LLOYD'S

WHERE THE WORLD TAKES RISKS

ANNUAL REPORT 2004

One Lloyd's, two reports
This document contains two separate reports: the first relating to the results achieved in 2004 by all the many businesses that make up the Lloyd's market; and the second referring to the performance of the Corporation of Lloyd's, the body responsible for the overall management and strategic direction of this unique institution.

2004 IN BRIEF

‘THESE RESULTS, ACHIEVED DESPITE SIGNIFICANT LOSSES FROM NATURAL CATASTROPHES, ARE TESTIMONY TO THE CONTINUALLY IMPROVING QUALITY AND STRENGTH OF THE LLOYD’S MARKET.’

PETER LEVENE, CHAIRMAN

2004 Net profit before tax

£1,357m

2004 Combined ratio

96.9%

2004 Capital, reserves and subordinated loan notes (see page 39)

£12,169m

PROFIT AND PROGRESS

DESPITE A YEAR OF NATURAL DISASTERS AND OTHER CHALLENGES FOR THE INDUSTRY, LLOYD'S ONCE AGAIN PERFORMED STRONGLY.

There is no doubt that 2004 was an exceptional year. With four hurricanes making landfall in the US and 10 typhoons in Japan, it seemed that the British obsession with the weather was suddenly a worldwide phenomenon. For Lloyd's it marked a return to a more normal risk environment following an extraordinarily benign year free from major losses, natural catastrophes and other events in 2003.

Despite this, 2004 was another year of profit and progress. The market recorded a profit of £1,357m on an annually accounted basis and a combined ratio of 96.9%; demonstrating the market's ability to withstand a year of claims on a par with the total incurred loss of the World Trade Center disaster.

During the last year, I have taken the Lloyd's message around the globe to North America, continental Europe and Asia; and it is clear that the market's impressive progress is well understood in both developed and emerging markets.

Lloyd's continues to benefit from its global network of licences and a high level of brand recognition. In 2004 we further developed our global reach, securing licenses to trade in eight of the new EU accession countries, appointing a full-time representative in Spain and opening a new West Coast office in the US.

We continue to look for opportunities in developing markets and are in ongoing discussions with the Chinese regulators to secure an onshore licence in China.

Let us not forget, however, that 2004 was not just another year of profit and progress, it was also a year of challenges for the insurance industry. The year was punctuated by a series of defining moments – the unprecedented series of natural catastrophes, the New York Attorney General, Eliot Spitzer's investigations, and the Silverstein trials in New York.

Risk management: an urgent priority

The events reinforced a number of issues that the industry must address. The first is a trend towards more severe catastrophe losses and the consequent need to improve the way the industry and businesses in general evaluate risk. Lloyd's has worked to improve its risk management capability in recent years, developing a series of realistic disaster scenarios for a range of catastrophes from windstorms to earthquakes. Risk management must now be on the agenda of every boardroom and we as an industry must pay more attention to preventative measures and early warning systems. The natural disasters also served as a pertinent reminder of the importance of pricing risk

Lord Levene introducing Her Majesty the Queen to Bronek Masojada, Deputy Chairman of Lloyd's, following her visit to Lloyd's to launch a British Red Cross Emergency Response Appeal.

correctly. The critical role of the industry in paying claims and assisting in the process of rebuilding can only be sustained if its balance sheet is strong. To ensure this, underwriters must continue to ground their decisions in economic reality and reflect the nature of the risk in their premium, terms and conditions. There is strong evidence that this is happening which has enabled us to say that we have weathered the recent storms but there are inevitably testing times ahead.

The need for greater transparency

Despite the catalogue of natural catastrophes, it was arguably the industry's reputation that took the greatest battering during 2004. The importance of greater transparency was highlighted by the New York Attorney General's investigation into commissions and bid rigging. It has presented a real and unstoppable mandate for change and looks set to end in a fundamental overhaul of industry practices. We need to deliver improved transparency by clarifying who is doing what, for whom and at what cost. We then need to communicate this to those outside the sector and rebuild trust with policyholders, politicians and leaders. If we do not take the opportunity to change, then it will be our industry that suffers.

The Silverstein trials, related to the insurance cover for the World Trade Center, highlighted the importance of what was to become an industry buzz word last year – contract certainty. The case illustrated the fundamental importance of agreeing final contract terms prior to inception – hardly earth shattering concepts in other sectors.

Contract certainty: a key Lloyd's objective

Improved contract certainty has been a key objective of Lloyd's for some time now and in the past year some important milestones were reached. A new standard slip for recording deals done in the London market was mandated and Kinnect, the electronic system for exchanging data and agreeing contract details in a secure and transparent way between brokers and underwriters, started to handle increasing volumes of live risks. The insurance industry owes it to its customers and to itself to deliver greater contract certainty. There is much to be done and everyone in the insurance chain from risk manager, to broker and underwriter must work together to deliver that change.

2004, despite its challenges, was another year of sustained progress for Lloyd's. A year when the progressing development of the franchise received positive recognition from the capital markets, the rating agencies, brokers and policyholders. A tough agenda has been set for 2005 to meet the challenges ahead and build upon the substantial and real progress that the market has made in 2004.

I would like to express my thanks to my colleagues on the Lloyd's Council and Franchise Board, for their hard work, co-operative spirit and dedication during the year, and pay tribute to the continuing commitment and achievements of the Corporation staff and the market. We have come a long way in recent years, but we cannot afford to become complacent.

Peter Levene, Chairman 6 April 2005

DRIVING LLOYD'S FORWARD

A HIGH PERFORMING YEAR, WITH POSITIVE PROGRESS TOWARDS BUILDING A MODERN AND EFFICIENT COMPETITIVE PLATFORM.

2004 was a significant year for Lloyd's. It was a year of choice when businesses had to decide whether to follow a business strategy that responded actively to external market conditions or become hostages to the fortunes of the insurance cycle.

Discipline in the market, combined with strong underlying conditions, helped to ensure that it was another high performing year for Lloyd's with profits of £1,357m.

We realised a number of key objectives and made continued progress in our drive to build a strong competitive platform which earns and retains the confidence of capital providers, regulators and customers by:

- delivering consistently good financial results;
- improving business processes; and
- protecting, strengthening and promoting the Lloyd's brand.

This progress did not go unnoticed. The ratings upgrades from A.M. Best and Fitch and Lloyd's successful debt issue were testimony to the greater confidence with which Lloyd's is now viewed.

Strength and security

A combined ratio of 96.9%, despite the worst year for natural catastrophes on record, is an excellent underwriting performance, comparing favourably with our peers. With the support of the Franchise Performance Directorate the market focussed on delivering an underwriting profit rather than chasing market share.

This trend has continued into 2005. The reduction in capacity to £13.7bn from £15bn, was widely recognised as a disciplined and prudent response to softening market conditions.

The financial security of the market was further strengthened with the success of the subordinated debt issue and the introduction of a new syndicate loan scheme which started on 1 April 2005.

In January 2005, we received the first partial decision of the tribunal in the Central Fund arbitration. The tribunal found in favour of Lloyd's on the issue of the proper interpretation of the wording of the policy. However, on the basis of its findings with respect to the presentation of the risk to Swiss Re, the tribunal held that Swiss Re was prima facia entitled to avoid the policy. This finding was subject to the Panel further considering the issue of whether Swiss Re had affirmed the contract and was therefore bound by its terms. In the circumstances, we considered it sensible to reach a commercial settlement with all of the insurers for £152m. We are continuing to examine the implications of the settlement and the options for funding the consequent Central Fund shortfall.

The financial position of the Society remains strong. The solvency ratio at the end of 2004 is estimated to be 299% (206% for 2003), with Central Assets of £1,184m, excluding the callable layer.

During 2004 and into the first part of 2005, a great deal of work has been done to review our risk-based capital setting methodology in light of the FSA's new Individual Capital

Adequacy Standards (ICAS) regime. This work will result in a new approach, which will be agreed and implemented over the course of the next 18 months. Setting capital requirements at the right level is key to the health of the Lloyd's franchise – allocating capital properly to risk, while allowing a competitive return on capital to be achievable. The market's return on capital in 2004 was 12%. This was lower than the 21% achieved in 2003 primarily due to the impact of the catastrophe losses but also reflects the additional capital held by the market in 2004. Achieving an adequate return on capital across the cycle is vital.

Franchise performance

The Franchise Performance team focussed on the ability of businesses in the market to manage their pricing and exposure in the light of prevailing market conditions. In a number of cases, syndicate growth plans were substantially modified. The team continued to apply the underwriting guidelines that were developed as part of the Chairman's Strategy Group proposals.

The intensive annual syndicate Business Plan process was the cornerstone of the Franchise Performance effort. It was supplemented by a programme of detailed visits and meetings with individual syndicates throughout the year as well as market meetings. All of this work paid dividends in 2004, but it should be noted that the availability and quality of up to date performance information needs to improve further to realise the full benefits of the new Franchise Performance approach.

Risk management

During the year under review, we continued to invest in upgrading and developing the sophistication of the market's risk management capability to ensure the effective management of all critical risks. Throughout the market all risk management plans were reviewed against new risk levels set out by the Franchise Board. Visits were made to 38 Managing Agents and key themed reviews of personal lines, insurance intermediary regulation, overseas licences and Members' Agents were also carried out. The series of 17 realistic disaster scenarios that model the potential impact of a range of catastrophes were updated. The spate of natural catastrophes during 2004 demonstrated just how important these tools are in strengthening the market's resilience and profitability.

In addition to the ongoing risk management activity, new Byelaws, rules and codes of practice, and binding authority wordings were introduced to help reduce and manage the risks of delegated underwriting; and an education programme was introduced to help spread best practice through 8 forums and training sessions.

Reinsurance and open years: reducing exposure

Significant collection and commutation work was undertaken during 2004 to reduce the market's exposure to low rated reinsurance security.

Further work was undertaken during the course of last year to increase supervision of open and run-off years to minimise future calls on the Central Fund. A dedicated team was created to facilitate the economic closure of run-off years by working closely with Managing Agents and Run-Off service providers.

Both projects are essential to protect our policyholders, capital providers and the Lloyd's brand.

THERE IS CLEAR RECOGNITION IN THE MARKET THAT PROGRESS MUST BE MADE TO ENABLE GREATER TRANSPARENCY, CONSISTENCY AND EFFICIENCY.

Business Process Reform
There is a clear recognition in the London market that, both for commercial and regulatory reasons, real progress must be made on reforming the business processes of the market and improving contract certainty, enabling greater transparency, consistency and efficiency.

Good progress was made during 2004. A new London Market Principles (LMP) slip to document the key data about the substance of a transaction was mandated in January 2004. The slip is the cornerstone in the drive to deliver improved contract certainty. By the end of the year the number of slips reaching the agreed standard had reached 90%, 5% short of our target but encouraging nonetheless. Further progress has been made on attaining this target in 2005 with 93% of slips meeting the agreed standard in January.

The LMP team is now publishing more guidance to help organisations to implement the slip requirements effectively and league tables which compare the performance of market participants. We are working with Xchanging Ins-sure Services to codify and streamline checking processes and improve the quality of submissions.

The market's commitment to the reform process was evident in its participation in the Market Reform Implementation Board (MRIB) and in its support of Kinnect. The Board, which comprises representatives from across the market, was formed to oversee the delivery of the Accounting and Settlement System, and Electronic Claims files. The Accounting and Settlement system, which is expected to become operational in 2006, will ensure that our standard electronic messages carrying payment and accounting information are compatible with standards in other international markets, greatly reducing costs for brokers and underwriters. The electronic claims infrastructure, also using international standards, will make claims available to relevant parties and speed up their processing of new claims from 2006.

Kinnect, which provides technology and supporting services that enable brokers and underwriters to exchange placing data electronically to international standards, began to handle increasing volumes of live risks. Kinnect is now routinely handling North American property business from two of the world's largest brokers, Willis and Marsh. Four more managing agents joined, alongside the four who started Kinnect with Willis and Marsh more than a year ago. Kinnect will build on these foundations in 2005 to produce a product that encompasses the entire lifecycle of a risk, from original placement to renewal and move into two new risk classes.

Claims
Significant progress was made in the effective management of the market's biggest cost, claims. A clear strategy and vision for claims handling was developed which identified and agreed controls to successfully manage significant claims-related market risks. It focussed on aligning processes, systems and behaviour to improve indemnity accuracy, expense management and reduce processing and reinsurance costs.

A series of claims management principles and minimum standards were introduced which set clear benchmarks for performance. Work was also undertaken to re-establish an effective claims agreement process for followers. These initiatives will lay the foundations for a more integrated approach to claims management.

WE HAVE LONG RECOGNISED THAT ONE OF OUR GREATEST ASSETS IS THE UNIQUE STRENGTH OF THE LLOYD'S BRAND.

Such progress should not be underestimated. It demonstrates what can be achieved when the market recognises that there is a problem and works together to solve it.

The challenge in the next 12 months will be to maintain this momentum with all businesses recognising the importance of claims in managing the market's performance.

Lloyd's brand

We have long recognised that, in a competitive global market, one of our greatest assets is the unique strength of the Lloyd's brand. Our name is instantly recognisable, synonymous with the stability and dependability of over 300 years of history as well as the innovation, creativity, agility and unmatched underwriting expertise – that come from being a dynamic and diverse marketplace.

Last year we recognised that there was a need to find a common language to describe the Lloyd's brand. As a result we carried out a detailed analysis in order to define more clearly what the brand stands for, and how we can use it for maximum advantage.

In 2005, we will build on this work by exploring how the newly defined brand idea can be applied across the wider aspects of the business, from our working environment to behaviour and communications. Crucially, this will involve engaging all members of the Lloyd's community in understanding and actively supporting the brand.

Operating costs

Continued cost discipline remains a clear priority and we are committed to maintain our rigorous attitude to containing increases to our cost base, while constantly improving the efficiency of our infrastructure and internal processes. Operating expenses from continuing activities have remained at a constant level over recent years and in 2004 were £161m.

Appointments

Both the market and Corporation were delighted that Lord Levene accepted an invitation from the Council of Lloyd's to serve a second term as Chairman. His experience, vision and pride in Lloyd's have been invaluable since he joined us in 2002. We are fortunate that Lloyd's will continue to benefit from his passionate championing of this market.

I was pleased to welcome Luke Savage who joined Lloyd's as Finance Director in September 2004. Luke has an outstanding record in investment banking, and is already playing a vital role in our key initiatives.

The future

We are under no illusions about the challenges that we face in the future. The business we are in is highly competitive. Most businesses that operate at Lloyd's have a choice as to where they write business. Policyholders and brokers have a choice about where to put their business. Capital providers certainly have a choice as to where they invest.

We must offer a platform which is unambiguously and sustainably the best for underwriting specialist insurance and reinsurance business. This has to be our guiding principle.

Nick Prettejohn

Nick Prettejohn, Chief Executive Officer 6 April 2005

2004 THE BIG PICTURE

FOR THE INDUSTRY, 2004'S NATURAL CATASTROPHES WERE A REMINDER OF OUR EXPOSURE TO LOSS. UNDER SUCH CIRCUMSTANCES LLOYD'S PERFORMANCE WAS EXCEPTIONAL.

Highlights

- A year of strong but softening underwriting conditions
- USA and Caribbean hit by four major hurricanes
- Highest recorded number of typhoons in Japan
- Largest recorded earthquake since 1964, triggering Indian Ocean tsunami
- Prior year reserving shortfalls still a drain on current earnings for the Property/Casualty industry

2004 Overall combined ratio*

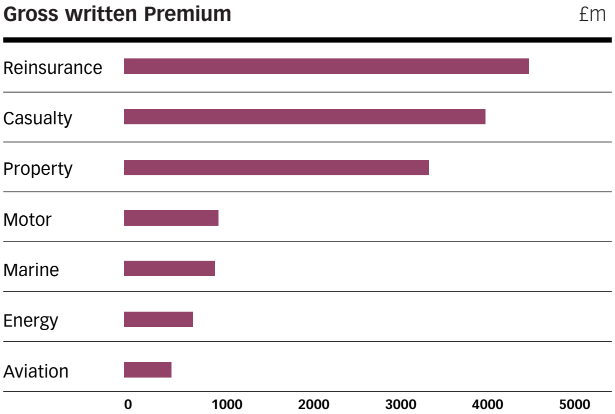
Accident year	91.7%
Prior year reserve movement	5.2%
Calendar year	**96.9%**

The world's meteorological specialists predicted a heavy storm season for 2004 and unfortunately they were proved correct. The four major hurricanes that made landfall across the Caribbean and southern US states were unprecedented in recent times, as were the 10 named typhoons which battered the coasts around Japan and South East Asia. Just as the industry was coming to terms with the impact of these events and preparing for the 2005 renewal season, one more shock was to be delivered on 26 December, when a giant undersea earthquake triggered a deadly tsunami across the Indian Ocean.

Overall, the cost of these natural catastrophes will run to tens of billions of dollars in economic and insurable loss. In human terms, the impact of the tsunami may never be accurately established; but the financial impact on the insurance industry will be relatively low because of the low level of insurance in many rural parts of Asia.

* The combined ratio for the market and by class of business is the ratio of net incurred claims and net operating expenses to net earned premiums.

The 2004 overall combined ratio for the market includes central adjustments in the technical account in respect of certain transactions of the Lloyd's Central Fund and the Corporation of Lloyd's as described in note 1C on page 40. The combined ratios for the individual classes of business do not include such adjustments because the market commentary for each class reflects trading conditions at syndicate level.



Coping with catastrophe
2004 was at or near a high point in terms of industry financial strength measured by balance sheets and cash flow. As a result, most industry observers and analysts – while not under-estimating the significance of the year's losses – have characterised them as 'earnings events' rather than 'capital events'. This has important ramifications for what occurs in 2005 and beyond since the underwriting cycle ebbs and flows according to the availability of capital. If these losses have not impaired the industry's capital base, itself replenished following 9/11 and the stock market slumps, then it would be logical to assume that the softening of the cycle, which was evident during 2004, will continue in 2005.

Facing up to liabilities
It may seem almost paradoxical that, on the one hand, the industry can afford to meet the cost of catastrophic losses out of earnings, yet, on the other, it continues to report combined ratios barely better than 100% – i.e. a break-even underwriting result, even before the hurricanes. This conundrum is explained by the commonly used term, the 'restoration phase'. This is the period when many industry players with legacy issues recognise that their claims reserves are inadequate. Thus in 2002 and 2003 there was significant capital raising activity (referred to in detail in last year's annual report); and, on the back of improved underwriting conditions, the industry was able to generate retained earnings, make increased provisions for prior year liabilities, and rebuild its financial security. In so doing, the reported results of the industry have looked modest at best given the context of a supposedly 'exceptionally hard' market. In the results declared for 2002 and 2003, Lloyd's was one of the very few markets able to report profits from underwriting activities.

Major prior period losses
As we mentioned last year, the issue of prior year reserving in respect of long tail liability business had become the bête noir of the industry, with good current trading results continually being undermined by the need to make additional provisions for liabilities incurred earlier. Following the collapse of companies such as Worldcom and Enron, as well as continuing fall-out from the bursting of the dot-com bubble, a number of claims against the directors of these companies and their professional advisors emerged during 2002-2004 – but relating to policies written between 1997 and 2001.

In addition to these relatively recent phenomena, the number of claims relating to pollution damage and health problems caused by asbestos, going back as far as the 1930s, continues to rise. This made a major impact on the 2003 results of the US Property/Casualty industry, with $17bn of extra provisions – bringing to $50bn the total prior year adjustments for the 2001-2003 accounts. While Lloyd's currently trading entities are not exposed to the longest tailed liabilities from the pre-1993 period, that does not mean the market is immune from prior year reserving issues. Last year's accounts revealed prior period losses of £545m, equating to 4.7% points of the market's combined ratio. This year, the figure stands at £609m, or 5.2% points of the combined ratio. This includes the effect of the Central Fund insurance settlement. Excluding the settlement, the prior period loss stands at £302m or 2.6% points of the combined ratio.

Investment markets remain difficult
In the capital markets, global equities continued the modest recovery which began in 2003: both US and UK equity markets rose by around 10% during the year. But only a small proportion

2004 THE BIG PICTURE
continued

of Lloyd's assets are exposed to equities. The majority of premium assets are invested in fixed interest securities and related investments, with relatively short average maturity. The general environment for such instruments remained weak in 2004, with low prevailing yield levels and rising interest rates. A large proportion of Lloyd's invested assets are in US dollars and this market has been particularly volatile as the US Federal Reserve raised interest rates significantly in 2004 from a very low base. Rising yields created capital losses on many bonds; overall returns recovered in the second half of 2004, but remained relatively low. The average return for all syndicate investments in 2004 was 2.8%. The US dollar weakened against sterling by around 7% during the period, extending the loss it recorded in 2003. This weakness highlights the importance of managing currency exposures for the many syndicates which have significant US business.

Lloyd's third successive year of profit

Against this background, it is a significant achievement that we are able to report our third annually accounted profit in a row. This has been possible because of Lloyd's focus on underwriting profit and our leadership in many business lines. As we explain below, the profit potential in our wide variety of business classes is not uniform. With varying degrees of volatility and exposure to catastrophic loss, we need to target different levels of profit margin at specific points in the underwriting cycle. Our many different lines of business are not always in phase with each other presenting a real challenge to construct an optimal underwriting portfolio for each year of account – particularly in an industry as competitive as insurance.

A disciplined approach, a positive outlook

We are cautiously optimistic about the outlook for 2005. Certainly, a strong and growing capital base across the industry is the primary driver of competitive behaviour; but the losses during 2004 were a reminder of the exposures carried by the underwriting community. At a time when pricing increases effectively came to a halt during 2004, and against a backdrop of modest worldwide economic growth, it concerns us to see some sectors of the industry still driving aggressively for premium income growth. At Lloyd's, our premium writings during 2004, adjusted for currency movements, actually dropped marginally compared to 2003 – a strong indication of the market's disciplined underwriting approach in the prevailing conditions.

That said, despite the emerging pricing pressures, profit margins are still available in the majority of business lines and experienced underwriters with well structured business plans should be able to deliver acceptable returns to their capital providers in 2005.

Highlights

- Pricing still firm but competition leads price reductions in some areas
- Tight policy wordings helping to prevent attritional losses
- Pressure for change in the US tort system remains a high priority, but yet to be delivered

2004 Casualty combined ratio

Accident year	97.9%
Prior year reserve movement	10.9%
Calendar year	**108.8%**

CASUALTY

IMPROVED UNDERWRITING CONDITIONS, BUT LONG TAIL LIABILITIES CONTINUE TO CAST A SHADOW OVER PROFITABILITY.

The collapse of the dot-com bubble and the slump in global stock markets had an unexpected and systemic impact upon the casualty insurance markets. Previously, this had been regarded as a class of business exposed mainly to attritional losses. But, as we highlighted in last year's report, certain elements of the casualty class are now more like a catastrophe-exposed account – where a single event can result in many very large claims from a wide range of policyholders.

Today's claims, yesterday's policies

The added complication of casualty business is the potential time delays inherent between the inception of policies and the emergence of claims. While Lloyd's current trading entities are not exposed to pre-1993 liabilites, this long tail characteristic has been an issue for several years now, relating to claims from as long as 70 years ago, emanating from pollution and health hazard issues such as asbestos, as well as to more recent events. The legal environment in which business was written in the past was very different, and policy wordings were often couched in terms that did not foresee the types of losses that were to emerge many years later, making claims difficult to defend. Claims continue to emerge from business written in the period 1997-2001 and these represent the majority of the prior year reserve movement of 10.9% shown above.

Lloyd's £3.9bn book

Lloyd's casualty book covers a broad spectrum of classes of business from professional lines such as directors' and officers' and professional indemnity, to lines where insurance is compulsory such as employer's liability. At £3.9bn of premium income, the casualty book is one of Lloyd's largest and has enjoyed strong underwriting conditions over the last three years.

Loss ratios for the 2002-2004 years of account are running at promising levels but the long tail nature of the business means that it can be several years before a reliable picture of profitability emerges. As the accident year combined ratio confirms, current trading conditions are strong; but the overhang of losses emerging from the prior years continues to undermine the overall profitability of this account.

US tort reform: a high priority

As a wider issue, the system of tort in the US has been a major contributory factor to the costs of dealing with long tail liability claims. Figures recently published by the Insurance Information Institute (III) in the US reveal that tort costs have risen from $129bn in 1990 to an estimated $262bn in 2004, representing a remarkable 2.25% of US GDP. The III has also suggested that the rapid growth in tort costs has begun to slow; however, this was looking solely at the figures for 2003-4 relative to a long term trend which has shown very rapid growth. In the absence of meaningful reforms in the tort system, it will continue to be difficult for insurers to offer liability products to policyholders at attractive prices. Clearly, this is highly undesirable, since many policyholders would not be prepared to trade without appropriate insurance protections.

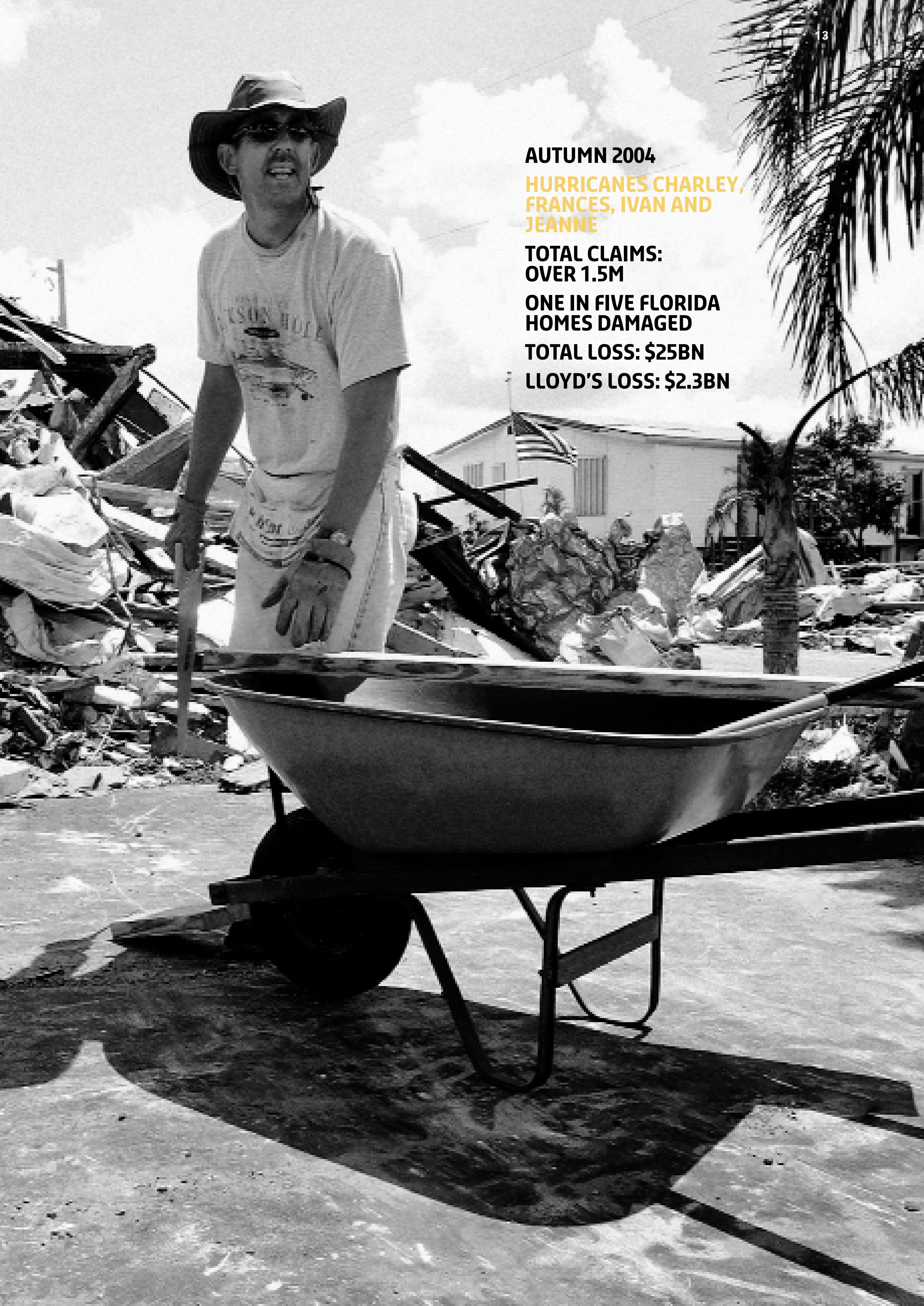
'It wasn't just the size of the loss, but how incredibly hard it was to adjust – with one hurricane following another. But we were there providing cover for homes and businesses immediately afterwards.'

Jonathan Gray, Underwriter, Beazley syndicate 623

Some scientists believe it's still too soon to link global warming to climate change. But the hurricanes of 2004 certainly provided fuel for the debate. In just over six weeks, Florida – the so-called Sunshine State – was battered into submission by Charley, Frances, Ivan and Jeanne. The devastation could, in fact, have been much worse, if more of Florida's built-up areas had been hit. But nevertheless, the total industry loss is estimated to cost approximately $25bn, of which Lloyd's share is $2.3bn. Unwelcome of course, but that's the business we're in. And, as ever, disaster presented us with an opportunity to demonstrate what makes Lloyd's different. In 1906, the speed with which we met claims following the San Francisco earthquake made Lloyd's reputation in the USA. Very nearly a century later, we reinforced that reputation, with 86% of the Florida claims settled by Christmas. And, while others battened down the hatches, we continued to offer insurance, partly explaining why Lloyd's share of the US home insurance market continues to grow dramatically.

HURRICANE WARNING

FOR THE WORLD, AN ENVIRONMENTAL WAKE-UP CALL. FOR LLOYD'S, A $2.3BN LOSS... AND AN OPPORTUNITY.



AUTUMN 2004

HURRICANES CHARLEY, FRANCES, IVAN AND JEANNE

TOTAL CLAIMS: OVER 1.5M

ONE IN FIVE FLORIDA HOMES DAMAGED

TOTAL LOSS: $25BN

LLOYD'S LOSS: $2.3BN

Highlights

- Disciplined underwriting reduced premium income in 2004 compared with 2003
- Underwriting conditions still strong, but pricing pressure emerging in larger commercial risks
- Results affected by major catastrophe losses, with over 1.5m claims following Florida hurricanes

2004 Property combined ratio

Accident year	97.1%
Prior year reserve movement	(1.3)%
Calendar year	**95.8%**

PROPERTY

A GOOD ATTRITIONAL LOSS RECORD AND STRONG PRICING, BUT THE US HURRICANES MADE A MAJOR IMPACT.

In recent years, the Property Direct and Property Treaty accounts have made the largest contribution to Lloyd's overall profits. This is partly due to the response to 9/11, which forced the global underwriting community to recognise not only the aggregations of exposures on its books, but also that the underlying profitability of the risks assumed was inadequate to generate acceptable returns on the capital employed. As a result, there were dramatic changes to pricing and to the terms of coverage offered. The underwriting years 2002 and 2003 reaped the benefits of strong pricing, as well as enjoying an unusually benign loss environment. So the 2004 calendar year result benefited from the flowing through of the earned premiums from these years; but this was counterbalanced by the increase in catastrophic losses mentioned.

Four hurricanes, over 1.5m claims

It's over 20 years since four or more named hurricanes made landfall in a single US state and the phenomenon of two major hurricanes crossing each other's paths in one state is an exceptionally rare occurrence. The scale of the devastation wrought by Charley, Frances, Ivan (whose impact was most acute in the Gulf of Mexico and in Alabama) and Jeanne was unprecedented and surpassed, in aggregate, the financial impact of Florida's last major disaster, Hurricane Andrew, in 1992. It is estimated that more than 20% of all homes in Florida were damaged by these storms and over 1.5m individual claims will be settled, three times the number that arose from Andrew. The global insurance community will meet policyholders' claims which ultimately are estimated to total approximately $25bn.

A challenge to adjust

A surge in demand, caused by the pressure on contractors and materials required to repair and rebuild, forced prices up and hence the cost of claims. A further expensive complication arose from the shortage of qualified loss adjusters in the southern US states. Hundreds of adjusters had to be flown in from all over the USA and even Canada to help insurers and policyholders determine the correct indemnities to be paid. Where the paths of hurricanes Frances and Jeanne crossed, it was particularly difficult to determine which storm caused what damage.

The Asian tsunami

Boxing Day 2004 will be remembered for the appalling loss of life caused by the Asian tsunami. The impact on the insurance industry pales beside the human toll, but there are thousands of claims to be resolved, with diligence and compassion. The destruction of holiday resorts and hotels and the consequent disruption of the region's vital tourist industry will account for the bulk of the property-related claims since sadly much of the local population's property would not have been insured.

The results achieved in Lloyd's property book are a clear reflection of how strong the underlying underwriting conditions were since, despite these loss events, underwriting profits were still achieved. These losses have been more than offset by the profits generated on the remainder of the property book from risks written all over the world.

Highlights

- Lloyd's continues to play a leading role in the global reinsurance community
- Underwriting conditions favourable in Lloyd's reinsurance lines
- Good levels of retention continue to limit attritional loss exposures

2004 Reinsurance combined ratio

Accident year	89.4%
Prior year reserve movement	5.2%
Calendar year	94.6%

REINSURANCE

ANOTHER STRONG YEAR, DESPITE THE IMPACT OF THE FLORIDA HURRICANES, AND THE CONTINUING NEED TO GUARD AGAINST CONCENTRATION OF RISK.

Lloyd's reinsurance book covers a range of business classes and types, both short and long tail, and uses a variety of placement types including facultative, or individual risk placements; proportional treaties; and non-proportional treaties, such as excess of loss placements. The reinsurance book has benefited from a significant tightening in the terms offered, particularly in the levels of retention accepted by cedants.

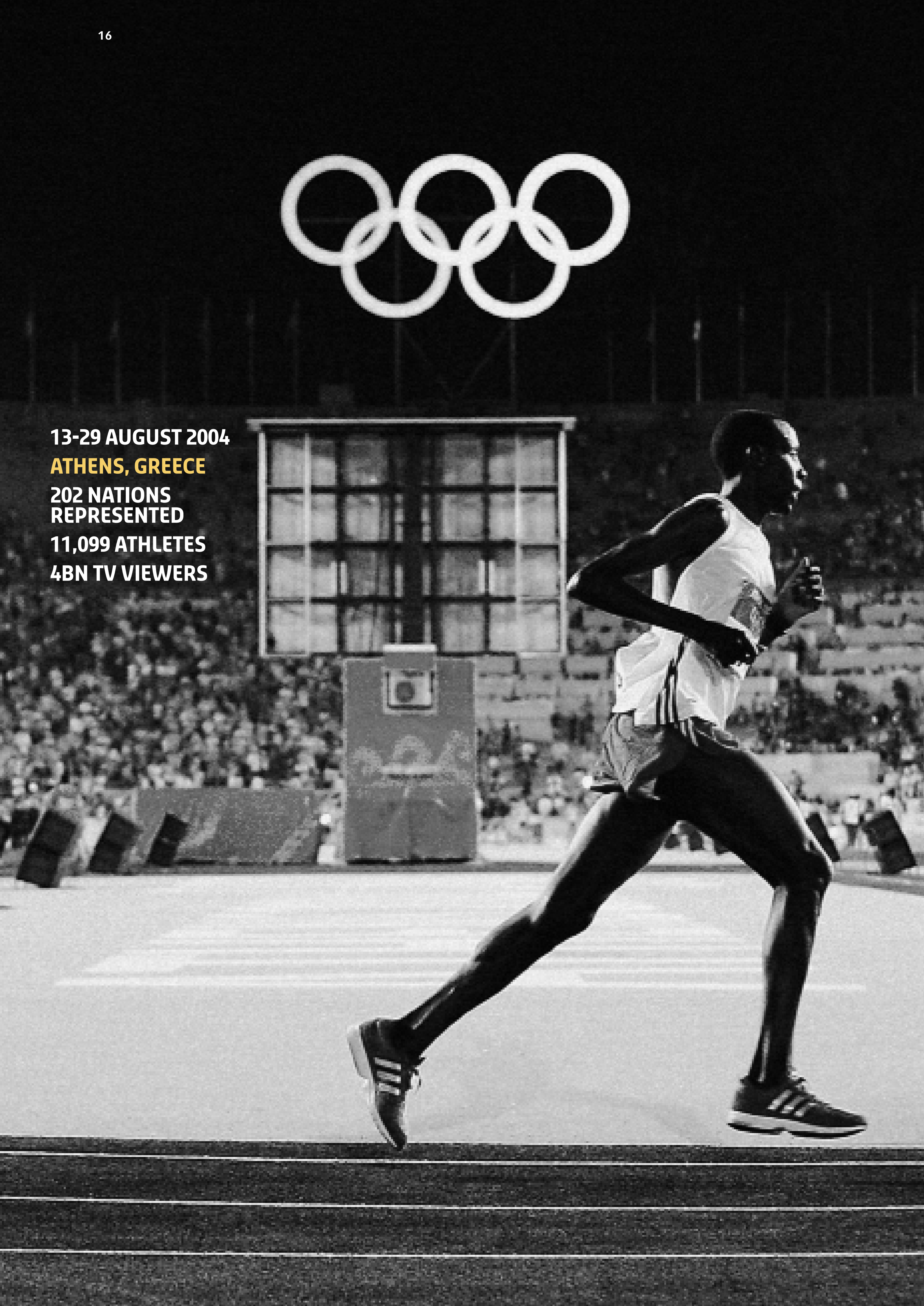
Tighter terms, a stronger premium base

The main benefit of this is that it reduces the erosion of the premium base by large numbers of relatively small individual claims. These not only add up in monetary terms, but their adjusting, reserving and settlement are also a drain on management resources, another significant cost to the business. Individual large claims events only rarely cause serious financial difficulties for a Lloyd's syndicate (although 9/11 certainly tested this); attritional claims are by far the largest threat to overall profitability, hence the importance of appropriate levels of deductible and tight policy forms.

Strong trading, hit by hurricanes

The results for the 2004 calendar year account, are generated from the premiums written in 2004, 2003 and earlier years as premiums earned, and losses paid, flow through the profit and loss account. The strong trading conditions in the period following 9/11 continue to influence the results announced in these accounts but these have been counterbalanced by the impact of the catastrophe losses during 2004.

Naturally, the hurricanes in the Caribbean and the USA made an impact on the direct accounts of property, marine and energy; but they also fed through to the relevant reinsurance accounts, where Lloyd's has provided protection both to other Lloyd's underwriters and to insurers operating around the world. Much of the impact from these storm losses fell on the property catastrophe accounts with the result that at renewal in 2005, prices have risen as reinsurers seek to recover some of the losses incurred. Against this current trading performance we have seen a deterioration emerging from reserves established in the casualty reinsurance accounts. In the circumstances, the calendar year combined ratio of 94.6% for the reinsurance book is an excellent result.



13-29 AUGUST 2004
ATHENS, GREECE
202 NATIONS REPRESENTED
11,099 ATHLETES
4BN TV VIEWERS

THE ULTIMATE CHALLENGE

FOR THE WORLD'S LEADING ATHLETES, THE OLYMPIC GAMES ARE THE BIGGEST TEST OF SKILL AND NERVE. DITTO FOR THOSE OF US IN INSURANCE.

'Others might shy away from providing cover at an event like the Olympics where there are so many potential risks, including the threat of terrorist attacks. But we're here to solve problems for clients; it's what we do.'

Jason Herriott, War Underwriter, Amlin syndicate 2001

For 17 days last year, the world turned its eyes to Athens. Thousands of athletes performed at their peak, watched by millions in the various Olympic arenas and by billions around the world on TV. From an insurance point of view, the risks involved were incredibly hard to calculate. What if, for any reason, the Games were cancelled? Or a leading athlete sustained a career-ending injury? Or one of the newly completed stadia collapsed? Or terrorists attacked the ships in Piraeus harbour where thousands of dignitaries were staying in huge floating hotels? No rating manual existed to provide the answers. Yet, naturally enough, everyone involved wanted to protect their investment in the Games – from the International Olympic Committee, which bought cancellation coverage for the first time; through broadcasters and advertisers; down to individual athletes and small businesses producing souvenirs. For Lloyd's, it was a tailor-made opportunity to show what we're made of. Our underwriters' game plan? To use their experience and expertise to understand and minimise the risks – sending in teams of security consultants, for example, to assess and advise on anti-terrorist measures. And thankfully, in the event, the only drama was provided by the athletes.

Highlights

- Lloyd's motor income continues to reduce
- Competition remains stiff but disciplined
- Pricing broadly static but claims inflation ever present

2004 Motor combined ratio

Accident year	102.0%
Prior year reserve movement	(8.7)%
Calendar year	**93.3%**

MOTOR

WITH SUPERMARKETS AND OTHERS PURSUING THE HIGH VOLUME BUSINESS, LLOYD'S UNDERWRITERS CONTINUED TO CARVE OUT A MORE SPECIALIST NICHE.

Ever since we wrote our first motor policy in 1904, Lloyd's has had a significant presence in the UK and, more recently, in overseas motor markets. As a relatively non-volatile class of business, motor business has long been regarded as an effective hedge against higher risk classes of business. So, in the past, many Lloyd's managing agencies had a motor syndicate in the group, alongside marine, aviation and other specialist syndicates. As the overall number of managing agencies and syndicates has shrunk, the number of stand-alone motor syndicates has fallen and today only three remain.

Accelerating competitive pressure

From a peak in 2001, gross premium income from UK motor business in 2004 fell, reflecting the reduced number of trading syndicates in the market and the continuing gradual erosion of pricing. Competition is always intense in motor business and now includes large, consumer-facing organisations such as supermarkets and, most recently, the Post Office, which have enormous 'semi-captive' markets.

Naturally, these types of competitors are focusing on the private motorist and this is part of the reason why Lloyd's motor underwriters have in many cases moved away from the standard private vehicle sector (now representing less than 50% of motor income) in favour of non-standard, fleet and commercial vehicles. In these areas, bespoke underwriting skills and claims handling services, experience and expertise remain more important than for high volume, homogenous risks.

Rather than focusing solely on price, Lloyd's is more interested in developing a good rapport and understanding with its policyholders which in turn leads to continuity and, in the long term, a better overall level of profit margin.

Current trading conditions are becoming increasingly difficult as revealed in the accident year combined ratio climbing above the 100% mark. However, prudent reserving in prior years has allowed for releases to be made thus bringing the overall underwriting result back into profit.

High performance underwriting skills

Similarly in the private motor market, bespoke underwriting of individual risks is commonplace and much of the focus is on non-standard risks such as high value vehicles, vintage or collectors' vehicles; drivers with convictions; or affinity groups. Again, these types of risk require experience and skill to underwrite effectively, and building a balanced book of business is complex. While the premiums available in writing the insurance of a high risk motorist, such as an individual with driving convictions, may initially appear high, the total loss of the vehicle, plus possible third party injuries, would quickly make these premiums seem modest.

Lloyd's overseas motor book has historically not been profitable in recent years and managing agencies have taken steps to address this by reducing premiums written.

Highlights

- Competition still intense in many marine accounts
- Global merchant shipping activity and construction at historically high levels
- High worldwide underwriting capacity undermining prices and margins
- Marine cargo peaked in 2004

2004 Marine combined ratio

Accident year	91.0%
Prior year reserve movement	(3.6)%
Calendar year	87.4%

MARINE

PRICING IMPROVEMENTS CONTINUED, BUT WITH INCREASING COMPETITION FROM OVERSEAS MARKETS.

The strong profitability of the Marine sector, with a combined ratio sub-90%, reflects the excellent terms which have been available in many of the sub-sectors such as Marine War, Cargo and Liability. A release from prior year reserves has also improved the combined ratio.

Not much has changed in the Marine market since we reported a year ago. In the marine hull account, the burgeoning economies of the Far East, particularly China, have such a high demand for raw materials that the world's merchant shipping fleet can barely keep pace. Similarly, the world's shipyards are so busy with new construction work that many have waiting lists extending to 2008. While this may look like a vibrant and healthy market which should provide good opportunities for underwriters, the reality is more complex. The worldwide availability of underwriting capacity is undermining efforts to push pricing and terms and conditions to levels which deliver acceptable returns on the capital employed.

Marine hull margins remain depressed

Pricing in this line is continuing to improve, but too slowly in the eyes of some underwriters in order to stay ahead of claims inflation. Underwriters are concerned that the activity in the Far East is unlikely to continue indefinitely, and that when the Asian economies begin to cool, the demand for merchant shipping will follow suit. It is typically at this point that large numbers of claims for repairs are lodged, having been postponed while the ships were in great demand.

Marine cargo premiums reach peak

Lloyd's Marine Cargo account has been growing in recent years as pricing has improved substantially and income is expected to peak in 2004. Underwriting terms and conditions are generally felt to have peaked during 2004 with the loss ratios on the years 2002-2004 tracking favourably. However, a degree of competitive pressure is beginning to reassert itself once more. Underwriters are concerned not so much with the actual price charged on each risk as with the breadth and type of coverage offered.

Marine liability performing strongly

The last large component of the Marine book is the Liability account. This book has had a good track record in recent years, although it is important to bear in mind that this is a long tail class of business and a seemingly benign loss record can always change as late claims advices are lodged.

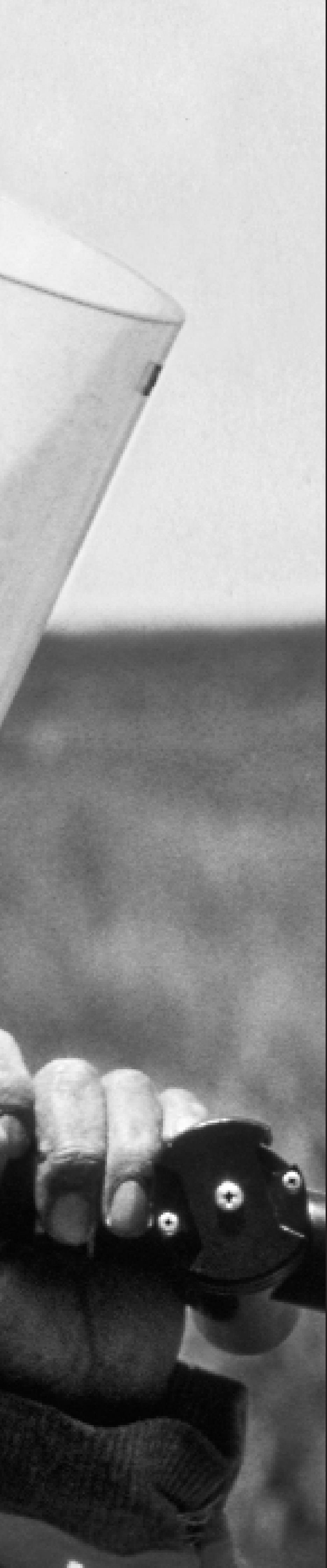
The Marine War book has had an exceptional run in the 2002-2004 period with loss ratios tracking below 25%. Naturally, however, such a benign loss record brings increased competition and Lloyd's income is dropping as a consequence.

ANGOLA, 2004

30 YEARS OF WAR FINALLY OVER

MINE CLEARANCE TEAMS IN ACTION

THOUSANDS OF REFUGEES RETURNING DAILY



'Our attitude to risk is that where there is volatility, there's opportunity. Assessing whether the risk is acceptable is all about having the specialist knowledge to ask the right questions.'

Tim Prifti, Underwriter, Kiln syndicate 510

DANGER ZONE: KEEP OUT?

IN THE WORLD'S MOST VOLATILE REGIONS, THE LLOYD'S MARKET PROVIDES THE COVER THAT ENABLES BUSINESSES TO OPERATE, PEOPLE TO WORK, LIFE TO GO ON.

We live in a dangerous world. From Afghanistan to Zimbabwe, there are numerous places which anyone would think twice about visiting. But, having done so, many people go ahead and pack their suitcases: aid workers, set on bringing relief; journalists in search of a story; businesses in pursuit of valuable contracts. At Lloyd's, we're with them all the way. As specialists in extreme risk, Lloyd's underwriters provide the cover they need to do their work. Insuring construction companies rebuilding Iraq; mine-clearers; news organisations reporting from the West Bank; and UN workers in the most troubled parts of the world. Why are we willing to venture into such hot-spots? Part of the answer – but only part – concerns our expertise: in many cases, our understanding of risk enables us to assess it more accurately than others, and to base our calculations on a more realistic picture. But there's another more important reason why we confront dangers that most would go out of their way to avoid. It's because we're Lloyd's. And since we started over 300 years ago, that is how we've built both our business and our reputation.

Highlights

- Hurricane Ivan produced largest recorded off-shore loss from a windstorm
- Pricing under sustained pressure as key international market players seek dominant positions
- Results continue to reflect inherent volatility of this account

2004 Energy combined ratio

Accident year	90.3%
Prior year reserve movement	(7.8)%
Calendar year	82.5%

ENERGY

DESPITE UNPRECEDENTED LOSSES AND INCREASED PRICING PRESSURE, LLOYD'S ENERGY BOOK DELIVERED AN EXCELLENT RESULT.

With a range of major individual risk and catastrophe event losses, 2004 was a difficult year for the energy industry, and its insurers. As we reported last year, the early part of 2004 saw four large risk losses although none was of significant concern to Lloyd's. In a repeat of last year's events, January 2005 saw the petrochemical company Suncor suffer a major loss at one of its plants in Canada the value of which is estimated at between $500m and $1bn; a reminder of the high values at risk and the inherent volatility of this type of insurance.

A sought-after account

These events aside, there's still a large amount of capital ready and willing to pursue this business, and pricing in the on-shore energy market remains under pressure. Lloyd's gross premium writings from its on-shore energy account are expected to have peaked in 2003 and 2004.

Hurricane Ivan: wind of change?

The off-shore energy market, the larger part of Lloyd's energy portfolio, was also coming under competitive pressure in the course of 2004, even before the largest loss the sector has ever suffered. Hurricane Ivan tore across the Gulf of Mexico damaging drilling and exploration rigs, and causing under-sea mud slides, which damaged pipelines – resulting in an extended interruption to oil production. Occurring when it did, with oil prices at or near historical highs, this business interruption will prove to be a significant element of the overall industry losses which may reach $2.5bn in total. This clearly exceeds the most recent major off-shore loss in 2001, the sinking of the Petrobras oil rig off the Brazilian coast which cost the insurance industry just under $500m.

Although this is the largest loss to the off-shore sector, it remains to be seen how the industry will react in terms of pricing and the terms and conditions under which coverage will be offered in future. In such a volatile and catastrophe-exposed account, underwriters need to maintain substantial margins.

The results achieved in Lloyd's Energy account reflect the underlying strong profitability of the business and underwriters' ability not to unbalance their accounts through over-exposure to a single event such as Hurricane Ivan. Once again, prudent reserving in prior years has allowed for releases to be made, enhancing the accident year result.

Highlights

- An outstanding loss record in airline hull puts pricing under pressure
- Lloyd's continues to perform strongly in general aviation business
- Satellite business enjoying the benefits of a disciplined market

2004 Aviation combined ratio

Accident year	79.6%
Prior year reserve movement	(7.0)%
Calendar year	**72.6%**

AVIATION

THE BEST LOSS RECORD SINCE 1945 LED TO DOWNWARD PRESSURE ON PRICES, BUT LLOYD'S EXPERTISE CONTINUED TO PAY.

The aviation market was severely jolted by the losses from 9/11 and by the loss of the American Airlines aircraft at Queens, New York State in November of the same year. As a result, pricing, terms and conditions improved significantly. Since then, the loss record for the period 2002 to date has been outstanding, falling to around 50% of the long term average. For example, 2004 saw the lowest number of commercial jet losses and passenger deaths since records began in 1945.

The results achieved by Lloyd's aviation underwriters reflect the improved pricing and claims environment. As with several other Lloyd's accounts, prudent reserving has permitted releases to be made, inuring to the benefit of the 2004 annual result.

Top flight risk management required

Although the individual risks in Lloyd's general aviation book are typically much smaller than those found in the airline sector, a lack of experience can still result in substantial losses. The variety of craft in use around the world – all with different reliability and loss histories – makes this a demanding class of business. One of the sectors in which Lloyd's trades is industrial aid, which covers risks such as helicopters serving off-shore oil platforms; a good example of a complex risk type, involving hazardous operating conditions – and requiring high standards of risk management, if underwriters are to trade profitably.

Alongside the airline and general aviation accounts, runs a variety of other business classes, including the insurances of air traffic controllers, refuellers, baggage handlers and product liabilities. This latter category is one of the largest and most complex, covering losses arising from the failure of a product which results in injury or financial impairment. This can cover virtually any product which is involved in the aviation industry – from aero engines to passenger seats on board aircraft.

Underwriters in space

The satellite account is another highly volatile area in which Lloyd's has traditionally been an industry leader. The high value of the risks insured, together with their limited numbers, means that even a small number of losses in a given year can push the account into overall loss. Another concern for underwriters is the potential for systemic faults, such as those recently experienced by a prominent manufacturer, where a design flaw was replicated across a fleet of satellites rendering their operational lives far shorter than planned. Again, this presents underwriters with the challenge of achieving a spread of risk while generating enough premium volume to keep the account viable.

Currently, underwriting conditions are good with a disciplined market offering the required limits of protection but with carefully structured coverages to contain exposures at acceptable levels. To some satellite manufacturers, these policy limitations are too narrow and some have taken the option to self-insure. This is a risky choice and has resulted in the bankruptcy of one satellite operator which suffered a total loss, wiping out its financial resources; a timely reminder of the value of insurance protections in allowing high risk ventures to be undertaken, with the potential for the losses of the few being shared among the many.

Who insures with Lloyd's?

94% **FTSE 100 Companies**

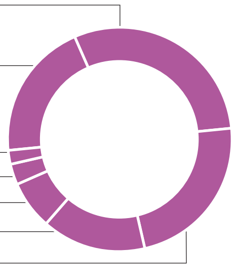
93% **Dow Jones Industrial companies**

DYNAMIC AND DIVERSE

THE LLOYD'S MARKET BRINGS TOGETHER AN UNRIVALLED CONCENTRATION OF SPECIALIST EXPERTISE AND TALENT.

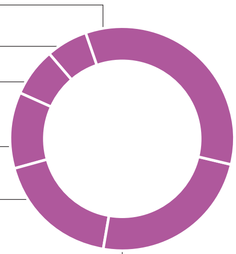
Lloyd's business by class

Reinsurance acceptances **30%**
Fire and other damage to property **20%**
Other **2%**
Accident and health **3%**
Motor **7%**
Marine, aviation and transport **15%**
Third-party liability **23%**



Lloyd's business by region

USA **34%**
Worldwide **6%**
Asia/Africa **7%**
Other Americas **11%**
Europe **18%**
UK **24%**



Lloyd's is famous for being the world's leading specialist insurance market, but much less widely known and understood is how this unique market operates. Hardly surprising, since Lloyd's structure is very unusual.

It's a Society of members, corporate and individual, who underwrite in syndicates. There are currently 62 syndicates, which are run by 44 managing agents (whose names appear opposite), firms of highly experienced specialist underwriters, who accept risk on behalf of syndicate members. Lloyd's brokers bring business to the market from clients, other brokers and intermediaries worldwide.

Together, the syndicates underwriting at Lloyd's form one of the world's largest commercial insurers, and a leading reinsurer. But far more important than sheer size are the breadth and depth of specialist broking and underwriting expertise, brought together under one roof at Lloyd's.

That's why we're trusted to insure the world's newest, toughest and most complex risks.

TOP 20 Global banks

TOP 7 Pharmaceutical companies

HISCOX

ace global markets

JUBILEE

AMLIN

Watkins Syndicate

FARADAY

CATLIN

Brit Insurance

AEGIS Energy Syndicate 1225

CATHEDRAL UNDERWRITING LTD

Chaucer

HARDY

Kiln

S.A Meacock & Company Limited

illium insurance

ST PAUL TRAVELERS

TALBOT UNDERWRITING

CANOPIUS

CREECHURCH UNDERWRITING LTD

Heritage

XL INSURANCE

ADVENT UNDERWRITING LIMITED

Wellington Underwriting plc

Limit

ATRIUM

SVB

GERLING AT LLOYD'S LIMITED

Argenta

MARKEL INTERNATIONAL

MARLBOROUGH UNDERWRITING AGENCY LIMITED

Marketform

IMAGINE group

COX SYNDICATE MANAGEMENT

kgm

Navigators

MAP underwriting at lloyd's

OMEGA

NEWLINE UNDERWRITING MANAGEMENT LTD

DANISH RE

Beaufort underwriting agency limited

Liberty Syndicates

BEAZLEY

abacus

Highlights

- Lloyd's Charities Trust celebrates its 50th anniversary as a channel for the market's charitable activities
- Continued focus on key areas, including children and young people; health and disability; and social welfare
- Three new partner charities selected for long term support, Hope and Homes for Children chosen to receive an additional 50th anniversary award

CHARITY MATTERS

IN ITS 50TH ANNIVERSARY YEAR, LLOYD'S CHARITIES TRUST RENEWED ITS EFFORTS TO HELP THOSE IN THE GREATEST NEED.

At Lloyd's we know more than most about disaster, accidents and misfortune. Not surprising, then, that within the market there has always been a strong sense of responsibility towards those most vulnerable and worst afflicted within society, and a powerful desire to help. This was demonstrated by the Lloyd's market's response to the tragic events of the Asian tsunami with a contribution of £400,000 to the critical relief work, of which £60,000 was donated by Lloyd's Charities Trust (LCT).

Half a century ago, the LCT was set up in order to channel this generous impulse, since then it has raised and donated many millions of pounds to good causes and worthwhile projects, from the East End to the Far East, North Shields to South Africa, Bosnia to Brazil. And in 2004, the Trust redoubled its efforts on behalf of the Lloyd's market to make a real difference to people's lives, far afield as well as in some of the deprived boroughs very close to where we do business.

Focusing our giving

For anyone involved in charitable activities, the biggest dilemma is deciding which of a thousand and one worthy causes to support. There are no easy answers, but the trustees of LCT (senior figures from across the Lloyd's market) take a rigorous approach, setting standards which potential recipient charities must meet. In particular, they demand evidence that the project to be supported will produce tangible and measurable results.

To increase the effectiveness of Lloyd's charitable giving, LCT has for some years focused on a number of key areas, including children and young people; health and disability; and social welfare.

And since 1998, the Trust has pursued a policy of working in close partnership with selected charities within each of these areas, to help establish and develop a specific project over a three-year period. Opposite, you'll find information on Lloyd's three new partner charities – one of which, Hope and Homes for Children, was chosen to receive a special additional 50th anniversary award.

Raising awareness, as well as money

As well as providing much needed financial support, LCT also plays an active role in raising awareness of Lloyd's partner charities and in encouraging support for their activities across the market. The Macmillan Cancer Relief 'World's Biggest Coffee Morning', for example, held in September in the Underwriting Room was a highly successful fund-raising initiative co-ordinated by Lloyd's, Amlin, Avenance, and Marsh.

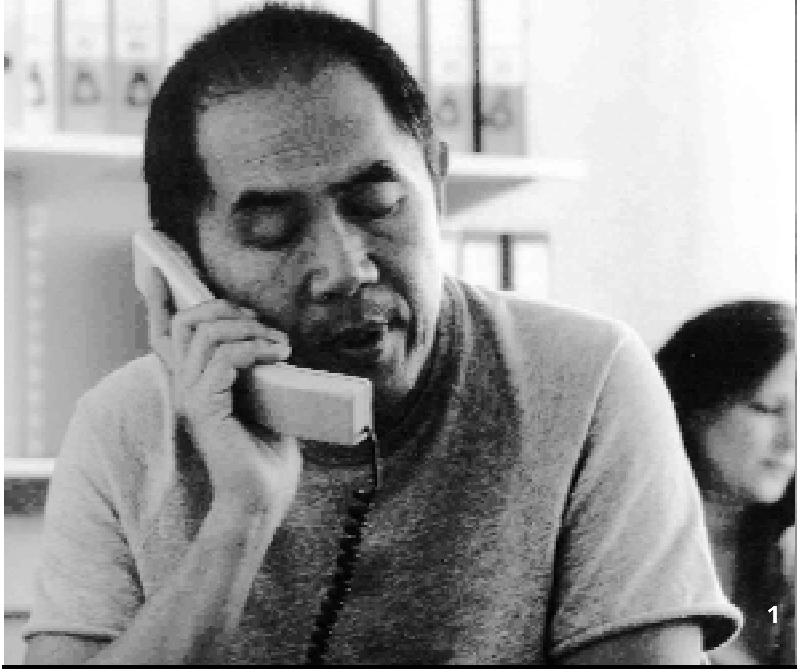
Throughout the year, the Trust also held a number of events aimed at raising awareness of the work of Lloyd's partner charities, and attended by high profile guests, including Professor Colin Blakemore, Chairman of the General Medical Research Council, and Princess Anne, President of Save the Children. Lloyd's Charities Trust also administers the Cuthbert Heath Fund, which supports education by giving annual bursaries.

Lloyd's also has three other separate charities which have been set up over the years to support various worthy causes:

Lloyd's Patriotic Fund. Having celebrated its bicentenary in 2003, this managed fund of £1.2m has been providing financial assistance to former servicemen and women, their widows and dependants for the last 200 years.

Lloyd's Tercentenary Foundation. This Foundation supports the advancement of medical, scientific, technical and business-related education and research. Invested funds of £2.4m are used to award research fellowships and scholarships to promising young academics.

Lloyd's Benevolent Fund. Founded in 1829, the objective of the Fund is to assist all those in necessitous circumstances who work or have worked in the Lloyd's community and their dependants or others at the discretion of the trustees.



1

2

1. Macmillan Cancer Relief
Set up in 2002, the Macmillan CancerLine is a free service that provides telephone support and advice to thousands of people with cancer. Now Macmillan want to build on this success and extend the service to provide specialist support for children and young people, as well as for members of ethnic minority groups whose first language is not English. Lloyd's Charities Trust funding: £50,000 per year for three years.

2. St Giles Trust
Every year, over 50,000 people are released from UK prisons with no home to go to. St Giles Trust helps prisoners to break the cycle of debt, homelessness, despair and re-offending. With our support, the charity will be running a major project across eight prisons in Kent, providing housing advice to 4,000 short term prisoners per year, greatly increasing their chances of rebuilding their lives. Lloyd's Charities Trust funding: £50,000 per year for three years.

3. Hope and Homes for Children
After 10 years of brutal war, over 40,000 children in Sierra Leone are orphans. LCT will help Hope and Homes for Children in their innovative childcare programme which will give hundreds of these children the chance to grow up in a safe and loving environment. Through education and training, the project will also enable the children to build a future for themselves and their country. Lloyd's Charities Trust funding: £75,000 per year for three years.

3

Highlights

- Highest ever support for Lloyd's Community Programme (LCP), with over 560 volunteers from across the market and 46 member companies
- Outstanding improvements in academic performance by LCP partner schools
- Recognition for LCP achievements, including Big Tick award for excellence from Business in the Community
- A range of new projects developed, including highly successful Police Mentoring scheme

BEING GOOD NEIGHBOURS

IN 2004 LLOYD'S COMMUNITY PROGRAMME MADE A REAL IMPACT, ACHIEVING BOTH RESULTS AND RECOGNITION.

Lloyd's home in the City is just minutes from some of London's poorest boroughs. Lloyd's Community Programme (LCP) was set up in 1989 to enable individuals and businesses within the market to make a positive contribution to the lives of their neighbours in these deprived areas.

Our employee volunteering programme began in earnest in 1994, when Swanlea secondary school in Tower Hamlets invited employees from across the Lloyd's market to set up a reading scheme. A decade on, volunteers from Lloyd's are still spending their lunch-hours helping students at Swanlea to improve their literacy.

Over the same period, the LCP has really achieved lift-off. In 2004, we had our highest ever number of volunteers, over 560; and we're now working in more than 20 schools on a wide range of partnership projects, focusing on numeracy, IT and career guidance, as well as reading. What's more, we've started to see some really exciting results.

Higher achievers and award winners

Over the last few years, academic results in Tower Hamlets have improved dramatically. In particular, one of our partner schools has performed astonishingly: Sir John Cass Foundation secondary came top of the government's league table of schools for the most improved GCSE results since 2000.

Of course, LCP volunteers can only take a small part of the credit for these remarkable achievements on the part of students, teachers, parents and governors. But we're proud to be involved in such an incredible success story.

And we're delighted, too, that our efforts to be good neighbours have won increasing recognition from leading bodies within both the charity and insurance sectors:

- In June, Lloyd's Community Programme won a Big Tick award in the national Business in the Community Awards for Excellence 2004
- In October, the LCP won the Lord Mayor's Dragon Award for our innovative new Police Mentoring scheme
- In December, we picked up the Insurance Day award for Charitable Initiative of the Year

Onward and upward

But there's absolutely no danger of us resting on our laurels. As the LCP continues to gain support and momentum, we're constantly developing new projects designed to make an even bigger contribution to the quality of life in the deprived boroughs close to the City.

And, a decade on, volunteers continue to widen the scope of their work in schools, developing new ways of enriching children's experience, from taking them on museum trips to organising sports activities, such as cricket coaching.

Through East London Business Alliance (ELBA), we've also become involved in community-based team challenges – one of which in 2004 involved 30 volunteers from across the Lloyd's market redecorating a Tower Hamlets community centre.

GIVING MONEY AS WELL AS TIME

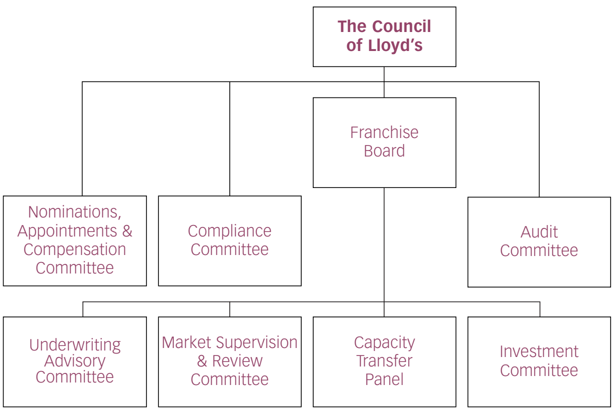
The Lloyd's Community Programme now has 46 member companies (up from 38 in 2003) who paid subscriptions totalling over £100,000 in 2004. This has enabled us to continue to give much needed financial support to our four key voluntary sector Community Partners: Tower Hamlets Education Business Partnership; the Royal National Theatre education project (which runs storytelling workshops for Tower Hamlets primary schools); East London Small Business Centre; and East London Business Alliance.

Lloyd's Community Programme member companies

Our warmest thanks go to:

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

Governance structure



THE COUNCIL

THE COUNCIL IS THE SOCIETY'S GOVERNING BODY.

Under the Lloyd's Act 1982, the Council of Lloyd's is responsible for the management and supervision of the market.

The Council normally has six working, six external and six nominated members. The working and external members are elected by the working and external members respectively. The Chairman and Deputy Chairmen are elected annually by the Council from among the working members of the Council. All members are approved by the FSA.

Although the Council discharges some of its functions directly, it acts by the Franchise Board in respect of the majority of those functions.

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

John Coldman
Deputy Chairman of Lloyd's
(Working member[†])

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

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

Nick Prettejohn
Chief Executive Officer of Lloyd's (Nominated member)

Steven Burns
Representative of Limit (No.2) Limited (External 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[*]) with effect from 16 March 2005

Nigel Hanbury
(Working member) with effect from 16 February 2005

Judith Hanratty
(Nominated member[†])

The Honorable Philip Lader
(Nominated member[‡])

Peter Morgan
Representative of AJSLP 9
(External member[‡†])

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

Preben Prebensen
Representative of Wellington (Five) Limited (External member) with effect from 25 February 2005

Andreas Prindl
(Nominated member)

David Shipley
(Working member[*])

‡ Member of Compliance Committee
* Member of Audit Committee
† Member of Nominations, Appointments and Compensation Committee

Council as at 6 April 2005

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.

The Board is chaired by the Chairman of the Council of Lloyd's. The Chief Executive Officer, Director, Finance and Risk Management and the Franchise Performance Director are also members. The Board currently has six non-executive directors appointed for their specialist knowledge and expertise.

Lord Levene
Chairman, Lloyd's

Nick Prettejohn
Chief Executive Officer of Lloyd's

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

* Member of Audit Committee

Franchise Board as at 6 April 2005

CORPORATE GOVERNANCE

The Council 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 global results, which are an aggregation of the accounts of all syndicates operating at Lloyd's, provide information about the financial performance of the market as a whole.

Together, the syndicates underwriting at Lloyd's form one of the world's largest commercial insurers and a leading global reinsurer. For the 2005 year of account, they have the capacity to accept insurance premiums of £13.7bn.

Governing body: The Council
Under Lloyd's Act 1982, the governing body of the market is the Council of Lloyd's. Under that 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 1982 Act.

Council members as at 6 April 2005 are listed on page 30. 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 and working and external members are generally elected for terms of three years by the working and external members of the Society respectively. Under the 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 Council may be regarded, for the purposes of the Combined Code, as independent members of Council with the exception of the Lloyd's Chief Executive Officer who is included within their number. One nominated member who retired from Council at the end of 2004 served as a member of Council for 14½ years. This was split between a five and a half year period of office and a second and final period of nine years which started three years after the end of the first period. 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 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 11 times in 2004 (including two joint meetings with the Franchise Board).

Attendance record:

Council member	Number of meetings attended
Peter Levene (Chairman)	11/11
Julian Avery	9/11
Steven Burns	9/11
Stephen Catlin	10/11
John Coldman	7/11
Sean Dalton	10/11
Christine Dandridge	9/11
Quentin Davies	11/11
Judith Hanratty	7/11
Bill Knight	10/11
Philip Lader	8/10
Bronek Masojada	8/11
Peter Morgan	11/11
Charles Philipps	9/11
Brian Pomeroy	10/11
Nick Prettejohn	9/11
Andreas Prindl	11/11
David Shipley	10/11

The Council in some cases discharges its functions itself. Only 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, Council also reserves to itself the right to appoint members of the Franchise Board and other committees of Council, on recommendation from the Nominations, Appointments and Compensation

Committee, and to review the budget and the Franchise Board's plan. 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 goal '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 will operate 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 the Financial Services Authority (FSA) requirements).

The members of the Franchise Board as at 6 April 2005 are listed on page 31. In 2004, the Franchise Board comprised the Chairman of Lloyd's, who was also its Chairman, the Chief Executive Officer, 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 four independent non-executives. The Franchise Board met 14 times in 2004 (including one all day off-site meeting and two joint meetings with the Council).

Attendance record:

Franchise Board member	Number of meetings attended
Peter Levene (Chairman)	14/14
Roy Brown	13/14
Steven Burns	13/14
Stephen Catlin	12/14
Edward Creasy	13/14
Judith Hanratty	10/14
Stephen Hodge	11/14
Andrew Moss	5/5
Nick Prettejohn	14/14
Luke Savage	5/5
Jim Stretton	13/14
Rolf Tolle	12/14

The Franchise Board has four main committees. These are:

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. MSARC 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.

MSARC met on six occasions in 2004.

Attendance record:

Committee member	Number of meetings attended
Judith Hanratty (Chairman)	6/6
Ian Agnew	4/5
David Gilchrist	6/6
Brian Pomeroy	4/6

Capacity Transfer Panel:

The Capacity Transfer Panel has been established principally to exercise 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 2004 met on five occasions.

Attendance record:

Committee member	Number of meetings attended
Andreas Prindl (Chairman)	5/5
Ralph Aldwinckle	3/5
Quentin Davies	4/5
Lady Delves Broughton	4/5
David Gittings	5/5
Ian Salter	3/5
Paul Swain	5/5

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 and strategic underwriting and risk issues. It met on four occasions in 2004.

Attendance record:

Committee member	Number of meetings attended
Jim Stretton (Chairman)	4/4
Gary Bass	4/4
Andrew Carrier	3/4
Tony Holt	4/4
Christopher Klein	1/1
Robin Mitra	1/1
Nigel Roberts	1/4
Oliver Sparrow	4/4

CORPORATE GOVERNANCE

Investment Committee:
The Investment Committee reviews and approves investment parameters for all investment assets managed by Lloyd's centrally. It also reviews the investment activities and performance of the Lloyd's Treasury Department, approves all investment counterparties, and may make more general recommendations concerning investment activity at Lloyd's. It met on four occasions in 2004.

Attendance record:

Committee member	Number of meetings attended
Andreas Prindl (Chairman)	4/4
Lady Delves Broughton	4/4
Alex Foster	2/4
Richard Hextall	4/4
Andrew Moss	1/1
Luke Savage	1/1

Other Principal Committees of Council
Compliance Committee:
The Compliance Committee's role is to examine the effectiveness of the Franchise Board in performing its functions and exercising its powers in accordance with its terms of reference. The objectives of the Compliance Committee are to ensure that the Franchise Board is in compliance with the Financial Services and Markets Act 2000 and the FSA Handbook and to ensure that the Franchise Board is operating in accordance with the Franchise Principles. The Compliance Committee met five times in 2004.

Attendance record:

Committee member	Number of meetings attended
Bill Knight (Chairman)	5/5
Christine Dandridge	4/4
Paul Kelly	1/1
Philip Lader	2/3
Bronek Masojada	2/5
Peter Morgan	4/4
Charles Philipps	4/5
David Robson	0/1

Audit Committee:
The Committee's role includes ensuring that the financial activities of Lloyd's are subject to independent review and audit. The Committee also reviews Lloyd's annual financial statements, the global results and principal regulatory filings. The Chief Executive Officer, the Director Finance and Risk Management, the Financial Controller and the 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 Committee met four times in 2004.

Attendance record:

Committee member	Number of meetings attended
Brian Pomeroy (Chairman)	4/4
Steven Burns	3/4
Sean Dalton	3/4
Stephen Hodge	3/4
Bill Knight	4/4
David Shipley	4/4

Nominations, Appointments and Compensation Committee:
The Committee is principally responsible for making recommendations to the Council on the appointment of the Chairman, Chief Executive Officer, new nominated Council members, Franchise Board members (including the Director, Finance and Risk Management and the Franchise Performance Director) and the members of a number of Council and Franchise Board committees. It also makes recommendations on the remuneration of the members of these bodies, including the Chairman, Chief Executive Officer, Director, Finance and Risk Management and the Franchise Performance Director. The Committee is also responsible for succession planning arrangements for these positions. The Committee met six times in 2004.

Attendance record:

Committee member	Number of meetings attended
Bill Knight (Chairman)	6/6
Julian Avery	5/6
Stephen Catlin	3/6
John Coldman	4/6
Judith Hanratty	3/6
Bronek Masojada	5/6
Peter Morgan	6/6

The terms of reference of the Audit Committee and the Nominations, Appointments and Compensation Committee are available from the Secretary to the Council on request.

Performance assessment
An evaluation of the 2004 performance of the Council and its principal committees (defined for this purpose as the Franchise Board, the Compliance Committee, the Audit Committee and the Nominations, Appointments and Compensation Committee) was undertaken. The evaluation also covered the performance of Council and committee members.

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 2004 performance. These discussions were based around the Performance Evaluation Guidance appended to the Combined Code.

The principal conclusion of the process was that the current governance arrangements were working well but that there was scope to redefine Council's role within the arrangements. To that end, the Council has concluded that it will devote more of its time to a consideration of the medium to long term strategy for the Society as developed by the Franchise Board.

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

Authority to act

The Franchise Board may act through the Chief Executive Officer, 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 Chief Executive Officer, the directors and the 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 also 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, marketing, systems, 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 of Lloyd's 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.

PRO FORMA ANNUAL ACCOUNTING STATEMENT

The information on pages 38 to 43 does not form part of the global results as required under the Lloyd's Sourcebook issued by the Financial Services Authority under the Financial Services and Markets Act 2000. It is included in order to present the aggregated results of the Lloyd's market on a basis that is broadly comparable with general insurance companies.

Under current legislation, Lloyd's is obliged to account on a three year basis as at 31 December 2004. While this forms the basis of the distribution of profits and collection of losses, it does mean that the market results are not readily comparable with those of insurance companies. Lloyd's therefore requires syndicates to provide results on an annual accounting basis, as well as the statutory three year basis.

In the balance sheet, the shareholders' funds attributable to equity interests, or capital and reserves, are represented by 'Syndicate profits/(losses) due to/(from) members', 'Members' Funds at Lloyd's', 'Central Fund Balance' and 'Corporation Reserves'. In addition, Lloyd's issued subordinated loan notes in 2004 which represent capital for meeting policyholder claims. Taken together with the subordinated loan notes they are referred to in the pro forma balance sheet as 'Capital, reserves and subordinated loan notes'. Members' funds at Lloyd's are described in detail in the section 'Security underlying policies issued at Lloyd's' (pages 55 to 59). 'Syndicate profits/(losses) due to/(from) members' represents syndicate results declared on an annual accounting basis, which have not yet been distributed to/(or collected from) members. 'Central Fund Balance' and 'Corporation Reserves' represent the net assets of the Central Fund and Corporation respectively (pages 108 and 83 respectively). These items reflect key differences in the capital structure between the Lloyd's market and unitary insurance companies.

While Lloyd's considers the pro forma results presented to be a reasonable representation of the financial results for the calendar year 2004, it is possible that the market result would be different if a full annual accounting regime were adopted.

There is still a substantial degree of uncertainty attaching to the ultimate gross and net liabilities arising from the catastrophic loss on September 11, 2001 though the market's estimates have shown considerable stability on a gross and net basis. A number of syndicate auditors' opinions reflect this uncertainty, although all of them were unqualified. This is to be expected, since Lloyd's, together with the rest of the industry, is faced with uncertainties arising from related legal disputes, reinsurance collectability issues and the emergence of further information as well as the impact of future economic conditions when establishing reserves in respect of this loss.

Lloyd's has made central adjustments in preparing the pro forma annual accounting results in order that these results may bear more realistic comparison to general insurance companies. They include a notional investment return on funds at Lloyd's and a reflection of the transactions and net assets of the Corporation of Lloyd's and the Lloyd's Central Fund, including the financial effect of the Central Fund insurance settlement. These adjustments are explained in note 1C on page 40.

REPORT OF ERNST & YOUNG LLP TO THE COUNCIL OF LLOYD'S ON THE PRO FORMA ANNUAL ACCOUNTING STATEMENT

We have reviewed the balance sheet, technical and non-technical accounts, segmental reporting and notes 1-3 (taken together the Pro Forma Annual Accounting Statement – PFAAS) in respect of business transacted by Lloyd's for the year ended 31 December 2004.

The PFAAS, which has been prepared under the historical cost convention (as modified by the valuation of investments at market value) includes the results and the financial position at 31 December 2004 of all syndicates which transacted business during the year and is based on returns from those syndicates as set out in notes 1A and 1B, together with central adjustments in relation to the capital base, investment income and expenses as set out in note 1C.

This report is made solely to the Council of Lloyd's in accordance with its instructions to us set out under 'Respective responsibilities of the Council of Lloyd's and Ernst & Young LLP' below. 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 addressees of this report for our work, for this report, or for the opinions 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 of the PFAAS.

You have instructed us to form an opinion on whether the PFAAS has been drawn up in accordance with the basis of preparation notes and presents a reasonable representation of the market results and state of affairs on an annual accounting basis broadly comparable with general insurance companies and to report our opinion to you.

Basis of review opinion

Our review consisted principally of making enquiries of Lloyd's and applying analytical procedures to the financial information and underlying financial data. A review excludes audit procedures such as tests of controls and verification of assets, liabilities and transactions as stated in the PFAAS. It is substantially less in scope than an audit performed in accordance with Auditing Standards and therefore provides a lower level of assurance than an audit. In addition, the PFAAS has been compiled from syndicate returns on which syndicate auditors have given review opinions (on which we have relied absolutely) as described in note 1B. Those auditors' reports indicate that the returns are free from material misstatement. We have not audited those returns. Further, the central adjustments set out in note 1C have not been audited. Consequently, we do not express an audit opinion on the financial information set out in the PFAAS.

We also read the PFAAS in order to assess whether it expresses clearly the uncertainties inherent in the preparation of the PFAAS.

Opinion

On the basis of the review set out above, in our opinion, the PFAAS has been drawn up in accordance with the basis of preparation notes and presents a reasonable representation of the market results and state of affairs on an annual accounting basis broadly comparable with general insurance companies.

Ernst & Young LLP

Ernst & Young LLP, London

6 April 2005

PRO FORMA ANNUAL ACCOUNTING RESULT

for the year ended 31 December 2004

Pro forma annual accounting technical account	**2004 £m**	**2004 £m**	2003 £m	2003 £m
Gross premiums written – continuing operations		**14,402**		15,702
– discontinued operations		**311**		720
		14,713		16,422
Outward reinsurance premiums		**(2,908)**		(4,172)
Premiums written, net of reinsurance		**11,805**		12,250
Change in the gross provision for unearned premiums	**290**		(246)	
Change in provision for unearned premiums, reinsurers' share	**(306)**		(293)	
		(16)		(539)
Earned premiums, net of reinsurance		**11,789**		11,711
Allocated investment return transferred from the non-technical account		**536**		445
		12,325		12,156
Claims paid				
Gross amount	**8,281**		9,204	
Reinsurers' share	**(2,981)**		(3,661)	
		5,300		5,543
Change in provision for claims				
Gross amount	**1,556**		(108)	
Reinsurers' share	**811**		1,262	
		2,367		1,154
Claims incurred, net of reinsurance		**7,667**		6,697
Acquisition costs	**2,801**		3,038	
Administrative expenses	**900**		854	
Loss on exchange	**51**		30	
Operating expenses		**3,752**		3,922
Balance on the technical account for general business		**906**		1,537
Attributable to:				
Continuing operations		**1,669**		1,866
Discontinued operations		**(763)**		(329)
Total		**906**		1,537
Pro forma annual accounting non-technical account				
Balance on the technical account for general business		**906**		1,537
Syndicate investment return	**536**		445	
Investment return on funds at Lloyd's	**487**		448	
Other investment returns and other income	**148**		127	
	1,171		1,020	
Allocated investment return to the technical account	**(536)**		(445)	
		635		575
Other expenses		**(184)**		(220)
Pro forma profit on ordinary activities before tax		**1,357**		1,892

There are no recognised gains or losses in the year other than those dealt with in the technical and non-technical accounts.

PRO FORMA ANNUAL ACCOUNTING BALANCE SHEET

as at 31 December 2004

	2004 £m	2004 £m	2003 £m	2003 £m
Financial investments				
Shares and other variable yield securities	**1,753**		1,626	
Debt securities and other fixed income securities	**14,992**		12,221	
Participation in investment pools	**407**		256	
Loans and deposits with credit institutions	**890**		704	
Deposits with ceding undertakings	**9**		14	
Members' funds at Lloyd's	**9,622**		9,659	
Other investments	**34**		23	
Total investments		**27,707**		24,503
Reinsurers' share of technical provisions				
Claims outstanding	**9,001**		9,959	
Unearned premiums	**875**		1,221	
		9,876		11,180
Debtors				
Debtors arising out of direct operations	**3,250**		3,694	
Debtors arising out of reinsurance operations	**3,654**		3,972	
Other debtors	**402**		469	
		7,306		8,135
Other assets				
Tangible assets	**15**		15	
Cash at bank and in hand	**2,325**		2,140	
Overseas deposits	**1,330**		1,250	
Other	**74**		70	
		3,744		3,475
Prepayments and accrued income				
Accrued interest and rent	**73**		39	
Deferred acquisition costs	**1,438**		1,467	
Other prepayments and accrued income	**104**		104	
		1,615		1,610
Total assets		**50,248**		48,903
Capital, reserves and subordinated loan notes				
Members' funds at Lloyd's	**9,622**		9,659	
Syndicate profits/(losses) due to/(from) members	**1,363**		(295)	
Central Fund balance	**556**		711	
Corporation reserves	**122**		70	
Capital and reserves	**11,663**		10,145	
Subordinated loan notes	**506**		–	
		12,169		10,145
Technical provisions				
Provision for unearned premiums	**6,769**		7,335	
Claims outstanding	**28,144**		27,758	
		34,913		35,093
Deposits received from reinsurers		**37**		92
Creditors				
Creditors arising out of direct insurance operations	**487**		446	
Creditors arising out of reinsurance operations	**1,742**		2,264	
Amounts owed to credit institutions	**7**		14	
Other creditors including taxation	**703**		718	
		2,939		3,442
Accruals and deferred income		**190**		131
Total liabilities		**50,248**		48,903

Signed on behalf of the Council of Lloyd's on 6 April 2005

Lord Levene of Portsoken, Chairman

Nick Prettejohn, Chief Executive Officer

NOTES TO THE PRO FORMA ANNUAL ACCOUNTING STATEMENT

as at 31 December 2004

1. Basis of preparation notes

A Basis of reporting

The purpose of the Pro Forma Annual Accounting Statement (PFAAS) is to present a technical and a non-technical account and balance sheet information on a basis broadly comparable with the general insurance industry. The result of the Lloyd's market on an annual accounting basis for the year ended 31 December 2004 shown in the PFAAS has been determined by aggregating the results as reported separately by all syndicates in their returns. 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. The result presented is before tax and does not include any adjustments that would be necessary to disclose a post-tax position.

The PFAAS has been prepared under the historical cost convention as modified by the valuation of investments at market value.

B Aggregation process

The PFAAS has been compiled from syndicate returns prepared by managing agents and reported on by syndicate auditors, and other information for central adjustments. The reports by syndicate auditors on the syndicate returns are required to state whether those returns have been properly prepared in accordance with the instructions issued by Lloyd's and are free from material misstatement. Relevant accounting policies which were included within the instructions are set out in note 2 on page 41.

C Central adjustments

Lloyd's has made central adjustments in preparing the PFAAS. The objective of these adjustments is to present the results on a basis broadly comparable to other general insurance companies.

- Return on funds at Lloyd's: Syndicates' investment return has been wholly credited to the technical account. A notional investment return on average funds at Lloyd's during the period has been included in the non-technical account. This notional investment return is based on returns applicable to different classes of assets held as funds at Lloyd's. This adjustment resulted in the inclusion of an investment return of £487m (2003: £448m) in the non-technical account.

- Inclusion of the transactions and net assets of the Lloyd's Central Fund and the Corporation of Lloyd's: The Central Fund is described in the section 'Security underlying policies issued at Lloyd's' but in summary has been established to meet policyholders' claims in the event of members being unable to meet their underwriting liabilities. The PFAAS result for the Lloyd's market includes the transactions of the Central Fund, including the financial impact of the Central Fund insurance settlement. The financial statements of the Corporation of Lloyd's demonstrate its income and expenditure and financial position to the members. The PFAAS result reflects the overall performance of the market and all its activities and has, therefore, been adjusted to include the Corporation's results. These adjustments have resulted in a net loss of £3m (2003: £590m profit) in the technical account and a net loss of £36m (2003: £93m loss) in the non-technical account.

- Funds at Lloyd's: Included in the balance sheet are members' funds at Lloyd's. These are described in more detail on page 56 but in summary the assets in funds at Lloyd's must be readily realisable and may include letters of credit and bank and other guarantees.

D Variability

Calendar year movements in reserves are based upon best estimates as at 31 December 2004 taking into account all available information as at the balance sheet date. These estimates will be subject to variability until the date at which the underlying claims are settled. Such changes in best estimate will be reflected in the technical account of the year in which they occur.

E Syndicate profits/(losses) due to/(from) members

The syndicate profits/(losses) due to/(from) members represents syndicate results declared on an annual accounting basis, which have not yet been distributed to members. It excludes the funds at Lloyd's which have been lodged by members in support of their underwriting and the central assets which are disclosed separately.

F Discontinued operations

Discontinued operations represent syndicates that have ceased trading and have no natural successor syndicate. The analysis does not include discontinued business lines within ongoing syndicates.

The continuing/discontinued analysis of gross premiums written and balance on the technical account for the 2003 comparatives have been amended to reflect those syndicates that were classified as continuing at 31 December 2003 but which, at 31 December 2004, are classified as discontinued.

G September 11

Included in the reserves are amounts relating to losses arising from the events of 11 September 2001. Whilst the reserves for September 11 losses are based upon best estimates as at the balance sheet date they create an additional level of uncertainty over and above that normally associated with reserving for insurance business.

2. Accounting policies notes

Managing agents have completed the syndicate returns using the principles set out in the accounting policies below. These policies, as regards underwriting transactions, are consistent with the recommendations of the Statements of Recommended Practice on Accounting for Insurance Business issued by the Association of British Insurers modified to reflect the unique structure of Lloyd's.

Premiums

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

Unearned premiums

The provision for unearned premiums represents that part of gross premiums written and the reinsurers' share that is estimated to be earned after the balance sheet date. Premiums are deemed to be earned over the period of cover under each policy having regard to the nature of the business written and the related spread of risk.

Deferred acquisition costs

Acquisition costs are deferred and amortised over the period in which the premium is earned. Deferred acquisition costs represent the proportion of acquisition costs incurred in respect of unearned premiums at the balance sheet date. Such costs include brokerage and expenses which relate to the acquisition of business.

Claims

Claims incurred comprise claims and claims handling expenses paid in the year and the movement in provision for outstanding claims including an allowance for the cost of claims incurred as at the balance sheet date but not reported. Included in the provision is an estimate of the cost of handling outstanding claims and claims incurred as at the balance sheet date but not reported. Explicit discounting of outstanding claims, including the costs of handling those claims, has been excluded.

Unexpired risk provision

A provision for unexpired risks is made when it is anticipated that unearned premiums will be insufficient to meet future claims and claims settlement expenses of business in force at the period end. Syndicates made the assessment of whether an unexpired risk provision was necessary based on the business of the syndicate as a whole across all years of account. The provision for unexpired risks is included within technical provisions in the balance sheet.

Profit commission

Profit commission due to the managing agent is recognised pro rata to the recognition of underwriting results on an annual basis.

Exchange rates

Syndicate assets and liabilities expressed in convertible currencies are translated at the rates of exchange ruling at 31 December. Income and expenditure transactions are translated using average exchange rates. Underwriting transactions in other foreign currencies are included in the accounts at historical rates. All differences on the translation of foreign currency amounts are dealt with in the technical account.

Investments

Listed investments are shown at market value.

Investment Return

The investment return comprises investment income, investment gains less losses realised and unrealised, and is net of investment expenses and charges. That element of the investment return that arises from underwriting activities has been transferred to the technical account.

As noted in note 1C, the non-technical account includes a notional return on funds at Lloyd's. The calculation of this figure is explained in note 1C.

NOTES TO THE PRO FORMA ANNUAL ACCOUNTING STATEMENT continued

as at 31 December 2004

Taxation

No provision has been made for United Kingdom taxation on the result shown in the underwriting account.

3. Capital, reserves and subordinated loan notes	2004 £m	2003 £m
The movements in capital, reserves and subordinated loan notes were as follows:		
Capital and reserves at 1 January	**10,145**	7,509
Profit before tax	**1,357**	1,892
Net (profits paid)/cash calls received(1)	**793**	823
Net purchases/(sales)/revaluation of FAL(2)	**(524)**	243
Undertakings/drawdowns to meet members losses(3)	**(152)**	(190)
Taxation credit/(charge)(4)	**64**	(89)
Exchange difference	**(23)**	(44)
Unrealised gains/(losses) during the year(5)	**3**	1
Capital and reserves at 31 December	**11,663**	10,145
Issue of subordinated loan notes	**506**	–
Capital, reserves and subordinated loan notes at 31 December	**12,169**	10,145

(1) Net (profits paid)/cash calls received represent the aggregate of syndicate profits paid to, and cash calls to fund syndicate losses received from, members in 2004. The net figure is an overall receipt as members funded their losses on the 2001 (2000) year of account that closed at 31 December 2003 (2002).

(2) Net purchases/(sales)/revaluation of FAL represents the movement in members' funds at Lloyd's, including actual investment return on FAL where retained, new monies provided, funds withdrawn, and the notional return of £487m (2003: £448m) reported in the non-technical account.

(3) Undertakings/drawdowns to meet members losses represent payments and provisions made in the Central Fund financial statements for losses of insolvent members (see notes 8 and 13 of the Central Fund financial statements). The undertakings/drawdowns figure is gross of the credit for £17m (2003: £110m) insurance recoveries within the Central Fund.

(4) Taxation credit/(charge) represents the current and deferred tax of the Corporation (note 10 to the Corporation financial statements) and of the Central Fund (note 11 of the Central Fund financial statements).

(5) Unrealised gains/(losses) during the year represent the unrealised gains on the revaluation of other investments and on the disposal of subsidiaries as reported in the Corporation financial statements (see notes 14 and 21 respectively in the Corporation financial statements).

(6) Following the closure of the 2002 year of account at 31 December 2004, there will be a significant transfer of syndicate profits to members in 2005, although this will be offset to some degree by further cash calls by syndicates to fund losses on 2001 and prior years of account. Following the amendments to the Release Test, introduced for 2005, the profits arising on the 2002 year of account are expected to generate a significant release of profits from Lloyd's.

SEGMENTAL REPORTING

as at 31 December 2004

	Direct										
	Accident and health £m	Motor (third party liability) £m	Motor (other classes) £m	Marine aviation and transport £m	Fire and other damage to property £m	Third party liability £m	Life £m	Other £m	Total direct £m	Re-insurance accepted £m	Total £m
2004											
Gross premiums written	**465**	**129**	**885**	**2,219**	**3,008**	**3,331**	**85**	**251**	**10,373**	**4,340**	**14,713**
Gross premiums earned	**460**	**127**	**911**	**2,273**	**3,079**	**3,557**	**40**	**289**	**10,736**	**4,267**	**15,003**
Gross claims incurred	**331**	**93**	**644**	**1,222**	**1,862**	**2,678**	**20**	**420**	**7,270**	**2,567**	**9,837**
Gross operating expenses	**137**	**31**	**207**	**574**	**840**	**898**	**15**	**79**	**2,781**	**971**	**3,752**
Gross technical result	**(8)**	**3**	**60**	**477**	**377**	**(19)**	**5**	**(210)**	**685**	**729**	**1,414**
Reinsurance balance	**(15)**	**8**	**(6)**	**(185)**	**(241)**	**(136)**	**(4)**	**66**	**(513)**	**(531)**	**(1,044)**
Net technical result	**(23)**	**11**	**54**	**292**	**136**	**(155)**	**1**	**(144)**	**172**	**198**	**370**
Allocated investment return											**536**
Balance on technical account											**906**
Net technical provisions	**890**	**330**	**1,396**	**2,945**	**3,520**	**8,373**	**93**	**789**	**18,336**	**6,701**	**25,037**
2003											
Gross premiums written	470	148	986	2,329	3,878	4,135	68	374	12,388	4,034	16,422
Gross premiums earned	518	179	1,107	2,323	3,662	3,843	64	421	12,117	4,059	16,176
Gross claims incurred	376	155	741	997	1,461	2,939	27	323	7,019	2,077	9,096
Gross operating expenses	177	42	262	583	879	908	33	96	2,980	942	3,922
Gross technical result	(35)	(18)	104	743	1,322	(4)	4	2	2,118	1,040	3,158
Reinsurance balance	(48)	14	11	(477)	(800)	(83)	(2)	(76)	(1,461)	(605)	(2,066)
Net technical result	(83)	(4)	115	266	522	(87)	2	(74)	657	435	1,092
Allocated investment return											445
Balance on technical account											1,537
Net technical provisions	1,131	507	1,228	2,454	3,187	8,377	66	1,005	17,955	5,958	23,913

REPORT OF ERNST & YOUNG LLP TO THE COUNCIL OF LLOYD'S ON THE 2004 GLOBAL RESULTS

We have reviewed the global results for the year ended 31 December 2004 which comprise the global balance sheet, the underwriting account for the 2002 and prior years of account, the underwriting accounts for the 2002, 2003 and 2004 years of account respectively, and the related notes 1 to 16. These global results have been prepared on the basis of the accounting policies set out therein.

This report is made solely to the Council of Lloyd's in accordance with its instructions to us set out under 'Respective responsibilities of the Council of Lloyd's and Ernst & Young LLP' below. 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 opinions we have formed.

Respective responsibilities of the Council of Lloyd's and Ernst & Young LLP

Lloyd's is responsible for the preparation of the global results, which are approved by the Council of Lloyd's, in accordance with the Lloyd's Sourcebook issued by the Financial Services Authority under the Financial Services and Markets Act 2000.

Our responsibility is to review the global results and report to you our opinion as to whether the global results have been properly prepared in accordance with the Lloyd's Sourcebook.

Basis of review opinion

Our review consisted principally of making enquiries of Lloyd's and applying analytical procedures to the financial information and underlying financial data and, based thereon, assessing whether the global results have been properly prepared in accordance with the Lloyd's Sourcebook. A review excludes audit procedures such as tests of controls and verification of assets, liabilities and transactions as stated in the global results. It is substantially less in scope than an audit performed in accordance with Auditing Standards and therefore provides a lower level of assurance than an audit. In addition, the global results have been compiled from syndicate returns on which syndicate auditors and syndicate actuaries have reported. We have relied absolutely on those reports by syndicate auditors and syndicate actuaries. We have not audited those returns. Consequently, we do not express an audit opinion on the financial information set out in the global results.

Opinion

On the basis of the review described above, in our opinion the global results have been properly prepared in accordance with the Lloyd's Sourcebook.

Ernst & Young LLP

Ernst & Young LLP, London
6 April 2005

2002 AND PRIOR YEARS OF ACCOUNT

as at 31 December 2004

		2002 year of account		2001 and prior years of account	
2001 and prior years of account Total £m		Pure year result £m	Movement on years of account reinsured therein £m	Calendar year movement on run-off years of account £m	**Total £m**
11,085	Gross premiums written (net of brokerage)	11,319	111	98	**11,528**
4,293	Outward reinsurance premiums	3,783	47	139	**3,969**
6,792	Net premiums	7,536	64	(41)	**7,559**
6,023	Reinsurance to close premiums received from earlier years of account	–	6,236	–	**6,236**
2,792	Amounts retained to meet all known and unknown outstanding liabilities brought forward	–	–	4,612	**4,612**
15,607		7,536	6,300	4,571	**18,407**
11,196	Gross claims paid	3,340	2,481	1,578	**7,399**
5,096	Reinsurers' share	726	1,291	727	**2,744**
6,100	Net claims	2,614	1,190	851	**4,655**
6,661	Reinsurance premiums paid to close the year of account	2,178	4,733	402	**7,313**
4,822	Amounts retained to meet all known and unknown outstanding liabilities carried forward	304	622	3,668	**4,594**
17,583		5,096	6,545	4,921	**16,562**
(1,976)	**Underwriting result**	2,440	(245)	(350)	**1,845**
(1,976)		2,195		(350)	**1,845**
30	Profit on exchange	69		27	**96**
(658)	Syndicate operating expenses	(667)		(44)	**(711)**
(2,604)	**Balance on technical account**	1,597		(367)	**1,230**
600	Investment income	529		109	**638**
(18)	Investment expenses and charges	(13)		(2)	**(15)**
(60)	Investment gains less losses	(88)		(40)	**(128)**
(2,082)	**Result before personal expenses**	2,025		(300)	**1,725**
(296)	**Personal expenses**	(532)		–	**(532)**
(2,378)	**Result after personal expenses**	1,493		(300)	**1,193**

UNDERWRITING ACCOUNT FOR THE 2002 YEAR OF ACCOUNT

after three years as at 31 December 2004

2001 at 36 months £m		2002 at 24 months £m	2002 Change in calendar year £m	**2002 at 36 months £m**
11,263	Syndicate allocated capacity	13,239	–	**13,239**
11,001	Gross premiums written (net of brokerage)	11,430	–	**11,430**
4,071	Outward reinsurance premiums	3,817	13	**3,830**
6,930	Net premiums	7,613	(13)	**7,600**
5,857	Reinsurance to close premiums received from earlier years of account	6,477	(241)	**6,236**
12,787		14,090	(254)	**13,836**
10,113	Gross claims paid	2,318	3,503	**5,821**
4,612	Reinsurers' share	467	1,550	**2,017**
5,501	Net claims	1,851	1,953	**3,804**
6,093	Reinsurance premiums paid to close the year of account	–	6,911	**6,911**
2,840	Amounts retained to meet all known and unknown outstanding liabilities	–	926	**926**
14,434		1,851	9,790	**11,641**
(1,647)	**Underwriting balance/result**	12,239	(10,044)	**2,195**
11	Profit on exchange	45	24	**69**
(634)	Syndicate operating expenses	(639)	(28)	**(667)**
(2,270)	**Balance on technical account**	11,645	(10,048)	**1,597**
527	Investment income	217	312	**529**
(17)	Investment expenses and charges	(7)	(6)	**(13)**
(38)	Investment gains less losses	(37)	(51)	**(88)**
(1,798)	**Balance/result before personal expenses**	11,818	(9,793)	**2,025**
(295)	**Personal expenses**	(372)	(160)	**(532)**
–	**Balance after personal expenses**	11,446	(9,953)	**–**
(2,093)	**Result after personal expenses**	–	–	**1,493**

UNDERWRITING ACCOUNT FOR THE 2003 YEAR OF ACCOUNT

after two years as at 31 December 2004

2002 at 24 months £m		at 12 months £m	2003 Change in calendar year £m	**at 24 months £m**
13,239	Syndicate allocated capacity	14,859	–	**14,859**
11,430	Gross premiums written (net of brokerage)	8,622	3,022	**11,644**
3,817	Outward reinsurance premiums	2,622	583	**3,205**
7,613	Net premiums	6,000	2,439	**8,439**
6,477	Reinsurance to close premiums received from earlier years of account	117	6,993	**7,110**
14,090		6,117	9,432	**15,549**
2,318	Gross claims paid	507	1,746	**2,253**
467	Reinsurers' share	107	361	**468**
1,851	Net claims	400	1,385	**1,785**
12,239	**Underwriting balance**	5,717	8,047	**13,764**
45	Profit on exchange	9	13	**22**
(639)	Syndicate operating expenses	(551)	(88)	**(639)**
11,645	**Balance on technical account**	5,175	7,972	**13,147**
217	Investment income	57	186	**243**
(7)	Investment expenses and charges	(4)	(3)	**(7)**
(37)	Investment gains less losses	(16)	(30)	**(46)**
11,818	**Balance on open year of account before personal expenses**	5,212	8,125	**13,337**
(372)	**Personal expenses**	(414)	6	**(408)**
11,446	**Balance on open year of account after personal expenses**	4,798	8,131	**12,929**

The balance on the 2003 year of account is prepared using the three year accounting method described in note 2A and excludes any estimation for future claims and hence does not purport to show a profit or loss.

UNDERWRITING ACCOUNT FOR THE 2004 YEAR OF ACCOUNT

after one year as at 31 December 2004

2003 at 12 months £m		**2004 at 12 months £m**
14,859	Syndicate allocated capacity	**15,092**
8,622	Gross premiums written (net of brokerage)	**8,124**
2,622	Outward reinsurance premiums	**2,009**
6,000	Net premiums	**6,115**
117	Reinsurance to close premiums received from earlier years of account	**66**
6,117		**6,181**
507	Gross claims paid	**1,041**
107	Reinsurers' share	**206**
400	Net claims	**835**
5,717	**Underwriting balance**	**5,346**
9	Profit on exchange	**4**
(551)	Syndicate operating expenses	**(451)**
5,175	**Balance on technical account**	**4,899**
57	Investment income	**59**
(4)	Investment expenses and charges	**(4)**
(16)	Investment gains less losses	**(9)**
5,212	**Balance on open year of account before personal expenses**	**4,945**
(414)	**Personal expenses**	**(494)**
4,798	**Balance on open year of account after personal expenses**	**4,451**

The balance on the 2004 year of account is prepared using the three year accounting method described in note 2A and excludes any estimation for future claims and hence does not purport to show a profit or loss.

GLOBAL BALANCE SHEET

as at 31 December 2004

2003 £m		Notes	2004 £m
	Assets		
14,172	Financial investments	3	**16,867**
14	Deposits with ceding undertakings		**9**
5,173	Debtors	4	**3,886**
3,481	Other assets	6	**3,693**
91	Prepayments and accrued income		**143**
22,931	**Total assets**		**24,598**
	Liabilities		
(2,093)	Result for the 2002 year of account	7	**1,493**
(285)	Result for the 2001 and prior run-off years of account	8	**(300)**
(2,378)			**1,193**
(290)	Balance of net uncalled deficiency on run-off years of account		**(501)**
	Balances on open years of account:		
11,446	Balance on 2003 year of account		**12,929**
4,798	Balance on 2004 year of account		**4,451**
4,822	Reserves retained in respect of run-off years of account		**4,594**
92	Deposits received from reinsurers		**37**
4,371	Creditors	9	**1,830**
70	Accruals and deferred income		**65**
22,931	**Total liabilities**		**24,598**

Signed on behalf of the Council of Lloyd's on 6 April 2005

Lord Levene of Portsoken, Chairman

Nick Prettejohn, Chief Executive Officer

NOTES TO THE GLOBAL RESULTS

as at 31 December 2004

1. Basis of preparation of global results

A Basis of reporting

The global results, comprising the underwriting accounts and the balance sheet, have been compiled from syndicate returns prepared by managing agents and reported on by syndicate auditors and other information and comply with the requirements of Regulation 4 of the Insurance Accounts Directive (Miscellaneous Insurance Undertakings) Regulations 1993.

B Aggregation of syndicate results

The global results of the Lloyd's market as at 31 December 2004 are determined by aggregating the results as reported by all syndicates in their returns. The global results do not present a consolidated view of Lloyd's business. These results include 93 syndicates which underwrote for the 2002 year of account (2001: 112 syndicates) together with the calendar year results of 97 prior years of account in run-off during 2004 (2003: 98 years of account in run-off).

The global results show the balances on the open years 2003 and 2004. In keeping with the three year accounting method described in note 2A below, these balances exclude any estimation for future claims, and hence do not purport to show a profit or loss.

2. Statement of accounting policies

A Three-year accounting method

The underwriting accounts are prepared using the three-year accounting method and are held open for a minimum of three years from the commencement of each underwriting year. By the end of the three-year period, outstanding liabilities can normally be determined with sufficient accuracy to permit the year of account to be closed by payment of a reinsurance to close premium to the successor syndicate. The two most recent years of account remain open under this accounting method, allowing further premium and claim transactions to be taken into account. The balances on the open years do not purport to give any indication of the likely profit or loss that may be determined when these years of account are finally closed.

B Premiums

Gross premiums, net of brokerage and commission, are allocated to years of account on the basis of the inception date of the policy. Gross premiums and reinsurance premiums include premiums in respect of inter-syndicate reinsurances. Commission and brokerage are charged to the same year of account to which the relevant policy is allocated. Premiums in respect of reinsurance ceded are either attributed to the same year as the original risk being protected or the year insured by the reinsurance policy as approved by the underwriter.

C Claims

Gross claims, defined as claims under contracts of insurance underwritten by the members of a syndicate plus internal and external claims settlement expenses less salvage or other recoveries, but before the deduction of reinsurance recoveries are allocated to the same year of account as that to which the corresponding premiums are allocated. Reinsurance recoveries are normally allocated to the year of account to which the claim was charged.

D Reinsurance to close

A year of account is normally closed at the end of the third year by the payment of a reinsurance to close premium to a successor syndicate. This premium is determined by reference to outstanding liabilities, including claims incurred but not yet reported, relating to the closed year and to all previous closed years reinsured therein. Although the estimate of net outstanding liabilities is considered to be fair and reasonable, it is implicit in the estimation procedure that the ultimate liabilities will be at variance from the premium so determined.

E Reserves retained in respect of run-off years of account

Where substantial uncertainties affect the assessment of the outstanding liabilities, a year of account might not be closed. In such cases, an amount to meet all known and unknown outstanding liabilities is retained at each year-end until the year of account is finally closed. Such an account is referred to as a run-off year of account. As at 31 December 2004 there were 104 years of account in run-off (31 December 2003: 97 years of account in run-off).

F Return on investments

The gross investment return, comprising income and investment gains less losses, net of investment expenses and charges, arising in a calendar year, is normally allocated to years of account in proportion to the average funds available for investment attributable to those years. Investments are stated at the market value ruling at the balance sheet date.

G Syndicate operating expenses

Syndicate operating expenses are normally allocated to the year of account for which they are incurred. The expenses of the open years of account are those incurred to date and are not finalised until the account is closed.

H Basis of currency translation

Underwriting business conducted in US and Canadian dollars, and other non-sterling settlement currency, is translated into sterling at the rate of exchange ruling at the year end. Other currency transactions are translated into sterling at the rate ruling at the time that those transactions are processed through the Lloyd's central accounting system.

I Taxation

The results are disclosed gross of all direct taxation. Managing agents are not required to deduct basic rate income tax from trading income of syndicates and any basic rate tax deducted at source from syndicates' investment income is recoverable by the managing agents and included in the amounts distributable to members. Consequently no charges to UK taxation are shown in the global results.

J Underwriting account for run-off years

All transactions in respect of years of account in run-off at the preceding year end are included on the basis of calendar year movements only.

3. Financial investments	2004 £m	2003 £m
Shares and other variable-yield securities	**1,537**	1,434
Debt securities and other fixed-income securities	**14,270**	12,087
Participation in investment pools	**398**	256
Loans guaranteed by mortgage	**23**	16
Deposits with credit institutions	**617**	369
Other	**22**	10
	16,867	14,172

4. Debtors	2004 £m	2003 £m
Brokers' balances	**2,893**	3,014
Reinsurance to close premiums receivable from other Lloyd's syndicates	**406**	1,576
Inter-syndicate balances	**169**	168
Unpaid cash calls	**101**	101
Other debtors	**317**	314
	3,886	5,173

5. Reinsurance bad debts

The global result at 31 December 2004 for the 2002 and prior years of account is shown after providing £347m (2003: £574m) in respect of reinsurance bad debts, analysed into £143m (2003: £246m) arising on reinsurers' share of claims paid and £204m (2003: £328m) relating to recoveries included within reinsurance to close and amounts retained to meet liabilities on run-off years. The balances due from reinsurers on paid claims are included in brokers' balances in note 4 and are shown net of the bad debt provision.

6. Other assets	2004 £m	2003 £m
Cash at bank and in hand	**2,369**	2,235
Overseas deposits	**1,324**	1,246
	3,693	3,481

NOTES TO THE GLOBAL RESULTS continued

as at 31 December 2004

7. Result for the 2002 year of account	2004 £m	2003 £m
Life syndicates	**2**	(1)
Other syndicates	**1,491**	(2,092)
	1,493	(2,093)

8. Result for 2001 and prior run-off years of account	2004 £m	2003 £m
Life syndicates	**–**	6
Other syndicates	**(300)**	(291)
	(300)	(285)

9. Creditors	2004 £m	2003 £m
Brokers' balances	**1,456**	1,809
Advance cash calls made	**23**	989
Continuous solvency transfer	**(816)**	(392)
Reinsurance to close premiums payable to other Lloyd's syndicates	**406**	1,576
Reinsurance to close premiums payable to the 2005 year of account	**247**	12
Inter-syndicate balances	**169**	168
Taxation	**13**	10
Overpaid cash calls	**11**	11
Other creditors and accruals	**321**	188
	1,830	4,371

10. Personal expenses	2002 year of account £m	2001 year of account £m
Annual subscriptions	**32**	28
Central Fund contributions	**131**	86
Managing agents' fees	**188**	136
Members' agents' fees	**21**	24
Managing agents' profit commission	**160**	21
	532	295

The personal expenses included above are broadly proportional to members' participation on syndicates underwriting for the 2002 year of account.

The managing agents' profit commission of £160m is in respect of 37 of the 69 syndicates which made a profit on the 2002 year of account (2001: £21m in respect of 17 of the 33 syndicates).

Personal expenses in respect of the open years comprise similar items. Profit commission is not charged until the year of account is closed.

Members may also incur other expenses on an individual basis in respect of their underwriting liabilities.

The global results are stated before deduction of members' agents' profit commission, which is only known once the distribution exercise is completed. The aggregate amount chargeable in respect of the 2002 year of account is estimated at £20m (2001 year of account: less than £1m).

11. Members' qualifying assets	2004 £m	2003 £m
Lloyd's deposits	**8,976**	9,102
Personal reserve funds	**636**	541
Special reserve funds	**10**	16
	9,622	9,659
Other qualifying assets	**219**	278
	9,841	9,937

The Lloyd's deposits, personal reserve funds and special reserve funds shown as at 31 December 2004 represent the total assets lodged at Lloyd's by all members to support their underwriting. The 'other qualifying assets' of £219m relate to other personal wealth declared by individual members. Certain corporate members may have other assets, beyond their funds at Lloyd's, which may be available to support their underwriting; these assets are not included in the above table.

12. Lloyd's central resources
Lloyd's central resources at 31 December 2004 totalled £1,184m (2003: £781m) as follows:

A The net assets of the Central Fund at 31 December 2004 amounted to £556m (2003: £711m) as shown in the Central Fund financial statements on page 108.

B The total value of the subordinated loan notes at 31 December 2004, as disclosed at note 14 on page 117 of the Central Fund financial statements, is £506m (2003: nil). As set out in note 14 to the Central Fund 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 insolvent members to any person (including any policyholders) arising out of or in connection with insurance business carried out at Lloyd's by the insolvent member.

C The net assets of the Corporation of Lloyd's amounted to £122m as at 31 December 2004 (2003: £70m), as shown in the Corporation of Lloyd's financial statements on page 83.

13. Inter-syndicate premiums and claims
No adjustment has been made in the underwriting accounts for inter-syndicate reinsurance premiums amounting to £466m for the 2004 calendar year (2003: £644m) and inter-syndicate claims paid in 2004 amounting to £306m (2003: £388m).

14. Average rate of brokerage and commission
The average deduction for brokerage and commission across all markets by agents and brokers at Lloyd's has been estimated at 20.3% (2003: 20.2%).

15. Members' premium income limit
The maximum annual premium income limit of members at Lloyd's is calculated by reference to the value of their funds at Lloyd's. Individual members are permitted to take credit for demonstrated personal wealth up to certain limits. Further details concerning the relationship between members' premium income limits and their capital provided are set out in the 'Security underlying policies issued at Lloyd's' section (pages 55 to 59).

16. Technical provisions for long term insurance business
The technical provisions for long term insurance business have been derived using appropriate actuarial principles which have due regard to the reasonable expectation of policyholders and make proper provision, using prudent assumptions, for all liabilities.

LLOYD'S MARKET STATISTICS

seven year summary

Summary of results by year of account	1996 £m	1997 £m	1998 £m	1999 £m	2000 £m	2001 £m	**2002 £m**
Net premiums	4,810	4,709	4,869	5,785	6,203	6,930	**7,600**
Underwriting result:							
– pure year	575	4	(904)	(1,563)	(1,794)	(1,396)	**2,440**
– prior years	160	159	127	(166)	(329)	(580)	**(595)**
– total	735	163	(777)	(1,729)	(2,123)	(1,976)	**1,845**
Gross investment return (before expenses)	591	398	520	596	608	540	**510**
Result after personal expenses	606	(209)	(1,065)	(1,952)	(2,397)	(2,378)	**1,193**
Exchange rate at close of account:							
£1 = US$	1.66	1.61	1.49	1.46	1.61	1.79	**1.92**
£1 = CAN$	2.56	2.34	2.24	2.32	2.54	2.31	**2.30**

The results and investment return shown above include calendar year movements in respect of run-off years.

Market capacity by year of account		1999	2000	2001	2002	2003	2004	**2005**
Total number of underwriting members participating:								
Individual		4,503	3,317	2,848	2,466	2,198	2,048	**1,625**
Corporate		668	853	895	837	762	752	**705**
Total market capacity:								
Individual	£m	2,700	2,003	1,800	1,766	1,844	1,869	**1,445**
Corporate	£m	7,170	8,042	9,463	11,473	13,015	13,223	**12,277**
Total	£m	9,870	10,045	11,263	13,239	14,859	15,092	**13,722**

Comparative information by year of account	1998 £m	1998 %	1999 £m	1999 %	2000 £m	2000 %	2001 £m	2001 %	**2002 £m**	**2002 %**
Net premiums	4,869	100.0%	5,785	100.0%	6,203	100.0%	6,930	100.0%	**7,600**	**100.0%**
Direct syndicate expenses	339	7.0%	378	6.6%	379	6.1%	394	5.7%	**383**	**5.0%**
Corporation charges	72	1.5%	71	1.2%	83	1.3%	91	1.3%	**76**	**1.0%**
Premium levy	82	1.7%	96	1.7%	113	1.8%	149	2.2%	**208**	**2.8%**
Members' subscriptions										
(excluding Central Fund)	51	1.0%	35	0.6%	27	0.5%	28	0.4%	**32**	**0.4%**
Central Fund	132	2.7%	99	1.7%	100	1.6%	86	1.2%	**131**	**1.7%**
Agents' fees	98	2.0%	92	1.6%	134	2.2%	160	2.3%	**209**	**2.8%**
Managing agents' profit commission	21	0.4%	8	0.1%	15	0.2%	21	0.3%	**160**	**2.1%**
Total market costs	795	16.3%	779	13.5%	851	13.7%	929	13.4%	**1,199**	**15.8%**

Details of net premiums and expenses are shown at the 36 months stage of the account; i.e. they do not reflect subsequent movements on run-off years.

SECURITY UNDERLYING POLICIES ISSUED AT LLOYD'S

as at 31 December 2004

Summary

Lloyd's is not an insurance company. It is a Society of members, both corporate and individual, who 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.

There are 62 syndicates registered to conduct business at Lloyd's in 2005. Each syndicate is managed by a managing agent. Managing agents write insurance business on behalf of the member(s) of the syndicate, who receive profits or bear losses in proportion to their share in the syndicate.

Every member underwriting at Lloyd's in 2005 is subject to an annual risk assessment, based on Lloyd's risk-based capital methodology. This determines a member's capital requirement subject to prescribed minimum levels.

The Lloyd's chain of security

The great 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 ensure that all valid claims by Lloyd's policyholders are met in full. Although aggregate numbers are shown below, the first three links each operate on a several basis: each member's resources are only available to meet their share of claims. The fourth link is a fund 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 four key features of the Lloyd's chain of security are described below. In combination they provide very strong security to all Lloyd's policyholders, reflected in the high quality ratings assigned by leading rating agencies.

First link

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 outstanding liabilities.

Premiums Trust Funds and overseas regulatory deposits*: £21,873m

Second link

Members' funds at Lloyd's: capital requirements are determined for each member by Lloyd's risk-based capital methodology, subject to prescribed minimum levels.

Capital held at Lloyd's*: £9,622m

Third link

Additional assets not necessarily held at Lloyd's but declared. Frequently members, both corporate and individual, have additional assets which are also liable to be required to meet claims. Individual members underwrite with unlimited liability.

Individual members' other declared assets*: £219m

Fourth link

The Central Fund is available to meet any portion of any member's 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 Corporation, totalling £122m, are available to meet underwriting liabilities in the last resort.

Lloyd's central assets excluding the subordinated debt liability and the callable layer*: £1,184m

* as at 31 December 2004

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 members' 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. Continuous solvency transfers (CSTs) on open years of account, to the extent permitted by reference to the cumulative annual accounting result up to 31 December 2004, may be applied to meet cash calls and loss payments. Any CSTs not used will be held in the members' personal reserve funds and will be available for release to members subject to the Release Test calculations to be conducted later in 2005.

SECURITY UNDERLYING POLICIES ISSUED AT LLOYD'S continued

as at 31 December 2004

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 Lloyd's 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, 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 £21,873m in aggregate, at 31 December 2004.

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 his underwriting business. Each member's net funds at Lloyd's requirement to support his underwriting at Lloyd's is determined using Lloyd's risk-based capital methodology. As at 31 December 2004, the total value of funds at Lloyd's held in trust by members amounted to £9,622m.

Minimum capital ratios are set at 40% for both corporate and individual members (35% for those members writing predominantly United Kingdom motor business). An individual member is permitted to take credit against his net funds at Lloyd's requirement for demonstrated personal wealth up to certain limits.

The third link

The third link is the other declared personal wealth of individual members and other assets other than funds at Lloyd's of individual and corporate members.

Individual members who show a minimum level of personal wealth (i.e. funds at Lloyd's and other personal wealth) of £350,000 may reduce their net funds at Lloyd's requirement by the amount of declared other personal wealth. This credit is limited to 10% of the member's net funds at Lloyd's requirement and must not reduce the net funds at Lloyd's below 35% of premium limit. The aggregate value of personal wealth declared to Lloyd's by individual members, not counting their funds at Lloyd's, was £219m at 31 December 2004. In addition, individual members of Lloyd's have other assets, not declared to Lloyd's, which are available to meet claims.

A corporate member may also have assets, beyond its funds at Lloyd's, which can be called upon to meet its underwriting liabilities.

The fourth link

The fourth link includes the Central Fund assets resulting from annual contributions made by all members. 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 his funds at Lloyd's or his own resources. The net assets of the Central Fund as at 31 December 2004 were £556m.

In late 2004, Lloyd's placed subordinated loan notes amounting to £506m in value, which are reflected as an asset and a liability within the Central Fund financial statements. As set out in note 14 to the Central Fund financial statements, payments on the notes are subordinated to certain payments which may be made out of central assets including payments made to discharge the liabilities of an insolvent member to any person (including any policyholders) arising out of or in connection with insurance business carried on at Lloyd's by that insolvent member.

Central Fund assets may be supplemented by an amount not exceeding 3% of members' overall premium limits callable in any one calendar year from members' premiums trust funds (described and included in the first link). Additional information regarding the Central Fund is contained on pages 107 to 120.

In addition, the other assets of the Corporation, totalling £122m at 31 December 2004, are available to meet underwriting liabilities in the last resort.

In aggregate, the value of Lloyd's central assets (excluding the subordinated debt liability and the callable layer) amounted to £1,184m at 31 December 2004.

Aggregate resources

Taken together with the total declared members' qualifying assets, the aggregate resources of all members of Lloyd's and those of the Society declared as at 31 December 2004 were £32.9bn. The total amount of estimated current and future liabilities at the end of 2004, was £19.3bn. The aggregate declared resources of the Society and its members were equivalent to 171% of the provision for current and future liabilities.

As stated in note 1B to the global results, the global 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 financial position of Lloyd's business taken as a single entity and as indicated above the first three 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 his 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 (i.e. solvency reserves) 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 Financial Services Authority (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 2004.

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

First, each member's solvency position is calculated. Each member must have sufficient assets – those held in the premiums trust funds, overseas regulatory deposits and his funds at Lloyd's – to cover his 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. With effect from 1 January 2004, 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 his underwriting liabilities and his solvency margin, the member has a solvency shortfall.

The second part of the solvency test calculation requires that Lloyd's central assets 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 Corporation net assets, excluding the subordinated debt liability but including the amount of the callable layer referred to previously – for this purpose the 'effective' callable layer, i.e. 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 his 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 DATA

as at 31 December 2004

	2004 £m	2003 £m
I Calendar year premium income		
Before ceded reinsurance		
a) before brokerage and commission (note 2)	**14,573**	15,193
b) after brokerage and commission (note 3)	**11,622**	12,132
After ceded reinsurance		
a) before brokerage and commission	**12,040**	11,743
b) after brokerage and commission	**9,089**	8,682
II Balances on open underwriting and run-off years (note 4)	**21,873**	18,995
III Members' qualifying assets		
Funds at Lloyd's:		
Deposits	**8,976**	9,102
Personal reserves	**636**	541
Special reserves	**10**	16
	9,622	9,659
Analysed by:		
Individual members	**1,426**	1,598
Corporate members	**8,196**	8,061
	9,622	9,659
Members' other qualifying assets	**219**	278
Total members' qualifying assets	**9,841**	9,937
IV Total net resources of the Society of Lloyd's and its members		
Balances on open underwriting and run-off years	**21,873**	18,995
Total members' qualifying assets	**9,841**	9,937
Total resources of members	**31,714**	28,932
Net Central Fund assets (note 5)	**556**	711
Subordinated debt (note 6)	**506**	–
Net assets of the Corporation of Lloyd's	**122**	70
Total resources of the Society of Lloyd's and its members	**32,898**	29,713
Provision for current and future liabilities (note 7)	**(19,277)**	(18,120)
Total net resources of the Society of Lloyd's and its members	**13,621**	11,593
V Ratios		
Total net resources as a percentage of premium income (before brokerage and after ceded reinsurance)	**113%**	99%
Total resources as a percentage of provision for liabilities	**171%**	164%

NOTES

Note 1
Basis of preparation – The statement of financial data 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.

Note 2
Calendar year premium income is arrived at after deducting inter-syndicate reinsurances of £466m (2003: £644m). The inter-syndicate claims paid were £306m (2003: £388m).

Note 3
The average deduction for brokerage and commission across all markets has been estimated at 20.3% (2003: 20.2%).

Note 4
Balance on open underwriting and run-off years.

	2004 £m	2003 £m
Balance on open underwriting accounts	**17,380**	16,244
Reserves retained in respect of run-off years of account	**4,594**	4,822
Result for 2002 and prior years of account	**1,193**	(2,378)
Cash calls made in advance	**23**	989
Continuous solvency transfer	**(816)**	(392)
Net uncalled deficiency on run-off years	**(501)**	(290)
	21,873	18,995

The balances on open underwriting years consist of the underwriting balances in respect of the two open years of account, including the premiums received for the reinsurance to close earlier years of account and are stated after deduction of personal expenses relating to these years.

Note 5
The net Central Fund assets at 31 December 2004 of £556m (2003: £711m) are as shown in the Central Fund financial statements (see page 108).

Note 6
Further information on the subordinated debt is set out at note 14 on page 117 of the Central Fund financial statements. Repayments to note holders are subordinated to payments which may be required to meet liabilities of insolvent members, i.e. to meet policyholder claims.

Note 7
The provision for current and future liabilities includes a provision for amounts which have been called by 31 December 2004 but remain outstanding of £101m (2003: £101m).

Lloyd's 2004 Annual Report
Corporation of Lloyd's

Lloyd's Central Fund

OPERATING AND FINANCIAL REVIEW

This review considers the activities of the Corporation of Lloyd's and the Lloyd's Central Fund.

The results of the Lloyd's market are considered in the Market Commentary on pages 8 to 23.

Operating Review

The progress achieved during 2004 towards meeting Lloyd's key strategic objectives is set out in the Chief Executive Officer's Report on pages 4 to 7. This review is directed towards the activities of the operations function whose objective is to provide value for money services to the Lloyd's market, including information technology, facilities and administration and other services to members and policyholders. It also drives the achievement of high operational standards throughout the Corporation.

Strong focus is placed on the maintenance of an effective commercial relationship with suppliers following the successful implementation over the last five years of Lloyd's outsourcing strategy. A supplier management framework was successfully implemented as planned in 2004. This not only ensures that all of parts of the business improve their management of suppliers, but also enables Lloyd's to demonstrate to regulators its ability to control supplier related risk. An organisation-wide supplier management solution will be implemented in 2005 to support the framework.

The relationship with Xchanging continues to develop, with strong emphasis on the enhancement of operational processes and service quality. Contractually, the signing of the Settlement Trust Fund Operation Agreement was a key achievement which formally marks the completion of the outsourcing of LPSO and gives clarity to the overall outsourcing arrangement.

The foundations for effective Business Continuity Planning have been strengthened by completing a Business Impact Analysis for the Corporation. Testing included technical recovery and emergency communications and work commenced on a broader range of disaster scenarios against which to test plans. Working with the LMA and the LMBC, a Market Working Group was formed to develop further contingency plans for the Underwriting Room and share best practice to identify practical solutions to market-wide business continuity issues.

Property Services

Close liaison with the City of London Police and Security Services has continued throughout 2004 with the 1986 building security remaining a priority. A new building access card and security barrier system has been installed and progress is being made with the local authorities to improve the security arrangements for the surrounding area.

Lloyd's Property Services has continued to provide the management of the buildings and facilities services throughout 2004 with improved customer service delivery and reduced financial costs from the outsourced suppliers.

The 1958 building sale agreement was successfully concluded with British Land, a further profit of £23.6m being recognised during 2004.

Information technology

The Lloyd's IT Group, which provides infrastructure and applications services internally and to many market customers, further reduced its operational costs during 2004 through the outsourcing of infrastructure services and an associated 40% reduction in staff. It is now well positioned to capitalise on recent changes to deliver enhanced service quality to all of its customers.

An information management programme successfully delivered a new central data warehouse in 2004. This programme will improve the collection, storage and distribution of data used by Lloyd's. In 2005 the data warehouse will be populated with further market data to enhance significantly the timely provision of key financial and performance information helping to rationalise the reporting requirements of the market.

Members' Services

2004 has been another year of significant change. Preparatory work has been completed for the implementation of major systems changes in 2005. Staff numbers have reduced to less than 100 but service standards have been maintained across the 400 different processes undertaken for members and their agents.

OPERATING AND FINANCIAL REVIEW continued

Complaints

The Complaints Department handled over 3,000 complaints on behalf of the market in accordance with FSA requirements during 2004. The level of complaints was higher in the fourth quarter than predicted following the Florida hurricanes. However, quality standards were maintained in terms of both timeliness and support from the Financial Ombudsman Service for decisions made.

Financial Review

This review should be read in conjunction with the financial statements of the Corporation of Lloyd's (see pages 82 to 105) and the Lloyd's Central Fund (see pages 108 to 120).

Introduction

For the year ended 31 December 2004 this review consists of two parts: the first reports on the consolidated results of the Corporation of Lloyd's; the second includes a review of the Lloyd's Central Fund. The objectives of the two sets of financial statements are different: the financial statements of the Corporation of Lloyd's show the income and expenditure, financial position and cash flows directly as a result of managing and supervising the activities of the Society; the Central Fund is held separately and administered by the Council of Lloyd's primarily as a fund available for the protection of policyholders. In future years, with effect from 2005, following changes to financial reporting standards, financial statements will be prepared for the Society of Lloyd's that consolidate the Corporation of Lloyd's, its subsidiaries and the Lloyd's Central Fund.

International accounting standards

It is proposed to adopt International Financial Reporting Standards (IFRS) for the preparation of financial statements for the Society (comprising the Corporation of Lloyd's and all of its subsidiaries and the Lloyd's Central Fund). The first reporting periods will be for the six months ending 30 June 2005 and the full year ending 31 December 2005.

The adoption of IFRS will result in significant changes in the accounting, presentation and disclosure of certain items in the financial statements. We believe we are well placed to comply with the Reporting Standards.

Financial review of the Corporation of Lloyd's in 2004

Basis of preparation and consolidation

The consolidated financial statements are prepared in accordance with generally accepted accounting principles in the UK. There are two particular matters that are relevant to an understanding of the basis of preparation and consolidation:

- Consistent with prior years, two insurance company subsidiaries whose activities relate to the underwriting affairs of certain syndicates and Names have not been consolidated. The Society of Lloyd's does not itself underwrite and the Council of Lloyd's has taken advantage of the exemption permitted by FRS 2 'Accounting for subsidiary undertakings' not to consolidate these subsidiaries on the grounds that their activities are so dissimilar that to consolidate their results would not achieve the objective of these financial statements – to show the financial effect of managing and supervising the activities of the Society. The two subsidiaries are Lioncover Insurance Company Limited and Centrewrite Limited. All of Lioncover's insurance liabilities, and the 1992 and prior liabilities of Centrewrite have been reinsured into Equitas. Details of the financial position of these companies have been included in note 14b (on page 91). As noted above, with effect from 1 January 2005 the exemption allowing non-consolidation of these subsidiaries has been removed and, in future, they will be consolidated together with the Lloyd's Central Fund.

- The subordinated loan notes issued by the Society on 17 November 2004 have been accounted for within the financial statements of the Central Fund, the proceeds of the issue being an addition to Central Fund assets.

Accounting policies and financial reporting standards

The accounting policies adopted in 2004 are consistent with the prior year and are disclosed in note 2 (on page 85). The following points in respect of 2004 should be noted:

- FRS 13 'Derivatives and other financial instruments – disclosures' has been fully adopted in 2004 following the issue of subordinated loan notes by the Society, notwithstanding the fact that they are not accounted for in the Corporation's financial statements. There has been no impact on the primary financial statements as a result of providing the additional disclosures.

- The effective date for the full adoption of FRS 17 'Retirement benefits' is 1 January 2005. The Corporation has not adopted the standard early but has made the transitional disclosures required in note 18 to the financial statements (on page 94). These show the effect on the financial statements had FRS 17 been adopted. The changes introduced by FRS 17 principally impact the accounting treatment of defined benefit schemes. At each year end, the pension scheme assets should be measured at market value while pension scheme liabilities should be measured at a present value using a specified actuarial valuation method and discounted at a high quality corporate bond rate. The resulting pension scheme surplus or deficit would be included on the balance sheet in place of the pension prepayment currently included under SSAP24 rules.

Basis of presentation of financial statements

The format of the financial statements is unchanged from 2004 with two exceptions.

Firstly, in previous years market settlement recoveries, which represent debt recoveries arising from the 1996 *Reconstruction and Renewal* settlement, have been separately disclosed in the revenue account below the surplus/(deficit) on ordinary activities. For 2004, these recoveries, which total £8.9m, have been included as part of operating income and the comparatives restated (£7.9m) in the revenue account and five year summary.

Secondly, any surplus/(deficit) on the sale and revaluation of statutory insurance deposits has been separately disclosed in the revenue account within the heading entitled 'Finance'.

Overall result

The overall surplus for the year after taxation is £48.6m and includes a group operating surplus of £19.7m and further proceeds from the sale of the Lloyd's 1958 building of £23.6m. An increase in the valuation of Lloyd's collection of paintings, antiques and artefacts of £2.8m is reflected as a movement in the revaluation reserve. At 31 December 2004, the Corporation's net assets are £121.9m, an increase of £51.5m during the year.

	2004 £000	2003 £000	2002 £000
Net assets at 1 January	**70,365**	87,151	90,714
Surplus/(deficit) for year	**48,611**	(17,286)	(4,117)
Movement in revaluation reserve	**2,797**	–	–
Other recognised gains	**109**	500	554
Net assets at 31 December	**121,882**	70,365	87,151

Group operating surplus/(deficit)

	2004 £000	2003 £000	2002 £000
Operating income	**180,453**	141,420	134,896
Operating expenses	**(160,742)**	(160,267)	(159,154)
Group operating surplus/(deficit)	**19,711**	(18,847)	(24,258)

In recent years, prior to 2004, the Corporation had absorbed substantial operating deficits which reflect litigation defence costs incurred, principally in 2001 and earlier years, and, since 2001, the investment in Kinnect.

Kinnect is a market infrastructure project, funded by the Corporation, to support the transfer of risk data between brokers and underwriters within a defined business process and using structured electronic messages. It is a critical component of Lloyd's business process reform initiatives. The development costs of Kinnect have been expensed to the revenue account as part of operating expenses and have not been capitalised.

In setting operating budgets for 2004 it was recognised that the Corporation could not continue to absorb such operating deficits which would further reduce working capital. As a result, the annual members' subscription, which is based on members' allocated premium limits, was increased to 0.50% having been held at 0.25% since 2000. This was intended to ensure that a group operating surplus was achieved in 2004, whilst containing operating costs, and to provide greater financial flexibility. Increased operating income in 2004, as a result of the increase in members' subscriptions, has improved the group operating result producing a surplus of £19.7m for the year compared to a deficit of £18.8m in 2003.

OPERATING AND FINANCIAL REVIEW continued

Operating income

The following table shows the main sources of operating income:

	2004 £000	2004 %	2003 £000	2003 %	2002 £000	2002 %
Market charges	**78,908**	**44%**	77,458	55%	75,833	56%
Members' subscriptions	**74,935**	**42%**	36,142	26%	31,600	23%
Other	**26,610**	**14%**	27,820	19%	27,463	21%
	180,453	**100%**	141,420	100%	134,896	100%

Operating income has increased in 2004 by £39.1m to £180.5m from £141.4m in 2003. This shows the effect of increasing the rate of members' subscriptions, which increased by £38.8m to £74.9m.

Total direct market charges, including the recovery of overseas operating expenses, members' services unit charges to members and managing agents and the Franchise Performance and Risk Management charge, have increased by £1.4m in 2004 to £78.9m.

Other income includes market settlement recoveries representing continuing debt recoveries for the 1996 *Reconstruction and Renewal* settlement, rent and building service charges, charges to associates and the Lloyd's Central Fund. In total, other income reduced by £1.2m to £26.6m. This includes a reduction of £1.9m relating to charges to associated undertakings, Xchanging Ins-sure and Xchanging Claims Services as they reduced their reliance on the Corporation for the provision of IT and property services.

Operating expenses and cost control

The increase in overall operating expenses in 2004 from £160.3m to £160.7m has been limited to £0.4m due to careful control of the Corporation's operating activities. Total operating expenses include the development costs of Kinnect of £15.1m in 2004 (2003: £17.9m).

The main operating costs can be summarised as follows:

	2004 £000	2004 %	2003 £000	2003 %	2002 £000	2002 %
Employment	**60,107**	**37%**	53,483	33%	47,242	30%
Premises	**30,339**	**19%**	30,127	19%	30,244	19%
Overseas operations	**20,592**	**13%**	21,524	13%	21,497	14%
Other	**49,704**	**31%**	55,133	35%	60,171	37%
	160,742	**100%**	160,267	100%	159,154	100%

The Executive Committee has contained increases in its cost base over recent years whilst making significant investment in initiatives such as the establishment of the Franchise Performance Directorate in 2003 and, since 2001, Kinnect. By the end of 2004 the Corporation had provided total funding of £55m for the development of the Kinnect infrastructure.

In 2004, employment costs have increased by £6.6m to £60.1m. This includes a substantial increase in pension costs from £0.5m in 2003 to £8.5m in 2004. The reasons for this increase are detailed below.

Pension costs

Pension costs of £8.5m in 2004 include the regular costs of providing pensions under SSAP24 of £4.0m and the award for 2005 of a discretionary increase to pre 6 April 1997 pensions when in payment, the latter required a contribution of £3.1m to be paid by the Corporation in 2004. The triennial valuation of the Lloyd's Pension Scheme for determining the funding position of the scheme and future contribution rates disclosed a past service deficit of £9m as at 30 June 2004. The Corporation has made two special contributions to eliminate the deficit, £4.2m being paid in December 2004 and a further £4.8m in February 2005. Normal employer contributions to the scheme recommenced with effect from January 2004 at a rate of 17% of pensionable salaries totalling £4.3m. Following the triennial valuation, with effect July 2004, the contribution rate has been increased to 21.2% and the Corporation has paid the additional contributions due from that date in 2005.

As noted above, the Corporation did not adopt FRS 17 in 2004 and continued to apply SSAP24. Under the valuation bases required by FRS 17 the Lloyd's Pension Scheme reports a net deficit of £37m, after allowance for deferred taxation, as at 31 December 2004. This compares with a net deficit of £38m as at 31 December 2003. The valuation results exclude liabilities for discretionary increases to pensions. Such increases have always been payable at the discretion of Lloyd's and will continue to be considered on the basis of affordability. As noted above, a discretionary award for 2005 was made in November 2004.

The valuation for SSAP24 purposes uses a best estimate of investment returns rather than the more prudent assumptions used for funding and FRS 17 purposes. On this basis there is a surplus which enables the pre-existing pension scheme prepayment included in the balance sheet to be retained. Indeed, because of the special contribution of £4.2m paid in 2004 to eliminate part of the past service deficit disclosed by the triennial review for funding purposes, the prepayment increases to £28.8m as at 31 December 2004.

Had FRS 17 been applied as at 31 December 2004 the reported net assets of the Corporation would have fallen from £122m to £56m reflecting the elimination of the SSAP24 prepayment and recognition of the deficit calculated using the FRS 17 valuation bases.

Share of operating profit of associated undertakings

The Corporation's share of operating profits from its interests in Xchanging Ins-sure and Xchanging Claims Services, before interest, taxation and amortisation of goodwill, is £2.7m (2003: £3.4m). This enabled the Corporation to rebate £2.1m to the Lloyd's market during 2004. Future rebates will be made directly by Xchanging Ins-sure and Xchanging Claims Services.

Finance

Included under finance are dividends receivable. Centrewrite, which is not consolidated, has declared a dividend of £7.49m for 2004 (2003: £7.49m). The dividend reflects the company's ability to release reserves as open years of account close.

Cash flows and liquidity

Net funds increased during 2004 from £55.9m to £118.2m. This reflects both the operating surplus for the year and the receipt of further proceeds from the disposal of the Lloyd's 1958 building which was sold in 2001. The Corporation has no bank borrowings, the £500m loan notes issued by the Society in November 2004 have been accounted for in the Central Fund financial statements (see page 117). The following table sets out net funds available resulting from cash flows:

	2004 £000	2003 £000	2002 £000
Increase/(decrease) in net funds in the year resulting from cash flows	**62,264**	13,254	(23,770)
Net funds at 1 January	**55,891**	42,637	66,407
Net funds at 31 December	**118,155**	55,891	42,637

Treasury management and policies

The Corporation's objectives and policies for holding financial instruments and similar contracts, and the strategies for achieving those objectives, are described in note 23 to the financial statements (on page 100).

Payment policies

It is Corporation policy to ensure that suppliers are paid within agreed terms. At the year end, the Corporation's trade creditors represented the equivalent of 27 days' credit.

Related party transactions

Except for disclosures made in note 26 (on page 104), no other related party has had material transactions with the Corporation of Lloyd's in 2004.

Outlook for 2005

Members' subscriptions were held at 0.50% of members' premium limits for 2005. As market capacity has reduced to £13.7bn for 2005, income from this source will reduce to £68.5m from £74.9m in 2004. Nevertheless, an operating surplus for 2005 is budgeted. There will be further investment in Kinnect during 2005.

Financial Review of the Lloyd's Central Fund in 2004

Basis of preparation

The Central Fund, which is held at the discretion of the Council of Lloyd's, has not been consolidated within the financial statements of the Corporation of Lloyd's as it is primarily a Fund available for the protection of policyholders and hence relates to the insurance related activities of the members of Lloyd's.

The liabilities of the Fund include those amounts contractually committed by the Fund and exclude provision for future discretionary payments. The financial statements therefore do not take account of claims approved after the balance sheet date or future payments that may be made to cover underwriting losses of members except to the extent that the Central Fund is contractually committed to make such payments under hardship and other agreements.

OPERATING AND FINANCIAL REVIEW continued

Accounting policies and financial reporting standards

The accounting policies adopted in 2004 are consistent with the prior period, except as noted below, and are disclosed in note 2 (on page 111):

- FRS 13 'Derivatives and other financial instruments – disclosures' has been fully adopted in 2004. In prior years FRS 13 did not apply to the Central Fund. There has been no impact on the primary financial statements as a result of providing the additional disclosures.

- The accounting policy in respect of claims and recoveries from members has been amended to account for recoveries when contractually agreed rather than when received. In 2004, the effect of this change has been to account for recoveries receivable of £7.4m as at 31 December 2004. This is a change in accounting policy as recoveries were previously accounted for on a received basis. No amounts were receivable at 31 December 2003 and therefore no prior year adjustment is required.

- Following the issue of subordinated loan notes in November 2004, the accounting policy adopted for recognising the loan notes at amortised cost, taking account of issue costs and issue discount has been set out at note 2G on page 112. Issue costs are amortised on a straight line basis over the period to the earliest option date. The principal disclosures relating to the loan notes are set out in note 14 (on page 117).

Basis of presentation of financial statements

The format of the General Fund Account (the revenue statement) has been changed for 2004 to reflect a clearer presentation. In particular, all investment returns (dividends and interest, the surplus on sale and revaluation of investments) have been grouped together under a 'Finance' heading and the distinction between realised and unrealised gains and losses on investments has been eliminated. In addition, income and expenditure is now described as 'operating income' and 'operating expenditure'.

Fund balance

At 31 December 2004, the combined assets of the Lloyd's Central Fund total £555.8m, a decrease of £155.3m since last year. This decrease reflects the net effect of the settlement of the dispute with insurers of the New Central Fund (the details of the dispute were noted in the 2003 financial statements) amounting to £323.8m before tax and £227m after tax following the write off of insurance claims previously considered to be receivable. The settlement of the dispute with insurers of the New Central Fund is described in note 9 (on page 114).

The movement in the Fund balance is summarised below:

	2004 £000	2003 £000	2002 £000
Operating income	**215,588**	444,881	390,106
Operating expenditure – before settlement of the arbitration dispute	**(148,943)**	(143,772)	(154,932)
Settlement of the arbitration dispute	**(323,755)**	–	–
(Deficit)/surplus on ordinary activities before finance	**(257,110)**	301,109	235,174
Finance	**29,167**	29,449	(26,500)
(Deficit)/surplus before tax	**(227,943)**	330,558	208,674
Taxation credit/(charge)	**72,688**	(95,750)	(59,266)
(Decrease)/increase in year	**(155,255)**	234,808	149,408
Total Fund balance at 1 January	**711,045**	476,237	326,829
Total Fund balance at 31 December	**555,790**	711,045	476,237

Regulatory solvency and the role of the Central Fund
Although provision is made in the Central Fund financial statements for amounts that may be payable under undertakings once they have been given, members' solvency deficiencies in the solvency test that the FSA required the Society to undertake are not reflected in the financial statements of the Central Fund. The security underlying policies issued at Lloyd's is described on pages 55 to 59.

Operating income
Contributions from members to the Lloyd's New Central Fund amounted to £190.7m in 2004. There were no contributions from the Corporation of Lloyd's during the year (2003: £279.5m representing the transfer of premium levy collections which ceased at the end of 2003).

New Central Fund contributions are based on a percentage of members' overall premium limits. The rate for 2004 was 1.25% for all members (2003: 1%). New corporate members underwriting on new syndicates in 2004 will be required to contribute at double the annual rate for their first three years of operations at Lloyd's.

The following table shows the sources of operating income:

	2004 £000	2003 £000	2002 £000
Contribution from members of Lloyd's	**190,657**	159,923	134,467
Contribution from Corporation of Lloyd's	**–**	279,493	246,809
Recoveries	**24,678**	5,465	8,830
Gain on exchange	**253**	–	–
	215,588	444,881	390,106

Operating expenditure
Overall operating expenses in 2004, before the effect of the settlement of the arbitration dispute with the insurers of the New Central Fund, have increased by £5.1m from £143.8m to £148.9m reflecting the continuing provisions for undertakings given to insolvent members. The settlement with the New Central Fund insurers, whereby they agreed to pay total claims under the policy of £152m, including amounts previously paid under the policy terms, has resulted in a write off of £323.8m before taking account of tax.

In 2004, the final refund of £2.6m in respect of members' special contributions arising from the 1996 *Reconstruction and Renewal* settlement was made.

Legal and professional fees include Lloyd's costs in connection with the arbitration dispute. There is no change for insurance premiums and brokerage fees in 2004 following the expiry of the insurance policy on 31 December 2003.

Lloyd's was brought within the scope of the Financial Services Compensation Scheme (FSCS) with effect from 1 January 2004, but was not required to contribute to levies raised by the FSCS in respect of 2004.

The operating costs can be summarised as follows:

	2004 £000	2003 £000	2002 £000
Refunds of members' special contributions	**(2,608)**	(39,988)	(46,591)
Income Support Schemes	**(2,193)**	(1,622)	(1,713)
Other claims and provisions	**(135,493)**	(79,669)	(87,726)
Run-off management costs (incl. provisional liquidators' fees)	**(2,273)**	(3,421)	(1,343)
Insurance premiums and brokerage fees	**–**	(16,706)	(16,706)
Legal and professional fees	**(5,580)**	(1,282)	(25)
Administrative expenses	**(796)**	(817)	(828)
Loss on exchange	**–**	(267)	–
	(148,943)	(143,772)	(154,932)
Settlement of Central Fund arbitration dispute	**(323,755)**	–	–
	(472,698)	(143,772)	(154,932)

OPERATING AND FINANCIAL REVIEW continued

Finance

As set out in the table below, net finance has decreased by £0.2m in 2004 to £29.2m. Dividends and interest have increased by £6.0m to £21.5m set against an interest charge of £4.0m in respect of the subordinated loan notes and an unrealised exchange loss on translation of subordinated loan notes of £2.6m.

	2004 £000	2003 £000	2002 £000
Dividends and interest receivable	**21,506**	15,477	14,409
Surplus on sale and revaluation of investments	**14,337**	13,972	(40,909)
Interest payable and similar charges	**(6,676)**	–	–
	29,167	29,449	(26,500)

Taxation credit

A tax credit of £72.7m on the deficit before taxation of £227.9m has been recognised for the year ended 31 December 2004 compared to a tax charge of £95.8m in 2003.

Cash flows and liquidity

The following table sets out the total investments and cash available resulting from cash flows including the issue of subordinated loan notes:

	2004 £000	2003 £000	2002 £000
Increase/(decrease) in net funds in the year resulting from cash flows	**40,106**	150,111	(20,545)
Net funds at 1 January	**491,037**	340,926	361,471
Net funds at 31 December	**531,143**	491,037	340,926
Subordinated loan notes	**506,439**	–	–
Total investments and cash	**1,037,582**	491,037	340,926

Net cash flows include the claims paid from the New Central Fund in respect of corporate and individual members as follows:

	2004 £000	2003 £000	2002 £000
Claims paid in respect of corporate members	**(137,411)**	(191,137)	(465,533)
Claims paid in respect of individual members	**(2,677)**	(4,447)	(2,231)
	(140,088)	(195,584)	(467,764)

Outlook for 2005

The basis for members contributing to the New Central Fund has changed for 2005. Members will continue to contribute based on a percentage of their allocated overall premium limit. However, from 2005 this will be partly by way of interest bearing loans from syndicate premiums trust funds. The annual contribution rate for existing members has fallen to 0.50% from 1.25% in 2004, while the rate for syndicate loans is 0.75%. New corporate members underwriting on new syndicates are required to contribute at an increased rate for their first three years of operations at Lloyd's. The rate for such new members in 2005 is 2.5%. Syndicate loans will ordinarily be repaid on the closure of the year of account after three years. Contributions for 2005 were collected on 1 April 2005 and total £69.7m in annual contributions and £103.2m by way of syndicate loans.

On 6 April 2005, 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 liability of the New Central Fund is £216.5m.

Going Concern

As part of its normal business practice, the Council of Lloyd's has considered whether it is appropriate to prepare the Corporation and Central Fund financial statements on a going concern basis. The executive team prepares annual and longer-term plans and in reviewing this information the Council of Lloyd's sees no reason why the Society should not remain as a going concern for the foreseeable future. Therefore the Corporation and Central Fund continue to adopt the going concern basis in preparing the financial statements.

Corporate governance

The Council has overall responsibility for the system of internal control and for reviewing its effectiveness. The Corporation's executive team is responsible for the implementation and maintenance of the internal control system. This incorporates an embedded, ongoing process for identifying, evaluating and managing significant business, operational, financial, compliance and other risks and receiving monthly reports of control failures. 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, on behalf of the Council and the Franchise Board, monitors the effectiveness of the system of internal control of the Corporation. Lloyd's maintains an internal audit function that reports to the Audit Committee. Both the Executive Committee and Audit Committee review internal audit plans and monitor progress against plans. The external auditors also contribute an independent perspective on aspects of financial control and annually report their findings to the Audit Committee and the Council.

An annual budget for the Corporation is reviewed in detail by the executive team 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 at least quarterly.

The operation of effective risk management is the responsibility of all managers. This is kept under review by the Executive Committee which is responsible for ensuring that the Corporation maintains effective and efficient internal control, and compliance with Financial Services Authority (FSA) and related requirements. The Corporation has a Head of Internal Audit who is supported by KPMG LLP who provide resources to complete the audit plan. The Corporation is committed to the highest standards of business conduct and has a clearly defined organisational structure.

Employment policy

Communications and employee involvement

The Corporation actively promotes the understanding and involvement of employees in the business objectives of Lloyd's by a variety of means. Currently these include: regular team meetings to keep employees informed and to provide feedback to management; and a Corporation intranet (C-net) which provides information rapidly to all employees and also a mechanism for employees to communicate directly with the Chief Executive.

Equal opportunities

The Corporation takes steps to ensure that all applicants and employees receive equal treatment regardless of sex, sexual orientation, age, race, colour, ethnic or national origin, religion, belief, marital status or disability.

The Corporation does not just avoid discrimination as required by law, but adopts policies and practices which treat as irrelevant all factors which do not genuinely affect a person's capability to undertake the work in question. The only criteria in selecting employees for recruitment, promotion and development are capability and performance. There are a series of initiatives to attract, retain and develop the best people.

The Corporation is a member of the 'Opportunity Now' campaign which works with employers to realise the economic potential and business benefits that women contribute to the workplace and, more generally, encourages diversity and an inclusive culture in the workplace.

Training and development

Training and development are conducted in order to achieve business objectives, meet FSA requirements and improve individual and business performance. The Corporation actively encourages employees to obtain relevant qualifications and to develop their full potential. Training and development is available to all staff. A system of internal job advertising is in place and internal transfer and promotion fill many vacancies.

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 Lloyd's is a market of many separate and competing trading entities; nonetheless, Council supports its principles in so far as they can be applied to the governance of the Society.

Composition of the NACC
The Nominations, Appointments and Compensation Committee (NACC) currently comprises two nominated, two external and three working members of the Council. The NACC members for 2004 are indicated within the remuneration table on pages 74 and 75.

The Committee met six times during the year. The attendance at meetings by members of the Committee is set out in the Corporate Governance report, page 34. The Committee'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 Council on the appointment of the Chairman, Chief Executive Officer (CEO), nominated Council members, Franchise Board members and members of a number of Council and Franchise Board committees. Other than the annual exercise of making recommendations with respect to the composition of Council and Franchise Board committees, the NACC made recommendations to Council during 2004 with respect to one new nominated member of Council and the Director, Finance and Risk Management (the latter is also a member of the Franchise Board). The nominations were accepted by Council.

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.

The NACC also recommended to Council that the Chairman should be offered a second three-year term of office to run from the expiry of his current term in November 2005. As before, the Chairman's employment is subject to 12 months' notice of termination by either party. The Chairman accepted the invitation and the Council agreed the recommendation. The appointment is subject to the Chairman being re-elected to Council in November 2005. In addition, under Lloyd's Act 1982, the Council of Lloyd's is required to elect annually a Chairman.

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, the CEO, the Director, Finance and Risk Management and the 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 the year, Deloitte & Touche LLP also provided other services to the Corporation including work on the capitalisation review and benchmark return on capital projects.

Remuneration of Council and Franchise Board members 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 Council and Franchise Board members 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 his or her 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 ('the 2004 LTIP') for the CEO and other senior executives of the Corporation was established with the approval of the NACC and Council in March 2004. This replaced the previous LTIP with effect from 1 January 2004, although transitional measures described below apply.

Objectives
The 2004 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 2004 LTIP
Three-year pooling principle
Payments made under the 2004 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 will be calculated each year on a rolling basis.

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

REPORT OF THE NOMINATIONS, APPOINTMENTS AND COMPENSATION COMMITTEE continued

Eligibility

Selected senior permanent employees of the Corporation are eligible for the scheme which include the CEO, Directors and existing staff in role level 1 as at 1 January 2004. 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 2004 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 a 2004 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, he 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 apply in order to assist the transition from the previous LTIP, so that an LTIP award under the 2004 LTIP will not be lower than the award that would have been made under the previous LTIP. This test is applied as at the first payment date in 2005. It will be 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 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 2004 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 2004, therefore, the award made under the LTIP, subject to adjustment for discretionary awards, is the greater of:

- the award calculated under the 2004 LTIP – i.e. the aggregate profits of the Lloyd's market for the financial years 2002-2004 of £2,988m x relevant % x salary of LTIP participant/£1m; and

- the award calculated under the previous LTIP – i.e. the aggregate projected pure year pre-tax profits (on a three-year accounting basis) of Lloyd's members after deducting personal expenses for the 2004 year of account provided by the Lloyd's market of £1,074m x 0.05% x salary of LTIP participant/£1m.

The discretionary element of the award is calculated in accordance with the rules of the relevant plan under which payment is being made as follows:

- the discretionary award calculated under the 2004 LTIP: 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, the Director, Finance and Risk Management, and the 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.

- the discretionary award calculated under the previous LTIP: one-third of the bonus is paid on a discretionary basis (the discretionary performance bonus) to reflect individual performance over the period, while two-thirds (the long term bonus) is based on a percentage of the participant's eligible salary as set out within the terms of the plan. The discretionary performance bonus is payable in March following the end of the underwriting year. The long term bonus is payable in three instalments commencing in October following the underwriting year and annually thereafter.

For those participants where the transitional arrangements apply, the higher award is that calculated under the previous LTIP and the amount and timing of payments of the 2004 award will therefore be based on the previous LTIP rules.

Details of the awards to the CEO, the Director, Finance and Risk Management and the Franchise Performance Director are shown on page 76.

Pension arrangements
The CEO, Director, Finance and Risk Management and the 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 CEO, Director Finance and Risk Management and the Franchise Performance Director are pensionable.

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

A pension contribution of £40,500 was payable in respect of the Chairman for 2004.

Contracts of employment
The Chairman has a three-year term of office, which may be extended by mutual agreement and is subject to a 12 months' notice of termination by either party (see paragraph above entitled 'Nominations and Appointments' for details of the offer and acceptance by the Chairman of a second three-year term of office, expiring in November 2008).

The CEO and Director, Finance and Risk Management have rolling one-year contracts providing for a maximum of one year's notice. In order to secure his services, the Franchise Performance Director was given an initial two year notice period. This notice period reduced proportionally during his first year of employment and reduced to one year on 3 March 2004.

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 2004	Notice Period(i)
Lord Levene of Portsoken	01/11/02	46 months	12 months
Nick Prettejohn(ii)	27/03/95	rolling 1 year	12 months
Luke Savage(iii)	20/09/04	rolling 1 year	12 months
Rolf Tolle(iv)	03/03/03	rolling 1 year	12 months

(i) Employment contracts do not contain provisions for compensation payable upon early termination
(ii) Nick Prettejohn was appointed CEO on 01/07/1999
(iii) Luke Savage was appointed to the Franchise Board on 30/09/04
(iv) Rolf Tolle was appointed to the Franchise Board on 03/03/03

REPORT OF THE NOMINATIONS, APPOINTMENTS AND COMPENSATION COMMITTEE continued

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

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

In 2004, fees for members of Council and Franchise Board were £25,000 and £37,500 per annum, respectively. Members of both Council and the Franchise Board receive fees of £50,000. Fees are also payable in respect of membership of a number of Council and the 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 Council while nominated members are appointed to Council, usually for a three-year period. Members of the Franchise Board are appointed by Council with non-executive directors appointed for a three-year period. These are not contractual arrangements and compensation is not paid if a member leaves early.

Information subject to audit

Basis of preparation

The following section provides details of the remuneration of all members of the Council of Lloyd's and Franchise Board for the year ended 31 December 2004. 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 Long Term Incentive Plan.

Remuneration of members of the Council of Lloyd's and 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 76.

	Salary/Fees		Taxable Benefits(i)		Annual Bonus		Other(xi)		Total	
	2004 £000	2003 £000	**2004 £000**	2003 £000	**2004 £000**	2003 £000	**2004 £000**	2003 £000	**2004 £000**	2003 £000
Chairman of Council of Lloyd's										
Lord Levene of Portsoken(ii) (viii)	**408**	400	**28**	–	**150**	150	**41**	38	**627**	588
Executive Directors										
Nick Prettejohn, CEO(ii) (viii)	**457**	440	**17**	14	**250**	205	**156**	152	**880**	811
Andrew Moss(ii) (ix) (xvi)	**125**	338	**4**	11	**–**	150	**37**	70	**166**	569
Luke Savage(ii) (ix) (xxi)	**93**	–	**3**	–	**54**	–	**–**	–	**150**	–
Rolf Tolle(ii) (ix) (xvii) (xviii)	**453**	372	**41**	25	**250**	250	**102**	334	**846**	981
Non-Executive Council Members										
Working members										
Stephen Catlin(viii) (x)	**55**	52	**–**	–	**–**	–	**–**	–	**55**	52
John Coldman, Deputy Chairman(x)	**36**	29	**–**	–	**–**	–	**–**	–	**36**	29
Christine Dandridge	**30**	–	**–**	–	**–**	–	**–**	–	**30**	–
Bronek Masojada, Deputy Chairman(x)	**41**	35	**–**	–	**–**	–	**–**	–	**41**	35
David Shipley	**31**	21	**–**	–	**–**	–	**–**	–	**31**	21
External members										
Julian Avery(iii) (x)	**30**	24	**–**	–	**–**	–	**–**	–	**30**	24
Steven Burns(vi) (viii) (xii)	**56**	27	**–**	–	**–**	–	**–**	–	**56**	27
Sean Dalton(vii) (xxii)	**31**	21	**–**	–	**–**	–	**–**	–	**31**	21
Quentin Davies	**30**	–	**–**	–	**–**	–	**–**	–	**30**	–
Peter Morgan(v) (x)	**35**	32	**–**	–	**–**	–	**–**	–	**35**	32
Charles Philipps(iv)	**30**	27	**–**	–	**–**	–	**–**	–	**30**	27

Remuneration of members of the Council of Lloyd's and Franchise Board continued

	Salary/Fees		Taxable Benefits(i)		Annual Bonus		Other(xi)		Total	
	2004 £000	2003 £000	**2004 £000**	2003 £000	**2004 £000**	2003 £000	**2004 £000**	2003 £000	**2004 £000**	2003 £000
Nominated members										
Judith Hanratty(viii) (x) (xx)	**67**	64	**–**	–	**–**	–	**–**	–	**67**	64
Bill Knight, Deputy Chairman of the Council of Lloyd's(x)	**53**	41	**–**	–	**–**	–	**–**	–	**53**	41
Philip Lader(xxiii)	**25**	–	**–**	–	**–**	–	**–**	–	**25**	–
Brian Pomeroy(xix)	**44**	42	**–**	–	**–**	–	**–**	–	**44**	42
Andreas Prindl(xiii)	**37**	2	**–**	–	**–**	–	**–**	–	**37**	2
Non-Executive Franchise Board Members										
Roy Brown	**38**	38	**–**	–	**–**	–	**–**	–	**38**	38
Edward Creasy	**38**	38	**–**	–	**–**	–	**–**	–	**38**	38
Stephen Hodge	**38**	41	**–**	–	**–**	–	**–**	–	**38**	41
Jim Stretton	**48**	48	**–**	–	**–**	–	**–**	–	**48**	48
Former Members										
Alastair Ross Goobey(xiv)	**–**	37	**–**	–	**–**	–	**–**	–	**–**	37
Andrew Kendrick(xv)	**–**	28	**–**	–	**–**	–	**–**	–	**–**	28
Paul Kelly(xxiv)	**–**	32	**–**	–	**–**	–	**–**	–	**–**	32
David Robson(xxiv)	**–**	29	**–**	–	**–**	–	**–**	–	**–**	29

(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
(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
(ix) Member of the Franchise Board only
(x) Member of the Nominations, Appointments & Compensations Committee (NACC) for 2004
(xi) Other includes payments into a Funded Unapproved Retirement Benefit Scheme (FURBS) of 20% of Executive Directors' total salary. This is grossed up for tax in respect of Nick Prettejohn only. In 2003, Rolf Tolle received a payment of £220,000 in respect of accepting office as an Executive Director. The amount stated in respect of the Chairman represents pension contributions to a personal pension scheme
(xii) Steven Burns was appointed a member of the Franchise Board on 3 December 2003
(xiii) Andreas Prindl was appointed a member of Council on 21 November 2003
(xiv) Alastair Ross Goobey's term of office as a Council member expired on 25 November 2003, until that date he was also a member of NACC
(xv) Andrew Kendrick resigned as a member of the Franchise Board on 25 September 2003
(xvi) Andrew Moss became a member of the Franchise Board on 1 January 2003 and left the Corporation of Lloyd's on 8 May 2004
(xvii) Rolf Tolle became a member of the Franchise Board on 3 March 2003
(xviii) 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
(xix) Brian Pomeroy's term of office as a Council member expired on 31 December 2004
(xx) Judith Hanratty retired from the Franchise Board on 31 December 2004
(xxi) Luke Savage joined the Corporation of Lloyd's on 20 September 2004 and was appointed to the Franchise Board on 30 September 2004
(xxii) Representative of SUMAC Underwriting (UK) Limited
(xxiii) Philip Lader was appointed a member of Council on 2 March 2004
(xxiv) Paul Kelly and David Robson's terms of office as Council members expired on 31 January 2004

REPORT OF THE NOMINATIONS, APPOINTMENTS AND COMPENSATION COMMITTEE continued

Lloyd's Pension Scheme provisions

	Contributions in year to 31 Dec 2004[i] £000	Age at 31 Dec 2004	Increase in pension in year to 31 Dec 2004 – actual £000	Increase in pension in year to 31 Dec 2004 – net of price inflation £000	Total accrued annual pension in year to 31 Dec 2004 £000 pa	Retirement age
Nick Prettejohn	n/a	44	2	1	24	60
Andrew Moss	n/a	46	2	2	9	60
Luke Savage	n/a	43	1	1	1	60
Rolf Tolle	n/a	57	3	3	6	60

(i) The Lloyd's Pension Scheme is a non-contributory pension scheme

Transfer values of accrued pension benefits

	Transfer value of accrued pension as at 31 Dec 2003 £000	Transfer value of accrued pension as at 31 Dec 2004 £000	Increase in transfer value over the year less director's own contributions £000
Nick Prettejohn	194	245	51
Andrew Moss	71	96	25
Luke Savage	n/a	6	6
Rolf Tolle	39	98	59

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

Members of the Council of Lloyd's and Franchise Board's share of the Long Term Incentive Plan

			Estimated Long Term Bonus						
	Award year	Discretionary Performance Bonus £000	As at 31 Dec 2003 £000	Change in year £000	As at 31 Dec 2004 £000	Total £000	Amount paid during the year ended 31 Dec 2003 £000	Amount paid during the year ended 31 Dec 2004 £000	Total award outstanding as at 31 Dec 2004 £000
Nick Prettejohn	2002	110	228	(65)	163	273	178	85	10
	2003	135	267	48	315	450	–	224	226
	2004	80	–	165	165	245	–	–	245
Luke Savage	2004	6	–	13	13	19	–	–	19
Rolf Tolle	2003	126	249	45	294	420	–	209	211
	2004	89	–	182	182	271	–	–	271

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 2004.

Composition of the Audit Committee
In 2004 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 four times during the year. The members of the Committee in 2004 and their attendance at meetings are indicated in the Corporate Governance report on page 34.

On 31 December 2004, Brian Pomeroy's term of office as a member of Council and Chairman of the Committee ceased. Stephen Hodge was appointed Chairman of the Committee by the Council on 2 February 2005.

For the purposes of the Combined Code, Stephen Hodge is 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 financial statements including the Pro Forma Annual Accounting Statement, the global results, the financial statements of the Corporation of Lloyd's and the Central Fund and principal regulatory filings;

- 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 Corporation of Lloyd's; and

- ensuring that appropriate arrangements are in place for ensuring compliance with relevant laws and regulations.

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

Report on the Committee's activities in 2004
The principal issues addressed during 2004 were:

- the annual financial statements for 2003 including financial disclosures and various accounting matters raised by management and auditors;

- the 2003 FSA return;

- the FSA risk assessment of Lloyd's and management's response;

- 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; and

- assessment of the effectiveness of internal controls.

The Committee also received reports from the Compliance Officer, reviewed management accounts and carried out an effectiveness review of internal and external auditors. It also reviewed its own performance.

The Chief Executive Officer, the Director, Finance and Risk Management, the 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

RISK AND RESPONSIBILITY

The Lloyd's market may be synonymous with risk, but the Corporation takes its wider responsibilities seriously. As franchisor, we recognise that our responsibilities to franchisees, suppliers, employees and neighbouring communities are wide-ranging. This is reflected in our Corporate Responsibility policy and action plan, which was developed in 2004.

Our Corporate Responsibility policy: an overview
Our commitments fall under four main headings:

- **Marketplace:** The insurance services provided by Lloyd's are important to a thriving UK and global economy. As well as its own responsibility to conduct business in full compliance with laws and regulations, including those relating to whistleblowing, financial crime, money laundering, conflicts of interest and client confidentiality, the Corporation recognises its role in helping and supporting franchisees in their efforts to conduct their business in compliance with such regulations.

- **Workplace:** All businesses depend on their people, Lloyd's is no exception. We fully recognise our responsibility for ensuring that all employees are treated with fairness, integrity and respect. To this end, we have developed a set of policies that cover every aspect of an individual's working life at the Corporation, from recruitment and remuneration, to flexible working and work/life balance. In 2004, a particular focus of activity has been to focus on the benefits of diversity.

- **Environment:** We operate a wide-ranging environment policy covering everything from energy efficiency to waste reduction and vehicle emissions. We are also developing work with our suppliers, tenants, staff and users of the Underwriting Room to ensure support for environmental initiatives; for example, encouraging suppliers to minimise packaging or use recyclable materials.

- **Community:** Lloyd's success is impacted by the health and prosperity of the communities of which it is a part – locally, nationally and internationally. Lloyd's has a long-standing tradition of charitable giving and involvement in the local community. Please turn to page 26 for more on the Lloyd's Charities Trust and page 28 for details of how employees from both the Corporation and firms across the market are supported and encouraged to give part of their time and skills to the local community.

Two successful initiatives drawn from our action plan for Corporate Responsibility are detailed below.

Diversity: realising the benefits
Lloyd's believes that diversity is good for business; a workforce that embraces individuals from a wide range of backgrounds is likely to perform better.

The Corporation has established a Diversity Steering Group to promote equality and diversity within the organisation. It meets monthly with members drawn from business units across the Corporation. The group exists to promote equality and diversity within Lloyd's by:

- Acting as a centre of excellence and knowledge for diversity issues;

- Recommending practical measures for meeting statutory and commercial requirements in relation to diversity; and

- Developing proposals that will help individuals and departments to take greater responsibility for diversity.

The Diversity Steering Group has the full support of the Executive Committee.

Recycling: finding a good home for unwanted furniture
In partnership with Green-Works, a social business in East London, Lloyd's has been able to pass on or recycle over 60 tonnes of old office furniture to local charities, schools, health centres and community groups. Some has even been used to create innovative artworks.

Corporate responsibility: aiming higher
Running a successful business in a socially responsible manner is always work in progress. As one goal is partially achieved, another presents itself. To ensure we continue to improve, in 2005 we aim to benchmark our Corporate Responsibility policy against other organisations throughout the UK. The results will help to further define the policy and identify new initiatives for the action plan.

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 2004, I received 16 new complaints; five more than the previous year.

In eight 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 these cases I explained to the complainant why this was so with a detailed letter of response. In one case I found that Lloyd's was guilty of maladministration; however, I was satisfied that the complainant had not suffered an injustice as a consequence of the maladministration and took no action against Lloyd's.

On four occasions I referred the complaint to the Lloyd's department concerned and in three of these cases Lloyd's was able to take action sufficient to resolve the complaint. In the remaining case Lloyd's wrote a letter of explanation which prompted the complainant to withdraw his complaint; however, he indicated that he might resurrect the complaint at a later date.

Two cases fell outside my jurisdiction and there is one complaint still under investigation.

The expenses incurred by my office during 2004 amounted to £37,835.

STATEMENT OF LLOYD'S RESPONSIBILITIES IN RESPECT OF THE FINANCIAL STATEMENTS

Byelaws made under Lloyd's Act 1982 require Lloyd's to prepare financial statements for each financial year which give a true and fair view of the state of affairs of the Corporation and of the surplus or deficit for that period. The financial statements are required to be approved by the Council of Lloyd's. The Council has determined that in preparing those financial statements it is appropriate to:

- Select suitable accounting policies and then apply them consistently;

- Make judgements and estimates that are reasonable and prudent;

- State whether applicable accounting standards have been followed, subject to any material departures disclosed and explained in the financial statements; and

- Prepare the financial statements on the going concern basis unless it is inappropriate to presume that the Corporation will continue in business.

Lloyd's is responsible for keeping proper accounting records which disclose with reasonable accuracy at any time the financial position of the Corporation. The Council is responsible for safeguarding the assets of the Corporation and hence 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 financial statements for the year ended 31 December 2004 which comprise the consolidated revenue account, consolidated balance sheet, consolidated cash flow statement, consolidated statement of total recognised gains and losses and the related notes 1 to 27. These financial statements have been prepared on the basis of 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 audited.

This report is made solely to the members of Lloyd's, as a body, in accordance with the Council of Lloyd's instructions to us as set out under 'Respective responsibilities 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 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 responsibility to anyone other than the Corporation 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 Lloyd's and auditors

As described in the Statement of Lloyd's Responsibilities, Lloyd's is responsible for the preparation of the financial statements and the Report of the Nominations, Appointments and Compensation Committee which are approved by the Council of Lloyd's.

The Council of Lloyd's has instructed us to audit the financial statements and the section of the Report of the Nominations, Appointments and Compensation Committee to be audited in accordance with United Kingdom Auditing Standards and report to you our opinion as to whether the financial statements give a true and fair view and whether the section of the Report of the Nominations, Appointments and Compensation Committee to be audited has been properly prepared in accordance with the basis of preparation described therein. We also report to you if, in our opinion, Lloyd's has not kept proper accounting records, or if we have not received all the information and explanations we require for our audit.

Basis of audit opinion

We conducted our audit in accordance with United Kingdom Auditing Standards issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the financial statements and the section 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 Lloyd's in the preparation of the financial statements, and of whether the accounting policies are appropriate to the Corporation'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 financial statements and the section 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 financial statements and the section of the Report of the Nominations, Appointments and Compensation Committee to be audited.

Opinion

In our opinion:

- the financial statements give a true and fair view of the state of affairs of the Corporation as at 31 December 2004 and of its surplus for the year then ended; and

- the section of the Report of the Nominations, Appointments and Compensation Committee to be audited has been properly prepared in accordance with the basis of preparation described therein.

Ernst & Young LLP

Ernst & Young LLP, Registered Auditor, London

6 April 2005

CONSOLIDATED REVENUE ACCOUNT

for the year ended 31 December 2004

	Note	2004 £000	2004 £000	2003 £000	2003 £000
Operating income	3		**180,453**		141,420
Operating expenses	4		**(160,742)**		(160,267)
Group operating surplus/(deficit)			**19,711**		(18,847)
Share of operating profits of associates	14	**2,736**		3,440	
Amortisation of goodwill of associates	14	**(118)**		(118)	
Total share of associates' results			**2,618**		3,322
Total operating surplus/(deficit)			**22,329**		(15,525)
Profit on sale of the Lloyd's 1958 building	12		**23,638**		–
Profit on disposal of discontinued operations			**–**		1,702
Surplus/(deficit) on ordinary activities before finance			**45,967**		(13,823)
Finance					
Dividends receivable from non-consolidated subsidiaries	14		**7,490**		7,490
Dividends and interest receivable:	7				
Group		**7,166**		5,986	
Associates		**103**		99	
Deficit on sale and revaluation of investments	15	**(2,812)**		(4,465)	
Interest payable and similar charges	7	**(501)**		(589)	
			3,956		1,031
Surplus/(deficit) on ordinary activities after finance			**57,413**		(5,302)
Premium levy income	8	**–**		260,858	
Transfers to Lloyd's New Central Fund	9	**–**		(279,493)	
			–		(18,635)
Surplus/(deficit) before taxation			**57,413**		(23,937)
Taxation (charge)/credit	10		**(8,802)**		6,651
Surplus/(deficit) for the year			**48,611**		(17,286)

CONSOLIDATED STATEMENT OF TOTAL RECOGNISED GAINS AND LOSSES

for the year ended 31 December 2004

	Note	2004 £000	2003 £000
Surplus/(deficit) for the year:			
Group		**46,750**	(19,673)
Associates		**1,861**	2,387
Total surplus/(deficit) for the year		**48,611**	(17,286)
Unrealised gain on disposal of subsidiaries	21	**109**	500
Unrealised gain on revaluation of other investments	14	**2,797**	–
Total recognised gains/(losses) relating to the year	24	**51,517**	(16,786)

CONSOLIDATED BALANCE SHEET

as at 31 December 2004

	Note	2004 £000	2003 £000
Fixed assets			
Tangible assets	11	**14,551**	15,023
Investments			
Investments in associates	14	**4,459**	6,332
Subsidiary companies not consolidated	14	**90**	155
Other	14	**9,710**	6,913
		28,810	28,423
Statutory insurance deposits	15	**112,641**	111,594
Funding provided by syndicates	15	**(106,831)**	(107,871)
		5,810	3,723
Total non-current assets		**34,620**	32,146
Current assets			
Stocks	16	**461**	467
Debtors and prepayments			
– amounts due: within one year	17	**51,756**	70,915
: after more than one year – pension scheme prepayment	18	**28,806**	24,318
Investments	19	**46,442**	5,134
Cash		**65,903**	47,034
Total current assets		**193,368**	147,868
Creditors – due within one year	20	**(99,453)**	(102,253)
Net current assets		**93,915**	45,615
Total assets less current liabilities		**128,535**	77,761
Provisions for liabilities and charges	21	**(6,653)**	(7,396)
Net assets		**121,882**	70,365
Revaluation reserve	24	**9,710**	6,913
Accumulated reserve	24	**112,172**	63,452
Total reserves	24	**121,882**	70,365

Signed on behalf of the Council of Lloyd's on 6 April 2005

Lord Levene of Portsoken, Chairman

Nick Prettejohn, Chief Executive Officer

CONSOLIDATED CASH FLOW STATEMENT

for the year ended 31 December 2004

	Note	2004 £000	2003 £000
Cash flow from operating activities	22	**32,113**	(1,158)
Dividends received from associates		**3,734**	2,086
Returns on investments and servicing of finance	22	**14,163**	8,014
Taxation		**(13)**	1,161
Capital expenditure and financial investment	22	**21,643**	(1,211)
Acquisitions and disposals	22	**–**	1,702
Cash inflow before use of liquid resources and financing		**71,640**	10,594
Management of liquid resources	22	**(45,167)**	(48,567)
Financing	22	**(7,604)**	53,410
Increase in cash in the year		**18,869**	15,437
Reconciliation of net cash flow to movement in net funds (note 22)			
Increase in cash in the year		**18,869**	15,437
Cash outflow/(inflow) from movement in financing		**7,604**	(53,410)
Cash outflow from movement in liquid resources		**45,167**	48,567
Change in net funds resulting from cash flows		**71,640**	10,594
Other movements	22	**(9,376)**	2,660
Movement in net funds in the year		**62,264**	13,254
Net funds at 1 January		**55,891**	42,637
Net funds at 31 December	22	**118,155**	55,891

NOTES TO THE FINANCIAL STATEMENTS

as at 31 December 2004

1. Basis of preparation and consolidation

In 1871, pursuant to 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). The activities of the Society are accordingly governed by statute and, since 1982, have been managed by the Council of Lloyd's (the Council) pursuant to Lloyd's Act 1982. The Society's main corporate purposes are to facilitate the carrying on of insurance business by members of Lloyd's and the advancement and protection of their interests in this context.

The purpose of the financial statements is to demonstrate the income and expenditure, financial position and cash flows of the Corporation of Lloyd's to members in their capacity as members. The financial statements exclude all insurance-related activities arising from members' underwriting at Lloyd's. In meeting this objective, certain operating subsidiaries are consolidated whilst others, principally Lioncover Insurance Company Limited and Centrewrite Limited, are excluded since their activities relate to running off the underwriting affairs of certain syndicates and Names. The Corporation of Lloyd's does not itself underwrite and the Council has taken advantage of the exemption permitted by FRS 2 'Accounting for subsidiary undertakings' not to consolidate these subsidiaries because their activities are so dissimilar that to consolidate their results would not achieve the objective of the financial statements. For the same reasons the Central Fund, which is held at the Council's direction, has not been consolidated, as it is primarily a fund available for the protection of policyholders. However, the Central Fund financial statements describe how its assets may be used to cover members' solvency shortfalls. In the last resort, the Corporation of Lloyd's assets may also be used for this purpose at the discretion of Council.

The subordinated loan notes issued by the Society on 17 November 2004 have been accounted for within the financial statements of the Central Fund, the proceeds of the issue being an addition to Central Fund assets, thereby strengthening the capital base of the Society and the Lloyd's market.

The financial statements have been prepared under the historical cost convention as modified by the revaluation of investments and in accordance with applicable accounting standards. There were no discontinued activities during 2004.

FRS 13 'Derivatives and other financial instruments – disclosures' has been fully adopted in these financial statements. In prior years FRS 13 did not apply to the Corporation of Lloyd's, however, certain voluntary disclosures were given. The additional information is also included in the 2003 comparatives in note 23. There has been no impact on the primary financial statements as a result of providing the additional disclosures.

The effective date for the full adoption of FRS 17 'Retirement benefits' is 1 January 2005. The Corporation of Lloyd's has not adopted the standard early but has made the transitional disclosures required by the standard in note 18.

Lloyd's is regulated by the Financial Services Authority (FSA).

2. Principal accounting policies

A Tangible fixed assets and depreciation

Fixed assets are included at cost.

Freehold land is not depreciated. Depreciation is provided on other assets at rates calculated to write off, on a straight-line basis, the cost less estimated residual value over their expected useful lives. The principal categories of assets and their expected useful lives are as follows:

Freehold buildings	60 years
Plant	15 or 25 years
Fixtures, fittings, furniture, computers, software and equipment	2 to 10 years
Motor vehicles	4 years

Costs incurred in acquiring and developing computer software are capitalised as tangible fixed assets where the software supports a significant business system and the expenditure leads to the creation of an identifiable durable asset.

The carrying values of tangible fixed assets and freehold buildings are reviewed for impairment if events or changes in circumstances indicate the carrying values may not be recoverable.

NOTES TO THE FINANCIAL STATEMENTS continued

as at 31 December 2004

2. Principal accounting policies continued

B Investments

Statutory insurance deposits comprise securities and cash deposits maintained in the United Kingdom and various overseas countries to comply with local insurance regulations. Investments are shown at market value at the balance sheet date and profits and losses arising on revaluation are dealt with in the consolidated revenue account.

In the consolidated financial statements, shares in associates are accounted for using the equity method. The consolidated revenue account includes the group's share of the pre-tax profits and attributable taxation of the associates based on financial statements for the year. In the consolidated balance sheet, the investment in associates is shown as the group's share of the net assets of the associates and any associated goodwill.

Other investments represent Lloyd's collection of various paintings, antiques and artefacts and are included at market valuation. The collection is revalued at least every three years and any revaluation surplus or deficit is taken to the revaluation reserve.

C Acquisitions and disposals

On the acquisition of a business, including an interest in an associate, fair values are attributed to the group's share of the net separable assets acquired. Where the cost of the acquisition exceeds the fair values attributable to such net assets, the difference is treated as purchased goodwill and capitalised in the balance sheet in the year of acquisition and amortised over the estimated useful life.

D Stocks

Stocks are stated at the lower of cost and net realisable value.

E Income

Income is attributable to the continuing activity of the provision of services and infrastructure principally for the operation of the Lloyd's insurance market.

Income, which is stated net of value added tax, represents amounts invoiced for goods and services provided, including members' subscriptions and is recognised in the period for which it is received.

Income excludes local premium taxes in connection with overseas underwriting activities.

F Pension costs

The expected cost of pensions in respect of the defined benefit pension scheme operated by the Corporation of Lloyd's is charged to the consolidated revenue account so as to spread the cost over the service lives of employees in the scheme. Variations from regular cost are spread over the expected remaining service lives of current employees to the extent that the resulting credit does not exceed the regular cost. The pension cost is assessed in accordance with the advice of qualified actuaries. Discretionary awards are charged to the consolidated revenue account in the year they are granted when there is an actuarial deficit.

G Taxation

Deferred tax is recognised in respect of all timing differences that have originated but not reversed at the balance sheet date where transactions or events have occurred at that date that will result in an obligation to pay more, or a right to pay less or to receive more, tax. Deferred tax assets are recognised only to the extent that it is considered that it is more likely than not that there will be suitable taxable profits from which the future reversal of the underlying timing differences can be deducted. 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.

H Foreign currency and derivative instruments

Transactions in foreign currencies are recorded at the rate ruling at the date of the transaction. Monetary assets and liabilities are retranslated at the rate of exchange ruling at the balance sheet date.

The Corporation of Lloyd's and its consolidated subsidiaries enter 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, contracted rates are used for balance sheet valuation purposes.

2. Principal accounting policies continued

H Foreign currency and derivative instruments

Where contracts are entered into to provide a service to the Lloyd's market, these are marked-to-market at the year end closing rate. Where gains or losses are not expected to be refunded to or recovered from the Lloyd's market, these amounts are taken to the consolidated revenue account.

The principal year end exchange rates were:

	2004	2003
US$	**1.92**	1.79
Can$	**2.30**	2.31
Euro	**1.41**	1.42

3. Operating income	2004 £000	2003 £000
Market charges		
Managing agents and syndicates	**52,152**	53,624
Members and members' agents	**14,463**	14,913
Franchise Performance and Risk Management charge (2003: Regulatory levy)	**12,293**	8,921
Total market charges	**78,908**	77,458
Members' subscriptions	**74,935**	36,142
Other income		
Market settlement recoveries	**8,864**	7,919
Rent and building service charges	**6,852**	6,707
Charges to associates	**5,043**	6,891
Charges to Lloyd's Central Fund	**2,599**	3,465
Income from other services	**3,252**	2,838
Total other income	**26,610**	27,820
Total operating income	**180,453**	141,420

Market settlement recoveries represent continuing debt recoveries from the 1996 *Reconstruction and Renewal* settlement.

4. Operating expenses	2004 Corporation £000	2004 Kinnect Limited £000	2004 Total £000	2003 Corporation £000	2003 Kinnect Limited £000	2003 Total £000
Operating expenses include:						
Employment costs (note 5)	**53,152**	**6,955**	**60,107**	45,902	7,581	53,483
Overseas operating expenses (note 6)	**20,592**	**–**	**20,592**	21,524	–	21,524
Professional fees, including legal fees and related costs	**10,208**	**412**	**10,620**	15,073	716	15,789
Operating lease rentals – land and buildings	**16,767**	**–**	**16,767**	16,767	–	16,767
Audit services	**187**	**17**	**204**	109	14	123
Further assurance services payable to Ernst & Young LLP	**410**	**–**	**410**	670	10	680
Tax services payable to Ernst & Young LLP	**74**	**17**	**91**	31	–	31
Other services payable to Ernst & Young LLP	**311**	**–**	**311**	430	23	453
Depreciation (note 11)	**2,541**	**37**	**2,578**	2,590	30	2,620
Charitable donations	**216**	**1**	**217**	199	–	199

The costs of Kinnect Limited to 31 December 2004 total £15.1m (2003: £17.9m) and include, in addition to the costs itemised above, systems and communications costs of £6.0m (2003: £7.9m).

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5. Employment	2004 £000	2003 £000
Salaries and wages (including performance-related bonus)	**33,393**	29,557
Long term incentive plan (excluding social security costs – note 21)	**2,823**	4,643
Pension costs (note 18)	**8,538**	536
Social security costs	**4,274**	3,986
Severance costs	**2,049**	1,818
Contract and agency staff	**4,087**	8,442
Other employment costs	**4,943**	4,501
	60,107	53,483

	2004 Number	2003 Number
Average numbers of employees during the year	**587**	582

The emoluments of the Chairman, Chief Executive Officer, members of Council and Franchise Board are included in the report of the Nominations, Appointments and Compensation Committee on page 70.

6. Overseas operating expenses	2004 £000	2003 £000
Expenses in connection with underwriting activities in the following areas:		
USA	**6,962**	8,146
Canada	**4,058**	4,433
Asia	**3,558**	3,692
Europe	**4,100**	3,560
Africa, Australasia, Central and South America	**1,914**	1,693
	20,592	21,524
Operating expenses include:		
Employment	**5,848**	5,258
Legal and professional	**4,672**	5,822
Systems and communications	**3,121**	3,099
Premises	**1,392**	1,471
Other expenses	**5,559**	5,874
	20,592	21,524

7. Interest	Other interest £000	Statutory insurance deposits £000	2004 Total £000	2003 Total £000
Dividends and interest receivable:				
Group Dividends and interest	**3,482**	**3,103**	**6,585**	4,573
Other movements	**–**	**581**	**581**	1,413
Total group	**3,482**	**3,684**	**7,166**	5,986
Associates	**103**	**–**	**103**	99
Total interest receivable	**3,585**	**3,684**	**7,269**	6,085
Interest payable and similar charges:				
Bank loans/overdrafts	**–**	**–**	**–**	(59)
Funding provided by syndicates	**–**	**(501)**	**(501)**	(511)
Foreign exchange movement	**–**	**–**	**–**	(19)
Total interest payable	**–**	**(501)**	**(501)**	(589)

Other movements include realised and unrealised exchange differences arising on the revaluation of foreign currency operating cash flows and funding provided by syndicates.

8. Premium levy income	2004 £000	2003 £000
Premium levy income:		
Receivable at 1 January	**(19,641)**	(18,635)
Levy collections	**19,641**	264,374
Receivable at 31 December	**–**	19,641
Refundable in respect of return premiums at 31 December	**–**	(4,522)
	–	260,858

The premium levy was originally required to repay a syndicated bank loan. The Council of Lloyd's agreed to continue to collect the premium levy after the syndicated bank loan was fully repaid in September 2001. For 2002 and 2003 the premium levy was increased to 2% of premiums received for most classes of business (1% for UK motor and life business). The premium levy ceased at the end of 2003 having achieved its objective of increasing central assets.

9. Transfers to Lloyd's New Central Fund

There were no contributions to the Lloyd's New Central Fund during the year (2003: £279.5m in respect of the premium levy which ceased at the end of 2003).

10. Taxation	2004 £000	2003 £000
(a) Analysis of charge in the year		
Current tax:		
UK corporation tax based on profits for the year at 30% (2003: 30%)	**–**	–
Current year group tax relief	**(7,925)**	3,660
Adjustments in respect of previous years	**(92)**	2,065
Foreign tax suffered	**(13)**	(26)
Share of associate undertakings' current tax	**(860)**	(1,034)
Total current tax (note 10(b))	**(8,890)**	4,665
Deferred tax:		
Origination and reversal of timing differences	**88**	1,986
Taxation (charge)/credit	**(8,802)**	6,651

(b) Factors affecting current tax charge	2004 £000	2003 £000
The tax assessed for the year is lower than the standard rate of corporation tax in the UK of 30%		
The differences are explained below:		
Surplus/(deficit) on ordinary activities before tax	**57,413**	(23,937)
Surplus/(deficit) on ordinary activities multiplied by standard rate of corporation tax in the UK of 30%	**(17,224)**	7,181
Expenses not deductible for tax purposes	**(1,732)**	(4,526)
Non-taxable income	**9,537**	2,247
Other timing differences	**(610)**	30
Capital allowances for the year in excess of depreciation	**1,324**	999
Utilisation of tax credits/(losses)	**15**	(3,305)
Overseas tax	**(13)**	(26)
Adjustments in respect of previous years	**(92)**	2,065
Other	**(95)**	–
Current tax (charge)/credit (note 10(a))	**(8,890)**	4,665

(c) Deferred tax	2004 £000	2003 £000
A deferred tax asset has been recognised in respect of the following timing differences:		
Accelerated capital allowances	**1,159**	594
Other	**1,597**	2,074
Deferred tax asset at 31 December	**2,756**	2,668
At 1 January	**2,668**	682
Deferred tax credit in consolidated revenue account (note 10(a))	**88**	1,986
At 31 December (note 17)	**2,756**	2,668

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as at 31 December 2004

11. Fixed assets	**Freehold land and buildings £000**	**Plant and other fixed assets £000**	**Total £000**
Cost:			
At 1 January 2004	**10,413**	**44,908**	**55,321**
Additions	**–**	**2,120**	**2,120**
Disposals	**–**	**(1,014)**	**(1,014)**
At 31 December 2004	**10,413**	**46,014**	**56,427**
Depreciation:			
At 1 January 2004	**3,426**	**36,872**	**40,298**
Charge for the year	**125**	**2,453**	**2,578**
Disposals	**–**	**(1,000)**	**(1,000)**
At 31 December 2004	**3,551**	**38,325**	**41,876**
Net book value:			
At 31 December 2004	**6,862**	**7,689**	**14,551**
At 31 December 2003	6,987	8,036	15,023

Included in freehold land and buildings is land valued at £2.5m (2003: £2.5m) which has not been depreciated in the year.

12. Profit on sale of the Lloyd's 1958 building

On 8 February 2001, the Corporation entered into an agreement with a subsidiary of British Land plc for the sale and the simultaneous leaseback of the Lloyd's 1958 building. The leaseback expired on 31 December 2001 and Lloyd's vacated the building on that date. A profit of £25.1m was recognised in 2001 and a further £1.9m in 2002.

The sale agreement provided for Lloyd's to benefit from any enhanced value as a result of the site being redeveloped. On 1 June 2004, additional proceeds of £24.3m were received and there were directly attributable costs of £0.7m, resulting in the recognition of a further profit of £23.6m.

13. Principal investments in subsidiary companies and associates

Entity	**Nature of business**	**Proportion of equity capital held**
Subsidiaries		
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 enables trading partners in commercial line insurance to store and exchange commercial terms, insuring clauses and risk data quickly and securely, to support placing and subsequent processing	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%

Centrewrite and Lioncover are not consolidated (note 14(b)).

13. Principal investments in subsidiary companies and associates continued

During 2001, the Corporation acquired interests in Ins-sure Holdings Limited and Xchanging Claims Services Limited.

The issued share capital of Ins-sure Holdings Limited is £4,000. There are three separate classes of shares. The Corporation 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 Corporation 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.

14. Investments

a) Investments in associates	Goodwill £000	Share of other net assets £000	2004 £000	2003 £000
At 1 January	**861**	**5,471**	**6,332**	6,031
Share of operating profits	**–**	**2,736**	**2,736**	3,440
Dividends received	**–**	**(3,734)**	**(3,734)**	(2,086)
Amortisation of goodwill	**(118)**	**–**	**(118)**	(118)
Share of interest income	**–**	**103**	**103**	99
Share of tax on profit on ordinary activities	**–**	**(860)**	**(860)**	(1,034)
At 31 December	**743**	**3,716**	**4,459**	6,332

Goodwill is being amortised on a straight-line basis over 10 years.

b) Subsidiary companies not consolidated	2004 £000	2003 £000
Shares of non-consolidated subsidiary companies at cost	**44**	44
Current accounts	**46**	111
	90	155

Non-consolidated insurance related subsidiaries 2004 balance sheet summary	Centrewrite £000	Lioncover £000	Total £000
Investments	**40,316**	**–**	**40,316**
Current assets	**13,199**	**3**	**13,202**
Current liabilities	**(11,380)**	**(80)**	**(11,460)**
	42,135	**(77)**	**42,058**
Insurance fund – assets	**686**	**599,362**	**600,048**
– liabilities	**(15,649)**	**(599,362)**	**(615,011)**
Shareholders' funds at 31 December 2004	**27,172**	**(77)**	**27,095**
Shareholders' funds at 31 December 2003	28,751	(61)	28,690
Profit/(loss) before dividends	**5,911**	**(16)**	**5,895**
Proposed dividends	**(7,490)**	**–**	**(7,490)**
Retained loss for the year	**(1,579)**	**(16)**	**(1,595)**

Dividends amounting to £7.49m have been proposed by Centrewrite in respect of the year ended 31 December 2004 (2003: £7.49m).

NOTES TO THE FINANCIAL STATEMENTS continued
as at 31 December 2004

14. Investments continued
Centrewrite Limited

Centrewrite, an authorised UK insurance company, was formed to reinsure individual syndicate years of account in run-off and individual members of such syndicates. In addition, it offers an estate protection plan to Names.

Lioncover Insurance Company Limited

Lioncover, an authorised UK insurance company, was formed to reinsure 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, all of Lioncover's reinsurance liabilities were reinsured to Equitas Reinsurance Limited.

As these financial statements are not yet available, the above figures have been produced from the management accounts as at 31 December 2004.

c) Other investments

Other investments represent Lloyd's collection of various paintings, antiques and artefacts. They have been included in the consolidated balance sheet at 31 December 2004 at an open market valuation of £9.7m (2003: £6.9m). The collection was valued 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, by Gurr Johns Limited, valuers and fine art consultants.

15. Statutory insurance deposits	2004 £000	2003 £000
Held by subsidiary companies:		
Statutory insurance deposits	112,641	111,594
Funding provided by syndicates	(106,831)	(107,871)
	5,810	3,723

Statutory insurance deposits	Securities £000	Cash deposits £000	2004 Total £000	2003 Total £000
Market value at 1 January	45,669	65,925	111,594	67,016
Additions at cost	29,701	352,102	381,803	279,929
Disposal proceeds	(36,725)	(341,219)	(377,944)	(230,886)
Deficit on the sale and revaluation of investments	(799)	(2,013)	(2,812)	(4,465)
Market value at 31 December	37,846	74,795	112,641	111,594

Analysis of securities at year end – statutory insurance deposits	2004 Cost £000	2004 Valuation £000	2003 Cost £000	2003 Valuation £000
Listed on:				
Overseas stock exchanges	32,551	32,818	40,093	40,268
	32,551	32,818	40,093	40,268
Unlisted:				
Fixed interest	4,964	5,028	5,609	5,401
	37,515	37,846	45,702	45,669

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

Unlisted fixed interest securities are valued as follows:

15. Statutory insurance deposits continued

	2004 £000	2003 £000
Foreign treasury bills – at market value	**4,520**	4,634
Foreign government debentures – at par and market value	**508**	767
	5,028	5,401

Funding provided by syndicates
These amounts comprise floating rate advances in foreign currencies and sterling repayable within one year:

	2004 £000	2003 £000
Lloyd's market – deposits	**(106,831)**	(107,871)
Allocated:		
Financing of underwriting deposits	**(101,629)**	(102,669)
Working capital	**(5,202)**	(5,202)
	(106,831)	(107,871)

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 Corporation avoids any risk arising from a mismatch between borrowing and lending terms (see note 23).

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.

16. Stocks	2004 £000	2003 £000
Consumables	**461**	467

17. Debtors and prepayments	2004 £000	2003 £000
Due within one year:		
Trade and other debtors	**24,425**	34,280
Dividends receivable from subsidiary companies not consolidated	**7,490**	7,490
Forward foreign exchange asset	**2,256**	3,233
Amounts due from group undertakings	**4,028**	4,028
Group tax relief receivable	**–**	3,664
Corporation tax receivable	**–**	9
Prepayments and accrued income	**10,801**	15,543
Deferred taxation (note 10)	**2,756**	2,668
	51,756	70,915
Due after more than one year:		
Pension scheme prepayment (note 18)	**28,806**	24,318

NOTES TO THE FINANCIAL STATEMENTS continued

as at 31 December 2004

18. Pension scheme

The Corporation of Lloyd's operates a defined benefit pension scheme with assets held in a separately administered fund. For the purposes of determining the funding position of the scheme and future contributions, a formal actuarial valuation of the scheme was carried out by Watson Wyatt LLP, actuaries and consultants, as at 30 June 2004 using the projected unit 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 was £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 subsidiaries 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. In November 2003, a discretionary increase of 2.8% for 2004 was awarded, which was funded out of the scheme surplus revealed by an interim actuarial review as at 30 June 2003. In November 2004, a discretionary increase of 3.1% was awarded for 2005. Because the results of the actuarial valuation for funding purposes disclosed a deficit as at 30 June 2004, a contribution of £3.1m was paid by the Corporation of Lloyd's in 2004. This has been charged to the 2004 consolidated revenue account in accordance with the requirements of SSAP24.

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 first payment of £4.2m was made in December 2004 and a further payment of £4.8m was made in February 2005. 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. During 2004, and up to February 2005, the Corporation of Lloyd's made contributions to Lloyd's Pension Scheme at a rate of 17% of pensionable salaries. In March 2005 a further contribution of £0.7m was made to reflect the increased contribution rate from 1 July 2004.

Disclosures under SSAP24

For the purposes of SSAP24, the market value of the scheme's assets equated to 112% of the benefits accrued to members, after allowing for assumed future increases in pensionable remuneration but excluding discretionary increases to pensions in payment as referred to above.

The liabilities of the scheme were valued using a discount rate which reflected best estimates of investment returns as at 30 June 2004 of 4.9% (in real terms relative to retail price inflation) rather than the more prudent assumptions adopted for the actuarial valuation carried out for funding purposes. Other assumptions remain unchanged from those noted above.

18. Pension scheme continued

The pension costs charged to the consolidated revenue account are as follows:

	2004 £000	2003 £000
Regular costs	**4,007**	–
Discretionary pension increase	**3,100**	–
Pension augmentation	**680**	–
Other pension costs	**751**	536
	8,538	536

The movement in the pension scheme prepayment included in the consolidated balance sheet is as follows:

	2004 £000	2003 £000
Balance at 1 January	**24,318**	24,318
Regular costs	**(4,007)**	–
Normal contributions	**4,295**	–
Special contributions	**4,200**	–
Balance at 31 December	**28,806**	24,318

The disclosures required in relation to the transitional arrangements within FRS 17 'Retirement benefits' have been based on the most recent formal actuarial review at 30 June 2004 updated to 31 December 2004. The major financial assumptions used by the actuary as at 30 June 2004 for the purposes of FRS 17 were as follows:

	2004 % per annum	2003 % per annum	2002 % per annum
General salary and wage inflation	**4.60%**	4.50%	4.10%
Rate of increase in pensions in payment			
– pre 6 April 1997 (in excess of GMPs)	**–**	–	2.30%
– post 5 April 1997	**2.80%**	2.70%	2.30%
Increases to deferred pensions	**2.80%**	2.70%	2.30%
Discount rate	**5.40%**	5.50%	5.75%
Price inflation	**2.80%**	2.70%	2.30%

FRS 17 will require immediate recognition in the consolidated balance sheet of the net surplus or deficit calculated at the balance sheet date. The standard requires the assets to be measured at their market value at that date and the liabilities to be discounted at the rate of return available at the balance sheet date on high quality corporate bonds.

Were FRS 17 to be implemented, the deficit in the pension scheme and the present value of the liability shown below would be included in the financial statements in place of the pension prepayment currently included in the consolidated balance sheet under SSAP24.

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18. Pension scheme continued

Asset analysis of the scheme and expected returns	2004 Expected rate of return % per annum	2004 Fair value £m	2003 Expected rate of return % per annum	2003 Fair value £m	2002 Expected rate of return % per annum	2002 Fair value £m
Bonds	**5.0%**	**105**	5.1%	101	5.0%	59
Equities	**8.2%**	**163**	8.3%	140	8.3%	160
Cash and net current assets	**3.6%**	**1**	3.7%	1	3.8%	1
Total market value of assets		**269**		242		220
Actuarial value of liability		**(322)**		(296)		(287)
Deficit in the scheme		**(53)**		(54)		(67)
Related deferred tax asset		**16**		16		20
Net pension liability		**(37)**		(38)		(47)

The table below shows the total reserves of the Corporation as disclosed in the consolidated balance sheet adjusted for the requirements of FRS 17 as at 31 December 2004:

	2004 £m	2003 £m
Total reserves	**122**	70
Exclude SSAP24 pension scheme prepayment	**(29)**	(24)
Net pension liability under FRS 17	**(37)**	(38)
Total reserves including pension liability	**56**	8

Movement in deficit during the year	2004 £m	2003 £m
Deficit in scheme at beginning of the year	**(54)**	(67)
Movement in the year:		
Contributions paid	**13**	–
Current service cost	**(7)**	(5)
Past service cost	**(4)**	(4)
Actuarial (loss)/gain recognised in statement of recognised gains and losses (STRGL)	**(1)**	22
Deficit in scheme before tax	**(53)**	(54)
Deferred tax	**16**	16
Deficit in scheme at end of the year after tax	**(37)**	(38)

18. Pension scheme continued

Analysis of the amount that FRS 17 would require to be recognised in the statement of total recognised gains and losses (STRGL)	2004 £m	2003 £m
Actual return less expected return on pension scheme assets	**11**	19
Experience losses arising on the scheme liabilities	**–**	(3)
Changes in the assumptions underlying the present value of the scheme liabilities	**(12)**	6
Actuarial (loss)/gain	**(1)**	22
Deferred tax movement during the year	**–**	(4)
Actuarial (loss)/gain net of deferred tax recognised in the STRGL	**(1)**	18

The measurement bases set by FRS 17 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.

Were FRS 17 to be implemented, the following amounts would be included in the consolidated revenue account for the year:

Analysis of the amount charged to operating profit	2004 £m	2003 £m
Current service cost	**7**	5
Past service cost	**4**	4
Total operating charge	**11**	9

Analysis of the amount credited to other finance income	2004 £m	2003 £m
Expected return on pension scheme assets	**16**	16
Interest on pension scheme liabilites	**(16)**	(16)
Net return	**–**	–

History of experience gains and losses	2004	2003	2002
Actual return less expected return on pension scheme assets:			
amount (£m)	**11**	19	(60)
percentage of scheme assets	**3.9%**	7.9%	(27.0%)
Experience gains and losses on scheme liabilities:			
amount (£m)	**–**	(3)	(9)
percentage of the present value of the scheme liabilities	**–**	(1.0%)	(3.2%)
Total amount recognised in the STRGL:			
amount (£m)	**(1)**	22	(57)
percentage of the present value of the scheme liabilities	**(0.3%)**	7.5%	(19.9%)

19. Current asset investments	2004 £000	2003 £000
Short term deposits and certificates of deposit	**46,442**	5,134

20. Creditors – due within one year	2004 £000	2003 £000
Accruals and deferred income	**31,403**	46,698
Forward foreign exchange liability	**1,899**	3,127
Trade and other creditors	**54,686**	44,966
Group tax relief payable	**4,353**	–
Taxation and social security	**4,248**	6,292
Arbitration awards	**2,864**	1,170
	99,453	102,253

NOTES TO THE FINANCIAL STATEMENTS continued

as at 31 December 2004

21. Provisions for liabilities and charges	Long term incentive plan £000	Travel insurance dispute £000	Other provisions £000	2004 Total £000	2003 Total £000
Balance at 1 January	**6,915**	**222**	**259**	**7,396**	4,263
Charged/(credited) to consolidated revenue account	**3,176**	**(156)**	**–**	**3,020**	5,278
Unrealised gain on disposal of subsidiaries	**–**	**–**	**(109)**	**(109)**	–
Utilised in the year	**(3,618)**	**(36)**	**–**	**(3,654)**	(2,145)
Balance at 31 December	**6,473**	**30**	**150**	**6,653**	7,396

Long term incentive plan

The Corporation of Lloyd's 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, and changes introduced for 2004, are outlined in the report of the Nominations, Appointments and Compensation Committee on pages 71 to 73. The provision, including employers' National Insurance, for estimated contribution amounts due in respect of the plan is as follows:

	Balance at 1 January £000	Paid in the year £000	Charged/ (released) in the year £000	Balance at 31 December £000
2002 Long term incentive plan	**1,621**	**(859)**	**(651)**	**111**
2003 Long term incentive plan	**5,294**	**(2,759)**	**360**	**2,895**
2004 Long term incentive plan	**–**	**–**	**3,467**	**3,467**
Total provisions	**6,915**	**(3,618)**	**3,176**	**6,473**

Included within the charge for the year are National Insurance contributions of £0.4m (2003: £0.6m).

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.

Travel insurance dispute

In 2001 a dispute arose that cast doubt on the validity of the travel insurance policies sold by The Management Company (London) Limited (in liquidation) to members of the public. The Management Company (London) Limited is not a related party to the Corporation of Lloyd's as defined by FRS 8 'Related Party Disclosures'. In order to protect the reputation of Lloyd's and the rights of policyholders, Lloyd's announced in July 2001 that it would meet all valid policyholders' claims. During 2002, the majority of the provision was utilised and parties involved in the dispute entered into a settlement agreement.

Other provisions

Other provisions comprise amounts provided for obligations arising from the sale of LPSO Limited during 2001.

22. Notes to the cash flow statement

A Reconciliation of surplus/(deficit) on ordinary activities before finance to operating cash flows	2004 £000	2003 £000
Operating surplus/(deficit)	**19,711**	(18,847)
Depreciation charges	**2,578**	2,620
Profit on sale of fixed assets	**(55)**	(39)
Decrease in stocks	**6**	–
(Increase)/decrease in debtors	**(8,511)**	8,385
Increase/(decrease) in creditors	**13,948**	(384)
(Decrease)/increase in provisions	**(634)**	3,133
	27,043	(5,132)
Premium levy collection	**19,641**	264,374
Transfers to Lloyd's New Central Fund	**(14,571)**	(260,400)
Net cash inflow/(outflow) from operating activities	**32,113**	(1,158)

B Analysis of cash flows for headings netted in the cash flow statement	2004 £000	2003 £000
Returns on investments and servicing of finance:		
Dividends received	**7,490**	2,750
Interest received	**7,196**	5,979
Interest paid	**(523)**	(715)
	14,163	8,014
Capital expenditure and financial investment:		
Purchase of tangible fixed assets	**(2,120)**	(1,801)
Sale of tangible fixed assets	**125**	590
Additional proceeds on sale of the Lloyd's 1958 building	**23,638**	–
	21,643	(1,211)
Acquisitions and disposals of business operations:		
Additional proceeds on sale of businesses	**–**	1,702
Management of liquid resources:		
Purchase of cash deposits	**(352,102)**	(244,891)
Purchase of securities	**(29,701)**	(35,038)
Sale of cash deposits	**299,911**	202,670
Sale of securities	**36,725**	28,692
	(45,167)	(48,567)
Financing:		
Increase in borrowings for insurance deposits	**(7,604)**	53,410
	(7,604)	53,410

Included within liquid resources are term deposits of less than a year, government securities and corporate bonds.

NOTES TO THE FINANCIAL STATEMENTS continued

as at 31 December 2004

22. Notes to the cash flow statement continued

C Analysis of net funds	At 01.01.04 £000	Cash flow £000	Other movements £000	At 31.12.04 £000
Cash in hand, at bank	47,034	18,869	–	65,903
Overnight deposit (see below, b)	4,605	(2,882)	–	1,723
	51,639	15,987	–	67,626
Current asset investments (see below, a)	5,134	41,308	–	46,442
Other deposits (see below, b)	106,989	6,741	(2,812)	110,918
Debt due within one year:				
Funding provided by syndicates	(107,871)	7,604	(6,564)	(106,831)
	55,891	71,640	(9,376)	118,155

a) Current asset investments comprise short term deposits and certificates of deposit that are not repayable on demand without penalty.

b) Overnight deposits and other deposits relating to the funding of Additional Securities Limited are included in the consolidated balance sheet under statutory insurance deposits.

23. Financial assets and liabilities

Financial instrument risk management

The Corporation's principle financial instruments comprise cash and liquid resources, investments, borrowings, provisions and items that arise directly from operations such as trade debtors and creditors.

Forward foreign exchange contracts are entered into to manage currency and interest rate risks of the Corporation and the Lloyd's group companies, as well as facilitating certain transactions in connection with the Lloyd's market. The Corporation separately provides a Currency Conversion Service (CCS) to participating Lloyd's syndicates.

The Corporation's treasury operations 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 Corporation, and related companies, 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.

Liquidity risk

The value and term of short term assets are carefully monitored against those of the Corporation's liabilities. The Corporation 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 Corporation as at 31 December 2004 (2003: £40m). There are no plans to utilise these facilities, which are available to meet unforeseen short term requirements and are renewed annually.

23. Financial assets and liabilities continued

Foreign currency risk

The Corporation enters into a variety of foreign exchange transactions in response to the foreign currency requirements of Lloyd's group companies, as well as facilitating certain transactions in connection with the requirements of the Lloyd's market. 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 Corporation 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 Corporation provides a Currency Conversion Service (CCS) to participating Lloyd's syndicates, converting insurance premiums and claims between 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 Corporation 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 Corporation.

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.

Financial assets and liabilities held

Other than short term debtors and creditors, the following material financial assets and liabilities were held at 31 December 2004:

	2004 Book value £000	**2004 Fair value £000**	2003 Book value £000	2003 Fair value £000
Primary financial instruments held or issued to finance operations				
Unhedged statutory insurance deposits	**112,641**	**112,641**	111,594	111,594
Investments	**46,442**	**46,442**	5,134	5,134
Cash and deposits	**65,903**	**65,903**	47,034	47,034
	224,986	**224,986**	163,762	163,762
Other financial assets				
Subsidiary companies not consolidated	**90**	**90**	155	155
Other investments	**9,710**	**9,710**	6,913	6,913
Financial assets	**234,786**	**234,786**	170,830	170,830
Funding provided by syndicates	**(106,831)**	**(106,831)**	(107,871)	(107,871)
Provisions for liabilities and charges	**(6,653)**	**(6,653)**	(7,396)	(7,396)
Financial liabilities	**(113,484)**	**(113,484)**	(115,267)	(115,267)
Net	**121,302**	**121,302**	55,563	55,563
Derivative financial instruments				
Outstanding forward foreign exchange gains	**2,256**	**2,256**	3,233	3,233
Outstanding forward foreign exchange losses	**(1,899)**	**(1,899)**	(3,127)	(3,127)

Outstanding forward foreign exchange contracts are marked-to-market at the year end closing rates to determine the fair value.

NOTES TO THE FINANCIAL STATEMENTS continued

as at 31 December 2004

23. Financial assets and liabilities continued

Funding provided by syndicates consist of annual multicurrency floating rate interest loans and 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.

The provisions for liabilities and charges are interest free and denominated in sterling.

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

	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
Sterling	**–**	**65,185**	**9,800**	**74,985**	**–**	**–**	**(6,653)**	**(6,653)**	**68,332**
United States dollar	**–**	**184**	**–**	**184**	**–**	**–**	**–**	**–**	**184**
Canadian dollar	**–**	**2,688**	**–**	**2,688**	**–**	**–**	**–**	**–**	**2,688**
Japanese yen	**–**	**12,017**	**–**	**12,017**	**–**	**–**	**–**	**–**	**12,017**
Australian dollar	**894**	**26**	**–**	**920**	**–**	**(941)**	**–**	**(941)**	**(21)**
Swiss franc	**31,731**	**17,550**	**–**	**49,281**	**–**	**(48,908)**	**–**	**(48,908)**	**373**
Singapore dollar	**–**	**30,405**	**–**	**30,405**	**–**	**(29,651)**	**–**	**(29,651)**	**754**
Hong Kong dollar	**–**	**22,934**	**–**	**22,934**	**–**	**(22,482)**	**–**	**(22,482)**	**452**
South African rand	**–**	**5,414**	**–**	**5,414**	**–**	**–**	**–**	**–**	**5,414**
Others	**5,221**	**30,737**	**–**	**35,958**	**–**	**(4,849)**	**–**	**(4,849)**	**31,109**
	37,846	**187,140**	**9,800**	**234,786**	**–**	**(106,831)**	**(6,653)**	**(113,484)**	**121,302**
	2003 £000	2003 £000	2003 £000	2003 £000	2003 £000	2003 £000	2003 £000	2003 £000	Net £000
Sterling	–	13,263	7,068	20,331	–	–	(7,396)	(7,396)	12,935
United States dollar	–	8,221	–	8,221	–	(2,898)	–	(2,898)	5,323
Canadian dollar	–	3,195	–	3,195	–	–	–	–	3,195
Japanese yen	–	13,471	–	13,471	–	(1,042)	–	(1,042)	12,429
Australian dollar	862	70	–	932	–	(915)	–	(915)	17
Swiss franc	39,211	14,628	–	53,839	–	(54,132)	–	(54,132)	(293)
Singapore dollar	–	19,496	–	19,496	–	(19,569)	–	(19,569)	(73)
Hong Kong dollar	–	18,301	–	18,301	–	(12,885)	–	(12,885)	5,416
South African rand	–	1,446	–	1,446	–	–	–	–	1,446
Cyprus pound	249	2,806	–	3,055	–	(10,353)	–	(10,353)	(7,298)
Others	5,347	23,196	–	28,543	–	(6,077)	–	(6,077)	22,466
	45,669	118,093	7,068	170,830	–	(107,871)	(7,396)	(115,267)	55,563

The average interest rate of the Australian dollar fixed interest security is 7.50% (2003: 9.00%) and the period for which the interest rate is fixed is 4.7 years (2003: 0.7 years). The average interest rate of the Switzerland franc fixed interest securities is 3.67% (2003: 3.83%) and the weighted average period for which the interest rate is fixed is 2.0 years (2003: 1.2 years).

Interest free financial assets represent other investments and investment in subsidiaries not consolidated (see note 14). Interest free financial liabilities represent provisions for liabilities and charges (see note 21).

23. Financial assets and liabilities continued

Borrowing facilities

The maturity profile of the undrawn committed facility is shown below:

	2004 £000	2003 £000
Expiring in one year or less	**40,000**	40,000

Derivative instruments	2004 £000	2003 £000
Cumulative gains unrecognised at 31 December	**2**	9
Gains expected to be recognised in the consolidated revenue account in the following year	**2**	9
Gains recognised in the consolidated revenue account in the current year arising in previous years	**9**	–

The Corporation and its consolidated subsidiaries enter 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 variance between closing and contracted rates are included in the consolidated balance sheet.

Where contracts are entered into to provide a service to the Lloyd's market, these are marked-to-market at the year end closing rates. Where gains and losses are not expected to be refunded to, or recovered from, the Lloyd's market, these amounts are taken to the consolidated revenue account as shown on the previous page.

24. Reserves	Revaluation reserve £000	Accumulated reserve £000	Total reserves £000	Total 2003 £000
Balance at 1 January	**6,913**	**63,452**	**70,365**	87,151
Total recognised gains/(losses) for the year	**2,797**	**48,720**	**51,517**	(16,786)
Balance at 31 December	**9,710**	**112,172**	**121,882**	70,365

Accumulated reserves attributable to:	2004 £000	2003 £000
Corporation of Lloyd's	**148,025**	89,754
Consolidated subsidiaries	**(41,804)**	(30,392)
Associates	**5,951**	4,090
	112,172	63,452

25. Commitments

a) Capital expenditure commitments

No contractual commitments exist at 31 December 2004 other than those included within the financial statements. The same applied at 31 December 2003.

	2004 Land and buildings £000	2003 Land and buildings £000
b) Operating lease commitments		
The annual commitments under non-cancellable operating leases are as follows:		
Leases expiring:		
Over five years	**16,767**	16,767

Commitments outstanding under the terms of the lease for the Lloyd's 1986 building have been included at current rental value to the first break of the lease in 2021. The lease was subject to a rent review in March 2001.

NOTES TO THE FINANCIAL STATEMENTS continued

as at 31 December 2004

26. Disclosure of related party transactions

In accordance with the exemption allowed by FRS 8 'related party disclosures', transactions with consolidated entities within the group have not been disclosed.

Services provided to Ins-sure Holdings Limited group in the year ended 31 December 2004 included operating systems support and development, premises and other administrative services. The total value of the services provided was £2,716,000 (2003: £4,738,000). In addition, Ins-sure Holdings Limited group have charged the Corporation £1,093,000 for services provided in the same year (2003: £1,077,000).

At 31 December 2004, there was a balance of £332,000 (2003: £921,000) owing from Ins-sure Holdings Limited group to the Corporation. The Corporation owed £15,000 to Ins-sure Holdings Limited at the same date (2003: £8,000).

Services provided to Xchanging Claims Services Limited group in the year ended 31 December 2004 included premises and other administrative services. The total value of the services provided was £2,327,000 (2003: £2,153,000). In addition, Xchanging Claims Services Limited group have charged the Corporation £131,000 for services provided in the same year (2003: £177,000).

At 31 December 2004, there was a balance of £340,000 (2003: £225,000) owing from Xchanging Claims Services Limited group to the Corporation. The Corporation owed £4,000 to Xchanging Claims Services Limited as the same date (2003: £5,000).

Services provided to Centrewrite Limited in the year ended 31 December 2004 included premises and other administrative services. The total value of the services provided was £549,000 (2003: £488,000). Centrewrite Limited did not charge the Corporation for any services in the same year. The same applied for 2003.

At 31 December 2004, there was a balance of £46,000 (2003: £111,000) owing from Centrewrite Limited to the Corporation.

Services provided to Lioncover Insurance Company Limited in the year ended 31 December 2004 included accounting and audit services. The total value of the services provided was £15,000 (2003: £13,000). Lioncover Insurance Company Limited did not charge the Corporation for any services in the same year. The same applied for 2003.

At 31 December 2004, there were no amounts due from Lioncover Insurance Company Limited to the Corporation. The same applied for 2003. The Corporation owed £nil (2003: £15,000) to Lioncover Insurance Company Limited at the same date.

In the normal course of business, the Corporation's own insurance arrangements may be underwritten by Lloyd's syndicates. Any such arrangements are based on independent professional advice.

There were no other related party transactions in 2004.

27. 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 2004 amounted to £9.3m (2003: £6.4m).

B) The Corporation of Lloyd's has given indemnities to Lioncover Insurance Company Limited, Centrewrite Limited and to certain Names under hardship and other agreements in respect of their underwriting losses. The Council has determined that any losses resulting from such indemnities will be met by the Central Fund. The financial statements of the Central Fund on pages 107 to 120 give further details of the indemnities and the exposures arising.

C) Uncollateralised bank guarantees and other arrangements have been entered into by the Corporation of Lloyd's and its subsidiary, Additional Securities Limited, to provide security in connection with the underwriting activities of the members of Lloyd's in the countries shown:

			2004 £000	2003 £000
Guarantees provided by the Corporation of Lloyd's:				
USA	US$1,500,000	(2003: US$1,500,000)	**781**	838
Guarantees provided by the Corporation of Lloyd's and Additional Securities Limited:				
Cayman Islands:				
Letter of credit	US$1,000,000	(2003: US$1,000,000)	**521**	559

D) The Corporation of Lloyd's has given indemnities to certain of its subsidiary companies, 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. Provision for any costs that may arise from these indemnities and agreements is made annually.

E) The claim in the Jaffray action that Lloyd's, between the years 1978 and 1988, made fraudulent misrepresentations which induced Names to become members of Lloyd's and continue underwriting was dismissed by the Court of Appeal on 26 July 2002 and the House of Lords has refused permission to appeal. Five Names have obtained permission to amend their pleadings in this action alleging negligent misrepresentation. 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) In the United States, the reparations action commenced against Lloyd's and others on behalf of descendents of slaves in respect of the insurance of slaves as cargo was dismissed by the US District Court for Northern District Court of Illinois on 26 January 2004. The Plaintiffs subsequently amended their complaint which Lloyd's (and other defendants) have applied to dismiss. The decision of the US District Court is awaited. Lloyd's does not accept any liability in respect of this action.

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 the involved Lloyd's syndicate. Lloyd's does not accept any liability in respect of this action.

In respect of all contingent liabilities noted above in paragraphs (A) – (H), no provision is made in these financial statements.

FIVE YEAR SUMMARY

	2000 £000	2001 £000	2002 £000	2003 £000	**2004 £000**
Consolidated revenue account					
Operating income	180,625	161,165	134,896	141,420	**180,453**
Operating expenses:					
Employment	(53,195)	(44,793)	(47,242)	(53,483)	**(60,107)**
Premises	(27,874)	(37,853)	(30,244)	(30,127)	**(30,339)**
Overseas operating expenses	(18,136)	(22,112)	(21,497)	(21,524)	**(20,592)**
Other expenses	(71,961)	(72,586)	(60,171)	(55,133)	**(49,704)**
Operating expenses	(171,166)	(177,344)	(159,154)	(160,267)	**(160,742)**
Operating surplus/(deficit)	9,459	(16,179)	(24,258)	(18,847)	**19,711**
Share of operating profits of associates before exceptional items	–	216	2,873	3,440	**2,736**
Share of exceptional items of associates	–	(495)	–	–	**–**
Amortisation of goodwill of associates	–	(78)	(118)	(118)	**(118)**
Total operating surplus/(deficit)	9,459	(16,536)	(21,503)	(15,525)	**22,329**
Profit on sale of the Lloyd's 1958 building	–	25,069	1,926	–	**23,638**
Profit on disposal of businesses	319	–	–	1,702	**–**
Dividends receivable	–	7,300	2,750	7,490	**7,490**
Finance	(7,064)	2,505	1,874	1,031	**3,956**
Premium levy income	–	–	256,147	260,858	**–**
Transfers to Lloyd's New Central Fund	–	(80,000)	(246,809)	(279,493)	**–**
Market settlement net	97,704	119,997	–	–	**–**
Taxation (charge)/credit	18,198	(491)	1,498	6,651	**(8,802)**
Surplus/(deficit) for the year	118,616	57,844	(4,117)	(17,286)	**48,611**

	Number	Number	Number	Number	**Number**
Average numbers of employees during the year	1,176	825	589	582	**587**

LLOYD'S CENTRAL FUND

Purpose of the Fund
The Lloyd's Central Fund continues to be held and administered by the Council of Lloyd's primarily as a fund available for the protection of policyholders, in accordance with the Byelaw of 14 July 1986 (the 'Old' Central Fund) and the Byelaw of 5 June 1996 (the New Central Fund). These financial statements reflect the separate activities of the New Central Fund and of the 'Old' Central Fund.

The 'Old' Central Fund will continue to receive recoveries of amounts contributed as part of the 1996 market settlement and meet any remaining liabilities arising from before the settlement date. The balance of the 'Old' Central Fund will eventually be transferred into the New Central Fund.

The New Central Fund was established with a transfer of £110m from the 'Old' Central Fund following authorisation by the Council on 4 June 1997. Members contribute to the New Central Fund each year based on a percentage of their allocated overall premium limit, partly by way of annual contribution and, from 2005, partly by way of loan from syndicate premiums trust funds. The annual contribution rate for 2004 was 1.25% (2003: 1%). New corporate members in 2004 underwriting on new syndicates are required to contribute at double the annual rate for their first three years of operations at Lloyd's. The New Central Fund syndicate loans rate is 0.75% of syndicate allocated capacity for the 2005 year of account. It is intended that syndicate loans will ordinarily be repaid on the closure of the year of account after three years.

As part of Lloyd's solvency procedures, assets of the Fund may be used to cover underwriting deficiencies of members at the preceding 31 December to enable them to pass the solvency test and meet the requirements of the Financial Services Authority. Assets may be made available to discharge the underwriting liabilities of members in the event of actual or potential default.

LLOYD'S CENTRAL FUND – INDEPENDENT AUDITOR'S REPORT TO THE COUNCIL OF LLOYD'S

We have audited the financial statements for the year ended 31 December 2004 which comprise the balance sheet, general fund account, cash flow statement and the related notes 1 to 21. These financial statements have been prepared on the basis of the accounting policies set out therein.

This report is made solely to the Council of Lloyd's in accordance with its instructions to us as set out under the 'Respective responsibilities of the Council of Lloyd's and auditors' below. Our audit work has been undertaken so that we might state to the Council those matters 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 responsibility to anyone other than the Council 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 is responsible for the administration of the Fund and approval of the financial statements prepared by Lloyd's. You have instructed us to audit the financial statements in accordance with United Kingdom Auditing Standards and report to you our opinion as to whether the financial statements give a true and fair view. We also report to you if, in our opinion, Lloyd's has not kept proper accounting records, or if we have not received all the information and explanations we require for our audit.

Basis of audit opinion
We conducted our audit in accordance with United Kingdom Auditing Standards issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the financial statements. It also includes an assessment of the significant estimates and judgements made by or on behalf of the Council in the preparation of the financial statements, and of whether the accounting policies are appropriate to the Fund'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 financial statements are free from material misstatement, whether caused by fraud or other irregularity or error. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the financial statements.

Opinion
In our opinion the financial statements give a true and fair view of the financial transactions of the Fund for the year ended 31 December 2004 and of the disposition at that date of its assets and liabilities.

Ernst & Young LLP

Ernst & Young LLP, Registered Auditor, London
6 April 2005

LLOYD'S CENTRAL FUND BALANCE SHEET

as at 31 December 2004

	Note	2004 £000	2003 £000
New Central Fund		**515,905**	674,889
'Old' Central Fund		**39,885**	36,156
Total Fund balance	15	**555,790**	711,045
Represented by:			
Investments			
Listed:			
United Kingdom		**517,383**	162,205
Overseas		**428,558**	163,797
Short term deposits		**91,625**	164,987
	6	**1,037,566**	490,989
Current assets			
Debtors	7	**136,112**	358,353
Cash		**16**	48
		136,128	358,401
Total assets		**1,173,694**	849,390
Current liabilities			
Creditors	12	**(19,561)**	(58,516)
Total assets less current liabilities		**1,154,133**	790,874
Creditors – amounts due after more than one year			
Subordinated loan notes	14	**(506,439)**	–
Provisions for liabilities and charges			
Undertakings given to insolvent members	13	**(91,904)**	(79,829)
Net assets		**555,790**	711,045

Signed on behalf of the Council of Lloyd's on 6 April 2005

Lord Levene of Portsoken, Chairman

Nick Prettejohn, Chief Executive Officer

LLOYD'S CENTRAL FUND GENERAL FUND ACCOUNT

for the year ended 31 December 2004

	Note	New Central Fund 2004 £000	'Old' Central Fund 2004 £000	Total 2004 £000	Total 2003 £000
Operating income					
Contribution from members of Lloyd's	5	**190,657**	**–**	**190,657**	159,923
Contribution from Corporation of Lloyd's	5	**–**	**–**	**–**	279,493
Recoveries		**20,114**	**4,564**	**24,678**	5,465
Gain on exchange		**253**	**–**	**253**	–
		211,024	**4,564**	**215,588**	444,881
Operating expenditure					
Refunds of members' special contributions		**(2,608)**	**–**	**(2,608)**	(39,988)
Income Support Schemes		**–**	**(2,193)**	**(2,193)**	(1,622)
Other claims and provisions	8	**(135,493)**	**–**	**(135,493)**	(79,669)
Run-off project costs (incl. provisional liquidators' fees)		**(2,273)**	**–**	**(2,273)**	(3,421)
Insurance premiums and brokerage fees		**–**	**–**	**–**	(16,706)
Legal and professional fees		**(5,570)**	**(10)**	**(5,580)**	(1,282)
Administrative expenses		**(399)**	**(397)**	**(796)**	(817)
Loss on exchange		**–**	**–**	**–**	(267)
		(146,343)	**(2,600)**	**(148,943)**	(143,772)
Settlement of Central Fund arbitration dispute	9	**(323,755)**	**–**	**(323,755)**	–
		(470,098)	**(2,600)**	**(472,698)**	(143,772)
(Deficit)/surplus on ordinary activities before finance		**(259,074)**	**1,964**	**(257,110)**	301,109
Finance					
Dividends and interest receivable		**18,965**	**2,541**	**21,506**	15,477
Surplus on sale and revaluation of investments	6	**13,787**	**550**	**14,337**	13,972
Interest payable and similar charges	10	**(6,676)**	**–**	**(6,676)**	–
		26,076	**3,091**	**29,167**	29,449
(Deficit)/surplus before taxation		**(232,998)**	**5,055**	**(227,943)**	330,558
Taxation credit/(charge)	11	**74,014**	**(1,326)**	**72,688**	(95,750)
Net (decrease)/increase in general fund for the year		**(158,984)**	**3,729**	**(155,255)**	234,808

There are no recognised gains or losses in the year other than those dealt with in the general fund account.

LLOYD'S CENTRAL FUND CASH FLOW STATEMENT

for the year ended 31 December 2004

	Note	2004 £000	2003 £000
Cash inflow from operating activities before claims paid and insurance recoveries	16	**214,028**	380,966
Returns on investments and servicing of finance	17	**9,788**	15,262
Claims paid in respect of corporate members	13	**(137,411)**	(191,137)
Claims paid in respect of individual members	8	**(2,677)**	(4,447)
Cash inflow from operating activities		**83,728**	200,644
Taxation paid		**(56,236)**	(64,238)
Cash inflow before use of liquid resources and financing		**27,492**	136,406
Management of liquid resources	17	**(532,240)**	(136,119)
Financing	17	**504,463**	–
(Decrease)/increase in cash in the year		**(285)**	287
Reconciliation of net cash flow to movement in net funds			
(Decrease)/increase in cash in the year		**(285)**	287
Cash inflow from movement in financing	17	**(504,463)**	–
Cash outflow from movement in liquid resources	17	**532,240**	136,119
Change in net funds resulting from cash flows		**27,492**	136,406
Gain/(loss) on exchange of cash balances		**253**	(267)
Movement in valuation of investments	6	**14,337**	13,972
Movement in valuation of borrowings		**(1,976)**	–
Movement in net funds in the year		**40,106**	150,111
Net funds at 1 January		**491,037**	340,926
Net funds at 31 December	18	**531,143**	491,037

LLOYD'S CENTRAL FUND NOTES TO THE FINANCIAL STATEMENTS

as at 31 December 2004

1. Basis of preparation

The Central Fund, which is held at the discretion of the Council of Lloyd's, has not been consolidated within the financial statements of the Corporation of Lloyd's as it is primarily a Fund available for the protection of policyholders and hence relates to the insurance-related activities of the members of Lloyd's.

The financial statements are prepared under the historical cost convention modified for the revaluation of investments.

These financial statements summarise the income, expenditure, assets and liabilities of the Fund at 31 December 2004. The liabilities of the Fund include those amounts contractually committed by the Fund and exclude provision for future discretionary payments. The financial statements therefore do not take account of claims approved after the balance sheet date or future payments that may be made to cover underwriting losses of individual Names except to the extent that the Central Fund is contractually committed to make such payments under hardship and other agreements. No value has been assumed for the assets pledged by hardship Names under the terms of their hardship agreements.

FRS 13 'Derivatives and other financial instruments – disclosures' has been fully adopted in these financial statements including prior year comparatives (see note 19). In prior years, FRS 13 did not apply to the Central Fund. There has been no impact on the primary financial statements as a result of providing the additional disclosures.

Lloyd's is regulated by the Financial Services Authority (FSA).

2. Principal accounting policies

A Investments

Investments are shown at market value at the balance sheet date and the profits and losses arising on revaluation are included in the general fund account.

B Dividends and interest

Dividends from equity investments are taken into account on the ex-dividend date of payment. Interest income is credited by reference to the amounts earned during the year.

C Claims and recoveries

Claims are charged to the general fund account when approved or contractually committed, net of insurance recoveries.

Insurance recoveries arise from the operation of the New Central Fund insurance contract, which is described in note 9. The contract provided that where the New Central Fund has been applied to meet members' cash calls in respect of any one year, the New Central Fund is entitled to a matching recovery of the claim paid (a 'qualifying debt'), subject to the policy terms. Consequently, insurance recoveries are accounted for when a qualifying debt has been paid or is expected to be paid when undertakings (see note 3) have been given, in accordance with the principles of the Statement of Recommended Practice on Accounting for Insurance Business.
The New Central Fund insurance contract commenced in 1999 and expired on 31 December 2003. However, insurers disputed their liability to meet the claims made under the policy and Lloyd's commenced arbitration proceedings in April 2003. A settlement was reached with all of the insurers on 14 March 2005 and the financial effect has been fully reflected in these financial statements.

Recoveries, other than insurance recoveries, in respect of claims approved are credited to the general fund account when contractually committed to be received. This is a change in accounting policy as recoveries were previously accounted for on a received basis. No amounts were receivable at 31 December 2003 and therefore no prior year adjustment is required.

D Loans and provisions

Loans made to syndicates are only recognised as debtors to the extent that they are expected to be recoverable from solvent members.

E Foreign currency

Transactions in foreign currencies are recorded at the rate ruling at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies are translated at the rate of exchange ruling at the balance sheet date. All differences are taken to the general fund account.

LLOYD'S CENTRAL FUND NOTES TO THE FINANCIAL STATEMENTS continued

as at 31 December 2004

2. Principal accounting policies continued

F Taxation

Deferred tax is recognised in respect of all timing differences that have originated but not reversed at the balance sheet date where transactions or events have occurred at that date that will result in an obligation to pay more, or a right to pay less or to receive more, tax. Deferred tax assets are recognised only to the extent that it is considered that it is more likely than not that there will be suitable taxable profits from which the future reversal of the underlying timing differences can be deducted. 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.

G Subordinated loan notes

The 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 on a straight-line basis over the period to the earliest option date. Amortised cost is calculated by taking into account issue costs and issue discount.

3. Solvency shortfalls

As part of Lloyd's solvency procedures, wherever there is a shortfall in comparing a member's Lloyd's assets with liabilities at the preceding year end, sufficient central and other assets are identified to enable the member to pass the solvency test and meet the requirements of the Financial Services Authority. The results of the 2004 solvency test will not be determined until June 2005.

The Council of Lloyd's 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 insolvent members to continue to be paid in full as and when the claims fall due. Provision has been made for these undertakings on the basis that they represent contractual commitments (see note 13). Unutilised undertakings as at 31 December 2004 were £91.9m. By 31 March 2005 this balance had been reduced to £5.0m by the payment of claims of £26.4m and the expiry of undertakings totalling £60.5m, which had been given in 2004. Those undertakings which expired have been replaced and further undertakings have been given on 6 April 2005 that total £277.0m, a net increase of £216.5m. No provision has been included in these financial statements in respect of these further undertakings.

On 11 April 2002 the Corporation of Lloyd's entered into an agreement with Cox Insurance Holdings plc ('CIH') and certain of its subsidiaries. Under the agreement, the underwriting liabilities of Cox Dedicated Corporate Member Limited ('CDCM') will be met from Funds at Lloyd's, profits arising in respect of the 2002 and prior years of account accruing to that member together with profits of the new corporate member, Equity Red Star Limited, arising in respect of the 2002 and prior years of account, a financing charge payable by Equity Red Star Limited and any amounts realised through the use of CDCM's tax losses within the Cox Group. Save as stated above, other assets of CIH shall not be available to meet the underwriting liabilities of CDCM. Based on information available to Lloyd's the underwriting liabilities of CDCM are not expected to exceed the available assets, as above. Therefore, no undertakings have been given in respect of CDCM and no provision has been included in these financial statements.

4. Contingent liabilities

The Society of Lloyd's 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. The Council has determined that any losses resulting from such indemnities will be met by the Central Fund.

Following the implementation of *Reconstruction and Renewal*, Names underwriting in respect of 1992 and prior years, Lioncover and Centrewrite have been 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.

5. Contributions to New Central Fund

New Central Fund contributions from members amounted to £190.7m in 2004 (2003: £159.9m). There were no contributions from the Corporation of Lloyd's during the year (2003: £279.5m in respect of a premium levy which ceased at the end of 2003).

Contributions from members	2004 £000	2003 £000
Individual members	**23,363**	18,374
Corporate members	**167,294**	141,549
	190,657	159,923

6. Investments	2004 £000	2003 £000
Movement in the year:		
Market value at 1 January	**490,989**	340,898
Additions at cost	**834,420**	117,270
(Decrease)/increase in short term deposits	**(70,636)**	66,984
Proceeds from disposals	**(231,544)**	(48,135)
Surplus on sale and revaluation of investments	**14,337**	13,972
Market value at 31 December	**1,037,566**	490,989
Analysis of securities at year end:		
Listed on London Stock Exchange:		
Fixed interest	**380,566**	60,513
Equities	**136,817**	101,692
	517,383	162,205
Listed on overseas stock exchanges:		
Fixed interest	**307,651**	72,763
Equities	**120,907**	91,034
	428,558	163,797
Short term deposits	**91,625**	164,987
	1,037,566	490,989

7. Debtors	2004 £000	2003 £000
Corporation tax	**84,654**	–
Group tax relief receivable	**7,366**	–
Interest and dividends receivable	**14,768**	3,050
Insurance policy claim receivable (notes 9 and 13)	**18,643**	326,538
Deferred taxation (note 11)	**2,915**	6,840
Other debtors and prepayments	**7,766**	21,925
	136,112	358,353

8. Other claims and provisions	2004 £000	2003 £000
Provision for amounts paid and payable under undertakings given to insolvent members (note 13)	**132,816**	75,541
Claims paid in respect of individual members	**2,677**	4,447
Release of provision against loans to syndicates	**–**	(319)
	135,493	79,669

LLOYD'S CENTRAL FUND NOTES TO THE FINANCIAL STATEMENTS continued

as at 31 December 2004

9. Settlement of Central Fund arbitration dispute	2004 £000	2003 £000
Insurance policy claim receivable written off (note 13)	324,582	–
Cancellation of premiums payable	(827)	–
	323,755	–

In 2002, insurers of the New Central Fund disputed their liability to meet the claims made under the policy. Lloyd's commenced arbitration proceedings on 2 April 2003 under the terms of the policy for recovery of the sums claimed from the insurers. As at 31 December 2004 Lloyd's considered it was entitled to claim £477m under the policy in respect of cash calls made in 2002 and 2003. The insurers had paid £134m during 2002, subject to a reservation of their rights made by certain insurers in respect of these claims.

On 14 March 2005, Lloyd's reached a settlement with all of the insurers involved. The settlement provides that the insurers agree to pay total claims under the policy of £152m which includes amounts previously paid under the policy terms.

The net effect of the settlement of the dispute on the financial statements as at 31 December 2004 has been to decrease the net assets of the Central Fund by £323.8m offset by a related tax credit of £97.1m.

10. Interest payable and similar charges	2004 £000	2003 £000
Interest payable on subordinated loan notes wholly repayable after more than five years	3,981	–
Amortisation of issue costs and unwinding of discount on issue of subordinated loan notes	65	–
	4,046	–
Unrealised exchange loss on retranslation of subordinated loan notes	2,630	–
	6,676	–

11. Taxation	New Central Fund 2004 £000	'Old' Central Fund 2004 £000	Total 2004 £000	Total 2003 £000
(a) Analysis of charge in year				
Current tax:				
UK corporation tax based on (deficit)/surplus for the year at 30% (2003: 30%)	**62,009**	**–**	**62,009**	(84,683)
Current year group relief	**12,601**	**(1,326)**	**11,275**	(3,659)
Adjustments in respect of previous years	**3,329**	**–**	**3,329**	(533)
Total current tax (note 11(b))	**77,939**	**(1,326)**	**76,613**	(88,875)
Deferred tax:				
Origination and reversal of timing differences	**(3,925)**	**–**	**(3,925)**	(6,875)
Taxation credit/(charge)	**74,014**	**(1,326)**	**72,688**	(95,750)
(b) Factors affecting tax charge for year				
The tax assessed for the year is lower than the standard rate of corporation tax in the UK of 30% The differences are explained below:				
(Deficit)/surplus before taxation	**(232,998)**	**5,055**	**(227,943)**	330,558
(Deficit)/surplus before taxation multiplied by standard rate of corporation tax in the UK of 30% (2003: 30%)	**69,899**	**(1,517)**	**68,382**	(99,167)
Non-taxable income	**4,711**	**191**	**4,902**	7,506
Utilisation of tax losses	**–**	**–**	**–**	3,319
Adjustments in respect of previous years	**3,329**	**–**	**3,329**	(533)
Current tax credit/(charge) for year (note 11(a))	**77,939**	**(1,326)**	**76,613**	(88,875)
(c) Provision for deferred tax				
Revaluation of investments	**2,915**	**–**	**2,915**	6,840
Deferred tax asset at 31 December	**2,915**	**–**	**2,915**	6,840
At 1 January	**6,840**	**–**	**6,840**	13,715
Deferred tax charge on revaluation of investments (note 11(a))	**(3,925)**	**–**	**(3,925)**	(6,875)
At 31 December (note 7)	**2,915**	**–**	**2,915**	6,840

12. Creditors	2004 £000	2003 £000
Corporation tax	**–**	37,170
Group tax relief payable	**–**	3,659
Amounts due to group undertakings	**4,007**	4,007
Other creditors and accruals	**9,871**	11,945
Income Support Schemes	**1,702**	1,735
Interest payable on subordinated loan notes	**3,981**	–
	19,561	58,516

Under the terms of the Income Support Scheme and the Hardship Income Top-Up Scheme, the Central Fund has a commitment in respect of Support Scheme payments approved by the Council of Lloyd's for 2005. These amounts are provided for at 31 December 2004.

LLOYD'S CENTRAL FUND NOTES TO THE FINANCIAL STATEMENTS continued

as at 31 December 2004

13. Provision for undertakings given to insolvent members

The Council of Lloyd's 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. Although the supporting undertaking is a legally enforceable commitment, it is acknowledged that it is not practicable to estimate a value to that commitment. Furthermore, whilst the Society is solvent, the likelihood of the supporting undertaking being called upon is extremely remote.

The aggregate amount of all undertakings (excluding the supporting commitment) given by the Council at 31 December 2004 was £925m of which £833m had been paid by that date.

Undertakings	2004 £000	2004 £000	2003 £000	2003 £000
Provisions for amounts payable at 1 January		**79,829**		85,110
Undertakings given in the year		**149,486**		185,856
Analysis of paid undertakings by member:				
Blodget and Hazard Limited	**(3,698)**		(3,160)	
Cotesworth Capital Limited (in provisional liquidation)	**(12,827)**		(50,920)	
Crowe Corporate Capital Limited	**(1,208)**		(2,284)	
Crowe Dedicated Limited	**(8,568)**		(29,462)	
Dreason Underwriting Limited	**(699)**		–	
Duncanson & Holt Underwriters Limited	**(23,193)**		(51,921)	
Grenville Underwriting I/II/III Limited	**(23,512)**		–	
Jago Capital Limited	**(3,608)**		–	
Margent Capital Management Limited (in provisional liquidation)	**(539)**		(500)	
Newmarket Corporate Member Limited (in provisional liquidation)	**–**		(19,580)	
North American London Underwriters Limited	**(1,304)**		(6,443)	
Riverside Corporate Underwriters Limited (in provisional liquidation)	**(858)**		(1,007)	
Shrewsbury Underwriting Capital (Bermuda) Limited and Shrewsbury Underwriting Capital Limited	**(50,000)**		(15,903)	
Standfast Corporate Underwriters Limited*	**(5,405)**		(7,757)	
Winford Company Limited	**(602)**		–	
Other corporate members	**(1,390)**		(2,200)	
Paid during the year		**(137,411)**		(191,137)
Provision for amounts payable at 31 December		**91,904**		79,829

Paid undertakings are disclosed by corporate member where the amounts in any one year exceed £500,000. If below this amount members are grouped together.

* Standfast Corporate Underwriters Limited is owned by Standfast Holdings Limited which entered members voluntary liquidation in 2003. In accordance with Lloyd's Byelaws and definitions, two of the shareholders of Standfast Holdings Limited are controllers of Standfast Corporate Underwriters Limited and other Lloyd's corporate members. After the funds at Lloyd's of Standfast Corporate Underwriters Limited had been fully drawn down, one of those shareholders provided additional funds to meet a proportion of the cash calls due from Standfast Corporate Underwriters Limited. The other shareholder, Markel Corporation, has not provided any further funds.

13. Provision for undertakings given to insolvent members continued	2004 £000	2004 £000	2003 £000	2003 £000
Insurance policy claim receivable				
At 1 January		**326,538**		216,223
Undertakings given in the year	**149,486**		185,856	
Less: drawdowns made against undertakings during the year under the 2003 policy excess where not previously provided	**–**		(14,890)	
Less: drawdowns made against undertakings during year in excess of 2002 policy limits	**–**		(4,085)	
Less: drawdowns made against undertakings during year not subject to the insurance policy	**(50,403)**		–	
Less: balance of undertakings falling due after 31 December either not subject to the insurance policy or up to the amount of the insurance policy excess	**(89,483)**		(56,566)	
Recoveries made or receivable under the insurance policy	**7,087**		–	
		16,687		110,315
		343,225		326,538
Insurance policy claim receivable written off (note 9)		**(324,582)**		–
Insurance policy claim receivable at 31 December (note 7)		**18,643**		326,538
Charge to general fund account				
Drawdowns made against undertakings during the year under the 2003 policy excess where not previously provided		**–**		14,890
Drawdowns made against undertakings during the year in excess of 2002 policy limits		**–**		4,085
Drawdowns made against undertakings during year not subject to the insurance policy		**50,403**		–
Balance of undertakings falling due after 31 December either not subject to the insurance policy or under the Central Fund insurance policy excess		**89,483**		56,566
Less: recoveries made or receivable under the insurance policy		**(7,087)**		–
Drawdowns made that are not covered by undertakings		**17**		–
		132,816		75,541

14. Subordinated loan notes	2004 £000	2003 £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**	–
5.625% subordinated notes of €300m maturing 17 November 2024	**212,389**	–
	512,389	–
Less: issue costs to be charged in future years (note 2G)	**(3,722)**	–
Less: discount on issue to be unwound in future years (note 2G)	**(2,228)**	–
	506,439	–

On 17 November 2004, the Society of Lloyd’s 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’).

The Sterling Notes mature on 17 November 2025, however, the Society of Lloyd’s 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 United Kingdom 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, however, the Society of Lloyd’s 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%.

LLOYD'S CENTRAL FUND NOTES TO THE FINANCIAL STATEMENTS continued

as at 31 December 2004

14. Subordinated loan notes continued

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 of Lloyd's. 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) 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).

15. Total Fund balance	New Central Fund £000	'Old' Central Fund £000	Total £000
Balance at 1 January 2004	**674,889**	**36,156**	**711,045**
(Decrease)/increase in general fund for the year	**(158,984)**	**3,729**	**(155,255)**
Balance at 31 December 2004	**515,905**	**39,885**	**555,790**

16. Reconciliation of (deficit)/surplus on ordinary activities before finance to operating cash flows before claims paid and insurance recoveries	2004 £000	2003 £000
Operating (deficit)/surplus	**(257,110)**	301,109
Undertakings given to insolvent members (note 13)	**149,486**	185,856
Decrease/(increase) in insurance claim receivable	**307,895**	(110,315)
Claims paid in respect of individual members	**2,677**	4,447
Decrease/(increase) in other debtors	**14,159**	(9,401)
(Gain)/loss on exchange	**(253)**	267
(Decrease)/increase in creditors	**(2,826)**	9,003
Net cash inflow from operating activities before claims paid and insurance recoveries	**214,028**	380,966

17. Analysis of cash flows for headings netted in the cash flow statement	2004 £000	2003 £000
Returns on investments and servicing of finance:		
Dividends and interest received	**9,788**	15,262
Net cash outflow from returns on investments and servicing of finance	**9,788**	15,262
Management of liquid resources:		
Purchase of fixed interest securities and short term deposits	**(782,561)**	(128,371)
Purchase of equities	**(51,859)**	(55,883)
Sale of fixed interest securities and short term deposits	**302,180**	48,135
Net cash outflow from management of liquid resources	**(532,240)**	(136,119)
Financing:		
Issue of 6.875% subordinated note of £300m maturing 17 November 2025, net of issue costs	**296,904**	–
Issue of 5.625% subordinated notes of €300m maturing 17 November 2024, net of issue costs	**207,559**	–
Net cash inflow from financing	**504,463**	–

Included within liquid resources are term deposits of less than one year, government securities, corporate bonds and equity stocks.

18. Analysis of net funds	At 01.01.04 £000	Cash flow £000	Loan note issue and discount costs £000	Other movements £000	At 31.12.04 £000
Cash at bank	48	(285)	–	253	16
Debt due after one year	–	(504,463)	654	(2,630)	(506,439)
Current investments	490,989	532,240	–	14,337	1,037,566
	491,037	27,492	654	11,960	531,143

Other movements include realised and unrealised exchange differences arising on the revaluation of foreign currency operating cash flows, investments and borrowings.

19. Financial assets and liabilities

Financial instrument risk management

The Central Fund's principal financial instruments comprise cash and liquid resources, investments, provisions, subordinated loan notes and items that arise directly from operations such as trade debtors and creditors.

The Corporation's treasury operations are managed within the formally defined policies which are reviewed regularly by the Lloyd's Investment Committee. Policies for managing these risks of the Central Fund are summarised below.

Interest rate risk

During the year, the Society issued capital market debt of £300m and €300m at fixed rates of interest. The subordinated loan notes have call options attached at different reset dates. Depending on whether the Society calls the notes on the first reset date will determine the rates of interest payable (see note 14). Interest rate risk in respect of this exposure is managed by investing assets within Lloyd's Central Fund to immunise the liability represented by the debt instrument.

Liquidity risk

The value and term of assets are carefully monitored against those of the Central Fund's liabilities. The Central Fund aims to maintain sufficient liquid assets to meet liabilities as they fall due. However, the Central Fund assets may be supplemented by an extra 3% of members' current overall premium limits callable from members' premiums trust funds (2003: 3%). This facility is available to meet unforeseen short term requirements and is renewed annually.

Foreign currency risk

The Central Fund enters into foreign exchange transactions in response to the foreign currency requirements.

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.

Financial assets and liabilities held

Other than short term debtors and creditors, the following material financial assets and liabilities were held at 31 December 2004:

	2004 Book value £000	2004 Fair value £000	2003 Book value £000	2003 Fair value £000
Primary financial instruments held or issued to finance operations				
Investments	1,037,566	1,037,566	490,989	490,989
Cash and deposits	16	16	48	48
Financial assets	1,037,582	1,037,582	491,037	491,037
Subordinated loan notes	(506,439)	(506,439)	–	–
Undertakings given to insolvent members	(91,904)	(91,904)	(79,829)	(79,829)
Financial liabilities	(598,343)	(598,343)	(79,829)	(79,829)
Net	439,239	439,239	411,208	411,208

The terms of the subordinated loan notes are set out in note 14.

The provisions for liabilities and charges are interest free and denominated in sterling.

LLOYD'S CENTRAL FUND NOTES TO THE FINANCIAL STATEMENTS continued

as at 31 December 2004

19. Financial assets and liabilities continued

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

	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
Sterling	**380,566**	**309,677**	**–**	**690,243**	**(296,581)**	**–**	**(91,904)**	**(388,485)**	**301,758**
United States dollar	**79,507**	**34,848**	**–**	**114,355**	**–**	**–**	**–**	**–**	**114,355**
Euro	**228,144**	**4,840**	**–**	**232,984**	**(209,858)**	**–**	**–**	**(209,858)**	**23,126**
	688,217	**349,365**	**–**	**1,037,582**	**(506,439)**	**–**	**(91,904)**	**(598,343)**	**439,239**

	2003 £000	2003 £000	2003 £000	2003 £000	2003 £000	2003 £000	2003 £000	2003 £000	Net £000
Sterling	60,512	352,925	–	413,437	–	–	(79,829)	(79,829)	333,608
United States dollar	51,846	3,757	–	55,603	–	–	–	–	55,603
Euro	20,917	1,080	–	21,997	–	–	–	–	21,997
	133,275	357,762	–	491,037	–	–	(79,829)	(79,829)	411,208

The average interest rate of the sterling fixed interest securities is 5.43% (2003: 6.18%) and the weighted average period for which the interest rate is fixed is 9.3 years (2003: 5.6 years). The average interest rate of the United States dollar fixed interest securities is 4.87% (2003: 6.06%) and the weighted average period for which the interest rate is fixed is 6.0 years (2003: 5.7 years). The average rate of the Euro fixed interest securities is 4.39% (2003: 4.87%) and the weighted average period for which the interest rate is fixed is 9.1 years (2003: 5.0 years).

Interest free financial liabilities represent undertakings given to insolvent members (see note 13).

Borrowing facilities

There are no undrawn committed borrowing facilities as at 31 December 2004. The same applied as at 31 December 2003.

20. 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.

21. 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 10 years for its obligations to Lioncover under the indemnity bond referred to in note 4. 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.

FIDENTIA

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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