other		**(10)**	1
		1,994	4,511
Cash flows were invested as follows:			
(Decrease)/increase in cash holdings	20	**(18)**	310
Net portfolio investments		**2,012**	4,201
Net investment of cash flows		**1,994**	4,511

1. Basis of preparation

A Basis of reporting

The Aggregate Accounts have been prepared in accordance with the Insurance Accounts Directive (Lloyd's Syndicates and Aggregate Accounts) Regulations 2004, and in accordance with applicable Accounting Standards and under the historic cost accounting rules, modified to include the revaluation of investments, in accordance with the provisions of Section 255A, Schedule 9A and other requirements of the Companies Act 1985.

B Aggregation of syndicate annual accounts

The Aggregate Accounts as at 31 December 2005 have been prepared by totalling the annual accounts of the 123 syndicates reporting as at 31 December 2005. The result does not present a consolidated view of the results of Lloyd's business taken as a single entity and, in particular, it does not eliminate inter-syndicate reinsurances.

2. Change in reporting basis

The result for the year is determined on the annual basis of accounting in accordance with UK GAAP. This represents a fundamental change in reporting basis rather than a series of changes in accounting policies. The prior year figures have been restated as set out in note 7. The comparative figures exclude syndicates which closed by reinsurance in 2004 and have not, therefore, prepared annual accounts as at 31 December 2005.

3. Accounting policies

General

Under the Insurance Accounts Directive (Lloyd's Syndicates and Aggregate Accounts) Regulations 2004, 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. 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.

Reinsurance premium ceded

Outwards reinsurance premiums are accounted for in the same accounting period as the premiums for the related direct or inwards business being reinsured.

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 is a reasonable approximation.

Where the overseas 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 from the re-translation of the opening net investment in the branch are accounted for through reserves.

For other overseas operations, monetary assets and liabilities are translated into pound sterling at the rates of exchange ruling at the balance sheet date. Resulting exchange differences on translation may be 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 overseas 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.

Investment return
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.

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. Investment return has been wholly allocated to the technical account as all investments relate to the technical account.

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 overseas 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 does not become payable until after 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.

4. Segmental analysis
The following segmental analysis is derived from the equivalent notes in the syndicate annual accounts. The syndicate annual accounts report the material direct classes of business and aggregate the balance as 'other'. Consequently, aggregation of those figures is not meaningful. Syndicates have provided returns to Lloyd's, including segmental analysis and syndicate auditors have given review opinions confirming that those returns have been prepared in accordance with instructions issued by Lloyd's, and that they are consistent with the syndicate annual accounts. Those figures have been aggregated to provide the following tables:

2005	Gross premium written £m	Gross premium earned £m	Gross claims incurred £m	Operating expenses £m	Re-insurance balance £m	Result £m
Accident and health	410	424	(227)	(160)	(57)	**(20)**
Motor (third-party liability)	98	105	(73)	(33)	–	**(1)**
Motor (other classes)	797	874	(557)	(238)	4	**83**
Marine, aviation and transport	2,024	1,983	(2,686)	(521)	1,195	**(29)**
Fire and other damage to property	3,118	3,151	(3,411)	(877)	681	**(456)**
Third-party liability	2,992	3,162	(2,133)	(752)	(78)	**199**
Pecuniary loss	224	223	(235)	(65)	28	**(49)**
Life	47	44	(13)	(21)	(9)	**1**
Other	29	25	(16)	(9)	8	**8**
Total direct	**9,739**	**9,991**	**(9,351)**	**(2,676)**	**1,772**	**(264)**
Reinsurance acceptances	5,261	5,239	(7,396)	(1,172)	2,022	**(1,307)**
Total	**15,000**	**15,230**	**(16,747)**	**(3,848)**	**3,794**	**(1,571)**

2004 restated	Gross premium written £m	Gross premium earned £m	Gross claims incurred £m	Operating expenses £m	Re-insurance balance £m	Result £m
Accident and health	457	458	(299)	(149)	(14)	**(4)**
Motor (third-party liability)	128	126	(92)	(34)	11	**11**
Motor (other classes)	887	914	(646)	(227)	7	**48**
Marine, aviation and transport	2,034	2,095	(1,167)	(569)	(129)	**230**
Fire and other damage to property	3,231	3,333	(1,953)	(990)	(218)	**172**
Third-party liability	3,358	3,551	(2,665)	(960)	11	**(63)**
Pecuniary loss	213	240	(261)	(70)	(19)	**(110)**
Life	65	35	(20)	(7)	3	**11**
Other	47	50	(164)	(12)	104	**(22)**
Total direct	**10,420**	**10,802**	**(7,267)**	**(3,018)**	**(244)**	**273**
Reinsurance acceptances	4,267	4,252	(2,613)	(1,040)	(409)	**190**
Total	**14,687**	**15,054**	**(9,880)**	**(4,058)**	**(653)**	**463**

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:

2005	Gross premiums written £m	Net earned premium £m	Result £m
Reinsurance	**5,261**	**3,722**	**(1,307)**
Casualty	**3,402**	**2,949**	**179**
Property	**3,199**	**2,474**	**(457)**
Marine	**1,017**	**853**	**73**
Motor	**895**	**937**	**82**
Energy	**804**	**508**	**(238)**
Aviation	**375**	**327**	**96**
Life	**47**	**33**	**1**
Total	**15,000**	**11,803**	**(1,571)**

5. Life business

The Aggregate Accounts include the results of all life and non-life syndicates transacting business during 2005. 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 and net assets for life business are reported in the segmental analysis (note 4).

6. 2005 US hurricanes

The effect of claims from hurricanes Katrina, Rita and Wilma are included in the Aggregate Accounts. The size and complexity of the losses arising, particularly the unusual combination of wind storm and flood for hurricane Katrina, creates an additional level of uncertainty, but not over and above that normally associated with establishing claims reserves for insurance business.

All syndicates have provided unaudited returns to Lloyd's including the estimated impact of the 2005 US hurricanes. Based on these returns, the estimated effect of the 2005 US hurricanes is gross claims of £8.8bn and net claims of £3.3bn, after accounting for reinsurance recoveries, inwards reinstatement premiums and outwards reinstatement premiums. These estimates do not take into account, *inter alia*, the original premium income on policies which have given rise to claims and do not, therefore, represent an estimate of the overall financial position resulting from those policies.

7. Change in reporting basis

As set out in note 2, these accounts are presented using the annual basis of accounting. Prior to 1 January 2005, the global results were prepared in accordance with the Insurance Accounts Directive (Miscellaneous Insurance Undertakings) Regulations 1993. Syndicate results were reported on the three-year basis whereby the result was ascertained only at the end of the third year when the year of account was closed by reinsurance, normally to the syndicate's following year of account. Under the three-year basis, premiums were recognised on a cash basis, net of brokerage, and no technical provisions were made in the accounts until the end of the third year.

This change represents a fundamental difference in the reporting basis rather than a series of changes of accounting policies. Comparative amounts for 2004 have been restated. The impact of the change in reporting basis on the financial statements for the previous period is summarised below:

	£m	2004 £m
Members' balances under previous basis		16,260
Annual accounting adjustments arising from:		
Premiums	1,185	
Claims	(6,816)	
Expenses	(3,870)	
Reinsurance to close	(5,380)	
Other	6	
		(14,875)
Members' balances restated under new basis		1,385

The change in the basis of accounting has no effect on the quantum and allocation of profits and losses ultimately attributable to members.

8. Claims outstanding

The aggregate of the prior year surpluses/deficiencies is a surplus of £14m. The surplus primarily arises in respect of short-tail classes for the 2002 and 2003 accident years offset by additional reserves established for professional liability business written in 1998 to 2001.

9. Net operating expenses	2005 £m	2004 Restated £m
Acquisition costs	**2,921**	2,803
Change in deferred acquisition costs	**(8)**	(1)
Administrative expenses	**1,052**	1,185
(Profit)/loss on exchange	**(117)**	71
	3,848	4,058

10. Investment income	2005 £m	2004 Restated £m
Income from investments	**843**	673
Gains on the realisation of investments	**99**	81
	942	754

11. Investment expenses and charges	2005 £m	2004 Restated £m
Investment management expenses, including interest	**22**	17
Losses on realisation of investments	**131**	188
	153	205

12. Other charges

Included in other charges are exchange losses of £3m (2004: £1m).

	Market value		Cost	
13. Financial investments	2005 £m	2004 Restated £m	2005 £m	2004 Restated £m
Shares and other variable yield securities and units in unit trusts	**1,350**	1,583	**1,302**	1,476
Debt securities and other fixed income securities	**17,231**	14,069	**17,325**	14,154
Participation in investment pools	**123**	362	**121**	363
Loans and deposits with credit institutions	**939**	777	**906**	781
Other	**7**	26	**12**	38
	19,650	16,817	**19,666**	16,812

14. Debtors arising out of direct insurance operations	2005 £m	2004 Restated £m
Due within one year		
– policyholders	**83**	41
– intermediaries	**3,748**	3,352
Due after one year		
– policyholders	**–**	35
– intermediaries	**22**	5
	3,853	3,433

15. Debtors arising out of reinsurance operations	2005 £m	2004 Restated £m
Due within one year	**3,621**	3,349
Due after one year	**29**	22
	3,650	3,371

16. Reconciliation of members' balances	2005 £m	2004 Restated £m
Members' balances brought forward at 1 January (note 7)	**16,260**	10,699
Prior year adjustment (note 7)	**(14,875)**	(10,570)
Members' balances restated at 1 January (note 7)	**1,385**	129
Result for the financial year	**(871)**	975
Transfers (to)/from members' personal reserve funds	**(977)**	281
Members' balances carried forward at 31 December	**(463)**	1,385

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.

17. Creditors arising out of direct insurance operations	2005 £m	2004 Restated £m
Due within one year	**883**	454
Due after one year	**1**	–
	884	454

18. Creditors arising out of reinsurance operations	2005 £m	2004 Restated £m
Due within one year	**2,219**	1,802
Due after one year	**9**	10
	2,228	1,812

19. Reconciliation of operating (loss)/profit to net cash inflow from operating activities	2005 £m	2004 Restated £m
Operating (loss)/profit on ordinary activities	**(871)**	975
Realised and unrealised investment (gains)/losses	**(1,196)**	678
Increase in net technical provisions	**4,315**	2,282
(Increase)/decrease in debtors	**(514)**	759
Increase/(decrease) in creditors	**1,056**	(605)
Other net cash inflow from operating activities	**158**	(113)
	2,948	3,976

20. Movement in cash, portfolio investments and financing	At 1 January 2005 £m	Cash flow £m	Changes to market value and currencies £m	At 31 December 2005 £m
Cash at bank and in hand	2,268	(18)	136	**2,386**
Loans, deposits and investments	18,022	2,012	1,060	**21,094**
	20,290	1,994	1,196	**23,480**

21. Related parties

The annual accounts of each syndicate provide, where appropriate, the required disclosures on related parties. The syndicate level disclosures are specific to that syndicate and its managing agent. As such, it is not practical or meaningful to aggregate the syndicate level disclosures into a single related parties note for these Aggregate Accounts.

22. Funds at Lloyd's

Every member is required to hold capital at Lloyd's to support their underwriting, which is held in trust as funds at Lloyd's (FAL).

The level of FAL which Lloyd's requires a member to maintain is determined in accordance with Lloyd's Individual Capital Assessment (ICA) capital setting framework. FAL is not dedicated to any specific syndicate year of account participation for any member.

23. Staff numbers and costs

The following disclosures are made in order to comply with the requirements of the Insurance Accounts Directive (Lloyd's Syndicate and Aggregate Accounts) Regulations 2004. These figures are aggregated from the syndicate accounts that made this disclosure.

	2005 **£m**	2004 Restated £m
Wages and salaries	**277**	247
Social security costs	**30**	27
Other pension costs	**57**	39
	364	313

The average number of employees as reported in the syndicate annual accounts was:

	2005 **Number**	2004 Restated number
Administration and finance	**2,047**	1,899
Underwriting	**2,100**	1,970
Claims	**876**	832
Other	**39**	35

SECURITY UNDERLYING POLICIES ISSUED AT LLOYD'S

as at 31 December 2005

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 of one single corporate member or any number of corporate and individual members, underwriting severally for their own account.

There are 62 syndicates registered to conduct business at Lloyd's in 2006. 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 aggregate syndicate accounts do not change the allocation of profits and losses to members.

Every member underwriting at Lloyd's in 2006 is subject to an annual risk assessment, based on Lloyd's Individual Capital Assessment (ICA) capital setting framework. This determines a member's capital requirement subject to prescribed minimum levels. Members' capital requirements are held centrally as funds at Lloyd's and are not held at syndicate level.

The Lloyd's chain of security

The majority of claims are met from members' premiums trust funds, forming part of what is described below as the first link in the Lloyd's chain of security. However, the resources described in each further link are also available to meet valid claims by Lloyd's policyholders. Although aggregate numbers are shown below, the first two links 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 description of the chain of security set out below relates to the support of 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'.

The three key features of the Lloyd's chain of security are described below. In combination, they provide strong security to all Lloyd's policyholders, reflected in the high ratings assigned by leading rating agencies.

First link – syndicate 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.

Premiums trust funds and overseas regulatory deposits*: £29,109m.

Second link – members' assets

Capital requirements are determined for each member by Lloyd's ICA capital setting framework, subject to prescribed minimum levels.

Capital held at Lloyd's*: £10,206m.

Third link – central resources of the Society

At the discretion of the Council, the Central Fund is available to meet any portion of any member's insurance liabilities that the member is unable to meet in full. The Council is also able to call from members' premiums trust funds (first link) an amount up to 3% of members' premium limits in aggregate, in any one year (the callable layer). In addition, the other assets of the Society are available to meet underwriting liabilities in the last resort.

Society central resources excluding the subordinated debt liability and the callable layer*: £1,266m.

*as at 31 December 2005.

The first link

The first link in the chain of security is the members' 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, managed by the managing agent 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 overseas regulatory deposits. Profit is not distributed until provision has been made for all outstanding liabilities.

Profits on open years of account, to the extent permitted by reference to the cumulative annual accounting result at the year end, may be applied to meet cash calls and loss payments. Any profits not used in this way will be held in the members' personal reserve funds and will be available for release to members subject to the rules of the Release Test.

There are separate premiums trust funds for life business and non-life general business. There is a further segregation in that a number of the premiums trust funds are exclusively available to support certain overseas 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 are held in the Lloyd's American Trust Fund (LATF) of each member, in New York. There are separate LATFs in New York for US dollar denominated life business, whenever written or incepting.

The other overseas premiums trust funds are the Lloyd's Canadian Trust Fund (LCTF) in Canada, comprising members' underwriting 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 are obliged, by the terms of the underwriting agency agreements with their managing agents, to ensure that there are sufficient funds in the member's 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 funds at Lloyd's or, at the Council's discretion, the New Central Fund.

Premiums trust funds are used to fund overseas 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 reinsurance, surplus lines and Kentucky business respectively.

These deposits would be available to meet judgment debts of a member in respect of business connected with the relevant overseas territory in the event that the relevant premiums trust fund of 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 £29,109m in aggregate, at 31 December 2005.

The second link

The second link is members' funds at Lloyd's. Funds at Lloyd's 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 held under the terms of the premiums trust deed. These are each available to meet cash calls made on the member in respect of a syndicate. The assets in funds at Lloyd's 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 net funds at Lloyd's requirement and certain liabilities in respect of its underwriting business. Each member's net funds at Lloyd's requirement is determined using Lloyd's ICA capital setting framework.

Minimum capital ratios are set at 40% for both corporate and individual members (35% for those members writing mainly UK 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 funds at Lloyd's, which can be called upon to meet its underwriting liabilities.

As at 31 December 2005, the total value of funds at Lloyd's held in trust by members amounted to £10,206m in the aggregate.

The third link

The third link is the central resources of the Society. These comprise the assets of the New Central Fund, '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 funds at Lloyd's or their own resources.

The New Central Fund is funded by annual contributions from members. In addition, with effect from the 2005 year of account, the net resources are enhanced by loans made to it by active syndicates. These amounts are treated as equity in the Society's financial statements. Repayment of these loans may be deferred at the discretion of the Council of Lloyd's although current expectations are that repayment will be made upon closure of the year of account. The net assets of the Central Fund (ie the New Central Fund and the 'Old' Central Fund) as at 31 December 2005 were £670m.

In late 2004, Lloyd's issued subordinated loan notes amounting to £501m in value at 31 December 2005, which are reflected as an asset and a liability within the Society's financial statements. As set out in note 20 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.

New Central Fund assets may be supplemented by an amount not exceeding 3% of members' overall premium limits callable in any one calendar year from members' premium trust funds (described and included in the first link).

In addition, the other assets of the Society, totalling £95m at 31 December 2005, 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 £1,266m at 31 December 2005.

Aggregate resources

The total of syndicate assets, members' funds at Lloyd's and central resources as at 31 December 2005, after the elimination of syndicate loans to the Central Fund and annual interest receivable, were £40.5bn. The total amount of net syndicate technical provisions (estimated current and future insurance liabilities) at the end of 2005 was £29.4bn. The total net aggregate declared resources of the Society and its members were therefore £11.1bn (excluding the subordinated debt liability). This reconciles to the 'capital, reserves and subordinated loan notes' of £11.0bn as shown in the PFFS on page 40, in accordance with note 2 to the financial summary on page 62.

The results on which the aggregated resources are based are determined by aggregating 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. Each member trades for its own account, and Lloyd's has, since the beginning of the last century, required an annual report of each member's underwriting position.

All members have an obligation to keep sufficient funds in trust to meet their liabilities and to satisfy any request for funds in respect of audited losses or future liabilities.

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 (ie solvency reserves or 'technical provisions for solvency') are subject to a statement of actuarial opinion. In the event that it is not possible for the managing agent to secure an unqualified actuarial opinion for any reason, the solvency reserves 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 at 31 December 2005.

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

Firstly, each member's solvency position is calculated. Each member must have sufficient assets – those held in the premiums trust funds, overseas regulatory deposits and its funds at Lloyd's – to cover its underwriting liabilities and on top of this an additional solvency margin. The solvency margin is calculated separately for each member, determined essentially as the greater of 16% of total 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 solvency margin, 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 amount of the callable layer referred to previously – for this purpose the 'effective' callable layer, ie that part of the callable layer not attributed 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.

Where it is apparent, either from the solvency testing process or elsewhere, that a member has insufficient assets in trust to meet its underwriting liabilities and solvency margin, Lloyd's will take action in respect of that member in order to protect policyholders, which will result in the member having to cease underwriting unless new funds are provided by that member.

Each year, Lloyd's files a return – 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 Lloyd's solvency test.

SECURITY UNDERLYING POLICIES ISSUED AT LLOYD'S: FINANCIAL SUMMARY as at 31 December 2005

	2005 £m	2004 Restated £m
I Assets held at syndicate level (several basis)	**29,109**	26,487
II Members' funds at Lloyd's (several basis)		
Deposits	**9,702**	8,976
Personal reserves	**468**	636
Special reserves	**36**	10
	10,206	9,622
III Central resources of the Society (mutual basis)		
Net Central Fund assets	**670**	607
Subordinated debt	**501**	506
Other net assets of the Society	**95**	83
	1,266	1,196
Elimination of syndicate loans to Central Fund and annual interest receivable	**(111)**	–
Total resources of the Society of Lloyd's and its members	**40,470**	37,305
Net syndicate technical provisions	**(29,406)**	(25,061)
Total net resources of the Society of Lloyd's and its members	**11,064**	12,244

Notes

1. This financial summary has been compiled by aggregating the assets and liabilities of all the underlying syndicates, the declared members' qualifying assets 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' reconciles to the 'capital, reserves and subordinated loan notes' shown in the PFFS as set out below:

	2005 £m	2004 Restated £m
Total net resources of the Society of Lloyd's and its members	**11,064**	12,244
Adjustments arising due to differences between IFRS and UK GAAP in Society financial statements	**(72)**	(75)
Capital, reserves and subordinated loan notes (per PFFS, see page 40)	**10,992**	12,169

SOCIETY OF LLOYD'S ANNUAL REPORT

SOCIETY REVIEW

This review considers the activities and financial results of the Society of Lloyd's including the Lloyd's Central Fund. Activities and financial results of the Lloyd's market comprising the 123 syndicates reporting as at 31 December 2005 are set out in the syndicate Aggregate Accounts on pages 47 to 57 and are considered in the Market Commentary on pages 14 to 17, 20, 21, 24, 25, 28 and 29. The pro forma financial statements on pages 39 to 45 include the results of the market and the Society. The purpose of each of the different financial statements is explained on page 37.

Since 2003, Lloyd's has operated a franchise structure which put a new emphasis on the relationship between the Society and the managing agents. Under the franchise structure, the Society acts as the franchisor and the managing agents are the franchisees. The Society's main corporate purposes are to facilitate the carrying on of insurance business by members of Lloyd's and the advancement of their interests in this context. As franchisor, the Society seeks to adopt a proactive role in the prudential management of the Lloyd's market. The franchise goal is: 'To create and maintain a commercial environment at Lloyd's in which the long-term return to all capital providers is maximised'.

Strategy – Building the Optimal Platform

Significant progress was made in 2005. Notable achievements included the successful integration of the Individual Capital Adequacy Standards (ICAS) regime into the capital setting process, affirmation of Lloyd's 'A' rating with stable outlook from Standard & Poor's, AM Best and Fitch, achievement of contract certainty goals for 2005 and the approval of Lloyd's application to establish an onshore reinsurer in China.

Although most deliverables in the 2005 plan were on track, three have been carried forward to 2006 (new entrants strategy, accounting and settlement and acquisition cost analysis). Two deliverables were not achieved. The first was the ability of Kinnect to offer an electronic data transfer system covering risk placement and endorsement for three risk classes by the end of 2005 and the second was to achieve a target loss ratio of 60% to 65%. Following the Franchise Board's decision in January 2006, Kinnect has closed. The target loss ratio was not met due to the US hurricane losses although the cross cycle return target remains valid.

The focus going forward will be on delivering the recently launched three-year strategy. 'Building the Optimal Platform' describes the actions that will be taken over the next three years to ensure that Lloyd's continues to compete effectively.

The strategy was developed with considerable input from the market – both through discussions with every franchisee and through specific input from the Lloyd's Market Association. There are five clear benefits that the platform will deliver:

- **A clear and transparent performance framework**
  A performance management framework that supports the achievement of superior operating returns through recognising the specific characteristics of each franchisee.

- **Capital advantages**
  A capital framework in which the benefits of mutuality demonstrably outweigh the costs and which cannot readily be duplicated outside Lloyd's.

- **A secure, highly-rated market**
  Insurer financial strength ratings of at least 'A' from Standard & Poor's, AM Best and Fitch.

- **Outstanding market access**
  Cost effective, easy access to the world's major markets supported by a global brand and licence network.

- **Efficient business processes**
  A framework of standards for business processes that enables firms to deliver services to customers at a cost and level of risk comparable with other platforms.

Building the Optimal Platform will be extremely challenging. This is a complex market dependent on many inter-relationships, operating in a complex area of financial services. The support and commitment of those working within the market will be critical to Lloyd's achieving its objective.

It will also be critical to make sure that the Society has the right structure and approach. This means people with the right skills in the right jobs, a culture which supports the commercial ambitions of the market and is customer-focused, rewards and incentives that are linked to the delivery of the Lloyd's goal, good communication with franchisees, and regular updates against plan.

People

Strategy is no more than good intentions until turned into action by people. Attracting, retaining and rewarding the right people have therefore been at the heart of our strategy for the past two years.

Total reward and development

This project has been aimed at making sure HR policies facilitate the delivery of business strategy and, over the longer term, build the HR and management capability necessary for sustained organisational success.

A review of incentives and total rewards was conducted during the year. As a result, part of the costs of providing pension benefits will be funded by the introduction of employee pension contributions from July 2006 and there will be a shift to variable performance-based pay. This rebalancing of rewards will enable us to increase bonus opportunities for staff at every level without substantially increasing our overall employment costs. Widespread communication with employees and formal consultation with elected employee representatives took place throughout 2005, in preparation for this change and to explain the rebalancing of rewards towards performance rather than service.

Employee consultation and communication

In addition to the communication and consultation relating to the total reward and development project, the Society continued its policy of actively promoting employees' understanding of and involvement in the business objectives of Lloyd's. This is achieved by regular team meetings to keep employees informed and provide feedback to management; staff forums at which the CEO briefs staff and answers questions on business progress and issues; an intranet (C-net) which provides information rapidly to employees; and a mechanism for employees to communicate directly with the CEO.

Training and development

The Society continued its strong commitment to training and development. This was aimed at making sure we had the skills, values and capabilities to achieve business objectives, meet FSA requirements and improve individual performance. Employees are actively encouraged to obtain relevant qualifications and fulfil their potential, financial and other support is available to all. A system of internal job advertising is in place so that as many vacancies as possible are filled through internal promotions, transfers and secondments.

Diversity

In addition to formal policies the Society has an active diversity group sponsored by the CEO. The diversity initiative is about promoting an environment at Lloyd's where all are valued and respected for individual abilities, skills and experience; where difference is respected and seen as a potential asset. It is about attracting and retaining a diverse workforce and harnessing its different skills, experiences and intellectual capability to enhance business performance and making sure that employees receive equal treatment regardless of factors such as age, race, colour, religion, belief, sex, sexual orientation, national or ethnic origin, marital status or disability.

During 2005, the diversity group led discussion forums aimed at identifying and overcoming obstacles to diversity. A computer-based training programme on diversity at work was also undertaken by all staff.

Retention and absence

Staff turnover, excluding retirements and redundancies, continued to be low at 9% compared to an industry average of over 12%, as did our sickness absence record at 2% compared to the industry average of 2.5%.

Corporate responsibility

Our responsibilities to members of the Lloyd's community, suppliers, employees and wider society are diverse. This is reflected in our corporate responsibility policy that was updated in 2005 to reflect business development. It seeks to ensure that as an organisation we take social, ethical and environmental issues into due consideration.

The policy addresses four main areas:

- **Marketplace:** As well as managing agents' responsibility to conduct their own business in compliance with laws and regulations which include those relating to whistle blowing, financial crime, money laundering, conflicts of interest and client confidentiality, the Society recognises its role in helping and supporting them in their efforts to conduct their business in compliance with such regulations.

- **Workplace:** As described above, we recognise our responsibility for ensuring that all employees are treated equally. Our actions in this area are guided by a set of policies that cover every aspect of an individual's working life, from recruitment and remuneration, to flexible working and work/life balance.

- **Environment:** We operate a wide-ranging environment policy to reduce our direct environmental impacts. The policy covers everything from energy efficiency to waste reduction and vehicle emissions.

- **Community:** The Lloyd's market's success is impacted by the health and prosperity of the local, national and international communities of which it is a part. Lloyd's has a long-standing tradition of charitable giving and involvement in the local community and the Society is committed to its own direct charitable giving as well as encouraging employees working in the Lloyd's market to provide volunteer and charitable support.

What we have done
Examples of progress made during 2005 include:

- **Marketplace:** Full annual accounting under UK GAAP was implemented as part of a commitment to strive for clear communications with stakeholders and to provide a more financially intelligible and transparent market.

- **Workplace:** Employee statistics show a ratio of men to women of 48:52 but also highlighted an imbalance in the number of women at more senior levels. As a result, interviews were undertaken with women at Lloyd's to understand whether there were any factors that might be inhibiting their progression. Whilst feedback was generally very positive, steps have been taken to address issues raised including updating and re-issuing flexible working guidelines to all employees.

- **Environment:** There has been a 50% decrease in the weekly amount of waste from the Lloyd's building in London going to landfill over the last two years. This has primarily been as a result of a number of recycling measures, including the introduction of a glass crushing machine to enable glass recycling.

- **Community:** The payroll giving scheme was re-launched to all employees resulting in a fourfold increase in employees using the facility. To encourage more participation, an additional 'bonus' donation to employees' charities was made when they signed up.

What we aim to do
In 2005, we undertook an exercise to benchmark our corporate responsibility policy and practices against other UK organisations.

The findings from the benchmark were used to develop a 2006 Action Plan which identified a number of further actions for the coming year, in particular relation to integrating, managing and communicating corporate responsibility issues more effectively. Progress against this Action Plan will be reported back on a quarterly basis to the Executive Committee. The Director of Operations has responsibility for corporate responsibility. More information on how employees from the Society and across the market are supported and encouraged to provide charitable and volunteer support to neighbouring boroughs can be found on pages 32 to 36.

Risk management
The risk management framework was developed in 2003, in order to help the Society identify, understand and manage risk more effectively.

The ongoing process of risk management takes in the activities of all areas of the franchisor, and consists of the risk framework, the governance structures, the internal control system and the assurance processes of Internal Audit, Compliance and Financial Control.

Risks are managed by the business. Escalation of risk issues is through the governance structure of directorates, committees and groups, the Executive Committee and Franchise Board. The risk management framework aims to pull together the key risks that the Society faces, and enable an assessment of these risks on a common basis. It seeks to provide assurance to the Franchise Board that risk is being identified and managed effectively.

Risk identification
The key risks to the franchise are identified and assessed via the combination of a facilitated risk and control self assessment process and environment scanning. All risks that are identified are owned by a relevant individual. Risk owners review risk each quarter, and environment scanning by the business, by project groups and by the Executive Committee and the Franchise Board identifies new risks or changes to existing risks which are fed into the framework.

The risk assessment
The self assessment process includes the assessment of risk for the potential impact on the Lloyd's market and therefore the Society should it occur, and the perceived likelihood of occurrence of risk within the next 12 months. Risk is assessed on an inherent (before control) basis, and a residual (after control) basis. Appetite is set for each risk identified, and actions identified for risks where residual

risk exceeds appetite. The quarterly risk and control assessment then tracks actions by key milestone or deliverable. The assessment process is coordinated by the Risk Management team, which undertakes an oversight and challenge role where appropriate.

Summary of types of risk

The risk framework currently places risks to the Lloyd's market and, therefore, the Society into one of eight risk categories. The risk framework is not a fixed number of risks or categories, and evolves to align with changes to the business and its environment.

- **Business strategy:** Whilst often included as an operational risk, the framework treats this area as significant in its own right. This covers risks that are potentially fundamental to the strategic viability of the Society arising out of the Lloyd's market position, strategic direction and commercial interests.

- **Capital:** The Lloyd's market has a unique capital structure. This generates a number of risks to the achievement of the Society's objectives. These include the pressures raised by the structure itself, but also a number of risks around the calculation of the appropriate level of capital for the Society and the way this is then distributed amongst the members.

- **Credit:** The Lloyd's market and therefore the Society has exposure to credit risk with a number of counterparties, including brokers and policyholders, reinsurers, banks and investment issuers and custodians.

- **Financial markets:** The Society's assets are exposed to fluctuation in markets, including asset markets, interest rates and exchange rates.

- **Insurance:** Risk comes from the underwriting, reinsurance, claims and reserving activities of the Lloyd's market and reflects the inherent uncertainties as to the occurrence, amount and timing of insurance liabilities.

- **Liquidity:** Risks in this category consider liquidity and solvency concerns for the Society in the UK and overseas.

- **Operational:** This covers the risk of loss, resulting from inadequate or failed internal processes, people or systems, or from external events. These include issues such as business interruption and continuity, provision of services and infrastructure, culture and competence, financial controls and execution of strategic initiatives.

- **Regulatory and legal:** The Society operates within a highly regulated industry and across multiple jurisdictions, generating a number of risks to the achievement of the Society objectives.

Risk management and mitigation

As well as identifying and assessing risk, the risk management framework identifies and assesses the controls that the Society operates to mitigate risk. Controls are owned by individuals and are assessed according to their design and performance – how well have they been designed to manage a particular risk and how well the control is then performed. The framework helps the Society to understand how well the risk is being managed, which of the controls are working effectively, and where to focus resource to best effect.

The results of the quarterly risk assessments are agreed by the Executive Committee and provide assurance to the Franchise Board about the effective management of risk, and help to ensure that the Society has an effective system of internal control.

The risk management framework is also used in the calculation of the Society Individual Capital Assessment (ICA), which is the level of capital resources required to withstand a 1-in-200-year event over a one-year time frame. Each risk within the risk framework is assessed to ensure it is treated appropriately from a capital perspective; as part of the stochastic model, as part of the stress and scenario testing or by being controlled by alternative methods. Whilst there is considerable stochastic modelling of insurance risk, and some other elements of risk such as credit risk, the risk framework was used to identify relevant stress and scenario tests for risks that were outside of the stochastic model. The scenario tests that followed were based on events where one or more of the risks in the framework could occur, and assessing the potential loss from a significant event. The results were fed into the calculation of the Society ICA.

Operating review

During 2005, the Executive Committee and the Franchise Board monitored progress against a series of financial and operating objectives and targets. With respect to operating objectives that relate to the Society's activities, the following were key achievements in 2005:

Economics

The FSA's ICAS regime was successfully implemented in 2005 for syndicates underwriting in 2006 and for the Society itself. This included the preparation of guidance for syndicates, tools and techniques to assist managing agents. 62 syndicates' ICAs were reviewed in a coordinated process that involved teams from Finance and Risk Management and Franchise Performance directorates. Multi-disciplinary teams were able to draw on insurance and actuarial input and benchmarking data to ensure appropriate challenge and consistency with syndicate business plans to ensure that a syndicate's ICA reflected its risk profile. The Franchise Performance directorate held more than 400 meetings with franchisees relating to underwriting and business plan reviews.

The Realistic Disaster Scenario (RDS) specifications were overhauled and two new RDS events were created in April 2005, including a $60bn Gulf of Mexico windstorm, which enabled managing agents to review their exposures and provided valuable comparison to the losses sustained from hurricane Katrina.

The eligible asset rules were simplified and brought in line with FSA rules in advance of the solvency test on 31 December. This provides managing agents with greater flexibility and should facilitate improved investment returns.

Earned profits are available for distribution prior to the closure of a year of account and may be released to members subject to the applicable capital tests.

Security

By the end of 2005, the rating agencies, Standard & Poor's, AM Best and Fitch all confirmed `A` ratings with stable outlook. This is set against a background where many reinsurers have been subject to downgrades or placed on credit watch.

The Open Years Management team worked closely with the managing agents of run-off syndicates and participated in review and reserving meetings to understand the impact on the Central Fund of insolvent members and ensure that robust closure plans have been put in place.

As described in the Risk Management section above, the risk profile of the Society continues to be developed. The appetite for each risk is identified and assessed in order to develop a risk mitigation strategy.

Infrastructure

Progress has been made to help create an environment for the effective and efficient management of claims. Lloyd's Claims Management Principles were introduced in July 2005 and the claims management performance of all managing agents was assessed against the minimum standards. Further standards will be issued for market consultation in 2006. In addition, a new service agreement has been agreed with Xchanging Claims Services (XCS), including provisions relating to claims agreement by following underwriters, and the 1999 Claims Scheme was revised to bring it in line with current market practices. The Lloyd's claims team will also participate in the new Claims Service Review Board, with representatives from the market and XCS to oversee the work of XCS. The claims team also coordinated the market's hurricane Katrina response.

Progress has been made through a number of initiatives to produce a framework of standards for business processes that enable market firms to deliver services to customers. These included: compliance checking of the quality of LMP slips which was rated 97% in December 2005; implementation of the LMP standard for binding authorities and lineslips; increased content of the LMP slip defined and incorporated into ACORD standards; further standardisation of the placing process for endorsements; contract certainty checklist, code of practice and further guidance issued; Xchanging Ins-sure policy checking codified, statistics published in checking process, error rates tracked and reduced; and contract certainty definition and targets agreed, and shared with the FSA and progress monitored. This enabled a success rate of more than double the year end target of 30% to be achieved.

The Accounting and Settlement project was reviewed in 2005 and the revised scope and requirements agreed. This targets delivery of a number of improvements in 2006.

An electronic claims file repository was implemented with 300 claims files and nearly 500 transactions made by the end of 2005.

The objective of offering an electronic data transfer system covering risk placement and endorsement had changed by the end of 2005. The Franchise Board decided that the Kinnect platform was not optimal in ensuring more efficient businesses processes for Lloyd's and the London market. As a result it was closed in early 2006. There had been a growing consensus that the market, on a peer to peer basis, was better equipped to solve the problem of electronic data placement and that the franchisor's role should be standard setting.

Market access

A priority has been to ensure that the franchise has access to, and is promoted in, major markets. In 2005, approval was given to establish an onshore reinsurance operation in China, enabling Lloyd's to reinsure local currency business and provide Chinese reinsurers with access to the Lloyd's market. Also, agreement was reached to establish a representative office in India in 2006. The Worldwide Markets directorate produced country strategy papers for China and India providing an in-depth view of the business and insurance environment, assessing competitors and Lloyd's entry strategies. In addition, ten country intelligence briefs and four Lloyd's snapshots at regional and country level were published. The directorate maintains an ongoing dialogue with overseas regulatory authorities, brokers, coverholders, cedants and the local media to promote Lloyd's interests and presence overseas. All 72 licences were sustained.

In 2005, the Lloyd's brand was reviewed and defined to develop a new identity and brand architecture. This was communicated throughout the franchise. Lloyds.com was re-launched with an improved look and feel.

Operations

Over 60 separate service standards for the supply of information and services to the market were agreed in 2005 with the Lloyd's Market Association to be effective for 2006.

The Complaints department handled 2,800 new complaints from Lloyd's policyholders on behalf of the market and closed 3,500 cases in 2005. This department also dealt with enquiries from US residents seeking to claim under their insurance for damage resulting from hurricanes Katrina, Rita and Wilma. The correct insurer, not always Lloyd's, was identified for 99% of enquiries.

Contingency planning and testing of business continuity plans progressed in 2005. Three tests of aspects of business continuity plans, including the IT infrastructure for managing agents at the underwriting room contingency site, were successfully completed. There is a regular sharing and discussion with the market of business continuity issues.

A key aspect of the IT services provided included the further development of Lloyd's data warehouse which now supports a major part of Society reporting, including core market returns.

Property Services handled the disposal of Lloyd's premises in Chatham in 2005 and the acquisition of a lease on new premises nearby which will result in operating cost savings over the period of the lease.

2006 performance measurement

In 2006, Society performance as franchisor will be measured against a series of key metrics. These metrics will include financial measures, franchisee satisfaction with the provision of business critical services, the achievement of agreed service levels, risk mitigation and people risk.

Financial review

This review should be read in conjunction with the financial statements of the Society on pages 93 to 140.

International Financial Reporting Standards

The Society adopted International Financial Reporting Standards (IFRS) from 1 January 2005. The 2005 financial statements of the Society are the first full financial statements prepared in accordance with IFRS, having previously applied UK accounting standards. They are also the first financial statements in which insurance company subsidiary undertakings of the Society as well as the Lloyd's Central Fund are consolidated.

The adoption of IFRS has resulted in significant changes in the accounting, presentation and disclosure of certain items in the financial statements. As a result of moving to reporting under IFRS, comparative information has been restated and an explanation of how the transition to IFRS has affected the reported financial position, financial performance and cash flows of the Society has been provided in note 30 on pages 133 to 140.

The basis of preparation and consolidation and the principal accounting policies adopted are set out in notes 1 and 2 on pages 96 to 103.

Overall financial result

The deficit for the year after taxation is £27.6m (2004: surplus of £122.8m). The deficit is mainly a consequence of the change in the basis of funding the New Central Fund in 2005 and the level of New Central Fund claims and provisions which have been partly offset by an increase in net finance income. The deficit was within planning expectations.

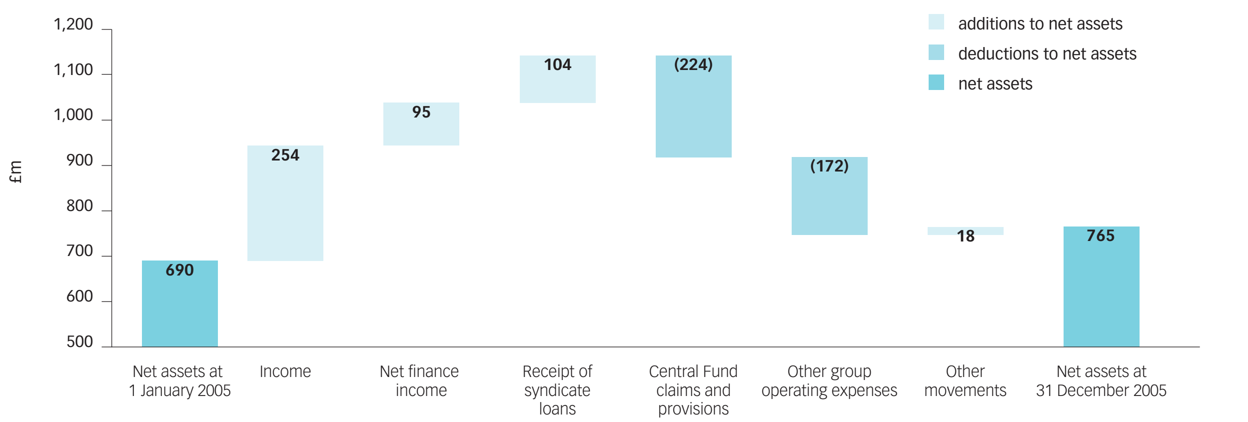
Members have continued to contribute to the Central Fund based on a percentage of their allocated overall premium limit. However, from 2005 this is achieved partly by contributions of 0.50% (2004: 1.25%) and partly by way of interest-bearing loans from syndicate premiums trust funds, referred to as syndicate loans, of 0.75% (2004: not applicable). The syndicate loans are treated as part of the Society of Lloyd's equity rather than as contributions from members in the group income statement (see note 25 on pages 129 and 130). Syndicate loans will ordinarily be repaid on the closure of the year of account after three years. Interest payable on the loans is accounted for when the Council of Lloyd's formally approves interest payments to be made. An amount of £4.4m was approved on 5 April 2006 in respect of interest for the year to 31 March 2006.

New corporate members underwriting on new syndicates are required to contribute to the New Central Fund at an increased rate for their first three years of operations at Lloyd's. The rate for 2005 was 2.5%.

Members' subscriptions which are used to finance the operations of the Society were unchanged in 2005 at 0.50%.

The Society net assets have increased from £690.0m to £764.6m. Details are set out below:

Movement of net assets



The net assets of the Central Fund are included within the above amounts and at 31 December were £670.4m (2004: £606.6m).

Solvency

Total assets for solvency purposes are set out below. The 2005 position is an estimate of the amount which will be finalised in June 2006 for submission to the FSA:

	2005 £m	2004 £m
Net assets at 31 December	**765**	690
Subordinated loan notes	**501**	506
Callable Central Fund contributions	**439**	411
	1,705	1,607
Other solvency adjustments	**133**	56
Central assets for solvency purposes	**1,838**	1,663

Based on central assets of £1.8bn, the estimated solvency ratio is 379% (2004: 300%).

In setting contribution levels, account was taken of the Society's ICA to ensure that Lloyd's is prudently but competitively capitalised. The medium-term target is that central assets for solvency purposes should exceed £1.7bn.

The operating (deficit)/surplus reported by business segment is set out below.

	Corporation of Lloyd's £000	Central Fund £000	Insurance activities £000	2005 Total £000	2004 Total £000
Income	**167,761**	**83,306**	**2,769**	**253,836**	392,230
Central Fund claims and provisions	**–**	**(223,889)**	**–**	**(223,889)**	(125,540)
Gross insurance claims incurred	**–**	**–**	**(30,039)**	**(30,039)**	(47,735)
Insurance claims recoverable from reinsurers	**–**	**–**	**29,844**	**29,844**	52,053
Other group operating expenses	**(166,006)**	**(5,907)**	**(184)**	**(172,097)**	(173,416)
Operating (deficit)/surplus	**1,755**	**(146,490)**	**2,390**	**(142,345)**	97,592

Income
The Society's income has decreased in 2005 by £138.4m to £253.8m (2004: £392.2m). This is principally attributable to lower market capacity and a reduction in New Central Fund contribution rates dealt with through income. New Central Fund contributions recognised within income reduced from £190.7m to £70.1m, a reduction of £120.6m, whilst members' subscriptions reduced from £74.9m to £68.8m, a reduction of £6.1m.

Central Fund claims and provisions
Central Fund claims and provisions increased in 2005 by £98.4m to £223.9m (2004: £125.5m). This principally reflects the granting of annual undertakings to insolvent members in order to meet their financial commitments to policyholders from the Central Fund. Annual undertakings are approved at the discretion of the Council of Lloyd's, normally in April of each year, and are based on anticipated cash flow requirements of insolvent members in the following 12 months. During 2005, payments made in respect of the undertakings totalled £145.6m.

Gross insurance claims incurred and insurance claims recoverable from reinsurers
The Society has two insurance company subsidiary undertakings, Centrewrite 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. The insurance contract liabilities of Lioncover were wholly reinsured into Equitas in 1997 and the company does not accept new business. Both within gross insurance claims incurred and insurance claims recoverable from reinsurers is a matching £30.4m relating to Lioncover. Movements in Lioncover's reserves do not therefore affect the result for the year.

Other group operating expenses
Operating expenses were stable in 2005 at £172.1m (2004: £173.4m) and are principally attributable to the Corporation of Lloyd's. Maintaining cost discipline is a priority, and opportunities to improve the efficiency of operations and bring down the cost of doing business at Lloyd's will continue to be sought.

Kinnect was such an initiative initially driven by the need to modernise the market. The Franchise Board, following a recommendation of the Kinnect Board, in January 2006 agreed not to continue to fund the Kinnect platform going forward. The costs of Kinnect had been expensed when incurred and not capitalised. Total costs, before tax relief, were £71.6m over the period 2001 to 2005, with £15.5m being incurred in 2005. Further costs of up to £3.5m are expected to be incurred in 2006 to close the operation.

Net finance income
Finance costs of £33.7m in 2005 (2004: £7.2m) include interest on subordinated loan notes issued in November 2004. The loan notes attracted two months, interest cost during 2004.

The increase in finance income to £129.0m (2004: £45.9m) is mainly due to the receipt of additional income from the proceeds of the subordinated loan notes together with favourable investment conditions in 2005. The overall investment returns on central assets were 9.30% (2004: 4.53%). The disposition of financial investments as at the year end is set out in note 16 on pages 118 to 120. The proceeds of the issue of subordinated loan notes and syndicate loans are broadly invested to immunise the related liabilities.

Taxation credit
A tax credit of £17.3m on the deficit before tax of £45.0m has been recognised for the year ended 31 December 2005. This includes a prior year tax credit of £7.4m arising from the agreement of issues outstanding on prior year tax returns and the finalisation of the 2004 tax position.

Pension scheme liability
On an IFRS valuation basis, the group pension scheme liability as at 31 December 2005 is £52.2m before allowance for deferred tax of £15.7m (31 December 2004: £53.7m deficit before allowance for deferred tax of £16.1m).

The IFRS valuation basis requires liabilities to be discounted at the rate of return on high quality corporate bonds. However, for the purposes of determining the funding position of the scheme and setting future contributions, liabilities are discounted at a higher rate determined by the expected returns on the scheme's investments which are currently invested in equities (60%) and bonds (40%). The last formal actuarial valuation of the scheme on this latter basis was as at 30 June 2004 and disclosed an actuarial deficit of £9m which was eliminated by special contributions in 2004 and 2005. This was confirmed by an interim review as at 30 June 2005. Further details are provided in note 21 on pages 121 to 123, including the assumptions under which valuations were carried out.

A number of initiatives are being introduced in order to mitigate exposure to pension scheme liabilities. These include the introduction of employee contributions from July 2006, an increased normal retirement age of 65 for new joiners from February 2005, and the closure of the final salary scheme to new joiners after June 2006 (they will be eligible to join a career average scheme).

Cash flows and liquidity
Cash and cash equivalents increased during 2005 by £235.7m to £417.1m (2004: £181.4m). This principally reflects the receipt of syndicate loans of £103.6m, phasing of Central Fund drawdowns, and cash flows from investing activities held as cash and short-term deposits with a maturity of less than three months.

Treasury management and policies
Financial instrument risk management
The Society's principal financial instruments comprise cash and liquid resources, investments, borrowings, provisions and items that arise directly from operations such as trade debtors and creditors. These include assets and liabilities of the Central Fund.

Forward foreign exchange contracts are entered into to manage currency and interest rate risks of the Society. The Society separately provides a Currency Conversion Service (CCS) to participating Lloyd's syndicates.

The Society's treasury operations and investments are managed within the formally defined policies which are reviewed regularly by the Lloyd's Investment Committee. Policies for managing these risks are summarised below.

Interest rate risk
Borrowings from the Lloyd's market for the purpose of funding 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 in duration with the objective of maximising current income whilst meeting liquidity requirements.

Interest rate risk, arising from the requirement to make fixed rate coupon payments in respect of the Lloyd's subordinated debt issues, is managed by investing in fixed rate assets of similar currency and duration.

Liquidity risk
The value and term of short-term assets are carefully monitored against those of the Society's liabilities. The Society aims to maintain sufficient liquid assets to meet liabilities as they fall due. However, a total of £40m of standby committed borrowing facilities, negotiated with leading international banks, was also available to the Society as at 31 December 2005 (2004: £40m). There are no plans to utilise these facilities, which are available to meet unforeseen short-term requirements and are renewed annually.

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 closely defined parameters. Consequently, whilst 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.

Separately, the Society provides a Currency Conversion Service (CCS) to participating Lloyd's syndicates, converting insurance premiums and claims between pound 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.

Credit risk
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, ensuring high credit quality and 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.

Further disclosures with regards to financial instruments are provided in note 24 on pages 126 to 129.

Related party transactions

Except for disclosures made in note 28 (see page 131), no other related party has had material transactions with the Society of Lloyd's in 2005.

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 financial statements.

Outlook

Market capacity for 2006 is £14.8bn, an increase of 7% on 2005 capacity. Members' subscriptions and syndicate loan rates remain at 2005 levels whilst Central Fund contributions increase to 1% in order to maintain central assets at around the target of £1.7bn. Income from members' subscriptions will increase to £74m. Central Fund contributions of £149m and syndicate loans of £111m were collected on 3 April 2006.

On 5 April 2006, 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 2006 income statement is £63m.

The operating expenses for the Corporation of Lloyd's, excluding the impact of the closure of Kinnect, are budgeted to increase by £12m in 2006 with increased resources allocated to key initiatives in order to deliver the strategic plan.

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 Combined Code on Corporate Governance, as far as they can be applied to the governance of a Society of members and a market of separate, competing entities.

The Lloyd's market
Lloyd's is not an insurance company. Its members, both corporate and individual, underwrite in syndicates on whose behalf professional underwriters accept risk. Supporting capital is provided by investment institutions, specialist investors, international insurance companies and individuals.

Lloyd's brokers bring business to the market. The risks shown to underwriters originate from clients and other brokers and intermediaries all over the world. The aggregate syndicate results, which are prepared on an annual accounting basis, provide information about the financial performance of the market as a whole.

Lloyd's is the world's leading specialist insurance market and has the capacity to write approximately £14.8bn of business in 2006. It occupies sixth place in terms of global reinsurance premium income, and is the second largest surplus lines insurer in the US. In 2006, 62 syndicates are underwriting insurance at Lloyd's, covering all classes of business from more than 200 countries and territories worldwide.

Governing body: The Council of Lloyd's
Under Lloyd's Act 1982, the governing body of the market is the Council of Lloyd's. Under the Act, 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. In addition, the Council also has the power to make byelaws for the proper and better execution of the Lloyd's Acts and the furtherance of the objects of the Society, and for various specific purposes set out in the Act.

The members of the Council as at 5 April 2006 are listed on page 79. The Council comprises six working and six external members, together with six nominated members. Nominated members are usually appointed for three-year terms which can be renewed. Working and external members are generally elected for terms of three years by the working and external members of the Society respectively. In accordance with Lloyd's Act 1982, the Chairman and Deputy Chairmen of Lloyd's are elected annually by the Council from among the working members of the Council.

The Chairman of Lloyd's commits as much time as is necessary to successfully undertake the role. The Council acknowledges that the Chairman has other commitments outside Lloyd's and is satisfied that these can be accommodated with the Chairmanship of Lloyd's.

The nominated members of the Council may be regarded, for the purposes of the Combined Code, as independent members of the Council with the exception of the CEO who is included within their number. Although the concept of a senior independent director does not strictly apply to the Council, Bill Knight (a nominated member) was elected a Deputy Chairman of the Council by the Council.

In the elections for working members of the Council, voting operates on a one member, one vote basis. In the elections for external members of the Council, the voting entitlement of an external member of the Society is based on the member's allocated underwriting capacity as determined under the Council and Committee Byelaw. The Council reports to the members annually at the Annual General Meeting. Voting entitlement at general meetings is 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 Council met seven times in 2005. It also held one joint meeting with the Franchise Board.

The Council in some cases discharges its functions itself. Only the Council can exercise those powers requiring a special resolution. For example, the making and amending of byelaws, setting the level of contributions to the New Central Fund and the amount of the annual subscription. Amongst other matters, the Council also reserves to itself the right to appoint members of the Franchise Board and other committees of the Council, on recommendation from the Nominations, Appointments and Compensation Committee, and to review the budget and the Franchise Board's plan. The Council must also approve all expenditure above a specified amount.

In respect of the majority of its other functions, however, the Council acts by the Franchise Board.

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

cover three main areas: the overriding principles (relating to legal, regulatory and corporate governance); the capital principles (which emphasise equity between capital providers and prudence in capital setting); and the operating principles (including setting the market supervision framework in accordance with FSA requirements).

The members of the Franchise Board as at 5 April 2006 are listed on page 79. In 2005, the Franchise Board comprised of the Chairman of Lloyd's, who was also its Chairman, the CEO (until his resignation on 31 December 2005), the Franchise Performance Director and the Director, Finance and Risk Management. The balance of the Board was made up of three non-executives connected with the Lloyd's market and three independent non-executives. The Franchise Board held 13 meetings in 2005 including one all day off-site meeting.

The Franchise Board has four main committees. These committees and their purpose are outlined below.

Market Supervision and Review Committee (MSARC)

MSARC acts as a review body capable, where appropriate, of amending, modifying or withdrawing certain decisions taken by the executive affecting franchisees. 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 itself. MSARC also takes decisions regarding the exercise of Lloyd's enforcement powers including the institution of disciplinary proceedings. The MSARC met on five occasions in 2005.

Capacity Transfer Panel

The Capacity Transfer Panel has been established principally to exercise the Council's powers in relation to mandatory offers and minority buy-outs. The Panel meets at appropriate times during the capacity transfer season and in 2005 met on three occasions.

Underwriting Advisory Committee (UAC)

The UAC has been established to provide the Franchise Board and the executive with an internally and externally informed view on the insurance cycle. It also seeks to identify broader and longer-term issues that may influence the underwriting environment. The UAC met on four occasions in 2005.

Investment Committee

The Investment Committee sets the investment objectives and parameters of centrally managed assets and is responsible for monitoring 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 met on four occasions in 2005.

Other principal committees of the Council

Franchise Principles Committee

The role of the Franchise Principles Committee (formerly known as the Compliance Committee) is to examine the effectiveness of the Franchise Board in performing its functions and exercising its powers, in accordance with the Board's terms of reference.

The objective of the Franchise Principles Committee is to ensure that the Franchise Board acts in accordance with the Franchise Principles in order to achieve the Franchise Goal. The Franchise Principles Committee met on four occasions in 2005.

Audit Committee

The Audit Committee's role ensures that the financial activities of Lloyd's are subject to independent review and audit. The Audit Committee also reviews Lloyd's annual financial statements, the aggregate syndicate results and the Lloyd's Return to the FSA. The CEO, Director, Finance and Risk Management, senior managers and external and internal auditors attend meetings as appropriate. Reports from internal and external auditors on aspects of internal control are reviewed by the Audit Committee and appropriate action taken in response. The Audit Committee met on five occasions in 2005.

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

Nominations, Appointments and Compensation Committee (NACC)

The NACC is principally 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 and Risk Management and Franchise Performance Director) and members of a number of the Council and Franchise Board committees. The NACC also makes recommendations on the remuneration of the members of these bodies, including the Chairman, CEO, Director, Finance and Risk Management and Franchise Performance Director. The NACC is also responsible for succession planning arrangements for these positions. The NACC met on three occasions in 2005.

The terms of reference of the NACC are available from the Secretary to the Council on request.

Performance assessment
An evaluation of the performance of the Council and its principal committees in 2005 (defined for this purpose as the Franchise Board, the Franchise Principles Committee, the Audit Committee and the NACC) was undertaken during the year. The evaluation also covered the performance of the Council and committee members including the chairman of each committee.

The assessment was conducted by the Secretary to the Council who met all Council and committee members on an individual basis to seek their views on 2005 performance. These discussions were based around the Performance Evaluation Guidance appended to the Combined Code. As part of this process, comments of the Council and Franchise Board members on the performance of the Chairman were discussed privately with him. The same process was followed with the Chairmen of the other committees subject to the performance assessment.

The principal conclusion of the process was that the current governance arrangements were working well but that the range of the Council's activities and its relationship with the Franchise Board should be reviewed. This had already been identified as an issue by the Council and work is being progressed by a group of members of the Council. Its recommendations were considered by the Council in April 2006.

Specific suggestions for performance improvements for individual committees subject to the assessment will be taken forward by those committees.

Board training and induction
As part of the induction process, 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 2005, briefing sessions on a range of Lloyd's related topics were made available to all members of Council. The programme will continue in 2006 and members of the Franchise Board will also be invited to attend.

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

Authority to act
The Franchise Board may act through the CEO, directors and employees of the Corporation of Lloyd's save in respect of those functions and powers reserved to it, the Council and their committees. The CEO, directors and employees must act in accordance with the Franchise Goal and Principles and in accordance with the strategy, policy and principles set by the Franchise Board.

Market services
The Corporation of Lloyd's provides services to the market including the development and protection of the Lloyd's brand and international trading licences, central accounting and reporting, market finance and treasury services, property management and members' services.

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 of Lloyd's, 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). Franchisees' governance arrangements are also reviewed on registration and as part of risk management assessments.

Attendance record

	Council	Franchise Board	Audit Committee	NACC[2]	Franchise Principles Committee	MSARC[1]	Capacity Transfer Panel	Under-writing Advisory Committee	Investment Committee
Council and Franchise Board members									
Chairman of the Council of Lloyd's									
Lord Levene of Portsoken	**[A]6/7**	**[A]13/13**	–	–	–	–	–	–	–
Executive directors									
Nick Prettejohn	**7/7**	**13/13**	–	–	–	–	–	–	–
Luke Savage	–	**13/13**	–	–	–	–	–	–	**4/4**
Rolf Tolle	–	**13/13**	–	–	–	–	–	–	–

Attendance record continued

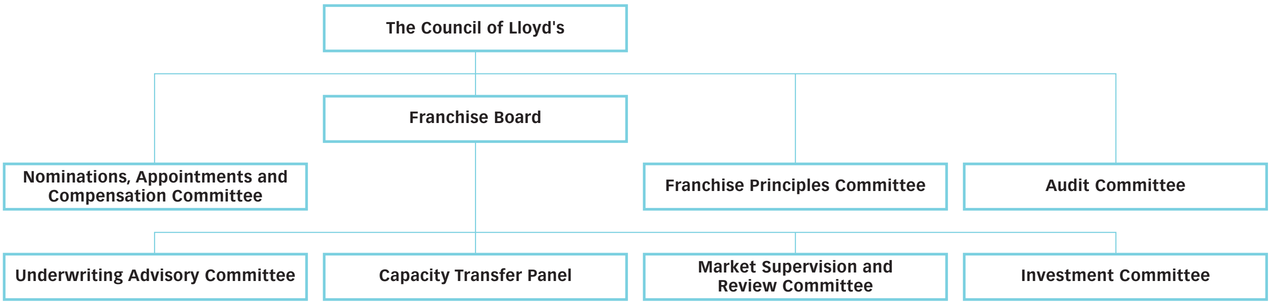
	Council	Franchise Board	Audit Committee	NACC[2]	Franchise Principles Committee	MSARC[1]	Capacity Transfer Panel	Under-writing Advisory Committee	Investment Committee
Non-executive Council members									
Working members									
John Coldman	4/7	–	–	1/3	–	–	–	–	–
Christine Dandridge	5/7	–	–	1/2	3/4	–	–	–	–
Nigel Hanbury	6/7	–	–	–	–	–	–	–	–
Bronek Masojada	6/7	–	–	2/3	4/4	–	–	–	–
David Shipley	7/7	–	5/5	–	–	–	–	–	–
External members									
Steven Burns	5/7	9/13	3/5	–	–	–	–	–	–
Sean Dalton	6/7	–	5/5	–	–	–	–	–	–
Quentin Davies	5/7	–	–	–	–	–	1/3	–	–
Peter Morgan	7/7	–	–	2/3	3/4	–	–	–	–
Charles Philipps	7/7	–	–	2/2	3/4	–	–	–	–
Preben Prebensen	6/6	–	–	–	–	–	–	–	–
Nominated members									
Celia Denton	5/5	–	3/3	–	–	2/2	–	–	–
Judith Hanratty	6/7	–	–	1/3	–	[A]5/5	–	–	–
Bill Knight	7/7	–	4/5	[A]3/3	[A]4/4	–	–	–	–
Philip Lader	7/7	–	–	–	2/4	–	–	–	–
Andreas Prindl	7/7	–	–	–	–	–	[A]3/3	–	[A]4/4
Non-executive Franchise Board members									
Roy Brown	–	11/13	–	–	–	–	–	–	–
Stephen Catlin	–	10/13	–	1/1	–	–	–	–	–
Edward Creasy	–	12/13	–	–	–	–	–	–	–
Stephen Hodge	–	11/13	[A]5/5	–	–	–	–	–	–
Jim Stretton	–	12/13	–	–	–	–	–	[A]4/4	–
Former Council members									
Julian Avery	1/1	–	–	0/1	–	–	–	–	–
Other Committee members									
Ralph Aldwinckle	–	–	–	–	–	–	2/3	–	–
Ian Agnew	–	–	–	–	–	5/5	–	–	–
Gary Bass	–	–	–	–	–	–	–	0/1	–
Andrew Carrier	–	–	–	–	–	–	–	4/4	–
Tim Congdon	–	–	–	–	–	–	–	–	3/3
Lady Delves Broughton	–	–	–	–	–	–	3/3	–	4/4
Alex Foster	–	–	–	–	–	–	–	–	2/4
David Gilchrist	–	–	–	–	–	5/5	–	–	–
David Gittings	–	–	–	–	–	–	3/3	–	–
Richard Hextall	–	–	–	–	–	–	–	–	4/4
Tony Holt	–	–	–	–	–	–	–	3/4	–
Christopher Klein	–	–	–	–	–	–	–	4/4	–
David Lang	–	–	–	–	–	–	–	2/2	–
Robin Mitra	–	–	–	–	–	–	–	4/4	–
Nigel Roberts	–	–	–	–	–	–	–	0/1	–
Ian Salter	–	–	–	–	–	–	3/3	–	–
Oliver Sparrow	–	–	–	–	–	–	–	4/4	–
Morley Speed	–	–	–	–	–	–	–	1/2	–
Paul Swain	–	–	–	–	–	–	2/3	–	–

1 Market Supervision and Review Committee

2 Nominations, Appointments and Compensation Committee

A Chairman

GOVERNANCE STRUCTURE



THE COUNCIL OF LLOYD'S

The governing body of the Society of Lloyd's

Lord Levene of Portsoken
Chairman of Lloyd's
(Working member)

Ewen Gilmour
Deputy Chairman of Lloyd's
(Working member†)

Bronek Masojada
Deputy Chairman of Lloyd's
(Working member‡†)

Bill Knight
Deputy Chairman of Council
(Nominated member‡*†)

Sean Dalton
Representative of Liberty
Corporate Capital Limited
(External Member*)

Christine Dandridge
(Working member‡†)

Quentin Davies
Representative of SUMAC
Underwriting (UK) Limited
(External member)

Celia Denton
(Nominated member*)

Nigel Hanbury
(Working member)

Judith Hanratty
(Nominated member†)

The Honorable Philip Lader
(Nominated member‡)

Peter Morgan
Representative of AJSLP09
(External member‡†)

Charles Philipps
Representative of Amlin
Corporate Member Limited
(External member‡†)

Andreas Prindl
(Nominated member*)

David Shipley
Representative of
MAP Capital Limited
(External member*)

Anthony Towsend
Representative of
Brit UW Limited
(External member)

Graham White
(Working member)

Council as at 5 April 2006

THE FRANCHISE BOARD

The goal is to create and maintain a commercial environment in which the long-term return to all capital providers is maximised.

Lord Levene of Portsoken
Chairman

Roy Brown

Steven Burns

Stephen Catlin

Edward Creasy

Stephen Hodge*

Luke Savage
Director, Finance and
Risk Management, Lloyd's

Jim Stretton

Rolf Tolle
Director, Franchise Performance,
Lloyd's

Franchise Board as at 5 April 2006

‡ Member of Franchise Principles Committee

* Member of Audit Committee

† Member of Nominations, Appointments and Compensation Committee

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 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 bi-annual reports are provided to the Franchise Board. There is an ongoing process, in accordance with the guidance of the Turnbull Committee 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 Compliance or, where appropriate, to the FSA, are clearly set out. This process has been in place throughout 2005 and up to the date of the approval of the financial statements. 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 Turnbull Guidance.

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

Management structure
'Lloyd's Governance Arrangements: 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 provided to all staff and include the Compliance Manual, Employee Handbook, Health and Safety Policy, Information Security and Computer Usage Policy, Procurement Policy, Financial Policies and authorisation limits.

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

Identification and evaluation of business risks
A risk management framework has been developed in recent years to identify, assess and monitor the major risks affecting the Society of Lloyd's. A comprehensive franchise risk and control assessment is completed on a quarterly basis. This review re-assesses the existing risks and identifies any new risks. It evaluates controls in terms of adequacy of design and 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 of the Society Review.

A framework of self-certification is in place; quarterly for the risk assessment and monthly for control exceptions. 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 Committee and Franchise Board on a quarterly basis. In addition, an annual self-certification process is conducted by the executive whereby they report on their directorate's compliance with the internal control framework.

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 reports to the Executive Committee on a regular basis and to each Audit Committee meeting.

A franchise compliance plan is in place to manage the risk associated with the non-compliance with FSA regulatory requirements. The Head of Compliance provides progress reports to both the Executive Committee and the Audit Committee. The wider coordination of compliance activities takes place through an Internal Compliance Committee.

Information and financial reporting systems
An annual budget for the Corporation is reviewed in detail by the Executive Committee and is considered and approved by the Franchise Board and the 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 NOMINATIONS, APPOINTMENTS AND COMPENSATION COMMITTEE

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

Composition of the Nominations, Appointments and Compensation Committee (NACC)
The NACC currently comprises two nominated, two external and three working members of the Council. The NACC members for 2005 are indicated within the remuneration table on pages 85 and 86.

The NACC met three times during the year. The attendance at meetings by members of the Committee is set out in the Corporate Governance report, pages 77 and 78. The NACC's terms of reference are available on request from the Secretary to the Council.

Nominations and appointments
The NACC is responsible for making recommendations to the Council on the appointment of the Chairman, CEO, nominated members of the Council, Franchise Board members and members of a number of the Council and Franchise Board committees. Other than the annual exercise of making recommendations with respect to the composition of the Council and Franchise Board committees, the NACC made recommendations to the Council during 2005 with respect to one new nominated member of the Council and the reappointment of an existing nominated member. The NACC also recommended to the Council that five non-executive directors on the Franchise Board, whose terms of office expired at the end of 2005, should be asked to serve second terms of varying length. These recommendations were accepted by the Council.

Following the announcement of Nick Prettejohn's resignation, the NACC initiated a search for a new CEO that led to the appointment of Richard Ward who will commence employment at Lloyd's on 24 April 2006.

To assist it with its work in this area, the NACC employs external search consultants from time to time as well as making use of its own resources and expertise.

Remuneration and compensation
The Council of Lloyd's is assisted in determining the remuneration of members of the Council and its subsidiary boards and committees by the NACC. The NACC also recommends for approval by the Council, the fees, salaries, bonuses and the terms and conditions of the office of the Chairman, CEO, Director, Finance and Risk Management and Franchise Performance Director.

In determining their recommendations for the year, the NACC consulted with the Chairman and the CEO about its proposals as well as engaging the assistance of remuneration advisers, Deloitte & Touche LLP. During 2005, Deloitte & Touche LLP also provided other services to the Corporation including engagement on an operational risk management programme that involved the secondment of staff to Lloyd's.

Remuneration of members of the Council and the Franchise Board who are employees of the Corporation
Lloyd's remuneration policy for all current and future employees is set out in the Employee Handbook as follows:

'Lloyd's remuneration policy is designed to meet individual and business needs by providing rewards that are linked to individual performance and the delivery of business objectives.

Our total remuneration approach is supported by the following practices:

- we look beyond base salary to the value of the total reward package; and

- 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. The remuneration policy is also founded on the proposition that the ultimate source of value is people, which means a reward system that responds creatively to employee needs as well as those of the business. This means a policy which:

- emanates from business strategies and goals;

- is based on business success (ability to pay);

- provides a flexible mix of rewards which will attract, retain and motivate the high calibre people we need with the varied range of experience and skills the business requires;

- is externally competitive and regularly monitored by means of remuneration surveys;
- rewards for performance not cost of living;
- ensures employees understand the criteria by which rewards are determined and reviewed;
- gives managers as much freedom as possible in deciding the rewards of their teams; and
- is in line with our equal opportunities and diversity policy.'

Remuneration

The current remuneration package of members of the Council and Franchise Board who are employees of the Corporation comprises both performance and non-performance-related components. The performance-related components comprise annual bonuses as well as a long-term incentive plan, while the non-performance-related components comprise basic salaries, benefits and pension entitlements.

The annual salary of the Chairman, CEO, Director, Finance and Risk Management and the Franchise Performance Director is reviewed by the NACC annually with increases taking effect from 1 April. No director plays a part in any discussion about their own remuneration.

The Chairman is entitled to receive private medical and life insurance. The CEO, Director, Finance and Risk Management and the Franchise Performance Director are entitled to receive certain benefits including a car or car allowance, private medical and life insurance in addition to their basic salary.

It is NACC policy that a significant proportion of executive remuneration should be at risk and determined by performance reviews.

Long-term Incentive Plan

A Long-term Incentive Plan (LTIP) for the CEO and other senior executives of the Corporation was established with the approval of the NACC and the Council in March 2004. This replaced the previous LTIP with effect from 1 January 2004, although transitional measures described below apply.

Objectives

The LTIP has been designed to meet key strategic objectives by enabling the Corporation to offer a long-term incentive which:

- is directly linked to the profitability of the Lloyd's market and will therefore align the interests of participants with the capital providers within the market; and
- will provide competitive incentives and, therefore, enable Lloyd's to recruit and retain the talented executives required to support the future strategy for the market.

The plan is operated at the discretion of the NACC and can be terminated at any time.

Operation of the LTIP

Three-year pooling principle

Payments made under the LTIP are determined by reference to the profitability of the Lloyd's market over three years, so that both profits and losses over a three-year period are taken into account in determining an LTIP award. The principle of pooling means that any losses made over the three-year period will offset profits when determining payments, thus encouraging prudential behaviour. Pooling also means that awards may be made in loss-making years. This would be the case if the aggregate profits outweighed the aggregate losses over the relevant three-year period.

The three-year pool is calculated each year on a rolling basis.

Profit/loss
Profit or loss is defined as the pro forma profit or loss on ordinary activities before tax as reported in the Lloyd's Annual Report, excluding investment returns on funds at Lloyd's.

Eligibility
Selected senior permanent employees of the Corporation are eligible for the scheme which include the CEO, directors and existing staff in role level one as at 1 January each year. The NACC retains absolute and sole discretion as to who participates in the LTIP in any particular year.

Limits
There is an overall limit such that the total LTIP awards for all participants in any year will not exceed 0.075% of the aggregate profits and losses for the relevant three-year period.

Joining employment
Subject to NACC's discretion, executives who are newly recruited or promoted may be made an LTIP award on a pro-rated basis. When this occurs, awards will normally be pro-rated in relation to the number of full months of employment during the 36 month period to which the three-year pool relates.

Leaving employment
Subject to the NACC's absolute discretion over the treatment of any and all LTIP awards on the termination of employment for any reason whatsoever, if a participant leaves employment due to retirement, redundancy, death, disability or ill health prior to the end of the deferred payment period, they will normally remain entitled to any outstanding instalments of previous awards, which will usually be paid on the normal payment dates. Any awards partially earned in the year of departure may be paid on a pro-rata basis, at the discretion of the NACC.

Again, subject to the NACC's discretion, if a participant leaves employment for any other reason, any outstanding instalments due in respect of previous financial years and any LTIP award due in respect of the financial year during which employment is terminated will both be forfeited immediately.

Transitional measures
In 2004 only, transitional measures were applied to ensure that an award under the current rules would not be lower than an award under the previous arrangements. This test was applied as at the first payment date in 2005. It has been applied only once and there will be no subsequent re-test. Vested awards under the previous LTIP continue to be paid as they fall due, subject to the rules of that plan. The transitional arrangements do not apply to any participant who joined on or after 1 January 2004.

Calculation of award and timing of payments
Under the LTIP, the value of an award is calculated as a percentage of the profits for the relevant three-year period for each £1m of aggregate LTIP participant salary. For the CEO and other directors, this percentage is 0.008%. For other participants, the percentage used is lower, 0.004%. The percentages have been set by reference to external market data on remuneration levels as measured against other organisations of similar complexity and size.

For the financial year 2005, the award made under the LTIP, subject to adjustment for discretionary awards, is the aggregate profits of the Lloyd's market for the financial years 2003-2005 of £1,609m x relevant % x salary of LTIP participant per £1m.

The payment of each award is made in three tranches, subject to continued employment with the Corporation, in April following the end of the financial year and in April of the following two years. For participants other than the CEO, Director, Finance and Risk Management and Franchise Performance Director, a discretionary adjustment may be made to the first payment of an LTIP award to increase or decrease it by a maximum of 100%, to reflect the individual's performance over the year. However, in no circumstances can an adjustment be made to increase the size of the total discretionary LTIP pool. The further two payments (of equal amounts) will be paid in the following two years, subject to the individual remaining in employment with the Corporation.

Details of the awards to the CEO (until his resignation on 31 December 2005), Director, Finance and Risk Management and Franchise Performance Director are shown on page 87.

Pension arrangements

The Director, Finance and Risk Management and Franchise Performance Director 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 provide for a pension on retirement of two thirds basic annual salary after 20 years eligible service, less any entitlement from previous pension arrangements and subject to an earnings cap, which is a restriction on the amount of pay that can be used to calculate pensions payable from a UK tax-approved pension scheme. No other payments to the Director, Finance and Risk Management and Franchise Performance Director are pensionable. The same pension arrangements applied to the CEO until his resignation on 31 December 2005.

In addition, for 2005, the CEO, Director, Finance and Risk Management and Franchise Performance Director were each entitled to a contribution to a Funded Unapproved Retirement Benefit Scheme (FURBS) of 20% of their salary. With respect to the CEO only, this payment was grossed up for tax and national insurance.

A pension contribution of £41,880 was payable in respect of the Chairman for 2005.

New pensions legislation comes into force from 'A' day on 6 April 2006 with the introduction of new Life Time Allowance rules. Due to these changes, the Lloyd's Pension Scheme rules have been changed to restrict the earnings that can be counted towards the calculation of benefits to a maximum earnings limit, which from 6 April 2006 will be £108,600. This will increase each tax year in line with inflation.

Due to the Life Time Allowance rules introduced from 'A' day it will no longer be possible for Lloyd's to make payments to the Chairman's personal pension and therefore this payment which equates to 40% of the maximum earnings limit will, from 6 April 2006, be paid as a cash allowance. Due to the tax changes affecting FURBS, the 20% of annual basic salary that Lloyd's pays into the executives' FURBS accounts will, from 6 April 2006, be paid as a cash allowance.

Contracts of employment

The Chairman has a three-year contract expiring in November 2008, which is subject to 12 months' notice of termination, which may be given at any time.

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

Details of the contracts of the Chairman and directors are summarised in the table below.

Members of the Council and Franchise Board who are employees of the Corporation

	Contract date	Unexpired term as at 31 Dec 2005	Notice period[i]
Lord Levene of Portsoken	01/11/02	34 months	12 months
Luke Savage[ii]	20/09/04	rolling 1 year	12 months
Rolf Tolle[iii]	03/03/03	rolling 1 year	12 months

(i) Employment contracts do not contain provisions for compensation payable upon early termination.
(ii) Luke Savage was appointed to the Franchise Board on 30 September 2004.
(iii) Rolf Tolle was appointed to the Franchise Board on 3 March 2003.

Remuneration and contracts of service for members of the Council and the Franchise Board who are not employees of the Corporation

Remuneration for all members of the 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 2005, fees for members of the Council and Franchise Board were £25,000 and £37,500 per annum, respectively. Fees for members of both the Council and Franchise Board were £50,000. Fees are also payable in respect of membership of a number of the Council and Franchise Board committees. 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 below.

External and working members are elected to the Council while nominated members are appointed to the Council, usually for a three-year period. Members of the Franchise Board are appointed by the 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 and Franchise Board for the year ended 31 December 2005. This section contains the following information in the form specified in Schedule 7A Part 3 of the Companies Act 1985:

- amount of each member's emoluments and compensation in the current financial year;
- details of each member's accrued benefits in the Lloyd's Pension Scheme and transfer values of those accrued benefits; and
- details of each member's interests under the LTIP.

Remuneration of members of the Council and the Franchise Board

Individual remuneration, excluding LTIP awards, for the year to 31 December is shown in the table below. LTIP awards are shown on page 87.

	Salary/fees		Taxable benefits[i]		Annual bonus		Other[xi]		Total	
	2005 £000	2004 £000	**2005 £000**	2004 £000	**2005 £000**	2004 £000	**2005 £000**	2004 £000	**2005 £000**	2004 £000
Chairman of the Council										
Lord Levene of Portsoken[ii][viii]	**440**	408	**28**	28	**150**	150	**41**	41	**659**	627
Executive directors										
Nick Prettejohn, CEO[ii][viii][xxi]	**512**	457	**18**	17	**–**	250	**180**	156	**710**	880
Luke Savage[ii][ix][xvi]	**344**	93	**9**	3	**117**	54	**105**	–	**575**	150
Rolf Tolle[ii][ix][xiii]	**467**	453	**43**	41	**400**	250	**105**	102	**1,015**	846
Non-executive Council members										
Working members										
John Coldman, Deputy Chairman[x]	**36**	36	**–**	–	**–**	–	**–**	–	**36**	36
Christine Dandridge[x]	**35**	30	**–**	–	**–**	–	**–**	–	**35**	30
Nigel Hanbury	**23**	–	**–**	–	**–**	–	**–**	–	**23**	–
Bronek Masojada, Deputy Chairman[x]	**41**	41	**–**	–	**–**	–	**–**	–	**41**	41
David Shipley	**31**	31	**–**	–	**–**	–	**–**	–	**31**	31
External members										
Steven Burns[vi][viii]	**56**	56	**–**	–	**–**	–	**–**	–	**56**	56
Sean Dalton[vii]	**31**	31	**–**	–	**–**	–	**–**	–	**31**	31
Quentin Davies[xvii]	**30**	30	**–**	–	**–**	–	**–**	–	**30**	30
Peter Morgan[v][x]	**56**	35	**3**	–	**–**	–	**–**	–	**59**	35
Charles Philipps[iv][x]	**35**	30	**–**	–	**–**	–	**–**	–	**35**	30
Preben Prebensen[iii]	**21**	–	**–**	–	**–**	–	**–**	–	**21**	–

REPORT OF THE NOMINATIONS, APPOINTMENTS AND COMPENSATION COMMITTEE continued

	Salary/fees		Taxable benefits[i]		Annual bonus		Other[xi]		Total	
	2005 £000	2004 £000	**2005 £000**	2004 £000	**2005 £000**	2004 £000	**2005 £000**	2004 £000	**2005 £000**	2004 £000
Nominated members										
Celia Denton[xx]	**30**	–	**–**	–	**–**	–	**–**	–	**30**	–
Judith Hanratty[x][xv]	**42**	67	**–**	–	**–**	–	**–**	–	**42**	67
Bill Knight, Deputy Chairman of the Council of Lloyd's[x]	**53**	53	**–**	–	**–**	–	**–**	–	**53**	53
Philip Lader[xviii]	**30**	25	**5**	–	**–**	–	**–**	–	**35**	25
Andreas Prindl	**37**	37	**–**	–	**–**	–	**–**	–	**37**	37
Non-executive Franchise Board members										
Roy Brown	**38**	38	**–**	–	**–**	–	**–**	–	**38**	38
Stephen Catlin[xix]	**39**	55	**–**	–	**–**	–	**–**	–	**39**	55
Edward Creasy	**38**	38	**–**	–	**–**	–	**–**	–	**38**	38
Stephen Hodge	**48**	38	**–**	–	**–**	–	**–**	–	**48**	38
Jim Stretton	**48**	48	**–**	–	**–**	–	**–**	–	**48**	48
Former members										
Julian Avery[iii]	**5**	30	**–**	–	**–**	–	**–**	–	**5**	30
Andrew Moss[ii][ix][xii]	**–**	125	**–**	4	**–**	–	**–**	37	**–**	166
Brian Pomeroy[xiv]	**–**	44	**–**	–	**–**	–	**–**	–	**–**	44

(i) Taxable benefits include items such as company car or car allowance, medical and life insurance.
(ii) Employee of the Corporation of Lloyd's.
(iii) Representative of Wellington (Five) Limited. Preben Prebensen was the representative with effect from 25 February 2005.
(iv) Representative of Amlin Corporate Member Limited.
(v) Representative of AJSLP 9.
(vi) Representative of Limit (No 2) Limited.
(vii) Representative of Liberty Corporate Capital Limited.
(viii) Member of both Council and the Franchise Board for 2005.
(ix) Member of the Franchise Board only.
(x) Member of NACC for 2005.
(xi) Other includes FURBS payments of 20% of executive directors' total salary. This was grossed up for tax in respect of Nick Prettejohn only. The amount stated in respect of the Chairman represents pension contributions to a personal pension scheme.
(xii) Andrew Moss became a member of the Franchise Board on 1 January 2003 and left the Corporation of Lloyd's on 8 May 2004.
(xiii) In 2003, Lloyd's paid £83,000 to Rolf Tolle's previous employer in respect of the assignment of a property lease to Lloyd's. The lease expired in August 2004 and £101,000 was paid to the landlord on renewal of the lease for a further two years. The property is occupied by Rolf Tolle. These amounts are not included in the table above.
(xiv) Brian Pomeroy's term of office as a Council member expired on 31 December 2004.
(xv) Judith Hanratty retired from the Franchise Board on 31 December 2004.
(xvi) Luke Savage joined the Corporation of Lloyd's on 20 September 2004 and was appointed to the Franchise Board on 30 September 2004.
(xvii) Representative of SUMAC Underwriting (UK) Limited.
(xviii) Philip Lader was appointed a member of Council on 2 March 2004.
(xix) Stephen Catlin's term of office as a Council member expired on 31 January 2005.
(xx) Celia Denton was appointed a member of the Council on 16 March 2005.
(xxi) Nick Prettejohn resigned with effect from 31 December 2005.

Lloyd’s Pension Scheme provisions

	Contributions in year to 31 Dec 2005(i) £000	Age at 31 Dec 2005	Increase in pension in year to 31 Dec 2005 – actual £000	Increase in pension in year to 31 Dec 2005 – net of price inflation £000	Total accrued annual pension in year to 31 Dec 2005 £000 pa	Retirement age
Nick Prettejohn	**n/a**	**45**	**3**	**3**	**27**	**60**
Luke Savage	**n/a**	**44**	**2**	**2**	**3**	**60**
Rolf Tolle	**n/a**	**58**	**4**	**4**	**10**	**60**

(i) The Lloyd’s Pension Scheme was a non-contributory pension scheme during 2005.

Transfer values of accrued pension benefits

	Transfer value of accrued pension as at 31 Dec 2004 £000	Transfer value of accrued pension as at 31 Dec 2005 £000	Increase in transfer value over the year less director’s own contributions £000
Nick Prettejohn	**245**	**322**	**77**
Luke Savage	**6**	**38**	**32**
Rolf Tolle	**98**	**169**	**71**

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 and Franchise Board’s share of the Long-term Incentive Plan

			Estimated long-term bonus						
	Award year	Performance bonus £000	As at 31 Dec 2004 £000	Change in year £000	As at 31 Dec 2005 £000	Total £000	Amount paid in prior years £000	Amount paid during the year ended 31 Dec 2005 £000	Total award outstanding as at 31 Dec 2005 £000
Nick Prettejohn	**2002**	**110**	**163**	**(10)**	**153**	**263**	**263**	**–**	**–**
	2003	**135**	**315**	**(226)**	**89**	**224**	**224**	**–**	**–**
	2004	**81**	**165**	**(165)**	**–**	**81**	**–**	**81**	**–**
Luke Savage	**2004**	**6**	**13**	**–**	**13**	**19**	**–**	**6**	**13**
	2005	**15**	**–**	**30**	**30**	**45**	**–**	**–**	**45**
Rolf Tolle	**2003**	**126**	**294**	**62**	**356**	**482**	**209**	**110**	**163**
	2004	**89**	**182**	**5**	**187**	**276**	**–**	**150**	**126**
	2005	**21**	**–**	**41**	**41**	**62**	**–**	**–**	**62**

Nick Prettejohn resigned with effect from 31 December 2005 and is not entitled to an award in respect of 2005 or any further payments in respect of earlier years. He also waived his entitlement to awards paid in October 2005.

Bill Knight, Chairman
Nominations, Appointments and Compensation Committee

REPORT OF THE AUDIT COMMITTEE

This report sets out the role, remit and activities of the Audit Committee during 2005.

Composition of the Audit Committee
In 2005, the Audit Committee comprised two nominated, two external and one working member of the Council and a non-executive member of the Franchise Board. The Committee met five times during the year. The members of the Committee in 2005 and their attendance at meetings are shown in the Corporate Governance report on pages 77 and 78.

For the purposes of the Combined Code, Celia Denton and Stephen Hodge, the Chairman of the Committee, are considered by the Council to have recent and relevant financial experience.

Terms of reference
The Council has delegated to the Committee responsibility for overseeing the financial reporting and internal controls of the Corporation of Lloyd's and its subsidiaries and the Central Fund. The principal responsibilities of the Committee include:

- ensuring that the financial activities of Lloyd's are subject to independent review and audit. The 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 with relevant laws and regulations; and
- ensuring appropriate whistle blowing arrangements are in place by which members of staff can, in confidence, raise concerns relating to possible improprieties.

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

Report on the Committee's activities in 2005
The principal issues addressed during 2005 were:

- the annual financial statements for 2004 including financial disclosures and various accounting matters raised by management and auditors;
- the interim financial statements for the six months to 30 June 2005 including the Pro Forma Annual Accounting Statement and the financial statements of the Society of Lloyd's. The latter have been prepared under International Financial Reporting Standards (IFRS). A separate IFRS transition document was also considered;
- the 2004 Lloyd's Return to the FSA;
- the FSA risk assessment of Lloyd's and management's risk mitigation programme;
- 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, including follow-up of findings;
- the reports of the Head of Compliance, including quarterly reports from the Internal Compliance Committee and the annual compliance plan; and
- assessment of the effectiveness of internal controls.

The Committee also reviewed management accounts and carried out an effectiveness review of internal and external auditors. It also reviewed its own performance.

The CEO, Director, Finance and Risk Management, Director and General Counsel, Head of Compliance, Financial Controller, Head of Internal Audit, Head of Market Reporting and the external and internal auditors attended meetings as appropriate. During the year, the Committee met separately with the external and internal auditors without executive management present.

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

Stephen Hodge, Chairman
Audit Committee

LLOYD'S MEMBERS' OMBUDSMAN'S REPORT

Report by Sir Brian Hayes GCB, Lloyd's Members' Ombudsman

The role of the Lloyd's Members' Ombudsman is to investigate complaints by members of the Society who believe that they have suffered injustice in consequence of maladministration in relation to any action taken by or on behalf of the Society. The Byelaw also requires that I consider complaints from former members who were members at any time after 30 November 2001. The Ombudsman's powers do not extend to complaints that Names may have against underwriting agents.

During 2005, I received seven new complaints; nine fewer than the previous year.

In six cases, I decided, after conducting the necessary investigations, to take no further action as I was satisfied that considerations of maladministration did not arise. In one case, the complainant, having submitted his complaint, asked me to defer my investigation. The complainant has not to date asked me to consider the matter further.

In addition to these complaints, a large part of my time in 2005 was concentrated on the investigation of a complaint submitted to me in November 2004. The complaint in question was submitted by 16 shareholders in a conversion vehicle designed to allow individual members to continue to participate in underwriting without incurring unlimited liability. The case presented a number of complex issues for my consideration and necessitated a lengthy and detailed investigation. Following my investigation, I concluded that, although the complainants had certainly suffered an injustice through no fault of their own, this was not consequent upon any maladministration on the part of Lloyd's. However, in view of the misfortune suffered by the complainants, I decided to go beyond my brief and suggest that Lloyd's consider the possibility of an ex-gratia award to them. Lloyd's decided that, as there had been no finding of maladministration, it would not be appropriate to make such an award. I understand Lloyd's decision and do not regard it as in any way unjustifiable.

The expenses incurred by my office during 2005 amounted to £27,000.

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) 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; and
- 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; and
- 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 loan notes are admitted to trading in a regulated market in the European Union, Article 4 requires group financial statements to be prepared in conformity with International Accounting Standards.) 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.

INDEPENDENT AUDITOR'S REPORT TO THE MEMBERS OF LLOYD'S

We have audited the group financial statements of the Society of Lloyd's (the 'Society') for the year ended 31 December 2005 which comprise the group income statement, group statement of recognised income and expense, group balance sheet, group cash flow statement and the related notes 1 to 30. These group financial statements have been prepared under the accounting policies set out therein. We have also audited the information in the Report of the Nominations, Appointments and Compensation Committee that is described as having been audited.

This report is made solely to the members of Lloyd's, as a body, in accordance with the Council of Lloyd's instructions summarised under 'Respective responsibilities of the Council of Lloyd's and auditors' below. 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

The Council of Lloyd's is responsible for the preparation of 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 as set out in the Statement of the Council of Lloyd's responsibilities and for the preparation of the Report of the Nominations, Appointments and Compensation Committee.

Our responsibility is to audit the group financial statements and the part of the Report of the Nominations, Appointments and Compensation Committee to be audited in accordance with relevant legal and regulatory requirements and International Standards on Auditing (UK and Ireland). We report to you our opinion as to whether the group financial statements give a true and fair view and whether the group financial statements and the part of the Report of the Nominations, Appointments and Compensation Committee to be audited are properly prepared in accordance with the Article 4 of the IAS Regulation. We also report to you if, in our opinion, the Report of the Nominations, Appointments and Compensation Committee is not consistent with the group financial statements, if the Society has not kept proper accounting records, if we have not received all the information and explanations we require for our audit, or if information specified by law regarding members' remuneration and other transactions is not disclosed. We read other information contained in the Annual Report and consider whether it is consistent with the audited group financial statements.

This other information comprises the Society Review. We consider the implications for our report if we become aware of any apparent misstatement or material inconsistencies with the group financial statements. Our responsibilities do not extend to any other information.

Basis of audit opinion

We conducted our audit in accordance with International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the group financial statements and the part of the Report of the Nominations, Appointments and Compensation Committee to be audited. It also includes an assessment of the significant estimates and judgements made by the Council of Lloyd's in the preparation of the group financial statements, and of whether the accounting policies are appropriate to the Society's circumstances, consistently applied and adequately disclosed.

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

Opinion

In our opinion:

- the group financial statements give a true and fair view, in accordance with IFRS as adopted by the European Union, of the state of the group's affairs as at 31 December 2005 and of its deficit for the year then ended; and
- the group financial statements and the part of the Report of the Nominations, Appointments and Compensation Committee to be audited have been properly prepared in accordance with Article 4 of the IAS Regulation.

Ernst & Young LLP

Ernst & Young LLP, Registered Auditors, London

5 April 2006

GROUP INCOME STATEMENT

for the year ended 31 December 2005

	Note	2005 £000	2004 £000
Operating income		**162,353**	169,166
Central Fund contributions		**70,077**	190,657
General insurance net premium income		**2,769**	3,428
Other group income		**18,637**	28,979
Total income	3b	**253,836**	392,230
Central Fund claims and provisions	4	**(223,889)**	(125,540)
Gross insurance claims incurred	14	**(30,039)**	(47,735)
Insurance claims recoverable from reinsurers	14	**29,844**	52,053
Other group operating expenses	5	**(172,097)**	(173,416)
Operating (deficit)/surplus		**(142,345)**	97,592
Profit on sale of Lloyd's 1958 building		**–**	23,638
(Deficit)/surplus before finance, associates and tax		**(142,345)**	121,230
Finance costs	8	**(33,653)**	(7,177)
Finance income	8	**129,033**	45,875
Share of profits of associates	13a	**2,006**	1,872
(Deficit)/surplus before tax		**(44,959)**	161,800
Tax credit/(charge)	9a	**17,343**	(38,959)
(Deficit)/surplus for the year		**(27,616)**	122,841

GROUP STATEMENT OF RECOGNISED INCOME AND EXPENSE

for the year ended 31 December 2005

	Note	2005 £000	2004 £000
Revaluation of the Lloyd's Collection	13b	**–**	2,797
Exchange difference on translating foreign operations		**(43)**	59
Actuarial (loss)/gain on pension liabilities – group	21	**(2,354)**	(1,100)
– associates	13a	**375**	(396)
Tax on items taken directly to equity		**594**	449
Net income and expense recognised directly in equity		**(1,428)**	1,809
(Deficit)/surplus for the year		**(27,616)**	122,841
Total recognised income and expense for the year		**(29,044)**	124,650

GROUP BALANCE SHEET

as at 31 December 2005

	Note	2005 £000	2004 £000
ASSETS			
Intangible assets	10	**176**	275
Lloyd's Collection	13b	**9,710**	9,710
Property, plant and equipment	11	**7,426**	6,124
Deferred tax asset	9c	**11,319**	615
Investment in associates	13a	**4,162**	3,283
Reinsurance assets – Lioncover Insurance Company Limited	14	**526,848**	541,835
Reinsurance assets – Centrewrite Limited	14	**174**	686
Loans recoverable	15	**61,609**	63,269
Financial investments	16	**1,153,146**	1,153,456
Inventories	17	**401**	461
Trade and other receivables	18	**34,440**	56,646
Prepayments and accrued income		**12,685**	19,068
Tax receivable		**9,917**	84,654
Forward currency contracts	24	**1,886**	2,256
Assets classified as held for sale	11	**–**	8,215
Cash and cash equivalents	19	**417,109**	181,445
Total assets		**2,251,008**	2,131,998
EQUITY AND LIABILITIES			
Equity			
Accumulated reserve	25	**648,008**	680,232
Syndicate loans	25	**106,834**	–
Revaluation reserve	25	**9,710**	9,710
Foreign currency translation reserve	25	**16**	59
Total equity		**764,568**	690,001
Liabilities			
Subordinated loan notes	20	**500,782**	506,439
Insurance contract liabilities – Lioncover Insurance Company Limited	14	**526,848**	541,835
Insurance contract liabilities – Centrewrite Limited	14	**16,424**	15,649
Pension liability	21	**52,209**	53,700
Provisions	22	**183,118**	108,585
Trade and other payables	23	**50,157**	64,930
Accruals and deferred income		**39,345**	42,129
Loans funding statutory insurance deposits	16b	**115,750**	106,831
Forward currency contracts	24	**1,807**	1,899
Total liabilities		**1,486,440**	1,441,997
Total equity and liabilities		**2,251,008**	2,131,998

Signed on behalf of the Council of Lloyd's on 5 April 2006

Lord Levene of Portsoken, Chairman

Luke Savage, Director, Finance and Risk Management and Acting CEO

GROUP CASH FLOW STATEMENT

for the year ended 31 December 2005

	Note	2005 £000	2004 £000
Cash flows from operating activities			
Operating (deficit)/surplus		**(142,345)**	97,592
Central Fund claims and provisions		**223,889**	125,540
Operating surplus before Central Fund claims and provisions		**81,544**	223,132
Adjustments for:			
Depreciation		**1,874**	1,984
Amortisation of intangible assets		**126**	99
Impairment losses		**231**	443
Loss/(profit) on sale of fixed assets		**3**	(55)
Premium levy collection		**–**	19,641
Operating surplus before working capital changes and claims paid		**83,778**	245,244
Decrease/(increase) in receivables		**41,519**	(48,611)
Decrease in inventories		**60**	6
(Decrease)/increase in payables		**(25,899)**	48,481
Increase/(decrease) in provisions other than for Central Fund claims		**681**	(602)
Cash generated from operations before claims paid		**100,139**	244,518
Claims paid in respect of corporate members		**(145,587)**	(137,411)
Tax and interest payments in respect of corporate members		**(2,121)**	–
Claims paid in respect of individual members		**(2,329)**	(2,677)
Cash generated from operations		**(49,898)**	104,430
Tax received/(paid)		**82,082**	(57,550)
Net cash from operating activities		**32,184**	46,880
Cash flows from investing activities			
Purchase of property, plant, equipment and software		**(2,774)**	(2,120)
Proceeds from the sale of equipment		**168**	125
Proceeds from sale of buildings		**9,463**	23,638
Sale/(purchase) of financial investments		**62,522**	(647,055)
Dividends received from associates		**1,390**	3,734
Dividends and interest received		**62,113**	19,952
Net cash used in investing activities		**132,882**	(601,726)
Cash flows from financing activities			
Interest paid		**(39,162)**	(523)
Increase/(decrease) in borrowings for statutory insurance deposits		**4,591**	(7,604)
Issue of subordinated loan notes		**–**	504,463
Receipt of syndicate loans		**103,611**	–
Net proceeds from financing activities		**69,040**	496,336
Net increase/(decrease) in cash and cash equivalents		**234,106**	(58,510)
Effect of exchange rates on cash and cash equivalents		**1,558**	(169)
Cash and cash equivalents at 1 January		**181,445**	240,124
Cash and cash equivalents at 31 December	19	**417,109**	181,445

NOTES TO THE FINANCIAL STATEMENTS

as at 31 December 2005

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 ('Lloyd's' or the 'Society' or the 'Corporation of Lloyd's'). 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.

All listed European Union (EU) groups are required to prepare group financial statements that comply with EU endorsed International Financial Reporting Standards (IFRS) for accounting periods beginning on or after 1 January 2005. Following the issue of subordinated loan notes by the Society, which are listed on the London Stock Exchange, the Society has been admitted to trading on a regulated market in the EU and has adopted IFRS from 1 January 2005. As part of the process of moving to reporting under IFRS comparative information has been restated. The Society has adopted all existing IFRS effective as at 1 January 2005.

An explanation of how the transition to IFRS has affected the reported financial position, financial performance and cash flows of the Society has been provided in note 30.

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 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 balance sheet date. Subsidiary undertakings are consolidated from the date of their acquisition, being the date on which the Society obtains control, and continues 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 have been eliminated in full.

The financial statements of subsidiary undertakings are prepared for the same reporting year as the parent company with the exception of Lioncover Insurance Company Limited (Lioncover) which has a reporting year of 31 March. This reporting date is the consequence of all Lioncover's reinsurance liabilities being reinsured with Equitas Reinsurance Limited (Equitas) and hence its alignment to Equitas' reporting year. Reinsurance contract assets and liabilities at 31 March have been adjusted to reflect claims settled from April to December.

The group financial statements have been prepared on a historic cost basis, except for financial assets and liabilities at fair value through profit or loss, which are measured at fair value. Loans and receivables and other financial liabilities are carried at amortised cost. Non-current assets held for sale are stated at the lower of their carrying amount and fair value less costs to sell. The Lloyd's Collection, loans recoverable and loans funding statutory insurance deposits are stated at fair value. The group financial statements are presented in pound sterling and all values are rounded to the nearest thousand (£000).

The Society has chosen early adoption of the amendments to IAS 19 (Actuarial Gains and Losses, Group Plans and Disclosures) and IAS 39 (Fair Value Option). The Society's documented investment strategy is to manage its financial assets on a fair value basis and therefore meets the fair value through profit or loss criteria of IAS 39.

There were no discontinued activities during 2005. Since the balance sheet date, the Council has taken the decision to cease the operations of a subsidiary undertaking (Kinnect Limited). Further information has been provided in note 26.

Lloyd's is regulated by the FSA.

2. Summary of significant accounting policies

Adoption of IFRS

The accounting policies adopted are consistent with those adopted at the date of transition (1 January 2004). The following optional exemptions provided by IFRS 1 'First-time Adoption of International Financial Reporting Standards' from full retrospective application of IFRS accounting were adopted:

(a) Investments in associates

The provisions of IFRS 3 'Business Combinations' were applied from 1 January 2004. The net carrying value of goodwill at 31 December 2003 under the previous accounting policies was deemed to be the cost at 1 January 2004.

2. Summary of significant accounting policies continued

Adoption of IFRS continued

(b) Recognition of other financial assets

In recognising certain assets the Society has applied IFRS 1 which allows the recognition of assets previously not recognised where the information needed to apply IAS 39 'Financial Instruments: Recognition and Measurement' was available at the time of initially accounting for the derecognition. The Society has applied the provisions of IFRS 1 which allows the designation of financial assets at fair value through profit or loss at the transition date.

(c) Cumulative translation differences

Cumulative translation differences arising on consolidation of foreign operations – IAS 21 'The Effects of Changes in Foreign Exchange Rates' requires such differences to be held in a separate reserve, rather than included in the profit and loss reserve under UK GAAP. This reserve was deemed to be nil on 1 January 2004.

(d) Estimates

Where estimates had previously been made under UK GAAP, consistent estimates (after adjustments to reflect any difference in accounting policies) were made for the same date on transition to IFRS (ie judgements affecting the Society's opening balance sheet were not revisited for the benefit of hindsight).

(e) Pension scheme

The Society has recognised all cumulative actuarial gains and losses as at 1 January 2004 directly in equity. Accordingly, the Society discloses prospectively from 1 January 2004 the information required by IAS 19 'Employee Benefits' on scheme obligations, scheme assets and experience adjustments on scheme assets and liabilities, as these amounts are determined.

(f) Claims development disclosure

The provisions of IFRS 4 'Insurance Contracts' has been applied for Lioncover. Claims development that occurred in the previous five years is disclosed for Lioncover. Centrewrite has been prepared from the period when the earliest material claim arose for which there is still uncertainty about the amount and timing of claims payments.

Principal accounting policies

A Property, plant and equipment

Property, 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:

- Freehold buildings are depreciated over 60 years;
- Plant, vehicles and equipment are depreciated over 2 to 25 years according to the estimated life of the asset;
- Equipment on hire or lease is depreciated over the period of the lease; and
- Land is not depreciated.

B Assets classified as held for sale

On initial classification as held for sale, assets are recognised at the lower of carrying value and fair value less costs to sell. Such assets are no longer depreciated. Impairment losses on initial classification as held for sale are included in the group income statement.

C 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 four years.

2. Summary of significant accounting policies continued

D Lloyd's Collection

Lloyd's Collection represents various paintings, antiques and artefacts which are included at fair value. Any revaluation surplus or deficit is taken to equity and is reflected in the revaluation reserve.

E Investment in associates

An associate is an entity in which the Society has significant influence and which is not a subsidiary undertaking or joint venture. The Society's investment in associates is accounted for under the equity method of accounting.

Under the equity method, the investment in associates is carried in the balance sheet at cost plus post-acquisition changes in the Society's share of net assets of the associate. 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 the associate. The group income statement reflects the share of the results of operations of the associate. Where there has been a change recognised directly in the equity of the associate, the group recognises its share of any changes and discloses this, when applicable, in the group statement of recognised income and expense.

F 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.

G Financial instruments

The Society classifies its financial instruments within the scope of IAS 39 into the following categories: financial assets and liabilities at fair value through profit or loss, loans and receivables and other financial liabilities. The classification depends on the purpose for which the financial instruments were acquired. Management determines the classification of its financial instruments at initial recognition as follows:

i) Financial assets and liabilities at fair value through profit or loss (including derivatives held for trading)

Financial assets and liabilities at fair value through profit or loss include financial instruments held for trading and those assets designated at fair value through profit or loss. A financial instrument is classified in this category if it is acquired principally for the purpose of selling or repurchasing in the short term or if it is a financial asset or liability so designated by management on initial recognition. Derivatives are included as held for trading.

ii) Loans and receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. They arise when the group provides money, goods or services directly to a debtor with no intention of trading the receivable.

iii) Other financial liabilities

Other financial liabilities which include the subordinated loan notes are carried at amortised cost using the effective interest method.

When financial assets are recognised initially, they are measured at fair value plus, in the case of loans and receivables and other financial liabilities, transaction costs. Gains and losses arising from changes in the fair value of financial assets and liabilities at fair value through profit or loss are included in the group income statement in the period in which they arise. When financial assets and liabilities are interest-bearing, interest calculated using the effective interest method is recognised in the group income statement. Loans and receivables and other financial liabilities are carried at amortised cost using the effective interest method.

2. Summary of significant accounting policies continued

G Financial instruments continued

The Society assesses at each balance sheet date whether there is objective evidence that a financial asset or a group of financial assets is impaired. Purchases and sales of investments are recognised on the settlement date. Investments are derecognised when the rights to receive cash flows from the investments have expired or have been transferred and the Society has transferred substantially all risks and rewards of ownership.

iv) Non-hedging derivatives

Changes in the fair value of any derivative instrument that does not qualify for hedge accounting are recognised immediately in the group income statement. The Society does not consider that it meets the strict hedging requirements under IFRS.

v) Fair value estimation

The fair value of financial instruments traded in organised active financial markets is based on quoted market prices at the close of business on the balance sheet 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.

The fair value of financial instruments for which there is no quoted market price is determined by a variety of methods incorporating assumptions that are based on market conditions existing at each balance sheet date.

The fair value of forward foreign exchange contracts is determined using spot amortised exchange rates at the balance sheet date. The nominal value less estimated credit adjustments of trade receivables and payables are assumed to approximate to their fair values.

H Insurance contracts (liabilities and reinsurance)

In accordance with IFRS 4 'Insurance Contracts', the Society has applied existing 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.

Insurance contracts are defined as those containing significant insurance risk 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 expire. Contracts can be reclassified as insurance contracts after inception if insurance risk becomes significant. Any contracts not considered to be insurance contracts under IFRS are classified as investment or service contracts.

Reinsurance assets primarily include amounts due from Equitas Reinsurance Limited arising from the reinsurance arrangements entered into by Lioncover as described in note 14. 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 that this can be measured reliably.

I 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.

2. Summary of significant accounting policies continued

J Employee benefits

The Society accounts for pensions and similar benefits (principally income protection due to ill health) under IAS 19 'Employee Benefits'. The Corporation of Lloyd's operates a defined benefit pension scheme 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 and financing income and costs are recognised in the periods in which they arise. Actuarial gains and losses are recognised in full in the group statement of recognised income and expense in the period in which they occur. Discretionary awards in respect of past service costs are recognised in the group income statement when awarded.

Payments to separately administered defined contribution schemes are charged to the group income statement as they fall due. Entitlements to payments to Funded Unapproved Retirement Benefits Schemes (FURBS) are recognised when the obligations to make the payments are incurred.

K Loans recoverable

Recoverable Central Fund loans made to hardship Names are recognised at fair value. 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.

L 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 equity, in which case it is recognised in equity.

Current tax is the expected tax payable on the taxable income for the year, using tax rates enacted or substantially enacted at the balance sheet 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 balance sheet date.

M Subordinated loan notes

Subordinated loan notes are initially recognised at cost, being the fair value of the consideration received net of issue costs associated with the borrowing.

After initial recognition, the loan notes are subsequently recorded at amortised cost using the effective interest rate over the period to the earliest option date. Amortised cost is calculated by taking into account issue costs and issue discount.

N Cash and cash equivalents

For the purposes of the group cash flow statement, 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.

O Income recognition

Income, which is stated net of value added tax and local premium taxes in connection with overseas underwriting activities, comprises the fair value of amounts recoverable. Where the impact of discounting to present value is significant, income is recognised at present value. Income is recognised as follows:

2. **Summary of significant accounting policies** continued

O Income recognition continued

i) Members' subscriptions, market charges and other services

Members' subscriptions, market charges and other services are recognised in the period to 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 its collectibility 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 consists of market settlement recoveries which represent continuing debt recoveries from the 1996 'Reconstruction and Renewal' settlement and recoveries in respect of undertakings given by the Lloyd's Central Fund. Other income is recognised when recoverability is agreed.

P Insurance premiums

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.

Q 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 balance sheet 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.

R 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 on an annual basis and therefore are not deemed to be constructive obligations. 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 the undertakings previously given are credited to the group income statement when contractually committed to be received.

2. Summary of significant accounting policies continued

S Foreign currency and derivative instruments

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 balance sheet date, monetary assets and liabilities denominated in foreign currencies are retranslated at the exchange rate prevailing at the balance sheet 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 are included in either the group statement of recognised income and expense or, the group income statement as appropriate.

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 balance sheet;
- Income and expenses are translated at the average exchange rate for the year; and
- All resulting exchange differences are recognised as 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 contracts are entered into to cover foreign exchange exposure or provide a service to the Lloyd's market, the fair value is determined using spot amortised exchange rates at the balance sheet date. Where gains and losses are not expected to be refunded to or recovered from the Lloyd's market, these amounts are taken to the group income statement. There are no embedded derivatives separated from the host contract or that are designated as hedging instruments.

The principal year end exchange rates were:

	2005	2004
US$	**1.72**	1.92
Can$	**2.01**	2.30
Euro	**1.46**	1.41

T Leases

Payments made under operating leases are charged to the group income statement on a straight-line basis over the period of the lease.

U Syndicate loans

Syndicate loans are treated as equity as they have no fixed repayment date and the payment of interest is made only at the discretion of the Council. Interest on these loans is accounted for when the Council formally approves interest payments to be made.

2. Summary of significant accounting policies continued

V New standards and interpretations not applied

During the year, the International Accounting Standards Board and International Financial Reporting Interpretations Committee have issued the following standards and interpretations relevant to the Society with an effective date after the date of these financial statements:

		Effective date
International Accounting Standards (IAS)		
IFRS 4	Insurance Contracts (Amendment to IAS 39 and IFRS 4 – Financial Guarantee Contracts)	1 January 2006
IFRS 7	Financial Instruments: Disclosures	1 January 2006
IAS 1	Amendment – Presentation of Financial Statements: Capital Disclosures	1 January 2007
IAS 21	Amendment – Net Investment in a Foreign Operation	1 January 2006
IAS 39	Cash Flow Hedge Accounting	1 January 2006
IAS 39	Amendment to IAS 39 and IFRS 4 – Financial Guarantee Contracts	1 January 2006
International Financial Reporting Interpretations Committee (IFRIC)		
IFRIC 4	Determining Whether an Arrangement Contains a Lease	1 January 2006
IFRIC 7	Applying the Restatement Approach under IAS 29 Financial Reporting in Hyperinflationary Economies	1 March 2006
IFRIC 8	Scope of IFRS 2	1 May 2006

The Council does not anticipate that the adoption of these standards and interpretations will have a material impact on the Society's financial statements in the period of initial application.

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. Assets are primarily held by the Society's UK based operations.

3. Segmental analysis continued

a) Information by business segment	Note	2005 Corporation of Lloyd's £000	2005 Lloyd's Central Fund £000	2005 Insurance activities £000	2005 Society total £000
Segment income					
Segment income (unconsolidated)		170,737	83,306	2,769	256,812
Less intra-segment income		(2,976)	–	–	(2,976)
Total income from external sources	3b	167,761	83,306	2,769	253,836
Segment operating expenses (consolidated)					
Central Fund claims and provisions	4	–	(223,889)	–	(223,889)
Gross claims incurred		–	–	(30,039)	(30,039)
Claims recoverable from reinsurers		–	–	29,844	29,844
Other group operating expenses:					
Employment (including pension costs)	6	(66,060)	–	–	(66,060)
Premises		(30,452)	–	–	(30,452)
Legal and professional	5	(10,253)	(3,887)	(85)	(14,225)
Overseas operations	7	(23,114)	–	–	(23,114)
Other		(36,127)	(2,020)	(99)	(38,246)
Total other group operating expenses		(166,006)	(5,907)	(184)	(172,097)
Total segment operating expenses		(166,006)	(229,796)	(379)	(396,181)
Net finance income		5,489	86,816	3,075	95,380
Segment surplus/(deficit)		7,244	(59,674)	5,465	(46,965)
Share of profits of associates	13a	2,006	–	–	2,006
Tax credit					17,343
Deficit for the year					(27,616)
Segment assets and liabilities					
Segment assets		303,131	1,346,631	575,848	2,225,610
Investment in associates	13a	4,162	–	–	4,162
Tax assets					21,236
Total assets					2,251,008
Segment liabilities		(258,046)	(684,262)	(544,132)	(1,486,440)
Other segment information					
Capital expenditure	10/11	3,511	–	–	3,511
Depreciation	11	1,874	–	–	1,874
Amortisation of intangible assets	10	126	–	–	126
Impairment of long-term assets	11	231	–	–	231
Average number of employees		603	–	–	603

3. Segmental analysis continued

a) Information by business segment continued	Note	2004 Corporation of Lloyd's £000	2004 Lloyd's Central Fund £000	2004 Insurance activities £000	2004 Society total £000
Segment income					
Segment income (unconsolidated)		180,845	211,024	3,428	395,297
Less intra-segment income		(3,067)	–	–	(3,067)
Total income from external sources	3b	177,778	211,024	3,428	392,230
Segment operating expenses (consolidated)					
Central Fund claims and provisions	4	–	(125,540)	–	(125,540)
Gross claims incurred		–	–	(47,735)	(47,735)
Claims recoverable from reinsurers		–	–	52,053	52,053
Other group operating expenses:					
Employment (including pension costs)	6	(62,567)	–	–	(62,567)
Premises		(30,276)	–	–	(30,276)
Legal and professional	5	(11,636)	(5,580)	(98)	(17,314)
Overseas operations	7	(20,592)	–	–	(20,592)
Other		(38,077)	(4,444)	(146)	(42,667)
Total other group operating expenses		(163,148)	(10,024)	(244)	(173,416)
Total segment operating expenses		(163,148)	(135,564)	4,074	(294,638)
Net finance income		3,844	33,171	1,683	38,698
Segment surplus		18,474	108,631	9,185	136,290
Profit on sale of Lloyd's 1958 building		23,638	–	–	23,638
Share of profits of associates	13a	1,872	–	–	1,872
Tax charge					(38,959)
Surplus for the year					122,841
Segment assets and liabilities					
Segment assets		286,033	1,162,707	594,706	2,043,446
Investment in associates	13a	3,283	–	–	3,283
Tax assets					85,269
Total assets					2,131,998
Segment liabilities		(259,626)	(623,990)	(558,381)	(1,441,997)
Other segment information					
Capital expenditure	10/11	2,120	–	–	2,120
Depreciation	11	1,973	–	11	1,984
Amortisation of intangible assets	10	99	–	–	99
Impairment of long-term assets	11	443	–	–	443
Average number of employees		592	–	–	592

3. Segmental analysis continued

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.

iii) Insurance activities: the Society has two insurance company subsidiary undertakings, Centrewrite 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. The insurance contract liabilities of Lioncover were wholly reinsured into Equitas in 1997 and the company does not accept new business.

	Corporation of Lloyd's		Lloyd's Central Fund		Insurance activities		Society total	
b) Income	**2005 £000**	2004 £000	**2005 £000**	2004 £000	**2005 £000**	2004 £000	**2005 £000**	2004 £000
Market charges								
Managing agents and syndicates	**54,007**	52,152	**–**	–	**–**	–	**54,007**	52,152
Members and members' agents	**13,288**	14,463	**–**	–	**–**	–	**13,288**	14,463
Franchise Performance and Risk Management charge	**11,581**	12,293	**–**	–	**–**	–	**11,581**	12,293
Total market charges	**78,876**	78,908	**–**	–	**–**	–	**78,876**	78,908
Members' subscriptions	**68,804**	74,935	**–**	–	**–**	–	**68,804**	74,935
Other charges	**13,539**	15,071	**1,134**	252	**–**	–	**14,673**	15,323
Total operating income	**161,219**	168,914	**1,134**	252	**–**	–	**162,353**	169,166
Central Fund contributions								
Individual members	**–**	–	**7,175**	23,363	**–**	–	**7,175**	23,363
Corporate members	**–**	–	**62,902**	167,294	**–**	–	**62,902**	167,294
Total Central Fund contributions	**–**	–	**70,077**	190,657	**–**	–	**70,077**	190,657
General insurance net premium income	**–**	–	**–**	–	**2,769**	3,428	**2,769**	3,428
Other group income	**6,542**	8,864	**12,095**	20,115	**–**	–	**18,637**	28,979
Total income	**167,761**	177,778	**83,306**	211,024	**2,769**	3,428	**253,836**	392,230

The basis for members contributing to the Lloyd's Central Fund changed in 2005. Members have continued to contribute based on a percentage of their allocated overall premium limit. However, from 2005 this is partly achieved by contributions of 0.50% (2004: 1.25%) and partly by way of interest-bearing loans from syndicate premiums trust funds, referred to as syndicate loans, of 0.75% (2004: not applicable). The syndicate loans have been treated as part of the Society's equity rather than as contributions from members in the group income statement (see note 25).

4. Central Fund claims and provisions	2005 £000	2004 £000
Provision for amounts paid and payable under undertakings given to insolvent members	**217,438**	122,863
Provisions made in respect of Limited Financial Assistance Agreements (note 22)	**2,001**	–
Claims payable in respect of individual members	**2,329**	2,677
Tax and interest payable in respect of insolvent members	**2,121**	–
	223,889	125,540
Consisting of:		
Annual undertakings granted	**217,568**	149,486
Decrease in the value of supporting commitments (note 22)	**(130)**	(7,997)
Provisions made in respect of Limited Financial Assistance Agreements (note 22)	**2,001**	–
Claims payable in respect of individual members	**2,329**	2,677
Tax and interest payable in respect of insolvent members	**2,121**	–
Other	**–**	17
Settlement with Central Fund insurers	**–**	(18,643)
	223,889	125,540

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 on an annual basis and therefore are not deemed constructive obligations (see note 22). Unutilised undertakings as at 31 December 2005 were £163.9m. By 31 March 2006, this balance had been reduced to £4.8m by the payment of claims of £47.4m and the expiry of undertakings totalling £111.7m, which had been given in 2005. Those undertakings which expired have been replaced and further annual undertakings have been given on 5 April 2006 that total £174.9m, a net increase of £63.2m. 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 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 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.

5. Other group operating expenses	2005 Corporation of Lloyd's £000	2005 Lloyd's Central Fund £000	2005 Insurance activities £000	2005 Total £000	2004 Total £000
Other group operating expenses include:					
Employment costs (note 6)	**66,060**	**–**	**–**	**66,060**	62,567
Overseas operating expenses (note 7)	**23,114**	**–**	**–**	**23,114**	20,592
Operating lease rentals – Lloyd's 1986 building	**16,767**	**–**	**–**	**16,767**	16,767
Operating lease rentals – other	**870**	**–**	**–**	**870**	749
Professional fees, including legal fees and related costs	**8,933**	**3,814**	**7**	**12,754**	16,175
Audit services	**296**	**64**	**56**	**416**	304
Further assurance services payable to Ernst & Young LLP	**705**	**–**	**–**	**705**	410
Tax services payable to Ernst & Young LLP	**26**	**–**	**–**	**26**	91
Other services payable to Ernst & Young LLP	**293**	**9**	**22**	**324**	334
Total legal and professional fees	**10,253**	**3,887**	**85**	**14,225**	17,314
Charitable donations	**281**	**–**	**–**	**281**	217

The costs of Kinnect Limited in the year to 31 December 2005 total £15.5m (2004: £15.1m) and include employment costs of £6.9m (2004: £7.0m), systems and communications costs of £6.4m (2004: £6.0m) and legal and professional fees of £0.4m (2004: £0.4m).

Excluded from the table above are additional fees of £30,000 paid to Ernst & Young LLP that were capitalised in relation to the Society's issue of subordinated loan notes (2004: £120,000).

6. Employment	2005 £000	2004 £000
Salaries and wages (including performance-related bonus)	**36,834**	33,632
Long-term Incentive Plan (excluding social security costs – note 22)	**2,104**	2,982
Defined benefit pension costs	**10,589**	10,464
Other pension costs	**913**	911
Social security costs	**4,390**	4,312
Severance costs	**1,875**	2,049
Contract and agency staff	**4,417**	4,087
Other employment costs	**4,938**	4,130
	66,060	62,567

The emoluments of the Chairman, CEO, members of the Council and Franchise Board are included in the report of the Nominations, Appointments and Compensation Committee on pages 85 to 87.

7. Overseas operating expenses	2005 £000	2004 £000
Operating expenses include:		
Employment	**6,141**	5,848
Legal and professional	**6,480**	4,672
Systems and communications	**3,283**	3,121
Premises	**1,611**	1,392
Other expenses	**5,599**	5,559
	23,114	20,592

8. Finance	2005 Corporation of Lloyd's £000	2005 Central Fund £000	2005 Insurance activities £000	2005 Total £000	2004 Total £000
Finance costs					
Interest payable and similar charges	**(7,200)**	**(32,187)**	**–**	**(39,387)**	(4,482)
Amortisation of issue costs and discount	**–**	**(564)**	**–**	**(564)**	(65)
Unrealised exchange gain/(loss) on borrowings	**–**	**6,298**	**–**	**6,298**	(2,630)
Total finance costs	**(7,200)**	**(26,453)**	**–**	**(33,653)**	(7,177)
Finance income					
Returns on investments	**12,899**	**70,365**	**2,744**	**86,008**	22,149
Unrealised fair value movement of investments	**(210)**	**40,590**	**(93)**	**40,287**	18,969
Increase in valuation of loans recoverable	**–**	**2,314**	**–**	**2,314**	4,296
Other income	**–**	**–**	**424**	**424**	461
Total finance income	**12,689**	**113,269**	**3,075**	**129,033**	45,875

Returns on investments include dividends and interest receivable, realised fair value gains and losses and realised and unrealised exchange differences arising on the revaluation of foreign currency investment holdings.

Other income includes realised and unrealised exchange differences arising on the revaluation of foreign currency operating cash flows.

9. Taxation

a) Analysis of charge in the year	2005 £000	2004 £000
Current tax:		
Corporation tax based on profits for the year at 30% (2004: 30%)	**–**	62,009
Adjustments in respect of previous years	**7,351**	2,447
Foreign tax suffered	**(6)**	(13)
Total current tax	**7,345**	64,443
Deferred tax:		
Origination and reversal of timing differences	**9,998**	(103,402)
Tax credit/(charge)	**17,343**	(38,959)

The prior year tax credit of £7.4m arises following the agreement of issues outstanding on prior year tax returns and the finalisation of the 2004 tax position.

b) Reconciliation of effective tax rate	2005 £000	2005 £000	2004 £000	2004 £000
(Deficit)/surplus before tax		**(44,959)**		161,800
Corporation tax at 30%	**30.0%**	**13,488**	30.0%	(48,540)
Expenses not deductible for tax purposes	**(11.0%)**	**(4,947)**	1.8%	(2,787)
Non-taxable income	**4.1%**	**1,860**	(6.0%)	9,645
Utilisation of tax credits	**–**	**2**	–	15
Unutilised tax losses	**(2.5%)**	**(1,128)**	–	–
Overseas tax	**–**	**(6)**	–	(13)
Adjustments in respect of previous years	**16.4%**	**7,351**	(1.5%)	2,447
Other	**1.6%**	**723**	(0.2%)	274
Tax credit/(charge) (note 9a)	**38.6%**	**17,343**	24.1%	(38,959)

c) Deferred tax	2005 Balance at 1 January £000	2005 Income statement £000	2005 Equity £000	2005 Balance at 31 December £000
Property, plant and equipment	**1,165**	**1,595**	**–**	**2,760**
Loans recoverable	**(18,981)**	**18,981**	**–**	**–**
Financial investments	**(3,281)**	**(6,558)**	**–**	**(9,839)**
Pension liability	**16,110**	**(1,153)**	**706**	**15,663**
Other employee benefits	**890**	**62**	**–**	**952**
Provisions	**3,394**	**(3,394)**	**–**	**–**
Unutilised tax losses	**–**	**173**	**–**	**173**
Other items	**1,318**	**292**	**–**	**1,610**
	615	**9,998**	**706**	**11,319**

9. Taxation continued

c) Deferred tax continued	2004 Balance at 1 January £000	2004 Income statement £000	2004 Equity £000	2004 Balance at 31 December £000
Property, plant and equipment	599	566	–	1,165
Loans recoverable	(19,061)	80	–	(18,981)
Insurance receivable	97,961	(97,961)	–	–
Financial investments	554	(3,835)	–	(3,281)
Pension liability	16,500	(720)	330	16,110
Other employee benefits	1,340	(450)	–	890
Provisions	5,794	(2,400)	–	3,394
Other items	–	1,318	–	1,318
	103,687	(103,402)	330	615

Deferred tax has not been recognised in respect of tax losses where it has not been considered probable that suitable taxable profits will be available to utilise these losses. These unrecognised tax losses amount to £7.2m (2004: £4.9m).

10. Intangible assets – software development	Total £000
Cost:	
At 1 January 2004	4,336
Additions	205
At 31 December 2004	4,541
Additions	**27**
At 31 December 2005	**4,568**
Amortisation:	
At 1 January 2004	4,167
Charge for the year	99
At 31 December 2004	4,266
Charge for the year	**126**
At 31 December 2005	**4,392**
Net book value at 31 December 2005	**176**
Net book value at 31 December 2004	275

The amortisation charge is included in other group operating expenses in the group income statement.

11. Property, plant and equipment	Freehold land and buildings £000	Plant and other assets £000	Total £000
Cost:			
At 1 January 2004	10,413	40,591	51,004
Additions	–	1,915	1,915
Transfers to assets classified as held for sale	(10,000)	(4,619)	(14,619)
Disposals	–	(1,014)	(1,014)
At 31 December 2004	413	36,873	37,286
Additions	**–**	**3,484**	**3,484**
Disposals	**–**	**(2,244)**	**(2,244)**
At 31 December 2005	**413**	**38,113**	**38,526**
Depreciation and impairment:			
At 1 January 2004	3,426	32,713	36,139
Depreciation charge for the year	125	1,859	1,984
Transfers to assets classified as held for sale	(3,202)	(3,202)	(6,404)
Impairment losses	–	443	443
Disposals	–	(1,000)	(1,000)
At 31 December 2004	349	30,813	31,162
Depreciation charge for the year	**32**	**1,842**	**1,874**
Impairment losses	**–**	**231**	**231**
Disposals	**–**	**(2,167)**	**(2,167)**
At 31 December 2005	**381**	**30,719**	**31,100**
Net book value at 31 December 2005	**32**	**7,394**	**7,426**
Net book value at 31 December 2004	64	6,060	6,124

Impairment losses

During 2004 and 2005, an impairment review was undertaken in which assets within plant and other assets had their recoverable amounts reassessed. As part of this assessment of the carrying value of assets, £231,000 was written off (2004: £443,000) which is included within other group operating expenses. The majority of the written down assets related to redundant or obsolete computer equipment.

Assets classified as held for sale

Following the decision to sell the Lloyd's Chatham building on 14 October 2004, the building was classified as held for sale in the group balance sheet as at 31 December 2004.

On 15 April 2005, the Corporation of Lloyd's completed an agreement with Thorstone Land & Property Limited, for the sale of its freehold interest.

12. Principal investments in subsidiary undertakings and associates

Entity	Nature of business	Proportion of equity capital held
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%
Kinnect Limited	An electronic platform that sought to enable trading partners in commercial line insurance to store and exchange commercial terms, insuring clauses and risk data, to support placing and subsequent processing. Kinnect Limited closed its operations on 24 January 2006 (see note 26)	100%
Associates		
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 issued share capital of Ins-sure Holdings Limited is £4,000. There are three separate 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 separate classes of shares. The Society holds 1,000 A shares of £1 each and 2,501 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.

13. Investments

a) Investments in associates	2005 Goodwill £000	2005 Share of other net assets £000	2005 Total £000	2004 Total £000
At 1 January	**861**	**2,422**	**3,283**	5,422
Share of operating profits	**–**	**3,059**	**3,059**	2,748
Share of interest income	**–**	**122**	**122**	103
Share of tax on profit on ordinary activities	**–**	**(1,175)**	**(1,175)**	(979)
Total share of profits of associates	**–**	**2,006**	**2,006**	1,872
Share of actuarial gain/(loss) on pension liability	**–**	**375**	**375**	(396)
Share of tax on items taken directly to equity	**–**	**(112)**	**(112)**	119
Dividends received	**–**	**(1,390)**	**(1,390)**	(3,734)
At 31 December	**861**	**3,301**	**4,162**	3,283

The share of actuarial gain/(loss) on pension liability in the table above includes a past service cost gain in 2005 of £1.0m.

13. Investments continued

a) Investments in associates continued

Summary financial information for associates – 100%:

	Assets £000	Liabilities £000	Revenues £000	Profit after tax £000
2005				
Ins-sure Holdings Limited	**28,814**	**(16,605)**	**53,180**	**4,529**
Xchanging Claims Services Limited	**11,031**	**(7,447)**	**24,442**	**2,302**
	39,845	**(24,052)**	**77,622**	**6,831**
2004				
Ins-sure Holdings Limited	29,649	(18,703)	54,448	3,418
Xchanging Claims Services Limited	7,349	(4,881)	17,734	1,079
	36,998	(23,584)	72,182	4,497

b) Lloyd's Collection

The Lloyd's Collection represents various paintings, antiques and artefacts. The collection was valued by Gurr Johns Limited, valuers and fine art consultants in September 2004, 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 £2.8m. In 2005, it has been assessed there was no change in valuation.

14. 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 balance sheet date. Outstanding claims provisions are not discounted for the time value of money.

Insurance claims	2005 Lioncover Insurance Company Limited £000	2005 Centrewrite Limited £000	2005 Total £000	2004 Total £000
Gross claims incurred:				
Claims paid	**(108,629)**	**1,092**	**(107,537)**	(143,710)
Change in provision for claims	**78,273**	**(775)**	**77,498**	95,975
	(30,356)	**317**	**(30,039)**	(47,735)
Claims recoverable from reinsurers:				
Claims recovered from reinsurers	**108,629**	**–**	**108,629**	138,588
Change in reinsurance contract assets	**(78,273)**	**(512)**	**(78,785)**	(86,535)
	30,356	**(512)**	**29,844**	52,053

14. Insurance activities continued

Lioncover Insurance Company Limited

Lioncover Insurance Company Limited (Lioncover) is a wholly owned subsidiary undertaking of the Society. Since its formation, Lioncover has reinsured the liabilities of Names on syndicates formerly managed by PCW Underwriting Agencies Limited, WMD Underwriting Agencies Limited and Richard Beckett Underwriting Agencies Limited and on syndicates 2 and 49 (collectively referred to as 'the PCW syndicates'). On 18 December 1997, Lioncover entered into an unlimited reinsurance of those liabilities with Equitas Reinsurance Limited (ERL).

Notwithstanding the reinsurance of liabilities by ERL, Lioncover remains liable to its policyholders in respect of the business originally underwritten. Accordingly, the Society's financial statements reflect a provision for claims outstanding, including losses incurred but not reported (IBNR), in respect of that business and an equal amount as recoverable from ERL.

Lioncover's long-term insurance liabilities include pollution and asbestos. Lioncover does not underwrite any new policies.

Insurance contract liabilities may be analysed as follows:

	2005 Insurance contracts liabilities £000	2005 Reinsurer's share of liabilities £000	2005 Net £000	2004 Insurance contracts liabilities £000	2004 Reinsurer's share of liabilities £000	2004 Net £000
Provision for claims reported	**394,960**	**(394,960)**	**–**	300,826	(300,826)	–
Provision for IBNR claims	**131,888**	**(131,888)**	**–**	241,009	(241,009)	–
Insurance contract liabilities	**526,848**	**(526,848)**	**–**	541,835	(541,835)	–

The movement in provision for insurance contract liabilities can be analysed as follows:

	2005 Insurance contracts liabilities £000	2005 Reinsurer's share of liabilities £000	2005 Net £000	2004 Insurance contracts liabilities £000	2004 Reinsurer's share of liabilities £000	2004 Net £000
At 1 January	**541,835**	**(541,835)**	**–**	672,518	(672,518)	–
Claims incurred	**30,356**	**(30,356)**	**–**	52,756	(52,756)	–
Claims paid	**(108,629)**	**108,629**	**–**	(138,588)	138,588	–
Effect of exchange rates	**63,286**	**(63,286)**	**–**	(44,851)	44,851	–
At 31 December	**526,848**	**(526,848)**	**–**	541,835	(541,835)	–

The provision for claims outstanding is based upon actuarial and other studies of the ultimate cost of liabilities performed by ERL including exposure based and statistical estimation techniques.

Significant delays occur in the notification and settlement of certain claims, and a substantial measure of experience and judgement is involved in making the assumptions for assessing outstanding liabilities, the ultimate cost of which cannot be known with certainty at the balance sheet date. The gross provision for claims outstanding and related reinsurance recoveries is estimated on the basis of information currently available.

The provision for claims outstanding includes significant amounts in respect of notified and potential IBNR claims for long-tail liabilities. The settlement of these claims is not expected to occur for many years, and there is considerable uncertainty as to the amounts at which they will be settled.

14. Insurance activities continued

Lioncover Insurance Company Limited continued

Where a claim is disputed, the validity of the claim is ultimately an issue that can only be determined by the courts. The provision for a disputed claim is based on Lioncover's view as to the expected outcomes of such court decisions.

Uncertainty is further increased because of the potential for unforeseen changes in the legal, judicial, technological or social environment, which may increase or decrease the cost, frequency or reporting of claims, and because of the potential for new sources or types of claim to emerge.

Asbestos claims

In estimating asbestos liabilities, Lioncover follows a highly developed actuarial framework. The majority of asbestos reserves are estimated by modelling the expected claims from policyholders of the reinsured syndicates.

The number of future claims is projected for direct policyholders based on past claims experience combined with the results of epidemiological and, other relevant studies that predict the incidence of asbestos-related diseases into the future. This is then combined with estimates of the average cost of settling different types of claims for each policyholder to give a total value of claims to the relevant underlying policyholders. The results of these projections are then applied to the insurance coverage available for those policyholders, resulting in an estimation of Lioncover's liabilities arising from claims against those policyholders. The results are then adjusted to take into account liabilities in respect of policyholders that are not modelled explicitly, including an amount for those liabilities of which Lioncover may be currently unaware.

The techniques described above include a number of important assumptions, including:

- the projected level of future valid claims filings for each policyholder by disease type;
- future levels of claims settlements values;
- the impact of bankruptcy of policyholders on the amount and timing of claims payments;
- the legal interpretation of insurance policies and the outcome of litigation, based upon legal advice received; and
- the period between the filing and payment of claims.

The assumptions on the proportion of claims filings that will ultimately lead to claims payments reflect an assessment that the claims management strategies adopted by Lioncover will reduce claims payments below the level that they would otherwise have been.

Pollution and health hazard claims

Pollution liabilities are estimated for policyholders of the reinsured syndicates by evaluating the expected costs to be incurred by the policyholders in cleaning up polluted sites and then applying these costs to the insurance coverage available. The pollution liabilities expected by means of inward reinsurance are evaluated in a similar manner, but with the additional step of applying the ceding companies' expected liabilities to the reinsurance cover available.

Allowance is then made for liabilities in respect of policyholders for which either sufficient information is unavailable to carry out the above analysis or, which have not yet been identified.

Health hazard liabilities are estimated using similar principles to the above, in that the liabilities of the policyholder are estimated for the majority of reserves and then applied to the insurance coverage.

These evaluation techniques involve a number of important assumptions, including:

- the validity and quantum of the claims potentially faced by the policyholder;
- the legal interpretation of insurance policies and the outcome of litigation, based upon legal advice received; and
- the degree to which potential or unforeseen health hazards may have an effect on the liabilities.

14. Insurance activities continued

Lioncover Insurance Company Limited continued

Reinsurance recoveries

For the purposes of preparing these financial statements the directors of Lioncover have taken into consideration that, in the financial statements of Equitas Holdings Limited, the parent company of ERL, specific reference has been made to the significant uncertainties regarding the determination of the ultimate cost of claims to be borne by ERL and to the potential for deterioration to affect materially the ability to pay claims in full.

At present, ERL and its subsidiary undertaking, Equitas Limited, which is responsible for the run-off of the reinsured business, continue to pay claims in full and the directors of ERL have stated that they believe that the assets should be sufficient to meet all liabilities in full. Accordingly, the directors of Lioncover have considered it appropriate to recognise the amounts recoverable from ERL in full. Should ERL ever cease to meet in full its obligations in respect of the PCW syndicates, Lioncover would be responsible to its policyholders for meeting any amounts remaining unpaid. Lioncover would, in turn, be entitled, under an agreement with Lloyd's dated 26 May 1987, to call on Lloyd's to make good the shortfall (see note 29).

Centrewrite Limited

The company's principal activities are:

a) to underwrite the Lloyd's Members' Estate Protection Plan, and

b) to reinsure individual members of Lloyd's participations on syndicates for underwriting years of account which have not been closed.

Insurance contract liabilities may be analysed as follows:

	2005 Insurance contracts liabilities £000	**2005 Reinsurers' share of liabilities £000**	**2005 Net £000**	2004 Insurance contracts liabilities £000	2004 Reinsurers' share of liabilities £000	2004 Net £000
Provision for claims reported	**16,283**	**(174)**	**16,109**	15,554	(686)	14,868
Provision for IBNR claims	**141**	**–**	**141**	95	–	95
Insurance contract liabilities	**16,424**	**(174)**	**16,250**	15,649	(686)	14,963

The movement in provision for insurance contract liabilities can be analysed as follows:

	2005 Insurance contracts liabilities £000	**2005 Reinsurers' share of liabilities £000**	**2005 Net £000**	2004 Insurance contracts liabilities £000	2004 Reinsurers' share of liabilities £000	2004 Net £000
At 1 January	**15,649**	**(686)**	**14,963**	25,792	(1,389)	24,403
Claims incurred/(released)	**(317)**	**512**	**195**	(5,021)	703	(4,318)
Claims recovered/(paid)	**1,092**	**–**	**1,092**	(5,122)	–	(5,122)
At 31 December	**16,424**	**(174)**	**16,250**	15,649	(686)	14,963

14. Insurance activities continued

Centrewrite Limited continued

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 balance sheet, 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 balance sheet date. Subsequent information and events may result in the ultimate liability being less than, or greater than, the amount provided. Any difference between the provision and subsequent settlements are dealt with in the technical accounts of later years.

Claims development triangles

The tables below show the development of claims over a period of time on a gross basis.

The tables show the cumulative incurred claims, including both notified and IBNR claims, for each successive year at balance sheet date, together with cumulative claims at the current balance sheet date.

Lioncover Insurance Company Limited	2001 £000	2002 £000	2003 £000	2004 £000	2005 £000	**Total £000**
At end of underwriting year	1,241,260	–	–	–	–	
One year later	1,064,520	–	–	–		
Two years later	840,945	–	–			
Three years later	848,850	–				
Current year	942,492					
Current estimate of cumulative claims	942,492	–	–	–	–	
Cumulative payments to date	(415,644)	–	–	–	–	
Insurance contract liabilities	526,848	–	–	–	–	**526,848**

The impact of exchange rate movements has increased the claims provision by £63.3m (2004: reduction in claims provision of £44.9m). This is represented in the movement in claims in the table above.

Centrewrite Limited	2001 and prior £000	2002 £000	2003 £000	2004 £000	2005 £000	**Total £000**
At end of underwriting year	99,746	8,453	4,640	4,101	3,407	
One year later	100,326	8,237	4,399	3,621		
Two years later	94,623	6,467	4,118			
Three years later	66,150	5,665				
Four years later	58,920					
Current estimate of cumulative claims	58,920	5,665	4,118	3,621	3,407	
Cumulative payments to date	(53,608)	(2,978)	(2,200)	(325)	(196)	
Insurance contract liabilities	5,312	2,687	1,918	3,296	3,211	**16,424**

15. Loans recoverable

	2005 £000	2004 £000
At 1 January	**63,269**	63,537
Recoveries during the year	**(3,974)**	(4,564)
Change in valuation of loans recoverable	**2,314**	4,296
At 31 December	**61,609**	63,269

16. Financial investments	2005 £000	2004 £000
Statutory insurance deposits (note 16a)	**121,484**	112,622
Other investments (note 16c)	**1,031,662**	1,040,834
	1,153,146	1,153,456

a) Statutory insurance deposits	2005 Securities £000	2005 Deposits £000	2005 Total £000	2004 Total £000
Market value at 1 January	**37,827**	**74,795**	**112,622**	111,584
Additions at cost	**21,611**	**254,435**	**276,046**	381,803
Disposal proceeds	**(18,755)**	**(252,966)**	**(271,721)**	(377,944)
Surplus/(deficit) on the sale and revaluation of investments	**(1,370)**	**5,907**	**4,537**	(2,821)
Market value at 31 December	**39,313**	**82,171**	**121,484**	112,622

Analysis of securities at year end – statutory insurance deposits	2005 Cost £000	2005 Valuation £000	2004 Cost £000	2004 Valuation £000
Listed on:				
Overseas stock exchanges	**33,918**	**33,118**	32,551	32,799
	33,918	**33,118**	32,551	32,799
Unlisted:				
Fixed interest	**5,990**	**6,195**	4,964	5,028
	39,908	**39,313**	37,515	37,827

Basis of valuation: listed fixed and floating rate securities are valued at their quoted bid market price at the balance sheet date.

Unlisted fixed interest securities	2005 £000	2004 £000
Foreign treasury bills	**5,622**	4,520
Foreign government debentures	**573**	508
	6,195	5,028

b) Loans funding statutory insurance deposits

These amounts comprise floating rate advances in foreign currencies and pound sterling repayable within one year:

	2005 £000	2004 £000
Lloyd’s market – deposits	**(115,750)**	(106,831)
Allocated to:		
Financing of underwriting deposits	**(110,548)**	(101,629)
Working capital	**(5,202)**	(5,202)
	(115,750)	(106,831)

16. Financial investments continued

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 (see note 24).

The terms and conditions of these advances are governed by the Overseas Underwriting Byelaw (No 2 of 2004) which enables the Council of Lloyd's to vary the amount, term and rate of interest of these loans, as appropriate. The provision of funds by members under this Byelaw is in respect of the establishment and maintenance of overseas deposits and is a condition of permission to underwrite insurance business at Lloyd's.

c) Other investments	2005 Corporation of Lloyd's £000	2005 Central Fund £000	2005 Insurance activities £000	2005 Total £000	2004 Total £000
Market value at 1 January	**15,469**	**985,058**	**40,307**	**1,040,834**	384,757
Additions at cost	**–**	**950,406**	**52,729**	**1,003,135**	910,961
(Decrease)/increase in short-term deposits	**(15,080)**	**(20,047)**	**–**	**(35,127)**	36,633
Disposal proceeds	**–**	**(983,221)**	**(51,634)**	**(1,034,855)**	(304,398)
Surplus on the sale and revaluation of investments	**–**	**57,598**	**77**	**57,675**	12,881
Market value at 31 December	**389**	**989,794**	**41,479**	**1,031,662**	1,040,834
Analysis of securities at year end:					
Listed on London Stock Exchange:					
Fixed interest	**–**	**442,469**	**34,103**	**476,572**	416,901
Equities	**–**	**103,096**	**–**	**103,096**	136,817
	–	**545,565**	**34,103**	**579,668**	553,718
Listed on overseas stock exchanges:					
Fixed interest	**–**	**317,140**	**7,376**	**324,516**	311,302
Equities	**–**	**100,658**	**–**	**100,658**	120,907
	–	**417,798**	**7,376**	**425,174**	432,209
Short-term deposits	**389**	**5,431**	**–**	**5,820**	33,907
Security deposits (see below)	**–**	**21,000**	**–**	**21,000**	21,000
	389	**26,431**	**–**	**26,820**	54,907
	389	**989,794**	**41,479**	**1,031,662**	1,040,834

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 June 2004, will be reviewed again in June 2006. 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.

16. Financial investments continued

Lioncover Insurance Company Limited

In 1999, Lloyd's assigned to Lioncover £1m of the 'Old' Central Fund by way of security for a period of ten years for its obligations to Lioncover under the indemnity bond referred to in note 29. The security was provided as consideration to those individual Names whose underwriting liabilities are reinsured by Lioncover for the release of Lloyd's syndicate 9001, for which Lioncover was substituted as direct reinsurer to close of those Names. Any of the funds remaining after this period will be repaid to the 'Old' Central Fund.

Unless and until there is any default under the security documentation, interest earned on the security is paid to the 'Old' Central Fund.

17. Inventories	2005 £000	2004 £000
Consumables	**401**	461

18. Trade and other receivables	2005 £000	2004 £000
Due within one year:		
Trade and other debtors	**34,440**	38,003
Central Fund insurance claim receivable	**–**	18,643
	34,440	56,646

19. Cash and cash equivalents	2005 £000	2004 £000
Cash at banks	**36,068**	51,552
Short-term deposits	**381,041**	129,893
	417,109	181,445

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 £417.1m (2004: £181.4m).

At 31 December 2005, the Society had available £40.0m (2004: £40.0m) of undrawn committed borrowing facilities in respect of which all conditions precedent had been met.

20. Subordinated loan notes	2005 £000	2004 £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 €300m maturing 17 November 2024	**206,129**	212,389
	506,129	512,389
Less: issue costs to be charged in future years	**(3,361)**	(3,722)
Less: discount on issue to be unwound in future years	**(1,986)**	(2,228)
	500,782	506,439

On 15 November 2004, the Society issued two tranches of subordinated debt, a £300m tranche which carries a coupon of 6.875% (the 'Sterling Notes') and a €300m tranche which carries a coupon of 5.625% (the 'Euro Notes' and together with the Sterling Notes, the 'Notes').

20. Subordinated loan notes continued

The Sterling Notes mature on 17 November 2025, although the Society may redeem them at 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 at 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 Society’s obligations to members under the New Central Fund Syndicate Loans which commenced on 1 April 2005 (see note 25) and also in priority 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).

21. Pension scheme

The Corporation of Lloyd’s operates a defined benefit pension scheme with assets held in a separately administered fund, the Lloyd’s Pension Scheme. 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 Watson Wyatt LLP, actuaries and consultants, as at 30 June 2004 using the projected unit credit method. The principal actuarial assumptions adopted in the valuation were that (in real terms relative to retail price inflation), present and future pensions in payment relating to benefits accruing on or after 6 April 1997 would remain constant whilst total pensionable remuneration would increase by 1.8% per annum. The real rate of return on investments held at the valuation date was assumed to be approximately 3.9% whilst the real rate of return on future contributions receivable after the valuation date was assumed to be 4.2%. The total market value of the scheme’s assets at the date of valuation were £245m, which equates to 96% of the value placed on the benefits that had accrued to members of £254m, after allowing for assumed future increases in pensionable remuneration. These figures exclude both liabilities and the related assets in respect of money purchase AVCs and in respect of the accrued benefits of scheme members employed by LPSO Limited, LCO Marine Limited and LCO Non-Marine and Aviation Limited. Whilst these companies are participating employers of the scheme, they ceased to be subsidiary undertakings during 2001.

No allowance has been made for discretionary increases to pre 6 April 1997 benefits when in payment. In 2003, the Corporation of Lloyd’s instructed Watson Wyatt LLP not to allow for such increases in calculating the scheme’s liabilities when carrying out a 2003 interim review and for future actuarial valuations. Such increases have always been payable at the discretion of Lloyd’s and will continue to be considered on the basis of affordability, but are no longer taken into account by the actuary in determining the funding level.

The Corporation of Lloyd’s has made two special contributions to the Lloyd’s Pension Scheme to eliminate the past service deficit of £9m revealed by the actuarial valuation as at 30 June 2004. The past service deficit having been eliminated, the actuary has determined the contribution rate for the Corporation of Lloyd’s in respect of future service from 1 July 2004 should be 21.2% of pensionable pay for existing members.

21. Pension scheme continued

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. Assumed mortality in retirement is based on published actuarial tables (PMA92BAS for men and PFA92BAS for women, rated down by one year for females), together with an allowance for future improvements in longevity. These assumptions are identical to those used for the most recent actuarial valuation of the scheme as at 30 June 2004.

These assumptions are equivalent to expected longevity at age 60 approximately as follows:

- for pensioners currently aged 60: ranging from 23 years to 27 years; and
- for non-pensioners currently aged 45: ranging from 24 years to 28 years.

The other major financial assumptions used by the actuary as at 31 December 2005 were as follows:

	2005 % per annum	2004 % per annum
General salary and wage inflation	**4.60%**	4.60%
Rate of increase in pensions in payment		
– pre 6 April 1997 (in excess of GMPs)	**–**	–
– post 5 April 1997	**2.80%**	2.80%
Increases to deferred pensions	**2.80%**	2.80%
Discount rate	**4.80%**	5.40%
Price inflation	**2.80%**	2.80%
Expected rate of return – Bonds	**4.40%**	5.00%
– Equities	**7.90%**	8.20%
– Cash and net current assets	**3.80%**	3.60%

The expected rate of return on assets is determined based on market prices prevailing on that date, applicable to the period over which the obligation is to be settled.

Amounts for the current and previous years are as follows:

Asset analysis of the scheme	**2005 Fair value £000**	2004 Fair value £000	2003 Fair value £000
Bonds	**126,363**	104,686	100,355
Equities	**193,226**	162,835	140,158
Cash and net current assets	**203**	235	775
Total market value of assets	**319,792**	267,756	241,288
Actuarial value of scheme liabilities	**(372,001)**	(321,456)	(296,288)
Deficit in the scheme	**(52,209)**	(53,700)	(55,000)

Changes in the present value of the defined benefit obligation are as follows:

	2005 £000	2004 £000
Actuarial value of scheme liabilities at 1 January	**321,456**	296,288
Interest cost on pension scheme liabilities	**17,005**	15,960
Current service cost	**8,495**	6,910
Past service cost	**3,595**	4,100
Benefits paid	**(13,433)**	(13,214)
Experience gains arising in scheme liabilities	**(606)**	(44)
Actuarial loss arising from changes in assumptions	**35,489**	11,456
Actuarial value of scheme liabilities at 31 December	**372,001**	321,456

21. Pension scheme continued

Changes in the fair value of plan assets are as follows:

	2005 £000	2004 £000
Fair value of scheme assets at 1 January	**267,756**	241,288
Expected return on pension scheme assets	**18,506**	16,506
Contributions paid – normal	**5,537**	4,884
– special	**8,897**	7,980
Benefits paid	**(13,433)**	(13,214)
Actuarial gain on scheme assets	**32,529**	10,312
Fair value of scheme assets at 31 December	**319,792**	267,756

The Society expects to contribute £5.8m in normal contributions to the pension scheme in 2006.

Analysis of the amount recognised in the group statement of recognised income and expense (SORIE)	2005 £000	2004 £000
Actual return on pension scheme assets	**51,035**	26,818
Less expected return on pension scheme assets	**(18,506)**	(16,506)
Actual return less expected return on pension scheme assets	**32,529**	10,312
Experience gains arising on scheme liabilities	**606**	44
Changes in the assumptions underlying the present value of the scheme liabilities	**(35,489)**	(11,456)
Actuarial loss recognised in the SORIE	**(2,354)**	(1,100)

The cumulative actuarial loss recognised in the group statement of recognised income and expense since 1 January 2004 is £3,454,000.

Analysis of the amount charged to the group income statement (recognised in other group operating expenses)	2005 £000	2004 £000
Current service cost	**8,495**	6,910
Past service cost	**3,595**	4,100
Expected return of pension scheme assets	**(18,506)**	(16,506)
Interest on pension scheme liabilities	**17,005**	15,960
Total operating charge	**10,589**	10,464

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	2005 £000	2004 £000
Difference between the expected and actual return on scheme assets:		
amount	**32,529**	10,312
percentage of scheme assets	**10.2%**	3.9%
Experience gains on scheme liabilities:		
amount	**606**	44
percentage of the present value of the scheme liabilities	**0.2%**	0.0%
Total amount recognised in the SORIE:		
amount	**(2,354)**	(1,100)
percentage of the present value of the scheme liabilities	**(0.6%)**	(0.3%)

22. Provisions	2005 Undertakings given to insolvent members £000	2005 Limited Financial Assistance Agreements £000	2005 Income Support Schemes £000	2005 Long-term Incentive Plan £000	2005 Other £000	2005 Total £000	2004 Total £000
Balance at 1 January	**103,219**	**–**	**1,702**	**3,484**	**180**	**108,585**	105,109
Charged to the group income statement	**217,438**	**2,001**	**1,542**	**2,323**	**177**	**223,481**	146,276
Arising on sale of assets held for sale	**–**	**–**	**–**	**–**	**1,343**	**1,343**	–
Utilised in the year	**(145,587)**	**–**	**(1,615)**	**(3,089)**	**–**	**(150,291)**	(142,800)
Balance at 31 December	**175,070**	**2,001**	**1,629**	**2,718**	**1,700**	**183,118**	108,585

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.

	2005 £000	2005 £000	2004 £000	2004 £000
Provisions for amounts payable at 1 January		**91,904**		79,829
Undertakings given in the year		**217,568**		149,486
Analysis of paid undertaking by members:				
Blodget and Hazard Limited	**(3,203)**		(3,698)	
Cotesworth Capital Limited (in provisional liquidation)	**–**		(12,827)	
Crowe Corporate Capital Limited	**(2,500)**		(1,208)	
Crowe Dedicated Limited	**(535)**		(8,568)	
Dreason Underwriting Limited	**(475)**		(699)	
Duncanson & Holt Underwriters Limited	**(973)**		(23,193)	
Grenville Underwriting I/II/III Limited	**(6,518)**		(23,512)	
Jago Capital Limited	**(1,116)**		(3,608)	
Kite Dedicated Capital Limited (formerly Goshawk Dedicated (No 2) Limited)	**(76,225)**		–	
Margent Capital Management Limited (in provisional liquidation)	**–**		(539)	
MMO UK Limited	**(4,917)**		–	
North American London Underwriters Limited	**–**		(1,304)	
Riverside Corporate Underwriters Limited (in provisional liquidation)	**–**		(858)	
Shrewsbury Underwriting Capital (Bermuda) Limited and Shrewsbury Underwriting Capital Limited	**(40,000)**		(50,000)	
SOC Corporate Member No.1 Limited	**(6,870)**		–	
Standfast Corporate Underwriters Limited	**–**		(5,405)	
Winford Company Limited	**(182)**		(602)	
Other corporate members	**(2,073)**		(1,390)	
Paid during the year		**(145,587)**		(137,411)
Provisions for amounts payable at 31 December		**163,885**		91,904
Supporting commitments at 31 December		**11,185**		11,315
Undertakings given to insolvent members at 31 December		**175,070**		103,219

The aggregate amount of all undertakings (excluding the supporting commitments) given by the Council at 31 December 2005 was £1,142m of which £978m had been paid by that date.

22. Provisions continued

Limited Financial Assistance Agreements (LFAA)

The first LFAA were provided to Names in 2005 to meet their outstanding underwriting liabilities. 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 Names 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)

The IHSS was established in 1996 to provide financial assistance to Names 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.

Long-term Incentive Plan (LTIP)

The Society operates a Long-term Incentive Plan for executive directors and senior employees that is related to the results of the Lloyd's market. This helps to ensure that the objectives of directors and employees are aligned with those of the Lloyd's market. Details of the plan are outlined in the report of the Nominations, Appointments and Compensation Committee on pages 81 to 87.
The provision, including employers' National Insurance, for estimated contribution amounts due in respect of the plan is as follows:

	2005 Balance at 1 January £000	2005 Charged/ (released) in the year £000	2005 Paid in the year £000	2005 Balance at 31 December £000
2002 LTIP	**110**	**(1)**	**(109)**	**–**
2003 LTIP	**1,448**	**1,691**	**(1,265)**	**1,874**
2004 LTIP	**1,926**	**475**	**(1,715)**	**686**
2005 LTIP	**–**	**158**	**–**	**158**
Total provisions	**3,484**	**2,323**	**(3,089)**	**2,718**

Included within the charge for the year are National Insurance contributions of £0.2m (2004: £0.4m).

Payments are made over three years commencing in the year following the underwriting year. One-third of the amounts payable are discretionary and based on performance.

Other provisions

Other provisions represent an estimate of contingent sales proceeds received on the sale of the Lloyd's Chatham building on 15 April 2005 amounting to £1.3m which could be repayable if certain conditions occur within three years of the sale. The maximum amount repayable is £3.6m (see note 29). Other provisions also include amounts provided for obligations arising from the sale of LPSO Limited during 2001 of £0.4m.

23. Trade and other payables	2005 £000	2004 £000
Due within one year:		
Trade and other creditors	**42,712**	53,837
Taxation and social security	**1,197**	4,248
Arbitration awards	**2,276**	2,864
Interest payable on subordinated loan notes	**3,972**	3,981
	50,157	64,930

24. Financial instruments

An explanation of the Society's financial instrument risk management objectives, policies and strategies are set out in the discussion of Treasury policies on pages 73 and 74 of the Society Review.

Financial assets and liabilities held

The following material financial assets and liabilities were held at 31 December 2005:

	2005 Carrying value £000	2005 Fair value £000	2004 Carrying value £000	2004 Fair value £000
Primary financial instruments held or issued to finance operations				
Statutory insurance deposits	**121,484**	**121,484**	112,622	112,622
Other investments	**1,031,662**	**1,031,662**	1,040,834	1,040,834
Reinsurance assets	**527,022**	**527,022**	542,521	542,521
Loans recoverable	**61,609**	**61,609**	63,269	63,269
Trade and other receivables	**34,440**	**34,440**	56,646	56,646
Accrued income	**5,257**	**5,257**	11,862	11,862
Cash and cash equivalents	**417,109**	**417,109**	181,445	181,445
Financial assets	**2,198,583**	**2,198,583**	2,009,199	2,009,199
Subordinated loan notes	**(500,782)**	**(548,590)**	(506,439)	(532,158)
Loans funding statutory insurance deposits	**(115,750)**	**(115,750)**	(106,831)	(106,831)
Insurance contract liabilities	**(543,272)**	**(543,272)**	(557,484)	(557,484)
Provisions	**(183,118)**	**(183,118)**	(108,585)	(108,585)
Trade and other payables	**(50,157)**	**(50,157)**	(64,930)	(64,930)
Accruals	**(19,405)**	**(19,405)**	(26,035)	(26,035)
Financial liabilities	**(1,412,484)**	**(1,460,292)**	(1,370,304)	(1,396,023)
Net	**786,099**	**738,291**	638,895	613,176
Derivative financial instruments				
Outstanding forward foreign exchange gains	**1,886**	**1,886**	2,256	2,256
Outstanding forward foreign exchange losses	**(1,807)**	**(1,807)**	(1,899)	(1,899)

The fair value of forward foreign exchange contracts is determined using spot amortised exchange rates at the balance sheet date.

Loans funding statutory insurance deposits consist of annual multicurrency floating rate interest loans which earn interest at various interest rates linked to currency borrowing rates. The currency profile is shown in the currency and interest rate profile table below.

Provisions are interest free and denominated in pound sterling.

24. Financial instruments continued

The currency and interest rate profiles of the financial assets and liabilities were as follows:

	Financial assets				Financial liabilities				
	2005 Fixed rate £000	2005 Floating rate £000	2005 Interest free £000	2005 Total £000	2005 Fixed rate £000	2005 Floating rate £000	2005 Interest free £000	2005 Total £000	Net £000
Pound sterling	**476,572**	**586,364**	**43,552**	**1,106,488**	**(296,884)**	**–**	**(272,785)**	**(569,669)**	**536,819**
US dollar	**102,485**	**85,565**	**522,639**	**710,689**	**–**	**–**	**(522,639)**	**(522,639)**	**188,050**
Euro	**222,031**	**33,081**	**–**	**255,112**	**(203,898)**	**–**	**–**	**(203,898)**	**51,214**
Canadian dollar	**–**	**3,333**	**528**	**3,861**	**–**	**–**	**(528)**	**(528)**	**3,333**
Yen	**–**	**2,834**	**–**	**2,834**	**–**	**–**	**–**	**–**	**2,834**
Australian dollar	**919**	**60**	**–**	**979**	**–**	**(973)**	**–**	**(973)**	**6**
Swiss franc	**31,999**	**8,531**	**–**	**40,530**	**–**	**(41,152)**	**–**	**(41,152)**	**(622)**
Singapore dollar	**–**	**39,859**	**–**	**39,859**	**–**	**(40,378)**	**–**	**(40,378)**	**(519)**
Hong Kong dollar	**–**	**27,592**	**–**	**27,592**	**–**	**(27,346)**	**–**	**(27,346)**	**246**
Rand	**–**	**2,905**	**–**	**2,905**	**–**	**–**	**–**	**–**	**2,905**
Others	**6,395**	**1,339**	**–**	**7,734**	**–**	**(5,901)**	**–**	**(5,901)**	**1,833**
	840,401	**791,463**	**566,719**	**2,198,583**	**(500,782)**	**(115,750)**	**(795,952)**	**(1,412,484)**	**786,099**

	Financial assets				Financial liabilities				
	2004 Fixed rate £000	2004 Floating rate £000	2004 Interest free £000	2004 Total £000	2004 Fixed rate £000	2004 Floating rate £000	2004 Interest free £000	2004 Total £000	Net £000
Pound sterling	416,960	467,016	76,051	960,027	(296,581)	–	(222,056)	(518,637)	441,390
US dollar	83,148	38,513	534,978	656,639	–	–	(534,978)	(534,978)	121,661
Euro	228,095	34,438	–	262,533	(209,858)	–	–	(209,858)	52,675
Canadian dollar	–	2,688	–	2,688	–	–	–	–	2,688
Yen	–	12,017	–	12,017	–	–	–	–	12,017
Australian dollar	894	26	–	920	–	(941)	–	(941)	(21)
Swiss franc	31,715	17,550	–	49,265	–	(48,908)	–	(48,908)	357
Singapore dollar	–	30,405	–	30,405	–	(29,651)	–	(29,651)	754
Hong Kong dollar	–	22,934	–	22,934	–	(22,482)	–	(22,482)	452
Rand	–	5,414	–	5,414	–	–	–	–	5,414
Others	5,218	1,139	–	6,357	–	(4,849)	–	(4,849)	1,508
	766,030	632,140	611,029	2,009,199	(506,439)	(106,831)	(757,034)	(1,370,304)	638,895

Interest-free financial assets include reinsurance assets of Lioncover Insurance Company Limited and Centrewrite Limited (see note 14). Interest-free financial liabilities include provisions (see note 22) and insurance contract liabilities of Lioncover Insurance Company Limited and Centrewrite Limited (see note 14).

24. Financial instruments continued

Interest rate risk

The following table sets out the carrying amount, by maturity, of the Society's financial instruments that are exposed to interest rate risk:

as at 31 December 2005	Within 1 year £000	1-2 years £000	2-3 years £000	3-4 years £000	4-5 years £000	More than 5 years £000	Total £000
Fixed rate							
Statutory insurance deposits	**14,756**	**4,051**	**5,977**	**13,393**	**–**	**1,136**	**39,313**
Other investments (excluding equities)	**35,303**	**77,131**	**36,959**	**15,148**	**55,310**	**581,237**	**801,088**
Subordinated loan notes	**–**	**–**	**–**	**–**	**–**	**(500,782)**	**(500,782)**
Floating rate							
Statutory insurance deposits	**82,171**	**–**	**–**	**–**	**–**	**–**	**82,171**
Other investments (excluding equities)	**5,820**	**–**	**–**	**1,000**	**–**	**20,000**	**26,820**
Loans recoverable	**1**	**–**	**–**	**29**	**224**	**61,355**	**61,609**
Cash and cash equivalents	**417,109**	**–**	**–**	**–**	**–**	**–**	**417,109**
Loans funding statutory insurance deposits	**(115,750)**	**–**	**–**	**–**	**–**	**–**	**(115,750)**

as at 31 December 2004	Within 1 year £000	1-2 years £000	2-3 years £000	3-4 years £000	4-5 years £000	More than 5 years £000	Total £000
Fixed rate							
Statutory insurance deposits	13,480	9,459	4,452	2,997	7,410	29	37,827
Other investments (excluding equities)	13,445	24,504	25,805	14,842	14,398	635,209	728,203
Subordinated loan notes	–	–	–	–	–	(506,439)	(506,439)
Floating rate							
Statutory insurance deposits	74,795	–	–	–	–	–	74,795
Other investments (excluding equities)	33,907	–	–	–	1,000	20,000	54,907
Loans recoverable	76	–	–	28	209	62,956	63,269
Cash and cash equivalents	181,445	–	–	–	–	–	181,445
Loans funding statutory insurance deposits	(106,831)	–	–	–	–	–	(106,831)

Credit risk

At the balance sheet 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 balance sheet.

24. Financial instruments continued

Borrowing facilities

The maturity profile of the undrawn committed facility is shown below:

	2005 £000	2004 £000
Expiring in one year or less	**40,000**	40,000

Derivative 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.

Where contracts are entered into to cover foreign exchange exposure, any variances between closing and contracted rates are included in the group balance sheet.

Where contracts are entered into to provide a service to the Lloyd's market, the fair value is determined using spot amortised exchange rates at the balance sheet date. Where gains and losses are not expected to be refunded to or recovered from the Lloyd's market, these amounts are taken to the group income statement.

25. Reconciliation of movement in equity	Accumulated reserve £000	Syndicate loans £000	Revaluation reserve £000	Foreign currency translation reserve £000	Total equity £000
At 1 January 2004	558,438	–	6,913	–	565,351
Total recognised income and expense for the year	121,794	–	2,797	59	124,650
At 31 December 2004	680,232	–	9,710	59	690,001
Total recognised income and expense for the year	**(29,001)**	**–**	**–**	**(43)**	**(29,044)**
Receipt of syndicate loans	**–**	**103,611**	**–**	**–**	**103,611**
Revaluation of syndicate loans	**(3,223)**	**3,223**	**–**	**–**	**–**
At 31 December 2005	**648,008**	**106,834**	**9,710**	**16**	**764,568**

Accumulated reserves	2005 £000	2004 £000
Attributable to:		
Corporation of Lloyd's and non-insurance-related subsidiary undertakings	**53,456**	33,310
Central Fund	**555,786**	604,495
Insurance-related subsidiary undertakings	**31,722**	37,652
Associates	**7,044**	4,775
	648,008	680,232

25. Reconciliation of movement in equity continued

Syndicate loans

The syndicate loans bear interest payable annually at a rate equal to specified market indices which record the performance of short-dated fixed interest securities. The principal will ordinarily be repaid on the closure of the syndicate year of account to which the loans relate. Both the payment of annual interest and repayment of principal may be deferred at the discretion of the Council. As a result, syndicate loans are treated as equity because there is no fixed repayment date. Current expectations are that interest will be paid annually and the principal will be repaid at the closure of the relevant syndicate year of account. Interest is accounted for when the Council formally approves interest payments to be made. Consequently, as at 31 December 2005, interest accruing of £3.8m has not been recognised in these financial statements.

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 equity.

Foreign currency translation reserve

The foreign currency translation reserve is used to record exchange differences arising from the translation of the financial statements of foreign subsidiary undertakings.

26. Post balance sheet events

Kinnect Limited closed its operations on 24 January 2006. The Society has agreed to provide the company with sufficient funds to meet its liabilities incurred to 24 January 2006 and the costs of closure. These financial statements reflect costs incurred to 31 December 2005 and the estimated realisable value of assets held as at that date. Transactions subsequent to 31 December 2005 will be reflected in subsequent financial statements of the Society. The costs of Kinnect Limited for 2006 are estimated at £3.5m.

27. Commitments

a) Capital expenditure commitments

No contractual commitments exist at 31 December 2005 other than those included within the financial statements. The same applied at 31 December 2004.

b) Operating lease commitments	2005 £000	2004 £000
Non-cancellable operating lease rentals are payable as follows:		
Within one year	**17,522**	17,379
After one year but not more than five years	**70,882**	68,298
More than five years	**175,198**	189,480

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 2001, the next review will be during 2006. The new Lloyd's Chatham building is included at the proposed rental value (£0.4m per annum) to the first break in the lease in 2016. The lease will be subject to rent review in 2011.

Subsidiary undertakings are party to a number of small operating leases mainly for property rental and small machinery where it has not been in Lloyd's interest to purchase these assets. The commitments outstanding have been included at the current rental value (£0.6m per annum) to the first break in the lease. These arrangements do not impose any significant restrictions on Lloyd's, renewals are at the option of each entity that holds the lease.

During the year ended 31 December 2005, £17.6m (2004: £17.5m) was recognised as an expense in the group income statement in respect of operating leases.

28. Disclosure of related party transactions

In accordance with the exemption allowed by IAS 24 'Related Party Disclosures', transactions with consolidated entities within the group have not been disclosed.

The group financial statements include the financial statements of the Society of Lloyd's and all of its subsidiary undertakings, the Lloyd's Central Fund and the group's interests in its associates as listed in note 12.

Other related party transactions

Associates

Services provided to Ins-sure Holdings Limited group in the year ended 31 December 2005 included operating systems support and development, premises and other administrative services. The total value of the services provided was £2,382,000 (2004: £2,716,000). In addition, Ins-sure Holdings Limited group have charged the Corporation £1,338,000 for services provided in the same year (2004: £1,093,000).

At 31 December 2005, there was a balance of £316,000 (2004: £332,000) owing from Ins-sure Holdings Limited group to the Corporation. The Corporation owed £11,000 to Ins-sure Holdings Limited at the same date (2004: £15,000).

Services provided to Xchanging Claims Services Limited group in the year ended 31 December 2005 included premises and other administrative services. The total value of the services provided was £339,000 (2004: £2,327,000). In addition, Xchanging Claims Services Limited group have charged the Corporation £nil for services provided in the same year (2004: £131,000).

At 31 December 2005, there was a balance of £94,000 (2004: £340,000) owing from Xchanging Claims Services Limited group to the Corporation. The Corporation owed £nil (2004: £4,000) to Xchanging Claims Services Limited at the same date.

Transactions with associates are priced on an arm's length basis.

There were no other related party transactions in 2005.

29. 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 2005 amounted to £14.3m (2004: £9.3m).

B) The Society has taken on the responsibilities of some individual Names under hardship and other agreements. The Society has also given indemnity bonds to Lioncover Insurance Company Limited (Lioncover) and Centrewrite Limited (Centrewrite) respectively against any shortfall in their assets.

Following the implementation of 'Reconstruction and Renewal', Names underwriting in respect of 1992 and prior years, Lioncover and Centrewrite were reinsured into Equitas. If Equitas were unable to discharge in full the liabilities which it has reinsured, any resulting shortfall in respect of Lioncover or Centrewrite could be met out of both the 'Old' Central Fund and the New Central Fund under the terms of their respective Lloyd's bond. Both the 'Old' Central Fund and the New Central Fund would also be available to meet the claims of policyholders of Names who are party to hardship agreements executed before 4 September 1996, to the extent that such an event resulted in a shortfall. However, unless the members of the Society resolve in a general meeting to make the New Central Fund available, only the 'Old' Central Fund would be available to meet the claims of policyholders of Names who are not party to hardship agreements executed before 4 September 1996.

The Council has determined that any losses resulting from such indemnities will be met by the Lloyd's Central Fund.

C) Uncollateralised bank guarantees and other arrangements have been entered into by the Corporation of Lloyd's and its subsidiary undertaking, Additional Securities Limited, to provide security in connection with the underwriting activities of the members of Lloyd's in the countries shown:

			2005 £000	2004 £000
Guarantees provided by the Corporation of Lloyd's:				
US	US $1,500,000	(2004: US $1,500,000)	**872**	781
Guarantees provided by the Corporation of Lloyd's and Additional Securities Limited:				
Cayman Islands:				
Letter of credit	US $1,000,000	(2004: US $1,000,000)	**581**	521

D) The Corporation of Lloyd's 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 Corporation of Lloyd's has also given indemnities to and has agreed to cover certain specific costs that may be incurred by members of the Council, Lloyd's Franchise Board, Lloyd's Regulatory Board and Lloyd's Market Board (the latter two boards ceased during 2002) and of their respective sub-committees, Corporation staff and also certain individuals and organisations who have been asked to carry out or provide services to the Corporation or on behalf of, or for the benefit of its members.

E) Lloyd's has been joined to an action brought by certain Lloyd's underwriters against certain brokers in respect of the underwriting of insurance in Italy. Lloyd's does not accept any liability in respect of this action.

F) Three Names have commenced proceedings claiming misfeasance in public office against Lloyd's in respect of an alleged failure to regulate, leading to the Names incurring underwriting losses as members of the 1993 accounts of syndicates 103 and 178, the business of which it is claimed was unauthorised and conducted fraudulently by their managing agents. Lloyd's does not accept any liability in respect of this action.

G) A counterclaim alleging fraud by Lloyd's has been filed in the US by one Name, in response to Lloyd's proceedings seeking recognition of a judgment obtained by Lloyd's in England. Lloyd's does not accept any liability in respect of this claim.

29. Contingent liabilities continued

H) In Quebec, proceedings have been issued by Agence Nationale D'Encadrement Du Secteur Financier as the regulator of the Quebec policyholder protection fund against Lloyd's and other parties arising out of the issue by a coverholder of purported 'policies of insurance' without the authority of a Lloyd's syndicate. Lloyd's does not accept any liability in respect of this action.

I) Two individuals have commenced an action in Alabama, US against Lloyd's underwriters, Lloyd's and certain members and former members of the Council claiming damages in respect of an alleged wrongful failure to pay an insurance claim and failure to provide adequate supervision over certain Lloyd's underwriters. Lloyd's does not accept any liability in respect of this action.

J) On 15 April 2005 the Lloyd's Chatham building was sold. The sale proceeds received of £9.6m are contingent on certain conditions not occurring within three years of the sale date. The maximum amount repayable is £3.6m of which £1.3m has been included in provisions (see note 22).

In respect of contingent liabilities noted above in paragraphs (A) – (I), no provision has been made in these financial statements.

30. Explanation of transition to IFRS

As stated in note 1, these are the Society's first group financial statements prepared in accordance with IFRS.

The accounting policies set out in note 1 have been applied in preparing the group financial statements for the year ended 31 December 2005, the comparative information presented in these group financial statements for the year ended 31 December 2004 and in the preparation of an opening IFRS balance sheet at 1 January 2004 (the Society's date of transition).

In preparing its opening IFRS balance sheet, the Society has adjusted amounts reported in prior financial statements prepared in accordance with its previous accounting basis (UK GAAP). An explanation of how the transition from UK GAAP to IFRS has affected the Society's financial position, financial performance and cash flows is set out in the following tables and the notes that accompany the tables.

30. Explanation of transition to IFRS continued

Group balance sheet as at 1 January 2004

	UK GAAP (as previously reported)							
	Corporation of Lloyd's and subsidiaries 1 January 2004 £000	Central Fund 1 January 2004 £000	Insurance related subsidiaries 1 January 2004 £000	Society total 1 January 2004 £000	UK GAAP adjustments 1 January 2004 £000	Adjusted UK GAAP total 1 January 2004 £000	IFRS adjustments 1 January 2004 £000	Society total 1 January 2004 £000
ASSETS								
Intangible assets	–	–	–	–	–	–	169	169
Lloyd's Collection	6,913	–	–	6,913	–	6,913	–	6,913
Property, plant and equipment	15,023	–	11	15,034	–	15,034	(169)	14,865
Deferred tax asset	2,668	6,840	6	9,514	–	9,514	94,173	103,687
Investment in associates	6,332	–	–	6,332	–	6,332	(910)	5,422
Reinsurance assets	–	–	800,420	800,420	(126,513)	673,907	–	673,907
Loans recoverable	–	–	–	–	–	–	63,537	63,537
Financial investments	116,883	490,989	37,793	645,665	(155)	645,510	(149,167)	496,343
Pension asset	24,318	–	–	24,318	–	24,318	(24,318)	–
Inventories	467	–	–	467	–	467	–	467
Trade and other receivables	45,798	329,588	95	375,481	(11,601)	363,880	(326,538)	37,342
Prepayments and accrued income	15,543	21,925	976	38,444	–	38,444	–	38,444
Group tax relief receivable	3,664	–	–	3,664	(3,664)	–	–	–
Tax receivable	9	–	–	9	–	9	–	9
Forward currency contracts	3,233	–	–	3,233	–	3,233	–	3,233
Cash and cash equivalents	47,034	48	22,921	70,003	–	70,003	170,121	240,124
Total assets	287,885	849,390	862,222	1,999,497	(141,933)	1,857,564	(173,102)	1,684,462
EQUITY AND LIABILITIES								
Equity								
Accumulated reserve	63,452	711,045	28,703	803,200	204	803,404	(244,966)	558,438
Revaluation reserve	6,913	–	–	6,913	–	6,913	–	6,913
Total equity	70,365	711,045	28,703	810,113	204	810,317	(244,966)	565,351
Liabilities								
Insurance contract liabilities	–	–	824,823	824,823	(126,513)	698,310	–	698,310
Pension liability	–	–	–	–	–	–	55,000	55,000
Provisions	7,396	79,829	–	87,225	–	87,225	17,884	105,109
Trade and other payables	52,428	5,742	8,166	66,336	(11,850)	54,486	(1,735)	52,751
Accruals and deferred income	46,698	11,945	357	59,000	(111)	58,889	715	59,604
Loans funding statutory insurance deposits	107,871	–	–	107,871	–	107,871	–	107,871
Forward currency contracts	3,127	–	–	3,127	–	3,127	–	3,127
Group tax relief payable	–	3,659	4	3,663	(3,663)	–	–	–
Tax payable	–	37,170	169	37,339	–	37,339	–	37,339
Total liabilities	217,520	138,345	833,519	1,189,384	(142,137)	1,047,247	71,864	1,119,111
Total equity and liabilities	287,885	849,390	862,222	1,999,497	(141,933)	1,857,564	(173,102)	1,684,462

30. Explanation of transition to IFRS continued

Group balance sheet as at 31 December 2004

	UK GAAP (as previously reported)							
	Corporation of Lloyd's and subsidiaries 2004 £000	Central Fund 2004 £000	Insurance related subsidiaries 2004 £000	Society total 2004 £000	UK GAAP adjustments 2004 £000	Adjusted UK GAAP total 2004 £000	IFRS adjustments 2004 £000	Society total 2004 £000
ASSETS								
Intangible assets	–	–	–	–	–	–	275	275
Lloyd's Collection	9,710	–	–	9,710	–	9,710	–	9,710
Property, plant and equipment	6,399	–	–	6,399	–	6,399	(275)	6,124
Deferred tax asset	2,756	2,915	1,324	6,995	–	6,995	(6,380)	615
Investment in associates	4,459	–	–	4,459	–	4,459	(1,176)	3,283
Reinsurance assets	–	–	600,048	600,048	(57,527)	542,521	–	542,521
Loans recoverable	–	–	–	–	–	–	63,269	63,269
Financial investments	159,173	1,037,566	40,316	1,237,055	(90)	1,236,965	(83,509)	1,153,456
Pension asset	28,806	–	–	28,806	–	28,806	(28,806)	–
Inventories	461	–	–	461	–	461	–	461
Trade and other receivables	35,943	33,411	11	69,365	(12,719)	56,646	–	56,646
Prepayments and accrued income	10,801	7,766	501	19,068	–	19,068	–	19,068
Group tax relief receivable	–	7,366	–	7,366	(7,366)	–	–	–
Tax receivable	–	84,654	–	84,654	–	84,654	–	84,654
Forward currency contracts	2,256	–	–	2,256	–	2,256	–	2,256
Assets classified as held for sale	8,152	–	–	8,152	–	8,152	63	8,215
Cash and cash equivalents	65,903	16	11,366	77,285	–	77,285	104,160	181,445
Total assets	334,819	1,173,694	653,566	2,162,079	(77,702)	2,084,377	47,621	2,131,998
EQUITY AND LIABILITIES								
Equity								
Accumulated reserve	112,172	555,790	27,110	695,072	254	695,326	(15,094)	680,232
Revaluation reserve	9,710	–	–	9,710	–	9,710	–	9,710
Foreign currency translation reserve	–	–	–	–	–	–	59	59
Total equity	121,882	555,790	27,110	704,782	254	705,036	(15,035)	690,001
Liabilities								
Subordinated loan notes	–	506,439	–	506,439	–	506,439	–	506,439
Insurance contract liabilities	–	–	615,011	615,011	(57,527)	557,484	–	557,484
Pension liability	–	–	–	–	–	–	53,700	53,700
Provisions	6,653	91,904	–	98,557	–	98,557	10,028	108,585
Trade and other payables	61,798	9,690	8,162	79,650	(13,018)	66,632	(1,702)	64,930
Accruals and deferred income	31,403	9,871	271	41,545	(46)	41,499	630	42,129
Loans funding statutory insurance deposits	106,831	–	–	106,831	–	106,831	–	106,831
Forward currency contracts	1,899	–	–	1,899	–	1,899	–	1,899
Group tax relief payable	4,353	–	3,012	7,365	(7,365)	–	–	–
Total liabilities	212,937	617,904	626,456	1,457,297	(77,956)	1,379,341	62,656	1,441,997
Total equity and liabilities	334,819	1,173,694	653,566	2,162,079	(77,702)	2,084,377	47,621	2,131,998

30. Explanation of transition to IFRS continued

Group income statement for the year ended 31 December 2004

	UK GAAP (as previously reported)							
	Corporation of Lloyd's and subsidiaries 2004 £000	Central Fund 2004 £000	Insurance related subsidiaries 2004 £000	Society total 2004 £000	UK GAAP adjustments 2004 £000	Adjusted UK GAAP total 2004 £000	IFRS adjustments 2004 £000	Society total 2004 £000
Continuing operations								
Operating income	180,453	215,588	–	396,041	(2,784)	393,257	(4,455)	388,802
General insurance net premium income	–	–	3,428	3,428	–	3,428	–	3,428
Total income	180,453	215,588	3,428	399,469	(2,784)	396,685	(4,455)	392,230
Central Fund claims and provisions	–	(135,493)	–	(135,493)	–	(135,493)	9,953	(125,540)
Other operating expenses	(160,742)	(337,205)	(712)	(498,659)	2,834	(495,825)	322,409	(173,416)
General insurance claims incurred	–	–	4,318	4,318	–	4,318	–	4,318
Operating surplus/(deficit)	19,711	(257,110)	7,034	(230,365)	50	(230,315)	327,907	97,592
Profit on sale of Lloyd's 1958 building	23,638	–	–	23,638	–	23,638	–	23,638
Surplus/(deficit) from continuing operations	43,349	(257,110)	7,034	(206,727)	50	(206,677)	327,907	121,230
Finance costs	(501)	(6,676)	–	(7,177)	–	(7,177)	–	(7,177)
Finance income	11,844	35,843	1,684	49,371	(7,490)	41,881	3,994	45,875
Share of profits of associates	1,861	–	–	1,861	–	1,861	11	1,872
Surplus/(deficit) before tax	56,553	(227,943)	8,718	(162,672)	(7,440)	(170,112)	331,912	161,800
Tax (charge)/credit	(7,942)	72,688	(2,821)	61,925	–	61,925	(100,884)	(38,959)
Surplus/(deficit) for the year	48,611	(155,255)	5,897	(100,747)	(7,440)	(108,187)	231,028	122,841
Ordinary dividends	–	–	(7,490)	(7,490)	7,490	–	–	–
Surplus/(deficit) for the year	48,611	(155,255)	(1,593)	(108,237)	50	(108,187)	231,028	122,841

Group changes in equity for the year ended 31 December 2004

Statement of recognised income and expense	Society total 2004 £000
Revaluation of the Lloyd's Collection	2,797
Exchange difference on translating foreign operations	59
Actuarial loss on pension liabilities – group	(1,100)
– associates	(396)
Tax on items taken directly to equity	449
Net income and expense recognised directly in equity	1,809
Surplus for the year	122,841
Total recognised income and expense for the year	124,650

Reconciliation of movement in equity	Accumulated reserve £000	Revaluation reserve £000	Foreign currency translation reserve £000	Society total equity 2004 £000
At 1 January 2004				
UK GAAP basis	803,404	6,913	–	810,317
Changes on adopting IFRS	(244,966)	–	–	(244,966)
At 1 January 2004 (restated)	558,438	6,913	–	565,351
Total recognised income and expense for the year	121,794	2,797	59	124,650
At 31 December 2004	680,232	9,710	59	690,001

30. Explanation of transition to IFRS continued

Notes supporting the restatement of financial information at 1 January 2004 and 31 December 2004 as a result of the transition to IFRS

The restated group income statement, group changes in equity, group balance sheet and the group cash flow statement have been presented in a format consistent with IFRS. This information has been prepared on the basis of the standards that are applicable at 31 December 2005.

The material adjustments to accumulated reserves between UK GAAP and IFRS are as follows:

	Note	1 January 2004 £000	31 December 2004 £000
Corporation of Lloyd's and non-insurance-related subsidiary undertakings		70,365	121,882
Central Fund		711,045	555,790
Insurance-related subsidiary undertakings		28,703	27,110
Opening accumulated reserves (as previously reported under UK GAAP)		810,113	704,782
Principal UK GAAP adjustments			
First time preparation of group financial statements	i	204	254
Restated opening accumulated reserves (UK GAAP basis)		810,317	705,036
Principal adjustments on adopting IFRS			
Investment valuation (move from mid to bid prices)	ii	(46)	(349)
Central Fund supporting commitments	iii	(19,312)	(11,315)
Recognition of loans recoverable under hardship agreements	iv	63,537	63,269
Recognition of other financial assets	v	21,000	21,000
Employee benefits	vi		
– elimination of SSAP24 debtor		(24,318)	(28,806)
– recognition of pension deficit under IAS 19		(55,000)	(53,700)
– Long-term Incentive Plan (LTIP) accrual basis change		3,163	2,989
– other employee benefits		(715)	(630)
Investment in associates	vii	(910)	(1,176)
Trade and other receivables (provision against Central Fund insurance claim debtor)	viii	(326,538)	–
Property, plant and equipment	ix	–	63
Deferred tax adjustments on the above items	x	94,173	(6,380)
Restated opening accumulated reserves (IFRS basis)		565,351	690,001
Decrease in accumulated reserves as a result of adopting IFRS		(244,966)	(15,035)

UK GAAP adjustments

The transition from UK GAAP to IFRS has resulted in an increase to accumulated reserves of £0.2m at 1 January 2004 and £0.3m at 31 December 2004. Besides accumulated reserve adjustments, certain items within the group balance sheet have been reclassified in the transition.

Note 30(i): First time preparation of group financial statements and adjustments for different accounting periods

First time preparation of the group financial statements, requires adjustments to be made in respect of intra-group transactions and other minor items.

Lioncover Insurance Company Limited has a reporting year end of 31 March. Adjustments totalling £126.5m at 1 January 2004 and £57.5m at 31 December 2004 have been made to both the reinsurance assets and insurance contract liabilities categories in the group balance sheet. This reflects the claims settled between 1 April and 31 December and aligns the reporting periods.

IFRS adjustments

The implementation of IFRS has resulted in a reduction in accumulated reserves of £245.0m at 1 January 2004 and £15.0m at 31 December 2004. A foreign currency translation reserve was created on 1 January 2004 and the balance as at 31 December 2004 was £0.1m. Besides accumulated reserve adjustments, certain items within the group balance sheet have been reclassified in the transition.

30. Explanation of transition to IFRS continued

Notes supporting the restatement of financial information at 1 January 2004 and 31 December 2004 as a result of the transition to IFRS continued

Further information in respect of the major adjustments are detailed in the following notes:

Note 30(ii): Investments and financial instruments
Investment classification and valuation methods have been revised by adopting IFRS. As a result of applying IAS 39, the Society now carries all investments in debt securities and equity instruments at fair values based on bid prices rather than mid-market prices.

IAS 39 requires the classification of financial instruments into different types for which the accounting requirement is different. The Society has classified its financial instruments as:

- Recoverable Central Fund loans made to hardship Names are classified as fair value through profit or loss and described as loans recoverable in the group balance sheet;
- Bank deposits, principally comprising funds held with banks and other financial institutions, are classified as loans and receivables and are mainly included in cash and cash equivalents in the group balance sheet;
- Investments (other than interests in associates and bank deposits) are classified as fair value through profit or loss and are included in financial investments in the group balance sheet;
- Statutory insurance deposits are classified as fair value through profit or loss and are included as financial investments within the group balance sheet;
- Subordinated loan notes are classified as other financial liabilities; and
- Derivatives, comprising forward foreign exchange contracts, are classified as held for trading.

Financial instruments are initially measured at fair value. Their subsequent measurement depends on their classification:

- Loans and receivables and other financial liabilities are held at amortised cost using the effective interest method;
- Investments designated as fair value through profit or loss are held at fair value. Changes in fair value are included in the group income statement;
- Held for trading instruments are held at fair value. Changes in fair value are included in the group income statement.

Note 30(iii): Central Fund supporting commitments
For 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 as at 1 January 2004 of £19.3m and £11.3m as at 31 December 2004 has been reflected in the IFRS statements.

Note 30(iv): Recognition of loans recoverable under hardship agreements
Recoverable Central Fund loans made to hardship Names, are recognised at fair value and are included as loans recoverable in the IFRS statements. In the UK GAAP financial statements, no value for the recovery of these amounts had been reflected as these assets were not readily realisable.

The recoverability of these loans recoverable are subject to a regular impairment review based on the value of the assets pledged under hardship agreements and an estimate of the length of time before charges may be enforced. The value of these loans recoverable was £63.5m as at 1 January 2004 and £63.3m as at 31 December 2004.

30. Explanation of transition to IFRS continued

Notes supporting the restatement of financial information at 1 January 2004 and 31 December 2004 as a result of the transition to IFRS continued

Note 30(v): Recognition of other financial assets
Two security deposits provided by the Lloyd's Central Fund to Tutelle Limited and Lioncover Insurance Company Limited, as disclosed in notes 20 and 21 of the 2004 Lloyd's Central Fund financial statements, had not been previously recognised as assets under UK GAAP. The deposits meet the criteria of assets under IFRS and £21.0m as at 1 January 2004 and 31 December 2004 have been recognised as financial investments. Interest on the deposits is paid to the Lloyd's Central Fund.

Note 30(vi): Employee benefits
(i) Pension scheme
The Corporation of Lloyd's operates a defined benefit pension scheme with assets held in a separately administered fund, the Lloyd's Pension Scheme. Previously under UK GAAP, the cost of providing pension benefits was expensed using actuarial valuation methods which gave a substantially even charge over the expected service lives of employees and resulted in either a prepayment or an accrual to the extent that this charge does not equate to the cash contributions made into the scheme. However, under IAS 19, the projected benefit obligation is matched against the fair value of the underlying assets and other unrecognised actuarial gains and losses in determining the pension expense for the year. Any pension asset or obligation must be recorded in the group balance sheet. Actuarial gains and losses are recognised in full in the group statement of recognised income and expense in the period in which they occur.

This change in accounting policy has eliminated SSAP 24 prepayments and recognised a pension deficit calculated in accordance with IAS 19. The effect is shown below:

	1 Jan 2004 £000	31 Dec 2004 £000
Removal of SSAP 24 pension scheme prepayment	(24,318)	(28,806)
Recognition of IAS 19 pension deficit	(55,000)	(53,700)
Effect on Society's net asset position before taxation	(79,318)	(82,506)

(ii) Long-term Incentive Plan (LTIP)
A significant employee benefit provided is participation in the LTIP for certain individuals. Under UK GAAP, the LTIP provision represented the estimate of future awards, payable over three years, in respect of past service and was expensed immediately. IAS 19 requires that the LTIP liability should be accrued and expensed over the vesting period. The change increases reserves by £3.2m as at 1 January 2004 and £3.0m as at 31 December 2004.

(iii) Other employee benefits
IAS 19 requires that provision is made for long-term disability payments to staff members and that short-term accumulated absences, which includes holiday pay, are recognised. An accrual of £0.7m as at 1 January 2004 and £0.6m as at 31 December 2004 has been included in these financial statements.

Note 30(vii): Investment in associates
The Society's investment in associates has been restated under IFRS to reflect group accounting policies, principally relating to changes in accounting for employee benefits. The effect is to reduce the carrying value of investments by £0.9m as at 1 January 2004 and £1.2m as at 31 December 2004.

Note 30(viii): Trade and other receivables
As at 1 January 2004, under UK GAAP the Lloyd's Central Fund included an insurance claim receivable of £326.5m. In the restated IFRS balance sheet, at that date, no value has been attributed to the receivable reflecting the inherent uncertainty at that time of the outcome of the arbitration proceedings which were described in the 2004 financial statements of the Lloyd's Central Fund.

Under UK GAAP, £324.6m was written off following the arbitration settlement in the 2004 financial statements. This item is not included in the 2004 IFRS income statement as it is reflected in the restated IFRS balance sheet at 1 January 2004.

30. Explanation of transition to IFRS continued

Notes supporting the restatement of financial information at 1 January 2004 and 31 December 2004 as a result of the transition to IFRS continued

Note 30(ix): Property, plant and equipment
As a result of adopting IFRS 5 'Non-current Assets Held for Sale and Discontinued Operations', non-current assets held for sale are separately disclosed in the restated IFRS balance sheet as at 31 December 2004. This standard applies where the carrying value of the asset will be recovered through a sale transaction rather than continued use. This applied to the decision taken in October 2004 to sell the Lloyd's Chatham building. The book value of the asset was £8.2m and this has been reclassified on the balance sheet as at 31 December 2004. Under IFRS 5, depreciation ceases to be charged upon designating an asset as held for sale. As a consequence, a depreciation adjustment of £63,000 has been credited to the group income statement which, under a UK GAAP basis, continued to be charged to the revenue account.

Note 30(x): Deferred taxes
Under IAS 12, 'Income Taxes', deferred taxes are provided under the liability method for all relevant temporary differences, being the difference between the carrying amount of an asset or liability in the group balance sheet and its value for tax purposes. The changes to deferred tax arise from changes to the valuation of the Society's assets and liabilities under IFRS. As at 1 January 2004 deferred tax assets increase by £94.2m and as at 31 December 2004 reduce by £6.4m.

Note 30(xi): Cash
IFRS requires a number of presentational changes to the disclosure of cash and cash equivalents and financial investments. These changes do not impact on the Society's accumulated reserves. Total assets of £170.1m as at 1 January 2004 and £104.2m as at 31 December 2004 previously treated as investments meet the definition of cash equivalents and, therefore, have been reclassified to 'cash and cash equivalents'.

Note 30(xii): Other items
The other changes that arise as a result of the transition to IFRS are principally reclassifications and presentational changes. This includes the following items at 31 December 2004:

- Reclassify £0.3m (£0.2m at 1 January 2004) from property, plant and equipment to intangible assets to reflect capitalised system development software.

- Reclassify £1.7m (£1.7m at 1 January 2004) from trade and other payables to provisions to reflect the commitment under the Income and Housing Support Scheme.

Note 30(xiii): Explanation of material adjustments to the group income statement for the year ended 31 December 2004
The material adjustments to the group income statement arise from the accounting treatment of the settlement of the Central Fund arbitration dispute and the recognition of Central Fund supporting commitments and are disclosed in notes 30(iii) and 30(viii).

Note 30(xiv): Explanation of material reclassifications to the group cash flow statement for the year ended 31 December 2004
There are no material differences between the cash flow statement presented under IFRS and the cash flow statement presented under UK GAAP other than those arising from the IFRS reclassifications detailed in the notes above.

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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