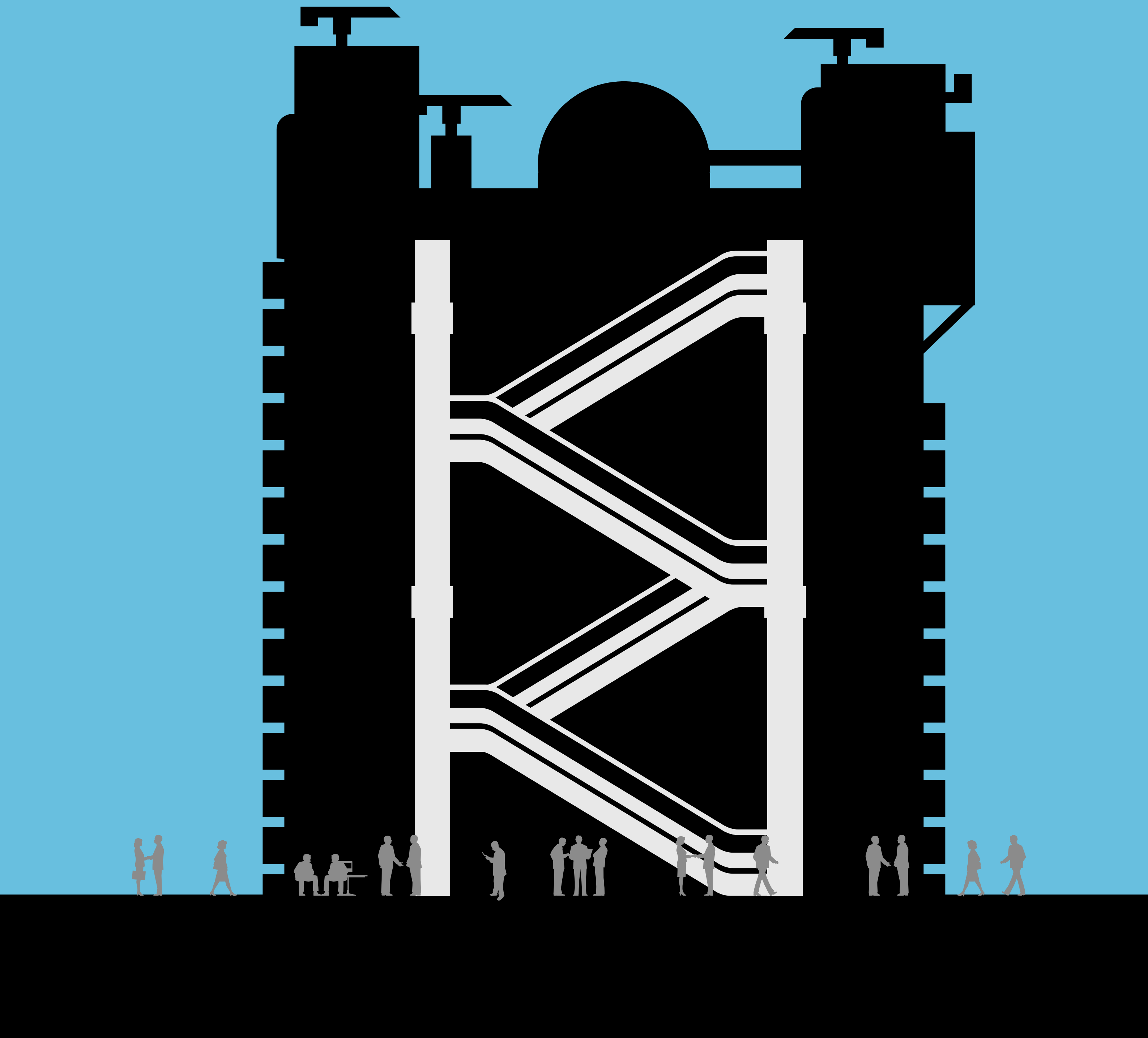
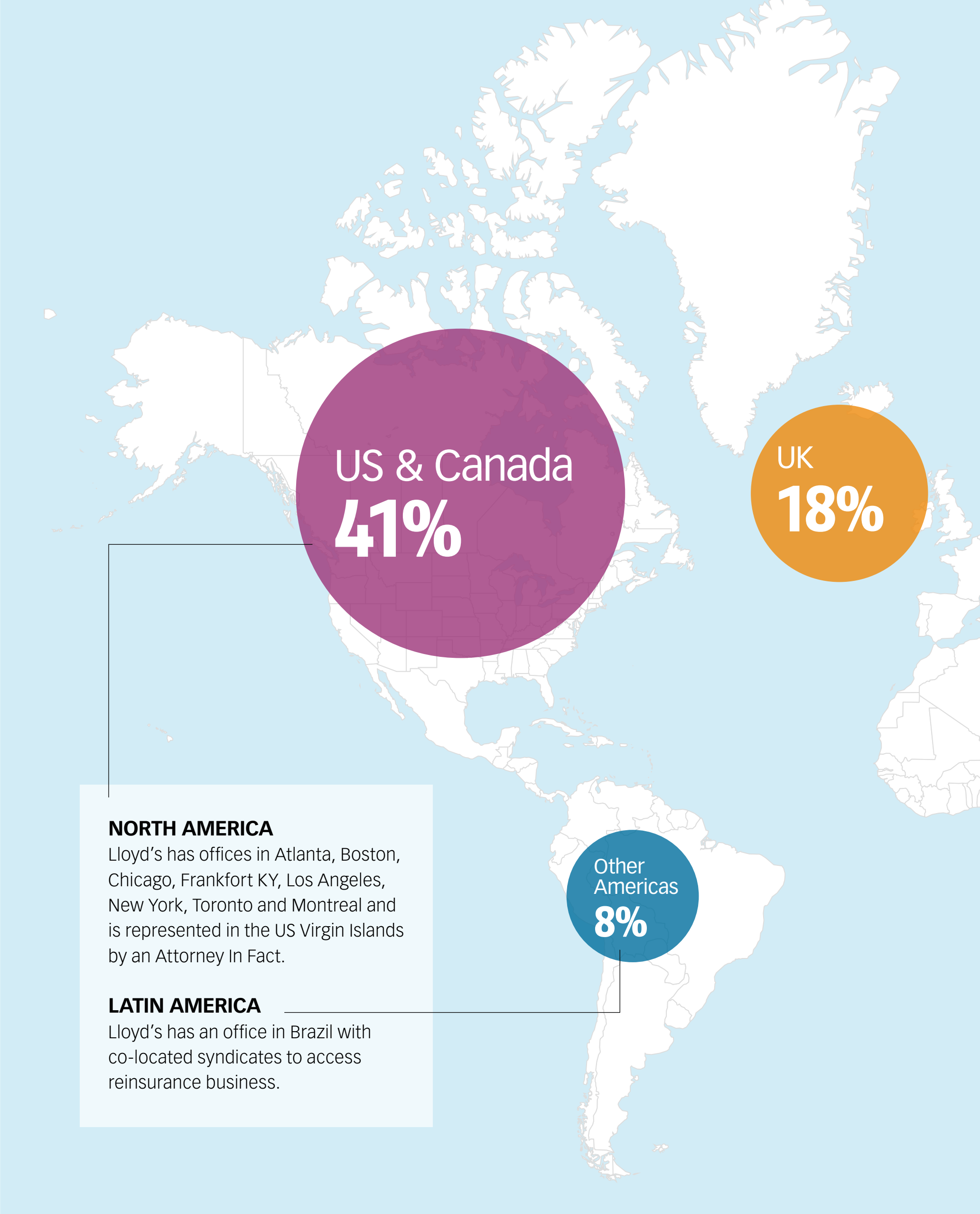
LLOYD'S ANNUAL REPORT 2012



OUR BUSINESS

Lloyd's accepts business from over 200 countries and territories worldwide. Our licences in over 75 jurisdictions, supported by a network of local offices and coverholders across the world, ensure access to insurance markets large and small.

LLOYD'S TOTAL BUSINESS BY REGION

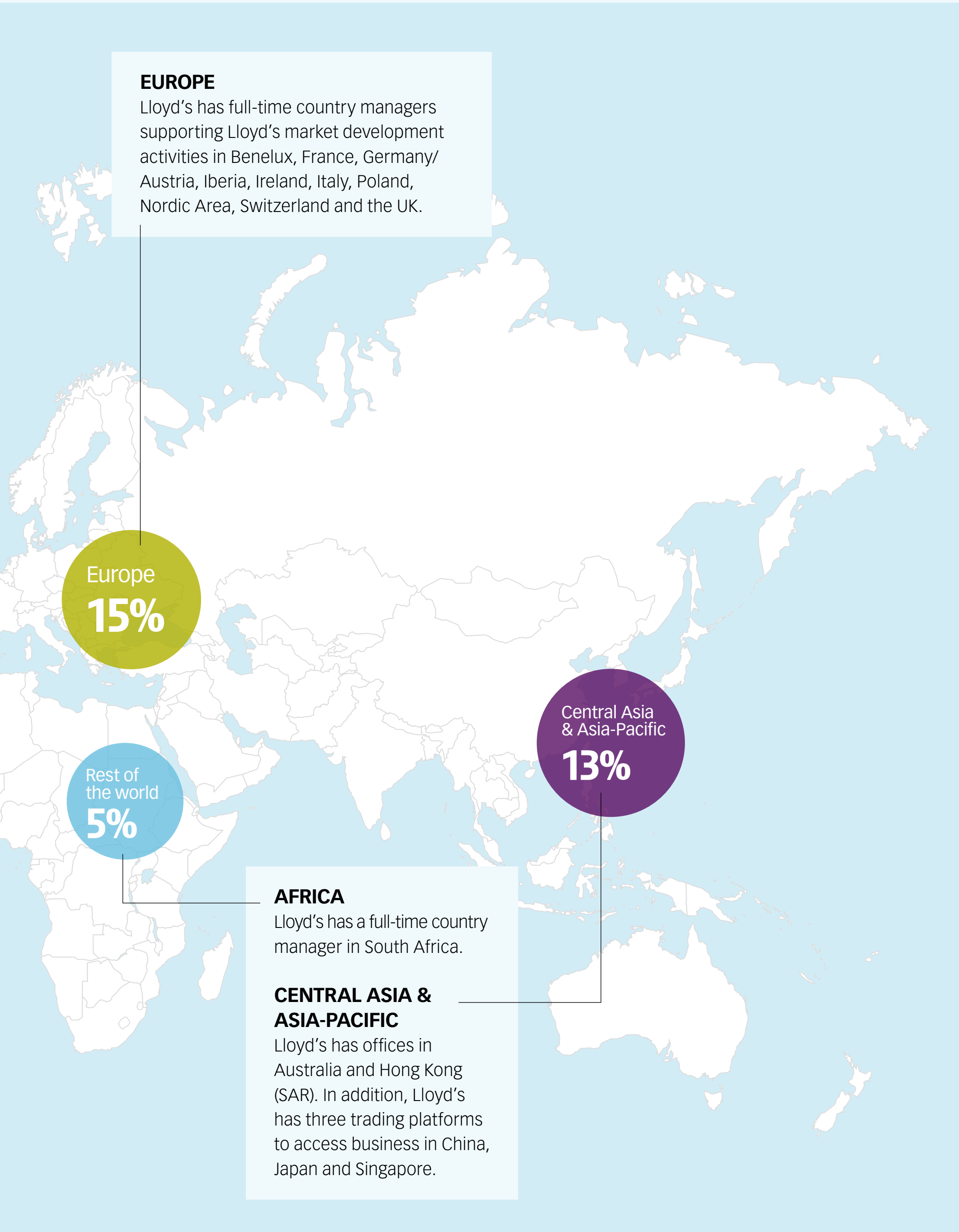


NORTH AMERICA
Lloyd's has offices in Atlanta, Boston, Chicago, Frankfort KY, Los Angeles, New York, Toronto and Montreal and is represented in the US Virgin Islands by an Attorney In Fact.

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

LLOYD'S CLASS BREAKDOWN BY REGION

	US & Canada	Other Americas	UK	Europe	Central Asia & Asia-Pacific	Rest of the world	Total for all regions
REINSURANCE	27%	77%	32%	38%	47%	64%	38%
PROPERTY	33%	6%	18%	14%	15%	7%	21%
CASUALTY	19%	6%	18%	16%	26%	10%	18%
MARINE	7%	5%	6%	18%	6%	9%	8%
ENERGY	10%	3%	3%	8%	3%	3%	7%
MOTOR	1%	1%	21%	1%	1%	2%	5%
AVIATION	3%	2%	2%	5%	2%	5%	3%
TOTAL	**100%**	**100%**	**100%**	**100%**	**100%**	**100%**	**100%**



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

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

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

LLOYD'S IN NUMBERS

87
SYNDICATES
of specialist underwriting experience and talent.

2798
COVERHOLDERS
offering a local route to Lloyd's.

192
BROKERS
bringing business from over...

200
COUNTRIES AND TERRITORIES
which covers...

95%
OF THE FTSE 100
and...

97%
OF DOW JONES
industrial average companies all underpinned by...

325
YEARS OF UNDERWRITING EXPERIENCE

OUR VISION 2025

To be the global centre for specialist insurance and reinsurance

CHAIRMAN'S STATEMENT

"Growing our business profitably in current market conditions will require concerted action from the market."

2012 marked a welcome return to profitability after the exceptional run of catastrophe losses in 2011. In 2012, we experienced a more normal claims environment.

The Lloyd's market has posted a profit for 2012 of £2,771m, representing a return on capital of 14.8% for the year. This is one of the market's best results, delivered despite the destruction which October's Superstorm Sandy caused. Over the last five years our average return on capital has been 12.1%.

We must recognise the continuing importance of the market's disciplined underwriting if we are to sustain such returns against a backdrop of both increasingly frequent and severe catastrophes and continuing challenging economic conditions. Balancing performance management, capital setting and risk management with the market's approach to innovation and growth will remain central to our continued success.

The financial landscape in which the insurance industry is operating remains challenging. Exceptionally low interest rates, coupled with concerns over stability and low growth in the Eurozone, remain significant features. There has also been a slowdown in the emerging and growing economies although there are some signs of recovery in two of the largest, China and India. The returns that the insurance industry continues to generate mean that capital availability is high and this is causing the premium rate environment to behave in a more subdued manner than it has historically.

It is looking increasingly likely that these challenges will remain for our industry. Under these circumstances, while the results may seem particularly strong, we need to bear in mind that for our continued profitability, underwriting discipline – important at any time – will increasingly prove the difference between business which is sustainable and business which is vulnerable.

In 2012, Lloyd's set out its new strategic direction – Vision 2025. The Vision, which was launched in May by the British Prime Minister, David Cameron, has at its heart profitable, sustainable growth, particularly from emerging and developing economies. This strategy will reinforce the position of the Lloyd's market as the global centre for specialist insurance and reinsurance, providing both established and new markets with the levels of underwriting expertise on which all Lloyd's customers rely.

To succeed, it needs market participants to invest time, resources and expertise to ensure both their products and distribution channels are the right fit for the needs of growing economies. Growing our business profitably in current market conditions will require concerted action from the market.

Our Three-Year Plan, published at the end of 2012, sets out the steps that the Corporation and the market must take in the early years to achieve this Vision.

On behalf of the market and the Corporation, I would like to thank the retiring members of the Council, Lord Henry Ashton and Sir Robert Finch, for their valuable contribution. I warmly welcome Andy Haste to the Council as Senior Independent Deputy Chairman, and Bruce Van Saun to the Franchise Board.

I would like to give particular thanks to Andreas Prindl, who retired as the Council's Senior Independent Deputy Chairman after nine years' outstanding service.

I believe that the Lloyd's market is extremely well placed to reinforce its position as the global centre for specialist insurance and reinsurance over the next decade or more. This will require considerable commitment both within the Lloyd's market and the Corporation.

JOHN NELSON
Chairman

2012 AT A GLANCE

Financial highlights

– Lloyd's made a profit before tax of £2,771m (2011: £516m loss) and a combined ratio of 91.1% (2011: 106.8%), despite claims arising from Superstorm Sandy, one of the largest ever catastrophe claims events for Lloyd's.

– Gross premium income £25,500m (2011: £23,477m).

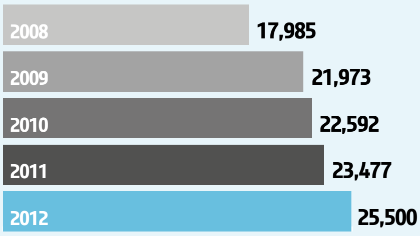
– Central assets maintained at record levels of £2,485m (2011: £2,388m).

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

To read more on our financial results see **page 29**.

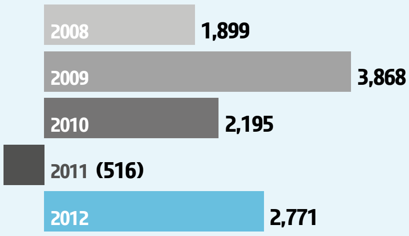
The Aggregate Accounts are reported as a separate document and can be found at: **www.lloyds.com/2012annualresults**

Gross written premium
£m



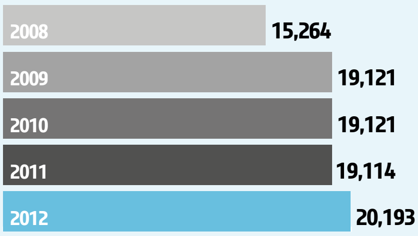
£25,500m

Result before tax
£m



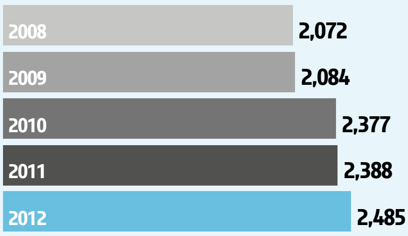
£2,771m

Capital, reserves and subordinated debt and securities
£m



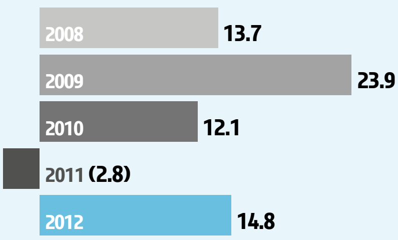
£20,193m

Central assets*
£m



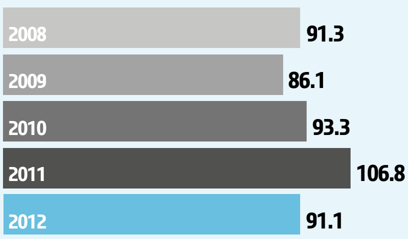
£2,485m

Return on capital
%



14.8%

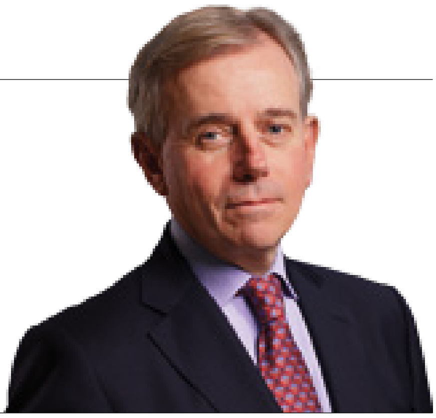
Combined ratio*
%



91.1%

* See Glossary on **pages 133-134**.
The basis for translating income and expenditure and assets and liabilities in foreign currency is set out on **page 48**.

CHIEF EXECUTIVE'S STATEMENT



"The Corporation made good progress against our strategic objectives while firmly controlling costs."

The Lloyd's market has performed strongly against a global backdrop of continued economic uncertainty in 2012, helped by a benign first ten months prior to Superstorm Sandy making landfall.

The Lloyd's market made a profit before tax of £2,771m. The market's combined ratio of 91.1% compares favourably with our peers and benefited from the release of claims reserves established in prior years. Gross written premium of £25.5bn represented a 9% increase year on year, including a slight increase of 3% in premium rates overall.

The Lloyd's market remains capitalised at record levels of more than £20bn. The strength of our financial position has again been confirmed by an A+ rating with a positive outlook from Standard & Poor's, an A+ rating with a stable outlook from Fitch and an A rating from A.M. Best. Corporation and central assets have reached a new record of £2.5bn.

The Corporation made good progress against its strategic objectives, while delivering the planned 8% reduction in costs year on year and passing the resulting saving of £14m to the market.

2012 saw many of the world's economies endure their fifth successive year of economic stagnation, providing further challenges to many of our customers. However, the increase in GDP of most of our target markets in high growth economies presents the insurance industry with new opportunities. Over 2012, the Corporation and the Lloyd's market identified and implemented a number of initiatives to support the market's future growth.

As part of our aim to attract new capital to the Lloyd's market, we launched a structured relationship management programme to forge links with potential trade capital partners, particularly from developing economies and from the parent organisations of existing managing agents.

Future profitable growth also depends on ensuring our network of licences keep pace with global economic changes. The Japan Open Model was launched in July, making it easier for syndicates to use Lloyd's direct licence for international business with Japanese exposures and where the purchase is made outside of Japan.

Coverholders are vital to growing new global business and in 2012, Lloyd's developed a revised application process with the aim of completing branch approvals within a maximum target of one working week. We are also part of a market working group to redraft the standard contract wordings, and final versions will be published in early 2013.

As we develop our business, we must also keep pace with regulatory changes. In July, on behalf of the entire market, Lloyd's submitted its Solvency II internal model to the FSA for approval. While the continued uncertainty about the implementation date for Solvency II is frustrating, the adoption of Solvency II internal models to determine our ICA capital requirements from January 2013 means the Lloyd's market is already benefiting from enhanced risk management and capital setting measures.

To take full advantage of the new opportunities for profitable growth, we must ensure that the Lloyd's market remains an attractive and efficient place to do business. 2012 was a productive year for the Central Services Refresh programme; we established a cross-market group to produce an in-depth analysis of market needs for central services and the role that 'package' technology solutions can play in meeting them. In 2013, the market and Corporation will focus on the priorities and mechanism for delivering against those needs.

We continue to build on our reputation for paying claims. In 2012, our Claims Transformation Programme delivered an average 49% improvement in transaction times for the claims within this Programme.

The fact that the Lloyd's market incurred total claims of more than £10bn in 2012, £1.35bn of them for Superstorm Sandy alone, demonstrates once again the strength of Lloyd's and the importance of the Lloyd's market's role in helping businesses and communities recover from disaster.

With record central assets, unique Chain of Security and the expertise offered by a specialist subscription market, the Lloyd's market is well placed to provide the expert underwriting which growing economies need, both now and in the future. Lloyd's will build further on these foundations in 2013 with the aim of growing our business profitably, sustainably and efficiently.

RICHARD WARD
Chief Executive

WELCOME TO LLOYD'S

Lloyd's started in a London coffee shop, bringing together shipowners with those who could insure their ships and the cargo they carried.

CONTENTS

WELCOME TO LLOYD'S

STRATEGIC OVERVIEW

MARKET PERFORMANCE

MARKET RESULTS

SOCIETY REPORT

ABOUT LLOYD'S

The world's specialist insurance market

Lloyd's began 325 years ago, in Edward Lloyd's coffee house in the City of London, as the place where shipowners met those with the capital to insure their ships and cargo. Lloyd's has been protecting business and trade ever since, becoming the world's leading market for specialist property and casualty insurance. The Lloyd's market provides insurance for 95% of FTSE 100 companies.

This dynamic market brings together underwriters who provide insurance coverage with brokers seeking the best insurance for their clients. Business at Lloyd's is still undertaken face-to-face in the busy underwriting room, where the subscription market enables different syndicates to take a share of the same risk.

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

The Lloyd's market provides a wide range of distribution channels for managing agents, who manage syndicates, to access specialist business, primarily through brokers, coverholders (companies given authority to write business on behalf of Lloyd's managing agents) and service companies.

Constantly evolving to meet new challenges, Lloyd's remains true to its original aim of helping clients to rebuild and recover after disaster and loss. We are always seeking new ways to ensure Lloyd's becomes an even easier and more attractive place for the world to do business.

GLOBAL UNDERINSURANCE REPORT

Many of the world's fastest growing economies are significantly underinsured against the cost of natural catastrophes. The Lloyd's Global Underinsurance Report, commissioned from the Centre for Economics & Business Research (CEBR), revealed that 17 high growth countries have an annualised insurance gap of $168bn. Inevitably, their governments – and taxpayers – end up picking up a disproportionate part of the cost of natural catastrophes.

This benchmark research also showed that post-catastrophe recovery costs are lower in countries with higher levels of insurance, and that insurance levels are linked to economic growth.

As the asset values of developing economies rise and their industries expand, so too will the cost of catastrophic events. Lloyd's calls on governments, businesses and the insurance industry to act now to close this underinsurance gap.

"An interesting and innovative report, particularly useful for the insurance industry for its socio-political implications."

JOHN HURRELL
Chief Executive, AIRMIC

Details can be found at:
www.lloyds.com/underinsurance

ABOUT LLOYD'S MANAGING AGENTS

At 31 December 2012, the Lloyd's market consisted of 87 active syndicates (plus five RITC syndicates) managed by the 57 managing agents shown here. The sheer scale of the market offers huge diversity of products; the scope of specialist broking and underwriting expertise found together under the Lloyd's umbrella makes it unique.

HOW LLOYD'S WORKS
MARKET STRUCTURE

Our unique structure creates a market based on trusted relationships and expertise

Most of the business written at Lloyd's is brought by brokers to specialist underwriters who price and underwrite these risks. Policyholders across the world may access the Lloyd's market via a broker, coverholder or a service company.

Members – Providing the capital
The capital which backs up the syndicates' underwriting is provided by members of Lloyd's. Members include many of the world's major insurance groups, listed companies, individuals and limited partnerships, with corporate groups providing most of the capital for the Lloyd's market. Members' agents provide advice and administrative services to members as needed.

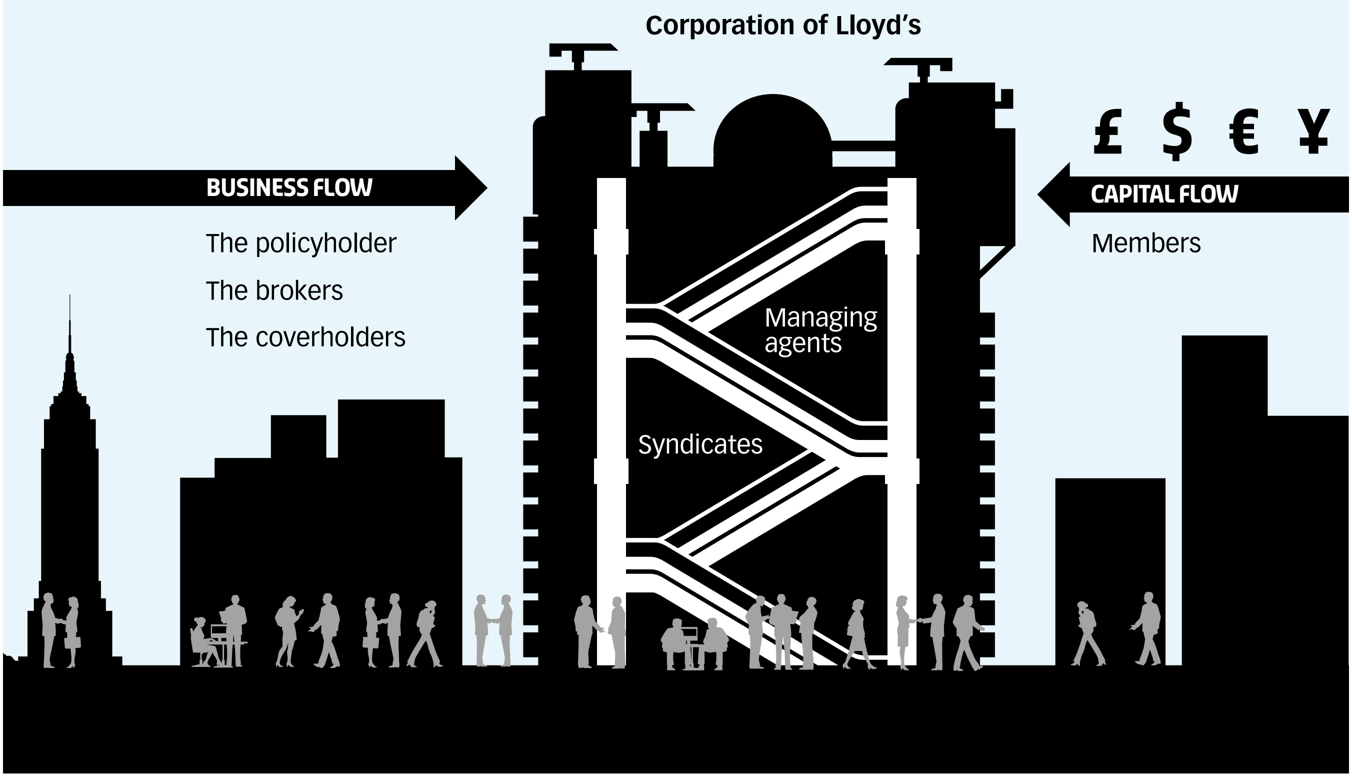
Syndicates – Writing the insurance
A Lloyd's syndicate is formed by one or more members joining together to accept insurance risks. Most syndicates write a range of classes of business but many will have areas of specific expertise. Much of this business involves face-to-face negotiations between brokers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

Syndicates are, technically, set up on an annual basis. In practice, they usually operate from year to year with members having the right, but no obligation, to participate in syndicates the following year.

These ongoing operations allow for a strong level of continuity in the capital which backs syndicates, meaning they function like permanent insurance operations under the Lloyd's umbrella.

Managing agents – Managing the syndicates
A managing agent is a company set up to manage one or more syndicates on behalf of the members who provide the capital. Managing agents have responsibility for employing underwriters, overseeing their underwriting and managing the infrastructure and day-to-day operations.

How the market works (Figure 1)



COVERHOLDERS

Local access to Lloyd's

Coverholders are a vital distribution channel, offering a local route to Lloyd's in many insurance markets around the world.

In 2012, Lloyd's had nearly 2,800 coverholders. Its largest coverholder markets are currently the US, UK, Canada, Europe and Australia but Lloyd's coverholders can be found as far afield as Chile, Tahiti and South Africa.

CORPORATION OF LLOYD'S

Supporting the market

The Corporation of Lloyd's (the Corporation) oversees the market; setting standards, approving business plans, providing support services and managing the Central Fund. The Corporation also manages Lloyd's network of international licences.

The Corporation's Executive Team exercise the day-to-day powers and functions of the Council of Lloyd's (the Council) and the Franchise Board. At the end of 2012, the Corporation and its subsidiaries had 890 staff.

As well as providing services to support the efficient running of the market, the Corporation works to continue to raise standards and improve performance across two main areas:

- Overall risk and performance management of the market; and
- Maintaining and developing the market's attractiveness to capital providers, distributors and clients, while preserving its diversity and London-based model.

MANAGING INSURANCE RISK

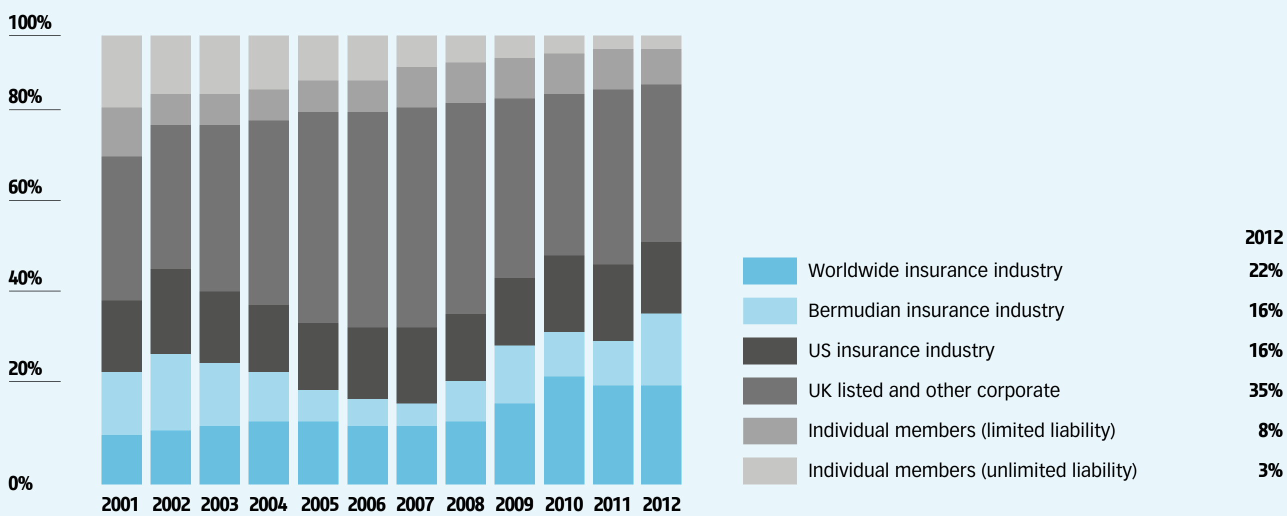
Each syndicate sets its own appetite for risk, develops a business plan, arranges its reinsurance protection and manages its exposures and claims. The Corporation reviews and approves business plans, monitors compliance against Lloyd's minimum standards and evaluates syndicates' performance against their plans. Syndicates can only underwrite in accordance with their agreed business plans. If they fail to do so, Lloyd's can take a range of actions including, as a last resort, stopping a syndicate underwriting.

For a list of managing agents and the syndicates they manage see **pages 131-132**.

See **pages 61-73** for more detail on the governance of Lloyd's.

For more information on managing insurance risk see **pages 40-41**.

Lloyd's capacity by source and location (Figure 2)



HOW LLOYD'S WORKS
SECURITY AND RATINGS

Lloyd's financial strength comes from its unique capital structure

THE CHAIN OF SECURITY

Lloyd's unique capital structure, often referred to as the Chain of Security, provides excellent financial security to policyholders and capital efficiency for members. The Chain of Security provides the financial strength that ultimately backs insurance policies written at Lloyd's and the common security that underpins the market's ratings and licence network.

Lloyd's Chain of Security has three links:

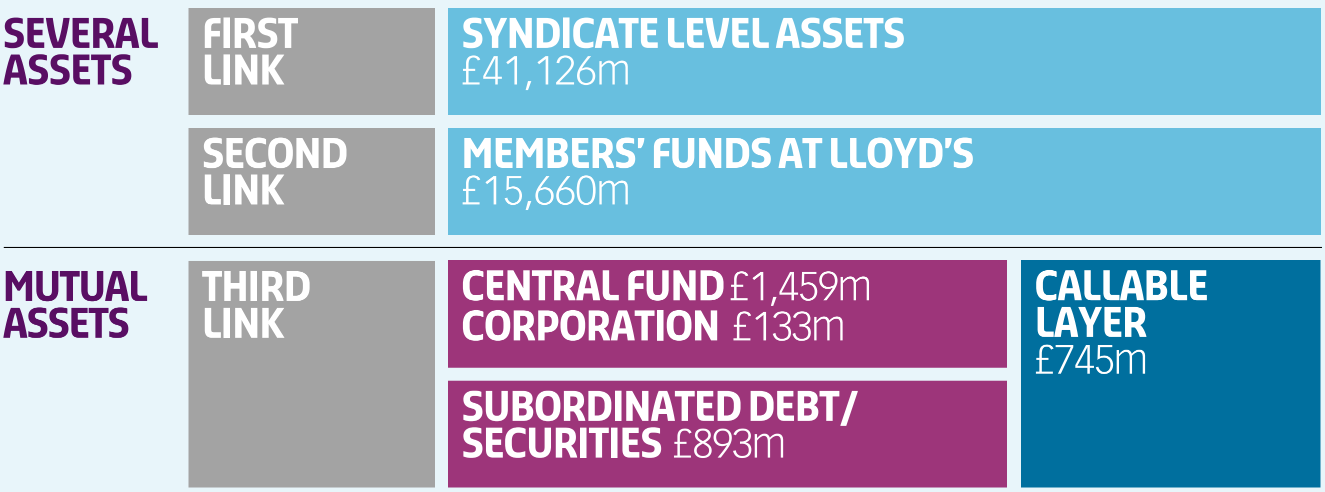
Link one – Syndicate assets
All premiums received by syndicates are held in trust as the first resource for paying policyholders' claims. Until all liabilities have been provided for, no profits can be released. Every year, each syndicate's reserves for future liabilities are independently audited and receive an actuarial review.

Link two – Members' funds at Lloyd's
Each member, whether corporate or individual, must provide sufficient capital to support their underwriting at Lloyd's. Each syndicate produces an Individual Capital Assessment (ICA) stating how much capital it requires to cover its underlying business risks at a 99.5% confidence level. The Corporation reviews each syndicate's ICA to assess the adequacy of the proposed capital level. When agreed, each ICA is then 'uplifted' to ensure there is sufficient capital to support Lloyd's ratings and financial strength. This uplifted ICA is known as the syndicate's Economic Capital Assessment and drives members' capital levels. The capital is held in trust for the benefit of policyholders, but not available for the liabilities of other members.

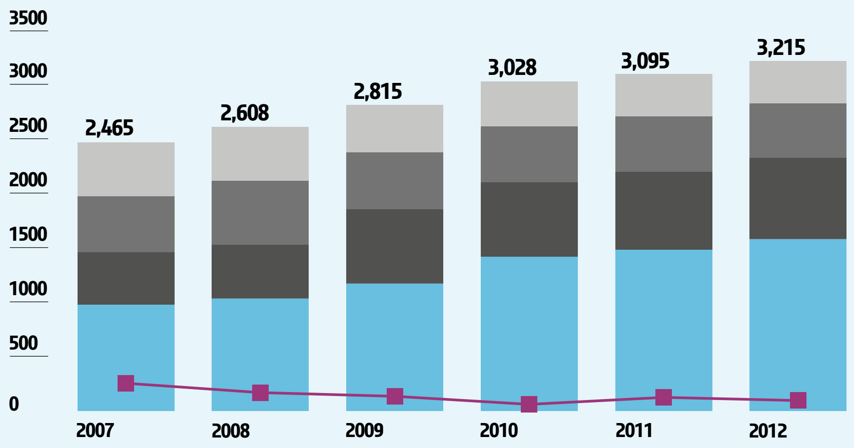
Link three – Lloyd's central assets
The central assets are available, at the discretion of the Council of Lloyd's, to meet any valid claim that cannot be met from the resources of any member further up the chain.

Should the first link need additional funds, the second link ensures members have additional resources available. In the rare event that these two links are insufficient, the third link, available at the discretion of the Council, provides further back-up to members to ensure valid claims are paid.

Lloyd's Chain of Security (Figure 3)



Corporation and Central Fund net assets for solvency† (Figure 4)



	2012
Corporation & Central Fund net assets	1,577
Callable layer	745
Subordinated debt issued 2004	503
Subordinated perpetual securities issued 2007	390
Solvency deficits	94

† The aggregate value of central assets of the Corporation for solvency purposes at 31 December 2012, excluding the subordinated debt liabilities, including the callable layer.

Lloyd's ratings (Figure 5)

STANDARD & POOR'S
A+ (STRONG)

FITCH RATINGS
A+ (STRONG)

A.M. BEST
A (EXCELLENT)

ENSURING THE OPTIMUM LEVEL OF CENTRAL ASSETS

The Corporation regularly runs detailed analyses of central assets, aiming to balance the need for financial security with the need for cost-effective mutuality of capital. Sophisticated modelling tests each member's underwriting portfolio against a number of scenarios and forecasts of market conditions.

The Corporation's current target for unencumbered central assets is that they should be at least 250% of the Society's ICA on a business as usual basis. Members' contributions to the Central Fund remain at 0.5% of gross written premiums for 2013. The Council of Lloyd's periodically reviews the central assets target and the level of contributions and will adjust the contribution levels as required.

LLOYD'S ICA AND SOLVENCY

The Corporation prepares an ICA for Lloyd's as a whole, using the FSA's six risk categories to examine risks not included in each syndicate's ICA, such as damage to the Lloyd's building. The Corporation also calculates the statutory solvency position of the Society of Lloyd's and reports this to the FSA. At 31 December 2012, the Society had an estimated solvency surplus of £3,121m.

LLOYD'S RATINGS

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

Three of the world's leading insurance rating agencies validate Lloyd's robust capitalisation and the market's financial strength. In 2012, all three reaffirmed our ratings. In recognition of Lloyd's ongoing risk management improvements, Standard & Poor's has revised Lloyd's outlook from 'stable' to 'positive'.

HOW LLOYD'S WORKS
SECURITY AND RATINGS
CONTINUED

Benefits of Lloyd's to market participants (Figure 6)

MANAGING AGENTS AND CAPITAL PROVIDERS

Market access
Access to major insurance markets supported by a global brand and licensing network.

Security and ratings
Financial security and strong ratings capable of attracting specialist insurance business.

Capital advantages
Capital-efficient framework driven by the benefits of mutuality.

Market oversight
A proportionate but robust market oversight regime consistent with an innovative and entrepreneurial culture.

Central processes and services
Infrastructure supporting the subscription market and the provision of tax and regulatory reporting. Other central services (eg lobbying) and the ability to benefit from a Solvency II ready environment.

BROKERS AND RISK MANAGERS

Product offering
Access to a wide range of specialist and bespoke (re)insurance solutions.

Claims payment
A reputation for paying all valid claims in a timely and efficient manner.

Chain of Security
Excellent financial security for policyholders which supports Lloyd's ratings.

Underwriting expertise
Access to specialist underwriting expertise and innovation.

STRATEGIC OVERVIEW

Vision 2025 sets out the new strategic direction for the Lloyd's market in a changing global economy.

BUSINESS AND ECONOMIC ENVIRONMENT

Continued economic volatility and an ongoing trend towards larger claims

The global economic environment remains characterised by uncertainty with, broadly speaking, an ongoing divide between the health of developed and developing economies. Low economic growth is expected to continue in developed markets and the outcome of the Eurozone crisis is still not clear. While growth in developing economies is expected to be stronger than in developed economies, reduction in domestic demand and exports has resulted in many growth forecasts for these regions being revised downwards. Some commentators believe these factors mean that the world economy will not have stabilised and returned to sustainable growth until 2018 at the earliest.

Inflation forecasts remain low in developed economies, given their economic growth prospects. However, given the size of the monetary stimulus provided by central banks in many of these economies in recent years, the risk of rising inflation remains. Economies with recent high inflation (some South American countries) or with uncertain inflation environments continue to provide a challenge for insurers' pricing and reserving accuracy.

The investment environment remains suppressed with interest rates forecast to remain low over the short to medium term. While investment opportunities exist in some emerging markets, insurers' ability to capture them may be limited by regulation and their investment policies. The strategic imperative to focus on profitable underwriting remains crucial.

For the insurance industry, lower levels of economic growth, trade and/or investment may result in falling demand. Profitable growth opportunities in Lloyd's largest and traditional markets (US, UK, Canada, Europe) will potentially be suppressed or, at best, remain stable. Opportunities are more likely to come from territories outside these markets (in particular Central Asia and Asia-Pacific, driven by China and India), with premium growth generated from increased insurance penetration in these territories and increased demand for specialist insurance as a result of strong economic growth.

POLITICAL AND REGULATORY ENVIRONMENT

Although the 2008/2009 financial crisis has led to a tightening of financial services regulation in various jurisdictions, a significant rise in protectionism is not expected. While there are isolated examples of restrictions being applied, there are no signs that market access will be materially affected in the future. In fact, the development of free trade areas, in emerging markets in particular, presents opportunities for insurers as the levels of trade increase and internal markets liberalise.

The implementation of the new UK financial services regulatory regime under the auspices of the Bank of England continues. A more intrusive oversight regime is anticipated which will result in regulatory overlap. Lloyd's is working closely with the new regulatory bodies to enhance their knowledge of the Lloyd's market and the role the Corporation plays in market oversight.

In the EU, work continues on the finalisation of the Solvency II regime. At the time of writing the implementation date remains uncertain, but Lloyd's significant levels of preparation will enable the market to start phasing in those elements of the regime which add most value for managing agents, using Solvency II internal models to set capital from January 2013. As and when Solvency II is fully implemented, the

market will have benefited from its capital model and enhanced risk management for several years.

As a result of substantial industry lobbying, the non-life regime appears satisfactory, although improvements are still being pursued in some areas. A critical aspect is the proportionate and sensible incorporation of the Solvency II regime within the new UK regulatory framework.

The development of the regulatory framework for Global Systemically Important Financial Institutions (GSIFIs) continues. The aim is to identify firms whose collapse would pose a serious risk to the global economy. These firms may have to meet higher capital standards and develop contingency plans for potential future failures. Lloyd's is actively engaged in this debate to ensure that traditional (re)insurance activities are not deemed a systemically risky activity.

INSURANCE MARKET

Until a broad-based global economic recovery becomes sustained, suppressed demand means non-life premium growth may be subdued. Lower demand combined with near record levels of reinsurance capital suggests that there will be little material change to the current ratings environment. In a flat ratings environment, with low investment income, delivering strong profits will be challenging for many firms. Given the level of capital in the market and ongoing economic uncertainty, it is unlikely that a broad-based, significant and quick hardening of rates will occur in the near future without a market-changing catastrophe or investment write-down (eg sovereign default) impacting the industry. The importance of underwriting expertise to price risks appropriately will be more important than ever in ensuring businesses remain sustainable, as will underwriters' ability to develop increasingly sophisticated risk management models to assess risk and monitor exposure. The opportunities presented by new markets, especially high growth economies, will become increasingly important. Market participants must combine underwriting discipline with expertise and innovation in developing risk solutions for these growing markets.

There is an ongoing trend towards larger claims influenced by a number of factors including climate change, urbanisation and increased economic development in catastrophe-prone areas. This trend has the potential to impact the profitability and volatility of insurers' results. The industry's focus on risk modelling, exposure data collection, exposure management and pricing adequacy must be maintained.

With disaster-related losses growing over the past 20 years, the vulnerability of people, governments and businesses to severe losses is increasing, particularly in those regions with low insurance penetration. Insurers may be able to develop their business by working to increase insurance penetration in less developed economies through educating individuals, governments and businesses about the benefits of insurance.

Merger and acquisition activity in the insurance sector is expected to continue, driven by the desire for growth, portfolio diversification, Solvency II capital efficiencies and private equity investors seeking an entry or exit. However, valuations remain low largely because of concerns about the prolonged flat market, reserve adequacy and the challenging macroeconomic environment. This is reducing the number of 'willing' sellers in the market.

Future losses may arise from a range of emerging risks including: climate-related catastrophes, potential litigation against 'polluters', space weather, supply chain disruption and cyber risk. Understanding the potential nature and impact of these risks is a key future activity for the industry.

LLOYD'S MARKET

Lloyd's is in a robust financial position, as demonstrated by its ability to withstand 2011's record level of natural catastrophes.

Although the international mix of Lloyd's business has increased in recent years, the market portfolio is skewed towards developed insurance and reinsurance markets, particularly those with high catastrophe exposure. With the developed markets continuing to account for the vast majority of global non-life premium, Lloyd's must work to maintain and grow its position in the large developed markets, while growing more quickly in the emerging and faster growing economies as they increase their share of global economic activity. This forms a significant element of Lloyd's Vision 2025.

The majority of Lloyd's current businesses are parts of larger insurance groups. This presents both opportunities and threats, reinforcing the need for Lloyd's to continue to strengthen its attractiveness compared to other specialist (re)insurance platforms.

The largest three brokers remain the largest source of Lloyd's business, reflecting their market shares in the wider insurance industry. Brokers continue to develop and implement initiatives to generate additional revenue from insurers. Where such arrangements could affect the financial performance of a managing agent, all parties need to have transparency and clarity on potential costs and benefits.

2012 BUSINESS HIGHLIGHTS

A year of consolidation and progress provides a new vision for the market

VISION 2025: ATTRACTING BUSINESS, PEOPLE AND CAPITAL

Our largest markets remain vitally important to our business and we are committed to continuing to develop both the products and relationships to build on our success in them. However, the Lloyd's market needs to ensure it also keeps pace with developing markets.

In May 2012, the Prime Minister, David Cameron, came to Lloyd's to help launch the new strategy for the development of the Lloyd's market – Vision 2025 – to position Lloyd's to take advantage of the opportunities presented by the world's developing economies. Core to Vision 2025 is the need for Lloyd's to be larger than today, targeting profitable growth both from developed and developing economies.

The aim of Lloyd's Vision 2025 is to ensure the position of the Lloyd's market remains as the global centre for specialist insurance and reinsurance. We will achieve this by:

- Growing our premium income from developed markets in line with their economic growth, with greater growth in developing markets.
- Encouraging a more diversified capital base, with greater contribution from high growth economies.
- Supporting a truly internationalised underwriting community.
- Remaining a broker market, utilising brokers' international networks.
- Having a small number of powerful overseas hubs in certain major overseas markets.

Much of the work of realising this Vision will fall to the market. It is managing agents' appetite for growing Lloyd's in new markets which will ultimately govern the success of the plan. The Corporation will do all it can to assist, whether through market development support, the improvement of back office processes or through attracting high performing and diverse professionals to work in the market.

"This great British industry… this extraordinary market… has huge potential to go further and faster."

DAVID CAMERON
British Prime Minister,
Launch of Vision 2025

Details can be found at:
www.lloyds.com/vision2025

VISION 2025

Following the launch of Vision 2025 in May 2012, we undertook a detailed analysis of potential opportunities offered in the large high growth economies and applied a number of factors to prioritise them, including managing agents' appetite, broker penetration, local business environment, business mix and catastrophe exposure. This analysis suggested that China, Brazil, Mexico, India and Turkey are Lloyd's current higher priority countries. Opportunities in these countries, as well as Lloyd's existing large developed markets, will be addressed within relevant country and regional development plans.

MONITORING AND MANAGING THE CYCLE

The Franchise Board and Executive Team oversee the management of the insurance cycle, raising relevant concerns and reviewing the market's level of natural catastrophe exposures.

Given the continued uncertainty in Europe, further work has been done in contingency planning for a member country exit from the Eurozone, together with continued management of the evolving regulation environment across multiple jurisdictions.

ACCESS TO BUSINESS

In an increasingly competitive environment, both in developed and developing markets, Lloyd's continues to deliver different ways to attract new business to the market. In 2012, the Lloyd's market approved 13 new brokers, bringing the total for the year to 192 Lloyd's registered brokers.

LICENCES

A key part of the work of our International Regulatory Affairs team is ensuring the appropriate maintenance of Lloyd's existing network of licences, while obtaining new access rights for the Lloyd's market. Lloyd's Japan negotiated an easier and more flexible use of the Lloyd's direct licence in Japan. The Indian Government agreed that the legislation needed to allow Lloyd's to establish a reinsurance branch operation in the country should be put forward for Parliamentary approval, although achieving this aim remains challenging. This year, Lloyd's applied for, and was awarded, an establishment authorisation in Lithuania, which will be its regional focus for promoting business in all three Baltic States. We continue to engage with the Turkish Government and regulator to explore ways in which Lloyd's can achieve a licence to write direct and reinsurance business onshore in Turkey. Lloyd's has also begun discussions with regulators in Colombia on the subject of Lloyd's future distribution options there. This work underlines the aims of Vision 2025 in seeking to diversify Lloyd's business profile to reflect global economic trends.

The regulatory and supervisory environment clearly presents considerable challenges; Lloyd's is continually reviewing the competitiveness of its licence network to ensure Lloyd's businesses have optimal market access around the world.

PINPOINTING GLOBAL RISK

The risks which brokers place at Lloyd's can be incredibly complex. If, for example, they want to place Marine Yacht cover for a company located in Hong Kong, for a yacht registered in Russia and operating in Italy, Spain and Greece, pinpointing the regulatory location and applicable taxes can be a minefield.

In response to increased support requested by managing agents, this year Lloyd's unveiled its Risk Locator, a web-based tool to help those in the market answer these questions.

By filling out a short questionnaire about the risk, users receive recommendations on the territorial and tax location of the risk.

All responses provide links to the relevant pages of Crystal, which covers international regulatory and taxation requirements, giving more detail on all regulatory aspects of the country or countries involved.

The Risk Locator has been enthusiastically welcomed by the market.

Details can be found at:
www.lloyds.com/risklocator

2012 BUSINESS HIGHLIGHTS CONTINUED

Amit Khilosia and John Sibanda, Lloyd's representatives in South Africa, handover a coverholder plaque to Praesidio Risk Managers (Pty) Ltd.

ADDING VALUE FOR COVERHOLDERS

2012 saw significant progress against a range of initiatives to enhance and improve the coverholder channel.

To make reporting for coverholders simpler, Lloyd's has a suite of coverholder reporting standards for premiums, claims and US property risk exposure reporting. This year we supplemented the standards by clarifying the existing requirements for coverholders to report to local Lloyd's offices. We have worked closely with ACORD to change its XML reporting standards so that these can be used to meet Lloyd's coverholder premium, claims and US property reporting standards. Coverholders have been kept regularly updated on regulatory and other changes via their own dedicated newsletter.

Lloyd's supported a successful market pilot to speed up claims handling, including co-lead claims. This significantly reduced turnaround times and the process is now live.

Many managing agents and brokers have also brought in new technology to better manage binder business.

In response to a raft of regulatory changes, we developed online anti-money laundering, bribery and sanctions training and ran a very well attended Town Hall meeting on financial crime in London.

Starting in the US in February, Lloyd's plaques were subsequently rolled out to coverholders in Australia, Belgium, Cyprus, Ireland, Greece, Hong Kong, Italy, the Netherlands, South Africa and Spain. Marketing material to support the Lloyd's brand was produced in a range of languages. Preparatory research and work was undertaken to improve the online coverholder section of the Lloyd's website, which was re-launched in December.

Details can be found at:
www.lloyds.com/coverholders

THE EXCHANGE

2012 saw the Exchange further established as the way to transfer structured data between broker and carrier. Electronic endorsements were rolled out to all classes of business in March.

All managing agents, 34 International Underwriting Association companies and 37 brokers are now using the Exchange for endorsements, placing support and non-bureau accounting messages. This year saw delivery of phase two of the Exchange portal, providing additional support services, including online help desk functions and self-service tools to manage connection details.

Towards the end of 2012 there was a major increase in the use of non-bureau accounting and settlement messages.

The Exchange has worked closely with ACORD to develop a series of hub tests, which both plan to use to certify the Exchange as the first ACORD certified hub.

CLAIMS TRANSFORMATION

Lloyd's continues to build strongly on its reputation for paying claims. In 2012, our Claims Transformation Programme delivered an average 49% improvement in transaction times for the 45,000 claims included in the Programme. In July, we extended the classes of business involved to include all new electronic claims.

At the start of the year, we introduced a revised Claims Scheme and enhanced minimum standards as well as a suite of claims performance metrics. We also started work to improve the ease and accuracy with which claims management information is reported to the market, and investigated a possible shared service for handling high volume claims with a particular focus on customer service.

INTERNATIONAL MARKETS

Lloyd's global reach is delivered through our global licence network, nearly 2,800 coverholders and our 40 offices across the world.

DEVELOPING THE MARKET

The International Market Development team support the business development of managing agents and Lloyd's brokers via our network of country managers and our work to promote Lloyd's internationally. New general representatives took up post in India and Boston, Massachusetts, and we appointed a new legal representative in Austria, and a new Attorney in Fact in Argentina.

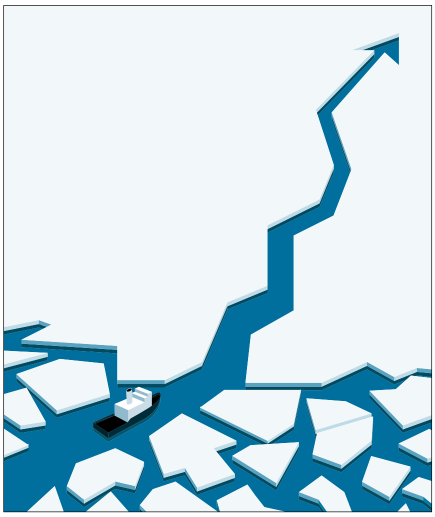
In an expanding and competitive environment, companies need in-depth and up to date information about the local commercial, political and regulatory environment. Lloyd's Market Intelligence launched updated Class Review reports on Brazil, Mexico, the US and new Turkey and UK Class Review products. We also launched a brand new Compare Countries database containing macroeconomic, insurance and Lloyd's premium data. The importance of market intelligence will only grow as the Lloyd's market takes up new opportunities in high growth economies; more market intelligence initiatives are planned for 2013.

INFLUENCING INTERNATIONALLY

Lloyd's supported over 100 events in over 25 countries in 2012, from the opening of the new Paris office in January to the Lloyd's South Africa coverholder event in Johannesburg in November. In February, managing agents and Lloyd's brokers visited India to help the Indian insurance market understand how they can do business through Lloyd's and discuss the new classes of business in the non-life insurance market generated by India's expanding economy. In October, Lloyd's Chairman John Nelson hosted the inaugural Lloyd's Day in Shanghai, bringing together over 400 representatives from the Chinese insurance market to exchange views, meet the 11 sponsoring managing agents and participate in workshops covering many of the classes of business at which the Lloyd's market excels. John Nelson, Dr Richard Ward and the Director of Lloyd's North America represented the market at a number of key US events, including the Risk and Insurance Management Society and The Council of Insurance Agents and Brokers' annual conferences.

LLOYD'S IN THE UK

The Lloyd's model of building relationships with regional brokers and coverholders, central to the market's business, has again made good progress in the UK, providing greater scope to underwrite risks for SMEs. In 2012, our programme of regional events to explain how UK brokers and coverholders can access the Lloyd's market included presentations at 13 events and 30 on-site coverholder visits, with more planned for 2013. Lloyd's also continued its support of the Managing General Agents Association (MGAA), on whose board it sits, by hosting ten events from its programme.



RISKS AND OPPORTUNITIES IN THE HIGH NORTH

Lloyd's, working with the Special Interest Group (emerging risk representatives from Lloyd's managing agents), produces a range of reports on emerging risks. Lloyd's commissioned Chatham House to look at the opportunities and challenges which the opening up of the Arctic through climate change might bring. Widely acclaimed by businesses, environmentalists and the insurance industry alike, *Arctic opening: Opportunity and Risk in the High North* found that investment in the Arctic could reach $100bn within ten years.

The report was launched at an event in Oslo by Lloyd's Chief Executive Dr Richard Ward, attended by business leaders, environmentalists and scientists. It urges businesses to start research to consider the substantial and unique risks of the region as soon as possible, and warns that the potential environmental consequences of any disasters and cost of clean-ups would be significantly greater than in other regions of the world.

Details can be found at:
www.lloyds.com/arcticreport2012

KEY PERFORMANCE INDICATORS

Measuring performance at Lloyd's

Key performance indicators (KPIs) are used by the management team to evaluate both the Lloyd's market and the Society's performance. Lloyd's has a range of metrics used internally for tracking and managing performance. Those shown here best illustrate Lloyd's financial performance and progress against delivering our strategy in 2012. Some of the measures change over time as the management team receive new information and to reflect significant changes in strategy. Trends that indicate changes in direction are important to the team, even in a market made up of independent businesses.

MARKET PERFORMANCE

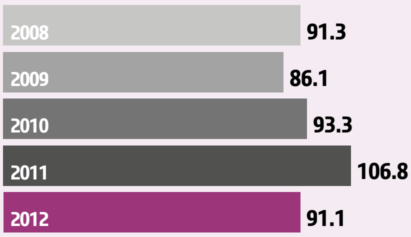
Combined ratio

- Definition: The combined ratio is an expression of net incurred claims and expenses against net earned premium. Any figure that is less than 100% signifies a technical underwriting profit.
- Rationale: Headline financial indicator for measuring underwriting performance. Lower is better.
- Progress: Underwriting discipline supported by robust claims reserves has driven an excellent combined ratio of 91.1%.

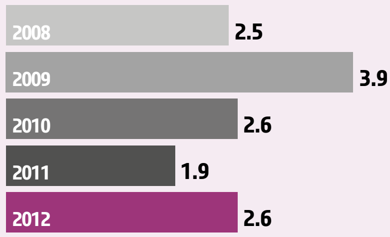
Investment return

- Definition: Net investment income plus realised and unrealised return on investments as a percentage of average total investments.
- Rationale: Investment return can have a significant impact on overall profitability for insurers/reinsurers.
- Progress: A return of 2.6% represents a solid performance in the continued low interest rate environment based on a conservative portfolio.

Combined ratio
%



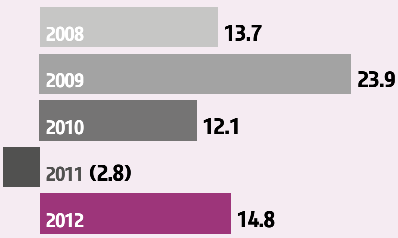
Investment return
%



Pre-tax return on capital

- Definition: Profits on ordinary activities before tax as a proportion of average capital and reserves held.
- Rationale: Indicates the capital efficiency of Lloyd's. The goal of the Franchise Board and Council is to support the market in monitoring cross-cycle returns to all capital providers.
- Progress: Strong return on capital of 14.8% despite claims from Superstorm Sandy and prevailing low investment yields.

Pre-tax return on capital
%



STRATEGIC PERFORMANCE

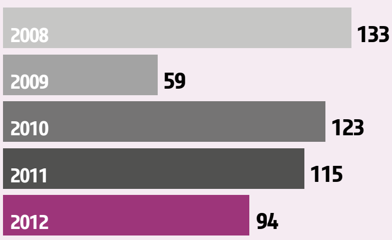
Solvency deficit

- Definition: The aggregate shortfalls for all members where the member's assets are insufficient to cover its underwriting liabilities and member capital requirement.
- Rationale: Indication of success at mitigating Central Fund exposure. Lower is better.
- Progress: Solvency deficits have remained low in the year with no impact from Superstorm Sandy.

Cost of mutuality

- Definition: Central Fund contribution rate charged to members. This includes the syndicate loans charged in 2005 and 2006, and subsequently repaid in 2007.
- Rationale: Medium-term cost indicator for the operational efficiency of mutually available assets. Lower is better.
- Progress: The 2012 contribution rate of 0.5% continues to represent a cost-effective benefit of mutuality; the rate for 2013 remains at 0.5%.

Solvency deficit
£m



Cost of mutuality
%

Security and ratings

- Definition: Lloyd's financial strengths as evaluated by the world's leading insurance rating agencies, taking into account operating performance, capitalisation, global competitiveness and financial flexibility.
- Rationale: Indicates the financial robustness of Lloyd's.
- Progress: Lloyd's ratings from all three ratings agencies are at the target level and were reaffirmed in 2012 with Standard & Poor's revising its outlook to positive from stable.

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

Brand strength

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

Insurance

Reinsurance

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

Managing agents

Lloyd's continually aims to further develop and improve its working relationship with managing agents, its key stakeholder group. There is regular interaction, in addition to a programme of market communication, that is designed to ensure open dialogue lies at the centre of the relationship between Lloyd's and managing agents. This interaction includes regular market meetings, technical briefings and face-to-face Three-Year Plan meetings between CEOs of managing agents and Lloyd's Directors as well as numerous working groups to address issues of mutual interest.

In light of the frequent and consistent nature of interaction and development activities it has been decided that it is unnecessary to continue to undertake the managing agent satisfaction levels survey going forward. Instead, satisfaction levels will be monitored on a company by company basis from within the Market Relationship and Development department.

RISK MANAGEMENT

Demonstrating the importance of managing risk

Year after year, Lloyd's demonstrates the importance of effective risk management; ensuring potential risks are identified, current risks are accurately assessed and both are practically managed.

RISK MANAGEMENT

Lloyd's employs a unique and comprehensive risk management framework to provide oversight and challenge to the risks facing the market and the Corporation.

Our risk governance structure uses both quantitative and qualitative risk information to provide this oversight. This is led by the Risk Committee, chaired by the CEO, and is responsible for the oversight of key risks facing the Society. During 2012, the Committee has focused on oversight and monitoring the implementation of activity to reduce the risk of poor underwriting profitability in the market and of significant losses in the event of any exits from the Eurozone.

The Risk Committee is supported by its three sub-committees who each specialise in different areas of oversight. This year, as a result of the Lloyd's Internal Model, prepared as part of the Solvency II requirements, these risk committees have prioritised aligning the reporting of risk and capital management information. The first Lloyd's Society Own Risk and Solvency Assessment (ORSA) was produced in April and provided clear management information for appropriate oversight and challenge at Franchise Board level. To provide better consistency with reporting, the quarterly risk and capital management information report was enhanced to reflect the ORSA.

As the Franchise Board has overall responsibility for risk management, the Risk Committee provides them with assurance, via the CEO, that risks to the market and Society are identified and managed against approved policies and risk appetites.

RISK MANAGEMENT FRAMEWORK

The Risk Management Framework includes management tools, a formal governance structure and a clearly defined approach to identifying, assessing, monitoring and managing key risks. This year, the Framework has been further embedded in the Lloyd's culture by both online training and briefings to all staff in the Corporation.

LLOYD'S RISK APPETITE FRAMEWORK

Lloyd's risk appetite establishes the level of risk-taking which the Franchise Board believes is acceptable for Lloyd's. Primarily operational oversight of the Framework is delivered through Lloyd's risk governance structure, with the Franchise Board retaining ultimate ownership.

Risk appetite statements – detailing the appropriate level of risk – have been produced for each material area. There are a total of 14 risk appetite statements, covering both market and Corporation risks. Each of these statements is supported by a set of metrics for detailed monitoring, which are regularly reviewed by the Franchise Board and the risk committees to ensure timely and appropriate management of the risks involved.

While Lloyd's has oversight responsibilities for the market, it does not have direct control over its risk taking, so some metrics are early warning triggers and others are guidelines only. Market-facing metrics are typically guidelines which prompt investigation if the market operates outside them, while Corporation metrics are usually formal limits.

MANAGING CATASTROPHE RISK

The nature of Lloyd's business means there is a constant risk of loss from natural catastrophes, as 2011 so clearly demonstrated. The risk committees have given particular focus to the controls over catastrophe exposures. The April 2012 ORSA reflected the increased level of catastrophe risk in the market.

We have taken steps to ensure that the Corporation maintains a proportionate level of oversight of this risk, given this increasing exposure.

NEW AND EMERGING RISKS

Lloyd's is at the forefront of thought leadership on risk. Using research undertaken by the Corporation's Emerging Risks team as well as new risks from all areas of the business, Lloyd's risk committees have developed an enhanced framework for early identification of new and emerging risks. When new risks are identified the risk committees undertake a detailed assessment to analyse potential impacts on Lloyd's. In addition to the widely acclaimed report on the Arctic, in 2012 the team also produced market-facing reports on behavioural risk and flood geomorphology.

KEY RISK ISSUES

The Framework ensures Lloyd's keeps pace with evolving economic, environmental and geopolitical risks. We use it to actively monitor their potential impact on the business and escalate them up the risk governance structure as required. Oversight and challenge is provided to ensure appropriate management action.

There are currently four key risk issues (shown in the table opposite) which are the focus of senior management and the risk governance structure. They were identified using the Risk Management Framework and have been confirmed as the current key risk issues facing Lloyd's by the Franchise Board and Risk Committee. There are a number of risks, such as geopolitical, which are not included opposite as they are not assessed as material to Lloyd's and are overseen and managed through the risk management framework.

For more on risks and uncertainties, see **pages 40-41**.

RISK ISSUE	POTENTIAL IMPACT	MITIGATION
THE INSURANCE CYCLE	Lloyd's businesses suffer losses or erode their capital base due to inappropriate underwriting or failure in management controls.	– The syndicates' business plans are reviewed to ensure the performance targets set are realistic and achievable given the market environment and the managing agents' capabilities. – The syndicates' business plans are monitored to ensure they do not materially deviate from the approved plan or, where they do, that the changes are acceptable. – Thematic/syndicate specific underwriting reviews undertaken to address potential performance issues and promote underwriting discipline.
UNSTABLE ECONOMIC AND FINANCIAL CLIMATE	Lloyd's suffers increased insurance liabilities, decreased asset values or capital constraints.	– Continued close monitoring of assets and credit ratings of largest counterparties. – Contingency plans developed for a member country exit from the Euro. – Stress tests revisited to determine and assess impacts of various Euro scenarios. – Specific economic scenario analysis to determine the impact of a range of economic and financial variables.
SIGNIFICANT REGULATORY CHANGE ACROSS MULTIPLE JURISDICTIONS	Lloyd's competitive position is weakened, suffers regulatory penalties or disadvantageous capital position.	– Continued lobbying to influence the evolution of the UK, European and global regulatory frameworks to ensure the continued competitive position of the market. – Lloyd's has materially completed its Solvency II project. There is continued close monitoring of the Solvency II implementation timetable to understand the impacts on the market.
CATASTROPHE EXPOSURE	Lloyd's businesses suffer losses or erode their capital base through material aggregations of risks and insufficient monitoring processes.	– Review of the Exposure Management Process has been undertaken, with changes implemented during the 2013 business plan approval process. – Lloyd's has continued to closely monitor and respond to the market risk appetite measures. – Managing agents continue to monitor exposures around the world in accordance with Lloyd's minimum standards. Key areas continue to be monitored centrally.

LLOYD'S THREE-YEAR PLAN 2013-2015

Vision 2025 – Meeting the world's changing insurance needs

ACHIEVING VISION 2025

The Three-Year Plan: 2013-2015 is a plan for the market, to be delivered by the Corporation, managing agents, brokers and members' agents. It marks the start of the market's delivery of Vision 2025 and focuses on six main areas.

MARKET OVERSIGHT

Market oversight has been, and remains, a key priority. The current market oversight regime will continue, built around:

- Robust performance management (the supervision of underwriting, reserving and claims activities).
- Capital oversight (capital setting).
- Risk management (setting Corporation and market risk appetites and operating the Risk Management Framework).

INTERNATIONAL GROWTH AND DIVERSIFICATION

Core to Vision 2025 is the need for Lloyd's to be larger than today, predicated on targeting profitable growth from both existing developed markets and from developing economies. To achieve Vision 2025 activity, the focus will be on:

- Market development: Maximise flows of profitable business predominately through existing cross-border (re)insurance channels.
- Licence enhancements: Where opportunities exist to extend Lloyd's licence network cost effectively, activity will be continued or initiated.
- Structured relationship management: Attraction of business and capital from new trade capital providers (especially in developing economies) as well as incremental new business from within the groups of managing agents and brokers.

STREAMLINING AND ENHANCING DISTRIBUTION

Lloyd's is a broker market. Strong relationships with both large brokers and smaller specialist brokers remain key to Lloyd's success, while coverholders and service companies provide efficient access to local markets. Activities to streamline and enhance distribution will include:

- Making face-to-face trading and negotiations as effective as possible through the use of technology.
- Facilitating access to technology and initiatives which allow the market to access attractive business being placed remotely.
- Continuing to improve the efficiency of the coverholder model.

EFFICIENT CENTRAL PROCESSES AND INFRASTRUCTURE: MARKET MODERNISATION

It is important that Lloyd's processes and infrastructure are refreshed as needed to ensure they are as efficient and cost effective as possible. Work in this area will be in response to market demand and will be market led:

- Central Services Refresh: The current focus is on design and consensus building; 2014 and beyond will be about execution.
- Claims Transformation Programme: Designing and embedding tactical solutions to continue to improve the effectiveness and efficiency of the market's claims handling; and determining the most appropriate solution for legacy claims.
- The Exchange: Increase usage across the Lloyd's and wider London markets and investigate how best to widen the reach of the Exchange.

ATTRACTING AND PROMOTING TALENT

Broadening the diversity of people in the market is an important part of attracting the best talent and supporting Lloyd's international growth aspirations. Three strands of activity aim to achieve Lloyd's objectives:

- Recruitment initiatives: To attract high calibre people at the start of their careers;
- Development initiatives: To retain and develop people with leadership and specialist skill sets; and
- Diversity initiatives: To attract and retain the best talent, leading to a more diverse and inclusive market.

MORE EFFICIENT DELIVERY OF PRIVATE 'NAMES' CAPITAL

The diversity of capital able to support underwriting is one of the strengths of the Lloyd's market. The work to invigorate private capital will be led by members' agents with a particular focus on:

- Members' agent-led initiatives to examine ways to make private capital more attractive to managing agents supported, as appropriate, by the Corporation.
- Contingent capital arrangements and the enhancement or simplification of structures and contractual arrangements (such as Special Purpose Syndicates).

Details can be found at:
www.lloyds.com/strategy

HUMAN RESOURCES AND PEOPLE STRATEGY

The ultimate source of value in our business lies in our people

The Corporation, together with the Lloyd's market, has developed significant expertise in tackling the challenge of attracting and fostering the brightest and the best people.

GRADUATE PROGRAMMES

The 18-month long Lloyd's Generalist Graduate Programme was launched in 2008; since then 31 generalist graduates have completed the programme which offers work placements both within the Corporation and the market. Retention rates have been high – with 95% of all graduates subsequently employed by the market. This year, we took on eight graduates to the Generalist Programme; next year we plan to increase this number to 15. Following the success of this programme, since 2010 we have also been running an eight week Summer Internship Programme. This year, five interns completed the programme, bringing the total since launch to 14 – all of whom have been offered places on the Generalist Graduate Programme.

CORPORATION EMPLOYEE DEMOGRAPHICS

UK employee joiners and leavers

	2012 number	2011 number
Employees as at 1 January 2012	**752**	748
Total joiners	**145**	182
Total leavers*	**(171)**	(178)
Employees as at 31 December 2012	**726**	752

* Including total voluntary, involuntary, retirements and completed contracts.

Total worldwide employees

	2012 number	2011 number
UK	**726**	752
US	**33**	32
Canada	**7**	6
Asia	**67**	67
Europe	**47**	46
Africa, Australia and South America	**10**	9
Employees as at 31 December 2012	**890**	912

The Claims Graduate Programme, to foster detailed knowledge and expertise in claims, was launched in 2011. Since then, 15 graduates have successfully secured a place, with six undertaking the 2012 programme. All nine of the 2011 intake have secured permanent roles in the market. For those further along in their careers, we run the Claims Practitioner Programme; ten delegates were accepted onto this programme in 2012.

FOSTERING TALENT INTERNATIONALLY

Lloyd's country managers continued to demonstrate their commitment to fostering talent across the world. In Singapore, Lloyd's Asia supports the General Insurance Association's Global Internship Programme and in 2012 ran a ten-week internship programme for four undergraduates. In 2010, the CEO of Lloyd's China was appointed as career mentor at the MBA Centre, Shanghai University and mentors two students each year. Lloyd's Asia and its service companies help run the Insurance Executive Scholarship Programme for the Singapore College of Insurance, aimed at attracting the best new talent into the local insurance industry. In Brazil, Lloyd's Brazil's partnership with the Brazilian National School of Insurance, FUNENSEG, delivered a number of lectures on Lloyd's in Brazil. The President of Lloyd's America sits on the Board of Overseers for the School of Risk Management at St John University in New York and the Regional Director, US Central Region, represents Lloyd's on the Advisory Board at Illinois State University's School of Insurance and Financial Services.

In Switzerland, our General Representative has educated students on Lloyd's and Lloyd's brokers as part of the Insurance Institute of Switzerland's Insurance Broking course for the past ten years. Other international offices, including Lloyd's Spain, Lloyd's Japan and Lloyd's Brazil organised visits and work experience to Lloyd's in London this year for insurance professionals in their respective regions. Further outreach to encourage talent into Lloyd's is planned across 2013.

CORPORATE SOCIAL RESPONSIBILITY

Maximising the impact of our social, ethical and environmental approach

EMBEDDING CSR AT LLOYD'S

The Corporation believes that all Lloyd's staff have a role to play in its approach to social, ethical and environmental issues. In 2012 we launched Lloyd's new Corporate Social Responsibility (CSR) strategy for the whole Corporation. It has three objectives:

- To help everyone in the Corporation of Lloyd's understand the role they can play.
- To work collaboratively with companies in the Lloyd's market and our suppliers on key CSR issues; and
- To operate in a way that makes our staff feel proud to work for a company that takes its social, ethical and environmental responsibilities seriously.

In February the Corporation published a new Code of Conduct, widely publicised to all its staff, which set out the principles that guide our conduct towards colleagues, business partners, the environment and wider society in every country in which Lloyd's operates. The induction process for new Corporation staff was also reviewed to ensure that all staff understand the importance of these ethics.

LLOYD'S IN THE COMMUNITY

The Corporation runs Lloyd's Community Programme on behalf of the market, which brings together volunteers from across the market to help foster the potential of young people in Lloyd's neighbouring communities. 2011 was a record year for volunteers, but 2012 surpassed it – with over 1,800 volunteers working through 13 different schemes. Together, they contributed over 17,000 hours and reached over 3,000 people through activities from reading partnerships to mentoring schemes and sporting opportunities.

2012 – A YEAR OF SPORTING SUCCESS

In the year when London hosted the Olympics, Lloyd's Community Programme was proud to continue its support of the Tower Hamlets Youth Sport Foundation, which provides young people and children in East London with opportunities to play sport. Our Sporting Chances programme helped the Foundation run Winter and Summer neighbourhood games in Tower Hamlets, with nearly 130 volunteers from the Corporation and market. Over 1,000 schoolchildren attended the games, which gave them the opportunity to try out sports as wide-ranging as archery and tennis.

In this year of sporting success, Lloyd's Community Programme also donated £80,000 to the charity to help it continue to offer sporting opportunities for Tower Hamlet's 35,000 schoolchildren. In recognition of its achievements, Sporting Chances was shortlisted for the 2012 Lord Mayor's Dragon Awards in the Social Inclusion category.

LLOYD'S IMPACT ON THE ENVIRONMENT

Lloyd's is always looking at ways to reduce the environmental impact of our operations. The Lloyd's Environmental Working Group meets quarterly to review progress against our Environmental Action Plan, analysing data on our energy consumption, air travel and recycling rates for all our UK operations. This year, in the UK we have increased our recycling to 85% of our total waste. The remaining 15% is incinerated at a waste-to-energy plant to produce electricity, ensuring none of our waste goes to landfill.

A LIVING WAGE AT LLOYD'S

The Living Wage is the hourly wage necessary for housing, food and other basic needs. It was launched in London in 2001 and extended nationally in 2011. It's a movement that's gaining momentum across the country, with over 140 organisations currently signed up.
In March, the Corporation of Lloyd's joined them, ensuring that we're now signed up to both the National and the London Living Wage. All contractors working for the Corporation in the UK, including cleaning and catering staff, will receive at least the Living Wage.

This has made a significant difference to their lives, particularly given London's high housing costs. Lovebridge Acheampong, a part-time cleaner at Lloyd's, explains:

"The London Living Wage has helped my family much more than when I was just working for an employer who paid the minimum wage. Because my job at Lloyd's pays the London Living Wage I can now take a rest and take care of my children. We don't have to borrow anymore. It feels good to be able to support myself and my family."

CARBON EMISSIONS

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

Lloyd's total reported GHG emissions for 2012 were 13,262 tonnes of CO_2 equivalent; a reduction of 4% on 2011 (13,891* tonnes of CO_2). Some of this reduction is due to a programme to improve the efficiency of the air conditioning system in the 1986 building which achieved two-thirds of the total 6% reduction in electricity use. This equates to a saving of 561 tonnes of CO_2 compared to 2011.

Business flights by Lloyd's decreased in 2012, resulting in carbon savings of 156 tonnes compared to 2011. Lloyd's offset its air travel emissions by buying carbon credits for renewable energy projects through the CarbonNeutral Company.

This year, Lloyd's also started work to analyse the carbon footprint in nine of our largest international offices. For more details about how Lloyd's is committed to reducing its carbon footprint visit www.lloyds.com/carbonemissions.

* The reported 2011 emissions have been recalculated to reflect updated emissions factors that have been issued by DEFRA.

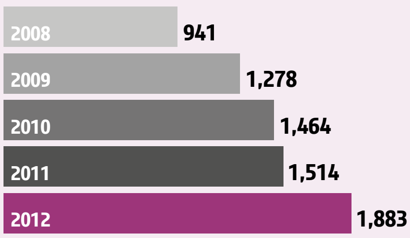
Further information can be found at:
www.lloyds.com/CSR

Lloyd's Community Programme members

Our warmest thanks go to:

ACE Underwriting Agencies Limited
Amlin Underwriting Limited
Antares Managing Agency Limited
Aon UK Ltd
Argo Managing Agency Limited
Ark Syndicate Management Limited
Ascot Underwriting Limited
Asta Managing Agency Limited
Atrium Underwriters Limited
Barbican Managing Agency Limited
Beazley Furlonge Limited
Besso Limited
BMS Group Ltd
Brit Syndicate Limited
Canopius Management Agencies Limited
Catlin Underwriting Agencies Limited
Chaucer Syndicates Ltd
Chubb Managing Agency Limited
Clyde & Co LLP
Edwards Wildman UK LLP
Faraday Underwriting Ltd
Hampden Agencies
Hardy Underwriting Agencies Ltd
Hiscox Syndicates Limited
Hyperion Insurance Group Limited
JLT Specialty Limited
Liberty International Underwriters
Liberty Syndicates Management Limited
Lockton Companies LLP
Markel Syndicate Management Limited
Marketform Managing Agency Limited
Marsh & McLennan Companies, Inc
Mazars
Miller Insurance Services Ltd
Mitsui Sumitomo Insurance Underwriting
Munich Re Underwriting Ltd
Newline Underwriting Management Ltd
Novae Syndicates Limited
PriceWaterhouseCoopers LLP
QBE Underwriting Limited
Renaissance Re Syndicate Management Limited
RJ Kiln & Co Ltd
RK Harrison Group Ltd
Sagicor at Lloyd's Limited
Talbot Underwriting Ltd
Thompson Heath & Bond Ltd
Travelers Syndicate Management Limited
XL Group
Zurich

Lloyd's Community Programme volunteer involvement (Figure 7)
Number of volunteers:



HOW THE MARKET PERFORMED IN 2012

Lloyd’s is the specialist insurer for property, transport and aviation across the world.

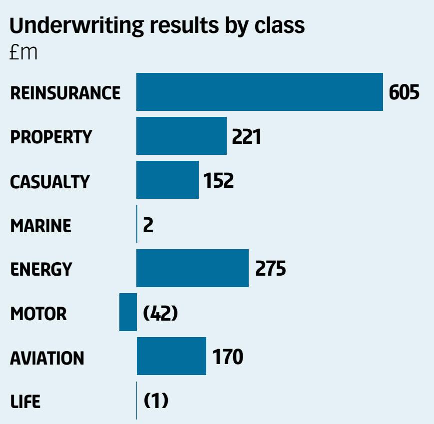
2012 MARKET PERFORMANCE REVIEW

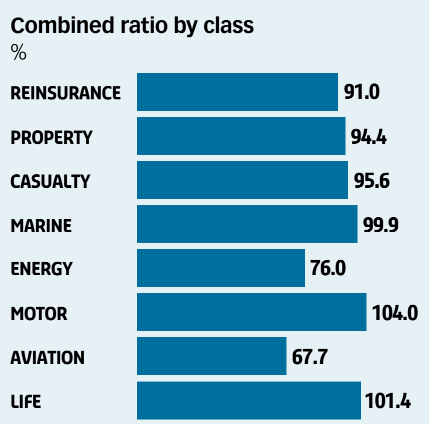
2012 highlights

- Profit before tax of £2,771m (2011: loss £516m) and a combined ratio of 91.1% (2011: 106.8%)
- Total investment return of £1,311m (2011: £955m)
- Overall surplus on prior years of £1,351m (2011: £1,173m)
- Pre-tax return on capital of 14.8% (2011: loss 2.8%)

2012 COMBINED RATIO*

Accident year	**98.3%**
Prior year reserve movement	**(7.2)%**
Calendar year	**91.1%**





* The combined ratio for the market and by class of business is the ratio of net incurred claims and net operating expenses to net earned premiums. The prior year reserve movement represents the ratio of the surplus/deficit arising on reserves set at December 2011 to overall net earned premiums in calendar year 2012. The overall combined ratio includes central adjustments in the technical account in respect of transactions between syndicates and the Society as described in notes 2 and 8 to the PFFS (pages 47 and 50). The combined ratios and results for individual classes of business do not include these adjustments as the market commentary for each class reflects trading conditions at syndicate level as reported in syndicate annual accounts.

The underwriting results and combined ratio tables include the results of all life and non-life syndicates transacting business during 2012. The results and net assets for life syndicates are not material and have not been separately disclosed in the profit and loss account and balance sheet. The results for life business have been reported in the segmental analysis, note 9 on page 51.

The Lloyd's market saw a strong return on capital of 14.8% with a pre-tax profit in 2012 of £2,771m (2011: loss £516m). This result was achieved despite the US being struck by Superstorm Sandy, the most costly US catastrophe since Hurricane Katrina in 2005. The market returned a combined ratio of 91.1% (2011: 106.8%), with an investment return of 2.6% (2011: 1.9%).

There was some improvement in rates, particularly in the earlier part of 2012, driven by classes impacted by the severe natural catastrophes in 2011. The general rating environment remained challenging, however, in a number of lines with limited movement year on year. Modest increases in exposures and further transfers of business on to the Lloyd's platform meant that the market grew premium volumes slightly more than the small overall increase in risk adjusted rate.

In contrast to calendar years 2010 and 2011 when the largest insurance losses arose from weather events in the Asia-Pacific region, in 2012 nine of the ten largest insured loss events occurred in the US. It has been estimated that 90% of all 2012 insured losses arose in the US.

The two largest US catastrophes produced insured claims in excess of US$20bn, namely Superstorm Sandy and the drought that affected the Mid-Western states. Claims from the drought were generally met by the US Department of Agriculture's Federal Crop Insurance Corporation and public insurers, but the claims from Superstorm Sandy were met by the wider insurance industry as well as by the National Flood Insurance Program (NFIP). The estimated net claims, after reinsurance, of Superstorm Sandy for the Lloyd's market was £1,351m (US$2,175m), representing three-quarters of the market's total major claim cost of £1,816m (2011: £4,608m).

The overall underwriting result was boosted by another strong performance on prior year reserves, mostly attributable to actual experience being significantly more favourable than projected. This produced an overall release of £1,351m (2011: £1,173m), reducing the combined ratio by 7.2%.

MARKET PERFORMANCE CONTINUED

LOOKING AHEAD

Once again we find ourselves writing a report in a new year that has already seen the impact of natural disasters, although not on the scale seen in the first quarter of 2011. In January 2013, there was severe flooding in Australia and Indonesia with initial estimates of insurance claims of over US$300m in both cases. February then saw severe snow storms in the North-Eastern US and Eastern Canada which led to five US states declaring a state of emergency and businesses and airports closed.

While Superstorm Sandy was a major claims event it does not appear to have been sufficient to materially impact rates. Its timing at the start of the main property treaty renewal season and uncertainty about the ultimate impact cost has resulted in rate improvements on North American property risks and limited rate reductions that had been anticipated in some of the January 2013 renewals. Barring any major negative developments, other classes affected by Superstorm Sandy are not, however, expected to experience material changes in market conditions. One exception is marine reinsurance, which saw significant rate rises in the 1 January renewals.

Across all lines in aggregate, rate changes in January were broadly flat, with no major surprises. Approximately 30% of Lloyd's premium is renewed in January, of which treaty reinsurance represents the largest proportion. Property treaty rates, though, remain relatively strong compared to long term averages and to other classes of business.

Aon's January 2013 publication Reinsurance Market Outlook stated that reinsurance capital has reached a record level of US$500bn in 2012 but that demand for reinsurance has fallen. With these record levels of capacity and a challenging economic environment, the rating environment is likely to stay challenging for some time. Underwriting discipline must remain the market's top priority.

2012 PERFORMANCE

Gross written premium for the year increased by 8.6% to £25,500m (2011: £23,477m). For 2012, the Lloyd's market recorded an accident year combined ratio of 98.3% (2011: 113.3%).

The overall risk adjusted rate change (RARC) for premiums in the Lloyd's market in 2012 was +3%, in line with projections within syndicate business plans. The improvement in rates during 2012, particularly in the first quarter, was driven by the property catastrophe classes which were affected by the frequency of large claims in 2011 and exposure model changes. Overall, although pricing is substantially better than the 1997-2001 soft cycle, the general rating environment remained under some pressure and rates in several sectors continue to fall. Aviation pricing is currently under the most extreme downward pressure.

Exchange rate movements have not had a significant impact on this movement as, while the US dollar denominated business accounts for the largest share of Lloyd's business, the average exchange rate in 2012 was US$1.59:£1 compared to US$1.60:£1 in 2011.

Premium volumes continued to rise ahead of RARC, driven by new opportunities and further transfers of business by international groups from the company market onto the Lloyd's platform. The main classes behind the increase in the market's gross written premiums were treaty reinsurance and property (direct and facultative), with smaller increases also seen in marine, general liability and accident and health.

The flexibility offered to insurance companies that wish to access third party capital at Lloyd's also contributes to an element of the reported growth at gross premium level. This is a function of aggregating the income of all separate syndicates within the market results. The underlying movement is better reflected in the increase in net written premium of 5.2% (2011: 4.6%).

The underlying accident year ratio, excluding major claims, was 88.6% (2011: 87.8%); a similar result to calendar years 2007 to 2011 on the same basis.

SUPERSTORM SANDY

Superstorm Sandy was the most costly event of 2012 for the Lloyd's market. The storm developed from a tropical wave in the Western Caribbean Sea on 22 October, which quickly strengthened and moved slowly through the Caribbean before making landfall along the US Eastern seaboard and Eastern Canada. Particularly significant was its diameter, with winds estimated to span 1,100 miles. The storm is considered to have caused more than 250 fatalities as it moved through the

ANALYSIS OF EXCHANGE GAIN/(LOSS)

	2012 £m	2011 £m
Impact of translating non-monetary items at average rates and monetary items at closing rates	**(37)**	38
Accident year – other	**9**	(47)
Prior years	**(55)**	(10)
(Loss) on exchange	**(83)**	(19)
(Loss)/gain within premiums/expenses through reversal of exchange movement reported in previous year	**(38)**	9
Total	**(121)**	(10)

Caribbean, notably in Haiti. The economic damage caused is estimated to be US$65bn which makes this the second most costly North Atlantic windstorm behind Hurricane Katrina in 2005 and the seventh costliest global loss event in the period 1950 to 2012. Most industry loss estimates for Superstorm Sandy are converging within a range of US$20-25bn which is towards the upper end of most original forecasts.

The Lloyd's classes most affected by Superstorm Sandy are property, both direct and reinsurance, but sizeable losses have been seen in marine (mostly specie and cargo). While Superstorm Sandy represents a significant cost to the Lloyd's market, it falls within the allowance for catastrophe experience within syndicate business plans given the absence of other extreme events. The net cost, after reinsurance and reinstatement premiums, to Lloyd's was US$2,175m (£1,351m) which is within the range published on 12 December 2012 of US$2-2.5bn. This makes it one of the most costly catastrophe events for the market since 1994 although significant uncertainty remains regarding the ultimate cost. There was no impact on Lloyd's Central Fund.

OTHER MAJOR CLAIMS

The North Atlantic windstorm season was an active one with 19 named storms and 10 hurricanes, but only two of these storms generated insured losses of more than US$1bn, namely Superstorm Sandy and Hurricane Isaac.

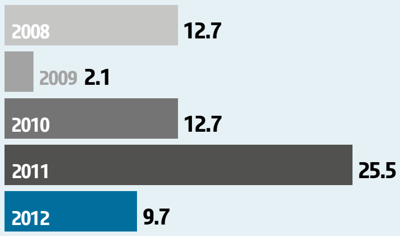
Hurricane Isaac developed in August 2012. It passed over Hispaniola and Cuba as a strong tropical storm, killing at least 29 people in Hispaniola, before it entered the Gulf of Mexico. From an insurance perspective this storm is estimated to have cost US$1.4billion in insured claims with the cost to Lloyd's limited to US$88m (£55m).

The largest non-US natural catastrophe was the period of earthquakes in Northern Italy in May, an event which caused more than €12bn in economic damage and €1.0bn in insured losses. The earthquakes were both centred near the cities of Bologna and Modena, causing damage to agriculture, business, homes, personal property and historic buildings. The net cost to Lloyd's was less than €50m.

Accident year excluding major claims
%

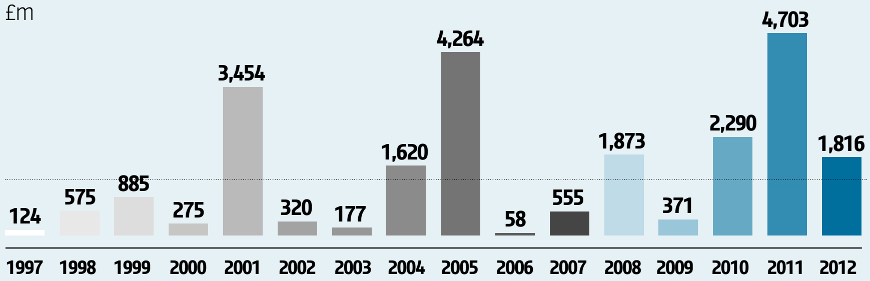
5 year average 88.1
10 year average 85.9

Major claims
%



5 year average 12.5
10 year average 11.0

Lloyd's major losses: net ultimate claims
£m



Indexed for inflation to 2012. Claims in foreign currency translated at the exchange rates prevailing at the date of loss.

£1,169m 18-year average
£1,436m 15-year average

The most notable major claim arising from man-made events in 2012 was the loss of the cruise ship, Costa Concordia. She partially sank on the night of 13 January 2012 after hitting a reef off the Italian coast and running aground at Isola Giglio, Tuscany causing the tragic loss of 32 lives. Insurers have suffered a loss in both hull and liability markets, with the cost to insurers increasing through the requirement to remove the ship in one piece. The net cost to Lloyd's from both direct and reinsurance placements is estimated to be in the region of £200m.

PRIOR YEAR MOVEMENT

The combined ratio has been reduced by 7.2% (2011: 6.5%) through material prior year reserve releases. The surplus represents 4.4% of net claims reserves brought forward at 1 January 2012.

This was the eighth successive year of prior year surpluses. Similarly to last year, the strong level of claims reserves support the releases that have been seen over almost all classes of business and years of account. Actual claims development for prior years remains significantly below projected levels and Lloyd's reserve monitoring has not identified any new specific areas of concern. The development on the longer-tail business written in the soft market conditions of 1997-2001 continues to be within expectations supporting the continued significant contribution seen from the older years (2006 and prior). Lloyd's continues to hold material reserves for these years of account, though the potential for further surpluses to materialise in future is dependent on the robustness of reserves for recent years.

MARKET PERFORMANCE CONTINUED

Claims estimates for the major catastrophe events in Australia, Japan and New Zealand in the first quarter of 2011 have continued to remain stable as have those for the floods in Thailand in the third quarter of that year.

REINSURANCE PROTECTION

The credit quality of the Lloyd's market's reinsurance cover remains extremely high with the top ten reinsurers and 96% of all recoveries rated 'A-' and above.

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

Under Lloyd's three-year accounting policy for final distribution of each underwriting year of account, the 2010 account reached closure at 31 December 2012. The 2010 calendar year saw claims from earthquakes in Chile and New Zealand, storm damage in Europe and the US, floods in Australia and even claims from volcanic activity. Furthermore, the 2010 year of account was also impacted by some of the catastrophic events at the beginning of calendar year 2011. It is no surprise therefore that the 2010 pure year of account made a loss, but releases from prior years means that the year closes with an overall profit of £551m. (2009 and prior £3,107m). The result includes a surplus of £992m arising on the 2009 and prior reinsurance to close (RITC) (2008 and prior £757m).

In aggregate, run-off years reported a loss of £24m including investment income (2011: loss of £87m). The reduced level of loss reflects fewer run-off years in 2012 compared to 2011 and that there has been less need to strengthen reserves in 2012 compared to the previous year.

Of the seven years of account that were in run-off at the beginning of 2012, two were closed by the end of the year. However, three syndicates were unable to close their 2010 year of account at the year end and, therefore, there was a net increase in open years of one.

The results of the major classes of business are discussed in detail on pages 34 to 39.

INVESTMENT REVIEW

Continued uncertainty about the prospects for global economic activity resulted in further volatility in financial markets during 2012. Much of the uncertainty again revolved around developments in the Eurozone. In the first half of the year, investor concerns about the solvency of some Euro sovereigns saw the yield on their debt rise to unsustainable levels, prompting a more general sell off in riskier assets. Ultimately however, measures taken by the European Central Bank, first providing massive liquidity support to Eurozone banks and subsequently undertaking to intervene to support Euro sovereign debt issuance, where necessary, served to improve market confidence and provide the basis for a significant rally in the value of many riskier investments in the second half of the year. Equity markets ended higher, year on year, whilst yields on many financial debt securities fell significantly.

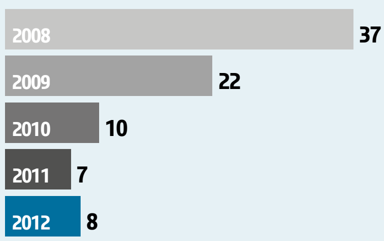
Despite improved investor sentiment, many of the issues underlying the recent volatility remain to be resolved. Global economic growth remains weak and volatile, despite substantial monetary stimulus in many countries. As a result, few sovereigns have made progress towards reducing budget deficits. In the banking sector, improved operating profits have been eroded by growing provisions and regulatory penalties, whilst the impact of forthcoming legislation in many jurisdictions has yet to be fully understood. The credit crisis continues to cast a long shadow and, despite the recent reduction in market volatility, significant uncertainties remain.

Syndicate premium assets form the largest element of investment assets at Lloyd's. Managing agents are responsible for the investment of these funds, which are used to meet insurance claims as they become payable. Traditionally, syndicates adopt

Prior year reserve movement
%

Combined ratio

Years of account in run-off



conservative investment policies, utilising cash and high quality fixed interest securities of relatively short duration. Some syndicates' investments include elements of more volatile asset classes, such as equities, hedge funds and lower rated debt securities. At the margin, the proportion of riskier assets has increased; however, high quality, short dated, fixed interest securities and cash continue to dominate syndicate portfolios, notwithstanding the low yields currently offered by such instruments.

Overall, syndicate investments returned £997m, or 3.0% in 2012 (2011: £791m, 2.4%). Investments are valued at market prices and unrealised gains and losses are included within reported investment returns. Continuing the trend of recent years, the low yield environment has resulted in a return which is modest by historic standards, but falling credit spreads on many corporate debt securities, as well as some further reduction in risk free yields, have generated capital gains on bond portfolios, resulting in an overall return which is better than might have been anticipated. This return is significantly in excess of the running yield on the in-force portfolio and, indeed, ever lower yields increase the risk of losses arising on such investments in future periods, when yields begin to rise once more.

Members' capital is generally held centrally at Lloyd's. A proportion of this capital is maintained in investment assets and managed at members' discretion. A notional investment return on members' capital of £199m, or 1.3% (2011: £69m, 0.5%) has been included in the pro forma financial statements (PFFS). This is based on the investment disposition of the relevant assets and market index returns. The return has been adversely impacted by the low level of interest available on the high proportion of cash and equivalent investments held within members' capital. However, rising equity markets have helped the overall members' investment return to exceed the level achieved in 2011.

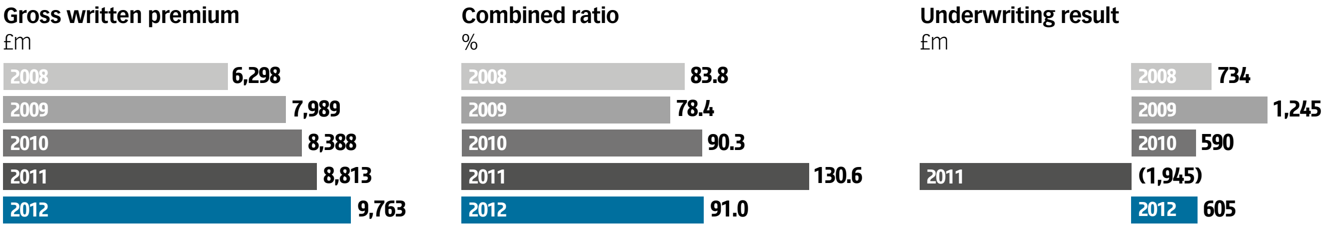
The investment return on Lloyd's central assets is also included in the PFFS. This was £115m or 4.5% in 2012 (2011: £95m, 3.9%). The investment performance of central assets is discussed on page 87. The total contribution from investment returns, including syndicate assets, members' capital and central assets, was £1,311m, or 2.6% (2011: £955m, 1.9%).

RESULTS SUMMARY

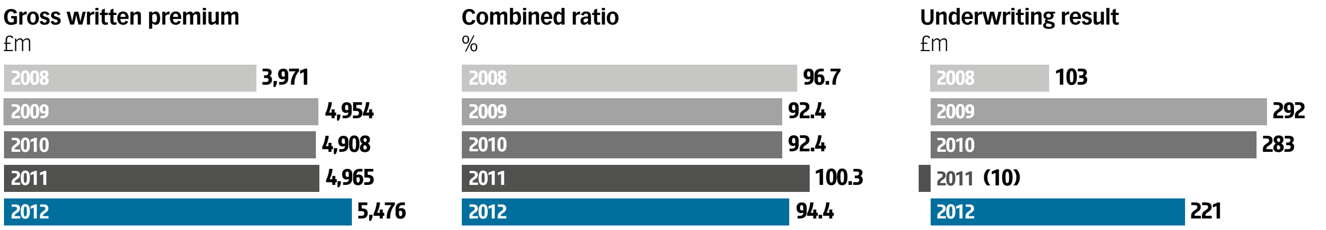
Lloyd's reported a profit before tax for the financial year of £2,771m (2011: loss of £516m) and a combined ratio of 91.1% (2011: 106.8%). The PFFS aggregates the results of the syndicate annual accounts, notional investment return on funds at Lloyd's (FAL) and the Society of Lloyd's financial statements. The basis of preparation of the PFFS is set out in note 2 on page 47. The syndicate annual accounts reported an aggregate profit of £2,379m (2011: loss of £710m).

MARKET PERFORMANCE CONTINUED

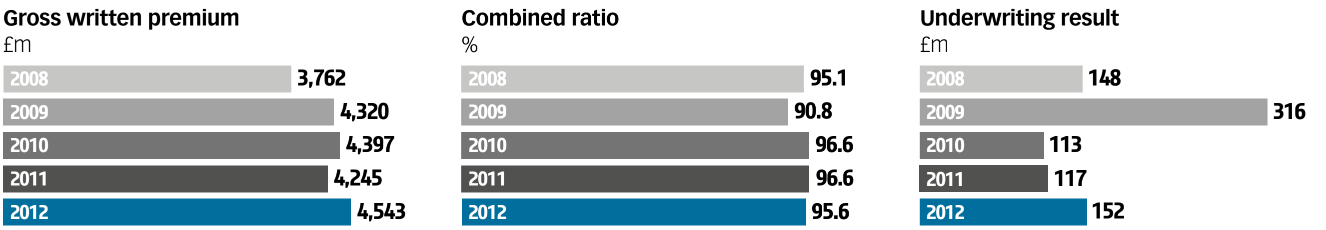
REINSURANCE



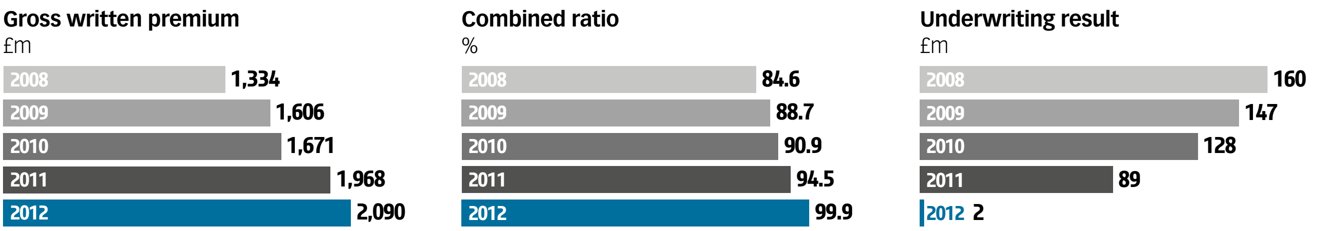
PROPERTY



CASUALTY

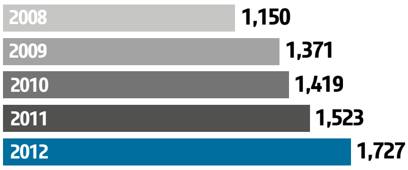


MARINE

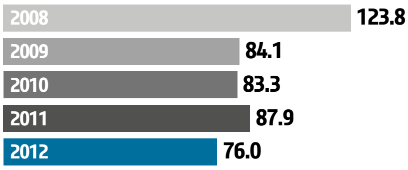


ENERGY

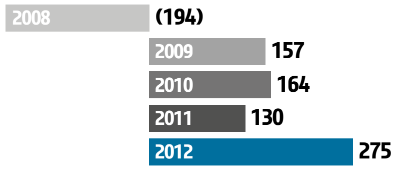
Gross written premium
£m



Combined ratio
%



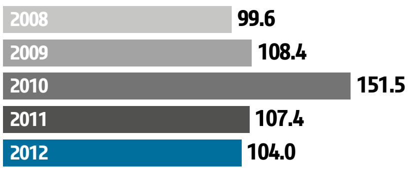
Underwriting result
£m



MOTOR

Gross written premium
£m

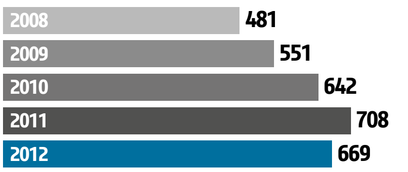
Combined ratio
%



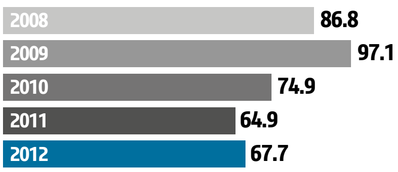
Underwriting result
£m

AVIATION

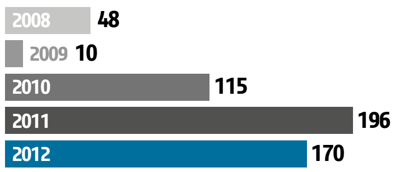
Gross written premium
£m



Combined ratio
%



Underwriting result
£m



MARKET PERFORMANCE CONTINUED

CLASS OF BUSINESS

Reinsurance

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

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

2012 Performance

Lloyd's gross written premium for 2012 was £9,763m (2011: £8,813m), an increase of 10.8%. The Lloyd's reinsurance sector reported an accident year combined ratio of 97.9% (2011: 138.1%).

The year was characterised by a rising rating market driven by US catastrophe exposed lines, building on a positive overall rating environment compared to historical averages and direct classes. Outside the US the movement in rates is uneven, depending on recent catastrophe losses and European markets are lagging behind.

Premium growth has moderated in part through the market reducing its exposures in some peak zones. The surplus capacity in the industry has enabled syndicates to balance their accounts through additional retrocessional coverage.

In marked contrast to 2011 there was a low level of major catastrophe activity until the impact of Superstorm Sandy in late October. Results have been aided by stable attritional loss ratios in most lines. The largest losses outside of the US to affect the property catastrophe market were the earthquake losses in Northern Italy and a hailstorm in Calgary, Canada, but these losses had little impact on pricing. The crop losses from the drought in the US are not considered material from Lloyd's perspective, either in terms of incurred claims or impact on rates.

The sinking of Costa Concordia has affected the marine reinsurance industry substantially. This has led to a marked reduction in retrocession capacity and an increase in rates and higher deductibles.

In casualty treaty the development of Periodical Payment Orders (PPOs) has led to significant uncertainty in UK motor excess of loss covers for both buyers and sellers.

Reported premium growth has been increased through the flexibility offered to insurance companies that wish to access third party capital at Lloyd's. This is a function of aggregating the income of all separate syndicates within the market results. The supply of capital through the vehicle of Special Purpose Syndicates (see Glossary page 133) does mean that the original business placed with one syndicate is effectively reported twice in the Lloyd's market headline figures. Together with a material whole account syndicate reinsurance, these account for 4.3% of the growth year on year. The underlying movement is better reflected in the increase in net written premium of 4.0%.

Prior year movement

The prior year reserve movement was a surplus of 6.9% (2011: 7.5%). Estimates for the major catastrophes in 2011 show stable development and other reinsurance risks are developing satisfactorily.

Looking ahead

Expectations for 2013 underwriting are for specific rate hardening for lines affected by Superstorm Sandy, including marine, balanced by a gradually weakening market in most lines. In view of the current rating levels overall, however, underwriting margins are still expected to satisfy return on capital requirements despite the increasing supply of capacity in this class. This trend will only be reversed if there is a very significant insured loss or a series of losses or another serious deterioration in the economies of the major markets where Lloyd's transacts its business.

Property

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

Business is written through the broker network as well as using the framework of coverholders and delegated authorities.

2012 Performance

Lloyd's gross written premium for 2012 was £5,476m (2011: £4,965m), an increase of 10.3%. The Lloyd's property sector reported an accident year combined ratio of 102.6% (2011: 106.3%).

Property premium income has grown over and above rate change as syndicates exploit the Lloyd's trading platform to expand into new markets. Premiums for catastrophe exposed lines have increased steadily through the year in line with rate improvements. The claims incurred from Superstorm Sandy should help further to maintain this momentum. Outside the US direct, binder and facultative business continues to be competitive. Trading in specialist property lines has become more competitive with some rate reductions but loss ratios have been broadly stable.

Attritional loss ratios have performed within planned figures and this extends to the allowance for major claims where the cost of Superstorm Sandy has been mostly absorbed by catastrophe loadings included within syndicates' business plans.

Bloodstock and livestock lines remains highly competitive with excess industry capacity. Rates do appear to have stabilised, though, following poor recent performance in 2010 and 2011.

Prior year movement

The prior year reserve movement was a surplus of 8.2% (2011: 6.0%) with loss estimates for the 2011 catastrophes remaining stable. There has been no adverse development in the major lines, with the only deterioration experienced in some specialty lines.

Looking ahead

Looking forward to 2013 we expect a slight weakening of the market across all lines leading to little headline growth, influenced by an expected increase in available capital. Growth in the major developed markets is likely to be constrained, while there should be more opportunities to develop in emerging markets, where Lloyd's market share is currently relatively low. Specialist and non-US business remain competitive.

Casualty

The casualty market at Lloyd's comprises a broad range of classes. The most significant

2012 COMBINED RATIO

		Accident year	Prior year reserve movement	Calendar year
	Reinsurance	97.9%	(6.9)%	91.0%
	Property	102.6%	(8.2)%	94.4%
	Casualty	100.4%	(4.8)%	95.6%
	Marine	103.8%	(3.9)%	99.9%
	Energy	95.1%	(19.1)%	76.0%
	Motor	104.9%	(0.9)%	104.0%
	Aviation	86.2%	(18.5)%	67.7%

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

2012 Performance
Lloyd's gross written premium for 2012 was £4,543m (2011: £4,245m), an increase of 7.0%. The Lloyd's casualty sector reported an accident year combined ratio of 100.4% (2011: 98.4%).

Despite isolated pockets of rate hardening in certain underperforming classes and improving stability elsewhere, surplus capacity was still evident in most lines and this resulted in further pressure on margins.

The ongoing poor economic environment continues to cast a shadow over the casualty lines performance particularly affecting the financial institutions sector. Rates generally continue to appear marginal with little sign of rate increases.

Financial Institution lines of business continue to produce a significant portion of the claims activity, much of it being of a systemic nature, hence the sector remains an area under some scrutiny. In view of the long-tail nature of this business, the market will continue to see new claims alleging wrongdoing by the professionals perceived as involved in the formation of the financial crisis. The correlation between economic downturns and the claims frequency and severity affecting the casualty lines of business is not restricted to financial lines, but stimulates a general claims and litigation culture across all lines. Given the long-tail nature of many of the lines written and the depth and longevity of the recession, it will take a considerable time for the full effects of the downturn to be determined.

Prior year movement
The prior year reserve movement was a surplus of 4.8% (2011: 1.8%). Although the casualty sector continues to generate surpluses on prior years in aggregate, some reserve strengthening has been seen on the more recent years, particularly from the financial institutions lines. The potential for overall reserve strengthening remains a possibility as the claims from the global economic downturn further develop.

Looking ahead
High profile scandals continue to impact the financial institutions sector, particularly Banks, where systemic mis-selling type claims and allegations of corporate wrongdoing appear to be an ongoing feature. Despite there being some evidence that the market has undergone a degree of re-underwriting within these lines, there remains some concern over the future potential claims impact compounded by the competitive market offering broad coverage at questionable pricing levels.

Due to the prevailing poor economic landscape, illustrated by the continuing high profile business failures with the correlation of increased claims, a challenging underwriting environment remains.

Modest rate increases are being achieved in some lines, particularly on US domiciled business, but overall casualty rates remain substantially off peak levels. The forecast is a flat rating environment with no lack of appetite for insurers to enter the casualty market. Indeed the much debated forthcoming 'hard market' has led to insurers positioning themselves to take full advantage of better trading times when they arrive, often by acquiring business at today's marginal rates with the goal of having the payback when the market turns.

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

MARKET PERFORMANCE CONTINUED

Marine

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

2012 Performance

Lloyd's gross written premium for 2012 was £2,090m (2011: £1,968m), an increase of 6.2%. The Lloyd's marine sector reported an accident year combined ratio of 103.8% (2011: 102.3%).

This sector is highly competitive in all areas with as much as US$2bn of capacity in place in the international marine market so it is easy to see why overcapacity still remains a concern. With the exception of marine liability, 2012 saw rates flat or falling in most other lines. Initially the multiple losses did not seem to have much impact on hardening rates in marine markets; however reinsurance costs and retentions are set to rise due to the various marine losses that have occurred or deteriorated in 2012.

Marine insurers have suffered one of their worst underwriting periods on record, with claims, principally from specie, yacht and cargo books of business, from Superstorm Sandy being in the region of US$2.5 billion.

The loss of the Costa Concordia on 13 January 2012 has resulted in a very large claim to hull and marine liability markets with the industry concerned at the escalating ultimate cost for the loss and wreck removal. In other marine areas, 2012 was a light claims year and there was a reduction in Somali piracy hijacks.

Prior year movement

The prior year reserve movement was a surplus of 3.9% (2011: 7.8%). While overall there has been a release of reserves in the Marine Liability class, claims in respect of the Rena, an oil spill in October 2011, and difficult wreck removal have led to a need for reserve strengthening.

Looking ahead

The anticipated slow emergence from global economic recession during 2012 has not materialised. Adding to the pressure on the marine sector will be the general impact on reinsurance costs of the claims incurred on Costa Concordia, Rena, multiple hull total losses and Superstorm Sandy. This led to much tougher renewals than had been previously anticipated.

Those with 1/1 reinsurance renewals for marine saw significant rate rises and many elected to retain more risk. This may lead to direct market rate hardening in some marine lines such as liability and specie in early 2013. However, surplus capacity remains for these classes and other lines, such as hull and cargo, may remain in a flat rating environment throughout 2013.

Energy

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

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

2012 Performance

Gross written premium for the Lloyd's energy sector in 2012 was £1,727m (2011: £1,523m), an increase of 13.4%. The Lloyd's energy sector reported an accident year combined ratio of 95.1% (2011: 97.6%).

Although the broader economic picture is still uncertain, the energy market remains in comparative good health due primarily to a catastrophe-free 2012 year and rate increases across energy of up to 5%. A major claims free year for offshore energy has driven down loss ratios and 2012 has been extremely profitable.

Both onshore and offshore energy markets remain significantly over-capitalised. With no major withdrawals and the introduction of additional capacity, the pressure to compete for premium income and market share has intensified particularly in offshore. That said, the Lloyd's market has been able to underwrite some very large offshore construction projects.

The absence of 2012 catastrophe activity combined with lower than expected levels of attritional loss in offshore energy have naturally reduced loss ratios.

Capacity remains at a premium in the liability market, due primarily to existing underwriters reducing individual commitments per risk to manage aggregations. Onshore energy rates and power generation terms and conditions have shown some signs of positive improvement this year following previous losses.

There was a noticeable reduction in significant offshore energy losses materialising in 2012 compared to 2011 and a fourth consecutive year without a major Gulf of Mexico (GOM) hurricane, means that offshore energy has performed well. The onshore energy market has suffered another poor underwriting year, with various attritional losses. The effects of Superstorm Sandy are limited to some onshore energy and power generation losses.

Prior year movement

The prior year reserve movement was a surplus of 19.1% (2011: 9.7%). The sector was able to generate significant reserve releases with no adverse development to absorb within allowances for large losses. In particular, the energy offshore property account, which holds substantial reserves, has seen minimal incurred development in 2012 in respect of the 2009 & prior years of account.

Looking ahead

With low level of loss occurrence in offshore energy in 2012, rates are likely to stabilise or even reduce as there continues to be plenty of capacity available. Terms and conditions for Gulf of Mexico windstorms may weaken in 2013, following four benign years without hurricane activity impacting the sector.

The timeline of marine loss deterioration has proved costly for the offshore energy market for those with 1/1 reinsurance renewals purchasing on a 'Whole account' basis, packaging the energy and marine portfolios. Many have elected to retain more risk. This may have a positive effect on direct market prices in 2013; however, capacity remains buoyant and some rate softening could develop in early 2013.

Onshore energy rates and power generation terms and conditions are expected to show some signs of positive improvement, however capacity remains high in this area too and determination to increase rates may be thwarted by excess capacity.

Motor

Lloyd's motor market primarily covers UK private car and commercial/fleet business. Private car represents around 45% of Lloyd's UK motor premium and includes niche motor risks. Lloyd's commercial/fleet business is very diverse, ranging from light commercial vehicles and taxis to buses and heavy haulage.

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

2012 Performance

Gross written premium in 2012 was £1,155m (2011: £1,187m), a decrease of 2.7%. The Lloyd's motor sector reported an accident year combined ratio of 104.9% (2011: 109.1%).

Risk adjusted rate decreases have been evident across most UK personal motor lines during 2012, with rates having reached their peak towards the end of 2011. Commercial motor has not been affected to the same extent and in some cases showed above-inflation rate increases throughout 2012. Rate softening has continued in some lines despite continued performance concerns.

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

2012 developed more favourably than the preceding few years. While there was no material change in claims inflation levels, which remain above the long term average, there was some improvement in underlying trends.

Prior year movement

Prior year reserves stabilised during 2012 with a small release of 0.9% (2011: 1.7%). However, there remains a risk that any possible alteration to the discount rate used to determine large payouts in bodily injury claims, in addition with high claims inflation levels, could affect current claims reserves in the future.

Looking ahead

The motor insurance industry is in a transitional phase with a raft of new regulation expected in 2013.

Private car rates are currently under pressure and long term underwriting profitability remains challenging. With industry pricing and premium levels falling, 2013 should offer marginal underwriting profitability.

The impact of PPOs will be influenced by the outcome of The Ministry of Justice review of the discount rate and this may have negative implications for insurers. This issue remains a significant financial uncertainty in the short term.

On a more positive note, a raft of legislation designed to cut claims costs in order to reduce motor insurance premiums will come into force shortly. Measures include removing premium recoveries for Success Fees and 'After-the-Event' (ATE) policies and banning the payment of referral fees in personal injury cases in England and Wales. Perhaps the most significant measure is the extension to the RTA Claims Portal (the fixed-fee, rapid settlement process) limit up to £25,000.

The Legal Aid, Sentencing and Punishment of Offenders Act 2012 (LASPO Act) has now passed and will come into effect from April 2013 for all Personal Injury claims. This will mean an immediate 10% uplift in General Damages for claims settlements but an overall drop in Legal fees which will eventually help to reduce insurers' costs. Other than this, the EU gender directive is unlikely to change materially the current general rating trends going forwards and there should be no material change in claims inflation trends in 2013.

Aviation

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

2012 Performance

Aviation business is written as both direct and reinsurance acceptances, on an excess of loss, proportional or facultative basis. Direct gross written premium was £669m (2011: £708m), a decrease of 5.5%. In 2012, Lloyd's syndicates also wrote £487m (2011: £491m) of aviation business on a facultative and treaty reinsurance basis.

The Lloyd's aviation sector reported an accident year combined ratio of 86.2% (2011: 91.4%).

With no major insured airline losses since Air France in 2009, safety has continued to improve in 2012 and overall loss levels for the year are among the lowest on record. Loss trends in other aviation classes were also mostly favourable with an absence of notable losses during the year. The strong accident year result reflects the abnormal low frequency of large losses.

Fuelled by the recent favourable results and significant over-capacity, competition intensified in all aviation classes during the course of the year. Significant rate reductions were particularly evident in the final quarter when most of the world's major airlines renew.

Industry exposures continued to grow in 2012, driven by increasing average airline fleet values and passenger numbers, particularly in emerging economies. However, the increase in exposures was not enough to offset the reduction in rates and Lloyd's premium income in 2012 was slightly down on the previous year.

Prior year movement

The prior year reserve movement was a surplus of 18.5% (2011: 26.5%). The prior years continue to develop very favourably with reserves being brought down on a number of large claims during the course of the year. The general aviation and airline classes have seen an aggregate improvement on incurred claims in 2012 in respect of the 2009 & prior years of account.

Looking ahead

Over-capacity remains a perennial feature of this potentially very volatile sector. Rates in all areas have been falling for a number of years and are now significantly below peak levels. Without a significant withdrawal of capacity, the aviation market is likely to experience further downward pressure in 2013. Should this be the case, syndicates will need to consider further refining their portfolios and risk appetites.

RISK AND UNCERTAINTIES

The approach to risk adopted by the Corporation is discussed in the Strategic Overview (pages 22 to 23). This includes oversight of the risks arising from the activities of the market. In addition, managing agents are responsible for identifying the risks that they and each of their syndicates face and developing relevant policies and procedures to assess, monitor and manage those risks. Syndicates' risk profiles vary so the steps taken to manage those risks will differ from one managing agent to another and be determined by the risk appetite of each syndicate and managing agent. Whilst this section provides an overview of the main risks faced by managing agents and their syndicates, the descriptions are generic in nature, based on the minimum standards Lloyd's requires of managing agents in dealing with risk.

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

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

Underwriting strategy is agreed by the board of each managing agent and set out in the syndicate business plan which is submitted to the Corporation for approval each year. Approval of business plans – and setting the capital requirements needed to support these plans – is the key control the Corporation uses to manage underwriting risk.

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

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

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

Managing agents may use catastrophe modelling software, where appropriate, to monitor aggregate exposure to catastrophe losses. The Corporation has developed a suite of Realistic Disaster Scenarios to measure syndicate level and aggregate market exposure to both natural catastrophes and man made losses. These are monitored frequently and revised annually. Further enhancements to the monitoring and oversight of aggregate market catastrophe risk exposure have been implemented within the Solvency II programme.

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

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

Lloyd's views the current level of aggregate market reserves as robust and the continued level of overall reserve releases is supported by underlying claims experience being more favourable than expectations. Individual syndicates could have outcomes that are less favourable, as a consequence of their particular circumstances, and Lloyd's monitors syndicates carefully to check for signs of reserving problems, but there are currently few specific reserving issues and the main perceived risks relate to macro influences such as inflation. Past experience indicates that reserving risk tends to be higher in times of economic downturn, as propensities to claim increases, and this will continue to be Lloyd's expectation despite the continuation of more favourable observed claims experience. Lloyd's analyses reserve developments carefully and briefs the market on issues it believes need to be looked out for, including inflationary risks and specific claims issues.

Syndicate claim reserves should make financial provision at reported loss levels, without prejudice to coverage, based on currently available information and factual supporting information in the claim file. Legal advisers and loss adjusters, together with underwriters' informed knowledge and judgement, are used to set the estimated level of case reserves required.

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

The syndicates' full reserves are subject to a formal actuarial opinion at the year end and are also reviewed by the Corporation. Lloyd's has issued updated reserving guidance during the year.

Regulatory risk
Regulatory risk is the risk of loss owing to a breach of regulatory requirements or failure to respond to regulatory change. Managing agents monitor regulatory development to ensure ongoing compliance and any impact on claims reserves. Additionally, given current developments in the global regulatory landscape, the Corporation closely monitors changes which may adversely impact the global licence network. Lloyd's is actively working with the market to prepare for the upcoming changes in the UK regulatory architecture and, in particular, the increased focus on conduct risk by the Financial Conduct Authority. Similarly, Lloyd's monitors global political trends and is taking action at both a Corporation and market level in response to a growing geopolitical risk facing companies operating around the world.

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

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

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

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

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

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

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

There is greater oversight of market risk in light of the volatile economic climate, which includes the implementation and monitoring of Investment Governance Minimum Standards. The Lloyd's Financial Risk Committee monitors assets across the full Chain of Security to ensure the asset disposition of the market and Corporation remains appropriate, closely monitoring global economic and market trends.

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

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

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

Liquidity risk
Liquidity risk arises where a syndicate has insufficient funds to meet its liabilities, particularly claims. Managing agents are expected to manage the cash needs of their syndicates on an ongoing basis and to avoid becoming forced sellers of assets. They are required to match the duration of their syndicates' investments with the liabilities to policyholders. Generally syndicates have a high concentration of liquid assets, namely cash and government securities.

Lloyd's centrally monitors syndicate liquidity both in terms of asset mix and future funding needs and conducts stress tests to monitor the impact on liquidity of significant claims events.

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

THE MARKET'S FINANCIAL RESULTS

Underpinned by its robust capital base, the Lloyd's market can be relied on to pay all valid claims.

STATEMENT OF COUNCIL'S RESPONSIBILITIES AND REPORT OF ERNST & YOUNG LLP TO THE COUNCIL OF LLOYD'S ON THE 2012 PRO FORMA FINANCIAL STATEMENTS

STATEMENT OF COUNCIL'S RESPONSIBILITIES

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

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

INDEPENDENT REASONABLE ASSURANCE REPORT OF ERNST & YOUNG LLP TO THE COUNCIL OF LLOYD'S ON THE 2012 PRO FORMA FINANCIAL STATEMENTS

In accordance with the engagement letter dated 13 December 2011 (the Instructions), we have examined the Lloyd's pro forma financial statements for the year ended 31 December 2012, which comprise the pro forma profit and loss account, the pro forma statement of total recognised gains and losses, the pro forma balance sheet and the pro forma cash flow statement and the related notes 1 to 17 which have been prepared on the basis set out in note 2.

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

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

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

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

Basis of conclusion

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

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

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

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

Conclusion

In our opinion, the PFFS for the financial year ended 31 December 2012 have been prepared, in all material respects, in accordance with the basis of preparation set out in note 2.

Ernst & Young LLP, London
26 March 2013

PRO FORMA PROFIT AND LOSS ACCOUNT

For the year ended 31 December 2012

Technical account	Note	£m	2012 £m	£m	2011 £m
Gross written premiums					
– continuing operations		25,489		23,419	
– discontinued operations	5	11		58	
	9		25,500		23,477
Outward reinsurance premiums			(6,065)		(5,005)
Premiums written, net of reinsurance			19,435		18,472
Change in the gross provision for unearned premiums		(994)		(473)	
Change in the provision for unearned premiums, reinsurers' share		244		101	
			(750)		(372)
Earned premiums, net of reinsurance			18,685		18,100
Allocated investment return transferred from the non-technical account			902		711
			19,587		18,811
Claims paid					
Gross amount		13,398		12,159	
Reinsurers' share		(2,940)		(2,343)	
			10,458		9,816
Change in provision for claims					
Gross amount		151		4,960	
Reinsurers' share		(511)		(1,876)	
			(360)		3,084
Claims incurred, net of reinsurance			10,098		12,900
Net operating expenses	11		6,926		6,437
Balance on the technical account for general business			2,563		(526)
Attributable to:					
– continuing operations		2,549		(461)	
– discontinued operations	5	14		(65)	
Total			2,563		(526)
Non-technical account					
Balance on the technical account for general business			2,563		(526)
Investment return on syndicate assets	12	997		791	
Notional investment return on funds at Lloyd's	6	199		69	
Investment return on Society assets		115		95	
		1,311		955	
Allocated investment return transferred to the technical account		(902)		(711)	
			409		244
Other income			61		80
Other expenses			(262)		(314)
Result for the financial year before tax	8		2,771		(516)

	Note	2012 £m	2011 £m
Statement of total recognised gains and losses			
Result for the financial year		2,771	(516)
Other recognised gains and losses		(52)	(46)
Total recognised gains and losses since previously reported	8	2,719	(562)

PRO FORMA BALANCE SHEET

As at 31 December 2012

Investments	Note	£m	2012 £m	£m	2011 £m
Financial investments	13		**41,875**		41,370
Deposits with ceding undertakings			**6**		8
Reinsurers' share of technical provisions					
Provision for unearned premiums		**1,759**		1,556	
Claims outstanding		**10,680**		10,597	
	16		**12,439**		12,153
Debtors					
Debtors arising out of direct insurance operations		**5,526**		5,172	
Debtors arising out of reinsurance operations		**4,187**		3,958	
Other debtors		**1,193**		1,032	
			10,906		10,162
Other assets					
Tangible assets		**48**		43	
Cash at bank and in hand	14	**9,892**		10,046	
Other		**50**		8	
			9,990		10,097
Prepayments and accrued income					
Accrued interest and rent		**78**		81	
Deferred acquisition costs		**2,640**		2,478	
Other prepayments and accrued income		**157**		199	
			2,875		2,758
Total assets			**78,091**		76,548
Capital and reserves					
Members' funds at Lloyd's	6	**15,660**		15,171	
Members' balances	15	**2,048**		1,555	
Members' assets (held severally)		**17,708**		16,726	
Central reserves (mutual assets)		**1,592**		1,490	
	8		**19,300**		18,216
Subordinated debt			**503**		509
Subordinated perpetual capital securities			**390**		389
Capital, reserves and subordinated debt and securities			**20,193**		19,114
Technical provisions					
Provision for unearned premiums		**11,314**		10,605	
Claims outstanding		**40,203**		41,313	
	16		**51,517**		51,918
Deposits received from reinsurers			**65**		87
Creditors					
Creditors arising out of direct insurance operations		**519**		724	
Creditors arising out of reinsurance operations		**3,714**		3,030	
Other creditors including taxation		**1,732**		1,346	
			5,965		5,100
Accruals and deferred income			**351**		329
Total liabilities			**78,091**		76,548

Approved by the Council of Lloyd's on 26 March 2013 and signed on its behalf by

John Nelson
Chairman

Richard Ward
Chief Executive

PRO FORMA CASH FLOW STATEMENT

For the year ended 31 December 2012

	2012 £m	2011 £m
Result on ordinary activities before tax	**2,771**	(516)
Depreciation	**7**	8
Realised and unrealised (gains)/losses and foreign exchange	**921**	(45)
Net purchase of investments	**(1,395)**	(1,415)
Notional return on funds at Lloyd's	**(199)**	(69)
(Decrease)/increase in technical provisions	**(654)**	3,650
Increase in debtors	**(957)**	(1,206)
Increase in creditors	**692**	437
Cash generated from operations	**1,186**	844
Tax paid	**(24)**	(84)
Net cash from operating activities	**1,162**	760
Cash flows from financing activities		
Net profits paid to members	**(1,903)**	(1,579)
Net movement in funds at Lloyd's	**536**	1,339
Capital transferred into syndicate premium trust funds	**117**	964
Purchase of debt securities	**–**	(23)
Interest paid	**(66)**	(65)
Net (decrease)/increase in cash holdings	**(154)**	1,396
Cash holdings at 1 January	**10,046**	8,650
Cash holdings at 31 December	**9,892**	10,046

NOTES TO THE PRO FORMA FINANCIAL STATEMENTS

As at 31 December 2012

1. INTRODUCTION

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

2. BASIS OF PREPARATION

General

The PFFS include the aggregate of syndicate annual accounts (Aggregate Accounts), members' funds at Lloyd's (FAL) and the financial statements of the Society of Lloyd's on pages 58 to 130.

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

The Aggregate Accounts report the audited results for calendar year 2012 and the financial position at 31 December 2012 for all syndicates which transacted business during the year. They include the syndicate level assets, which represent the first link in the Chain of Security (see page 55). The Aggregate Accounts are reported as a separate document and can be viewed at www.lloyds.com/financialreports. During 2012, certain syndicates changed their accounting policies in relation to deferred acquisition costs resulting in a restatement of the comparative figures for 2012 within their annual accounts and the Aggregate Accounts have been restated accordingly. The restatements are not material and, therefore, the comparative figures within the PFFS have not been restated.

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

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

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

Overall, the PFFS aggregate the results and resources of the Society and its members and reflect all the links in Lloyd's Chain of Security as described in detail in the 'Security underlying policies issued at Lloyd's' section on pages 55 to 57. The PFFS may, therefore, be used as a reasonable presentation of the results and state of affairs of the Lloyd's market on a basis that is broadly comparable with general insurance companies.

Taxation

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

Funds at Lloyd's

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

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

SOCIETY OF LLOYD'S FINANCIAL STATEMENTS

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

Transactions between syndicates and the society

- Central Fund contributions, members' subscriptions and other market charges levied by the Society are reported as net operating expenses in the syndicate annual accounts and as income in the Society financial statements.
- Central Fund claims and provisions to discharge the liability of members where they have unpaid cash calls, and do not have the resources to meet those cash calls, are reported as a profit and loss charge and balance sheet liability in the Society financial statements. The Central Fund's other income includes recoveries from insolvent members. The syndicate annual accounts for calendar year 2012 and earlier years include those members' results and at the balance sheet date will report the outstanding liability within members' balances.
- Loans funding statutory overseas deposits are reported as assets within the syndicate annual accounts and as liabilities in the Society financial statements.

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

NOTES TO THE PRO FORMA FINANCIAL STATEMENTS CONTINUED

As at 31 December 2012

2. BASIS OF PREPARATION CONTINUED

Inter-syndicate loans

The syndicate annual accounts report debtor and creditor balances for inter-syndicate loans totalling £106m (2011: £170m). These amounts have been eliminated from the amounts reported in the balance sheet to provide a more meaningful presentation of the balance sheet for users of the PFFS.

Subordinated debt and securities

In accordance with the terms of the subordinated debt and securities, the capital raised is available for payment to policyholders in advance of repayment to the note holders and is included in 'capital, reserves and subordinated debt and securities' in the pro forma balance sheet. The Society financial statements on pages 58 to 130 provide additional information.

3. ACCOUNTING POLICIES NOTES

A. Aggregate Accounts

General

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

Premiums written

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

Unearned premiums

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

Outwards reinsurance premiums

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

Claims provisions and related recoveries

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

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

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

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

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

Unexpired risks provision

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

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

Acquisition costs

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

Foreign currencies

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

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

3. ACCOUNTING POLICIES NOTES CONTINUED

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

Investments

Investments are stated at current value at the balance sheet date. For this purpose listed investments are stated at their bid price market value, and deposits with credit institutions and international deposits are stated at cost. Unlisted investments for which a market exists are stated at the average price at which they are traded on the balance sheet date or the last trading day before that date.

Syndicate investment return

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

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

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

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

Taxation

Under Schedule 19 of the Finance Act 1993 managing agents are not required to deduct basic rate income tax from trading income. In addition, all UK basic rate income tax deducted from syndicate investment income is recoverable by managing agents and consequently the distribution made to members or their members' agents is gross of tax. Capital appreciation falls within trading income and is also distributed gross of tax.

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

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

Operating expenses

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

Profit commission

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

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

B. Funds at Lloyd's

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

Investments are stated at current value at the balance sheet date. For this purpose, listed investments are stated at their bid price market value, and deposits with credit institutions and international deposits are stated at cost. Unlisted investments for which a market exists are stated at the average price at which they are traded on the balance sheet date or the last trading day before that date.

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

C. Society of Lloyd's

The accounting policies adopted in the Society of Lloyd's financial statements are set out on pages 98 to 103.

4. VARIABILITY

Calendar year movements in reserves are based upon best estimates as at 31 December 2012 taking into account all available information as at the balance sheet date. These estimates are subject to variability until the date at which the underlying claims are settled. Such changes in best estimate are reflected in the technical account of the year in which they occur.

5. DISCONTINUED OPERATIONS

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

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

Where business has been reported as discontinued in 2012, the results for that business have also been reported as discontinued in the 2011 comparative figures.

NOTES TO THE PRO FORMA FINANCIAL STATEMENTS CONTINUED

As at 31 December 2012

6. MEMBERS' FUNDS AT LLOYD'S

The valuation of members' FAL in the balance sheet totals £15,660m (2011: £15,171m). The notional investment return on FAL included in the non-technical profit and loss account totals £199m (2011: £69m).

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

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

Investment type	Index	Proportion of FAL December 2012 %	Investment Return 2012 %	Investment Return 2011 %
UK equities	FTSE All share	**6.0**	**11.8**	(4.2)
UK fixed income securities	UK Gilts 1-3 years	**14.3**	**0.2**	3.1
UK deposits managed by Lloyd's	Return achieved	**5.4**	**0.3**	0.3
UK deposits managed externally	LIBID	**21.8**	**0.4**	0.4
US equities	S&P 500 Index	**3.5**	**14.4**	(3.7)
US fixed income securities	US Treasuries 1-3 years	**18.9**	**0.3**	1.4
US deposits managed by Lloyd's	Return achieved	**1.5**	**0.0**	0.0
US deposits managed externally	LIBID	**28.6**	**0.0**	0.0

7. SOCIETY OF LLOYD'S

The results of the group financial statements of the Society included in the profit and loss account are a profit of £279m (2011: £266m) in the technical account and a loss of £86m (2011: £141m) in the non-technical account.

8. AGGREGATION OF RESULTS AND NET ASSETS

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

Profit and loss account	2012 £m	2011 £m
Result per syndicate annual accounts	**2,379**	(710)
Result of the Society	**123**	89
Central Fund claims and provisions incurred in Society financial statements	**26**	15
Central Fund recoveries from insolvent members	**–**	(4)
Taxation charge in Society financial statements	**35**	29
Notional investment return on members' funds at Lloyd's	**199**	69
Movement in Society income not accrued in syndicate annual accounts	**9**	(4)
Result on ordinary activities before tax	**2,771**	(516)

Statement of total recognised gains and losses	2012 £m	2011 £m
Result for the financial year	**2,771**	(516)
Foreign currency movements in the syndicate annual accounts	**(27)**	–
Other recognised losses per syndicate annual accounts	**(5)**	–
Other recognised losses of the Society	**(20)**	(46)
Total recognised gains and losses	**2,719**	(562)

8. AGGREGATION OF RESULTS AND NET ASSETS CONTINUED

Capital and reserves	2012 £m	2011 £m
Net assets per syndicate annual accounts	**2,056**	1,581
Net assets of the Society	**1,592**	1,490
Central Fund claims and provisions	**14**	8
Members' funds at Lloyd's	**15,660**	15,171
Unpaid cash calls reanalysed from debtors to members' balances	**(14)**	(17)
Society income receivable not accrued in syndicate annual accounts	**(8)**	(17)
Total capital and reserves	**19,300**	18,216

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

9. SEGMENTAL ANALYSIS

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

2012	Gross written premiums £m	Net earned premium £m	Under-writing Result £m
Reinsurance	**9,763**	**6,713**	**605**
Property	**5,476**	**3,963**	**221**
Casualty	**4,543**	**3,469**	**152**
Marine	**2,090**	**1,736**	**2**
Energy	**1,727**	**1,147**	**275**
Motor	**1,155**	**1,062**	**(42)**
Aviation	**669**	**526**	**170**
Life	**77**	**69**	**(1)**
Total from syndicate operations	**25,500**	**18,685**	**1,382**
Transactions between syndicates and the Society (notes 2 and 8) and insurance operations of the Society	**–**	**–**	**279**
PFFS premiums and underwriting result	**25,500**	**18,685**	**1,661**
Allocated investment return transferred from the non-technical account			**902**
Balance on the technical account for general business			**2,563**

2011	Gross written premiums £m	Net earned premium £m	Under-writing Result £m
Reinsurance	8,813	6,365	(1,945)
Property	4,965	3,847	(10)
Casualty	4,245	3,467	117
Marine	1,968	1,609	89
Energy	1,523	1,080	130
Motor	1,187	1,113	(82)
Aviation	708	559	196
Life	67	59	2
Total from syndicate operations	23,476	18,099	(1,503)
Transactions between syndicates and the Society (notes 2 and 8) and insurance operations of the Society	1	1	266
PFFS premiums and underwriting result	23,477	18,100	(1,237)
Allocated investment return transferred from the non-technical account			711
Balance on the technical account for general business			(526)

NOTES TO THE PRO FORMA FINANCIAL STATEMENTS CONTINUED

As at 31 December 2012

10. LIFE BUSINESS

The PFFS include the results of all life and non-life syndicates transacting business during 2012 The results and net assets for life syndicates are not material and have not been separately disclosed in the profit and loss account and balance sheet. The results for life business are reported in the segmental analysis (note 9).

11. NET OPERATING EXPENSES

	2012 £m	2011 £m
Acquisition costs	**5,346**	5,066
Change in deferred acquisition costs	**(209)**	(116)
Administrative expenses	**1,706**	1,468
Underlying operating expenses	**6,843**	6,418
Loss on exchange	**83**	19
	6,926	6,437

12. SYNDICATE INVESTMENT RETURN

	2012 £m	2011 £m
Income from investments	**738**	786
Net realised gains on investments	**88**	57
Net unrealised gains on investments	**222**	(8)
Investment management expenses, including interest	**(51)**	(44)
	997	791

The breakdown of the Society investment return is provided in the Society's financial statements on page 109. This analysis is not appropriate for the notional investment return on funds at Lloyd's.

13. FINANCIAL INVESTMENTS

	2012 £m	2011 £m
Shares and other variable yield securities and units in unit trusts	**4,123**	4,182
Debt securities and other fixed income securities	**30,469**	30,066
Participation in investment pools	**1,731**	1,639
Loans and deposits with credit institutions	**5,516**	5,461
Other	**36**	22
	41,875	41,370

13. FINANCIAL INVESTMENTS CONTINUED

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

	2012 £m	2011 £m
Government, agency and supranational	**13,066**	13,179
'AAA' rated	**4,101**	4,369
'AA' rated	**3,712**	4,397
'A' rated	**4,798**	4,079
'BBB' and lower rated	**1,759**	1,224
Equity and hedge funds	**1,007**	904
Cash equivalents	**3,148**	3,759
Total syndicate investments	**31,591**	31,911
FAL investments	**7,807**	7,071
Society investments	**2,477**	2,388
Total per PFFS	**41,875**	41,370

Government, agency and supranational investments are predominantly within the US, UK and Canada.

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

	2012 %	2011 %
Less than one year	**8**	32
Between one and two years	**39**	35
Between two and three years	**28**	24
Over three years	**25**	9
Total per PFFS	**100**	100

14. CASH AT BANK AND IN HAND

Cash at bank and in hand includes letters of credit and bank guarantees held in trust within members' FAL to meet policyholder claims as required, totalling £7,900m (2011: £8,100m).

15. MEMBERS' BALANCES

	2012 £m	2011 £m
Balance at 1 January	**1,555**	2,912
Result for the year per syndicate annual accounts	**2,379**	(710)
Distribution on closure of the 2009 (2008) year of account	**(2,547)**	(1,448)
Advance distributions from open years of account	**(117)**	(587)
Movement in cash calls	**764**	434
Capital transferred into syndicate premium trust funds	**117**	964
Foreign currency movements	**(89)**	(5)
Other movements	**(14)**	(5)
Balance at 31 December	**2,048**	1,555

Members participate on syndicates by reference to years of account. Members' ultimate results, assets and liabilities are assessed by year of account with reference to policies incepting in that year of account. Members' balances represent the net profit/(loss) to be distributed/(collected) by syndicates to/(from) the members. Where there are profits and funds at Lloyd's held in excess of members' capital requirements, they will be distributed in the second quarter of 2013.

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

NOTES TO THE PRO FORMA FINANCIAL STATEMENTS CONTINUED

As at 31 December 2012

16. TECHNICAL PROVISIONS

	2012 £m	2011 £m
Gross		
Claims reported	**21,597**	22,848
Claims incurred but not reported and unallocated loss adjustment expenses	**18,606**	18,465
Unearned premiums	**11,314**	10,605
Total technical provisions, gross	**51,517**	51,918
Recoverable from reinsurers		
Claims reported	**6,316**	6,257
Claims incurred but not reported and unallocated loss adjustment expenses	**4,364**	4,340
Unearned premiums	**1,759**	1,556
Total reinsurers' share of technical provisions	**12,439**	12,153
Net		
Claims reported	**15,281**	16,591
Claims incurred but not reported and unallocated loss adjustment expenses	**14,242**	14,125
Unearned premiums	**9,555**	9,049
Total net technical provisions	**39,078**	39,765

17. FIVE YEAR SUMMARY

	2012 £m	2011 £m	2010 £m	2009 £m	2008 £m
Results					
Gross written premiums	**25,500**	23,477	22,592	21,973	17,985
Net written premiums	**19,435**	18,472	17,656	17,218	14,217
Net earned premiums	**18,685**	18,100	17,111	16,725	13,796
Result attributable to underwriting	**1,661**	(1,237)	1,143	2,320	1,198
Result for the year before tax	**2,771**	(516)	2,195	3,868	1,899
Assets employed					
Cash and investments	**51,767**	51,416	48,483	46,254	44,370
Net technical provisions	**39,078**	39,765	36,191	33,613	35,792
Other net assets	**6,611**	6,565	5,899	5,522	5,604
Capital and reserves	**19,300**	18,216	18,191	18,163	14,182
Statistics					
Combined ratio (%)	**91.1**	106.8	93.3	86.1	91.3
Return on capital (%)	**14.8**	(2.8)	12.1	23.9	13.7

SECURITY UNDERLYING POLICIES ISSUED AT LLOYD'S

As at 31 December 2012

SUMMARY

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

There were 87 syndicates, (excluding syndicates set up to accept RITC of orphan syndicates but including the 9 Special Purpose Syndicates) as at 31 December 2012, registered to conduct business at Lloyd's. Each syndicate is managed by a managing agent. Managing agents write insurance business on behalf of the member(s) of the syndicate, which receive profits or bear losses in proportion to their share in the syndicate for each underwriting year of account. The adoption of annual accounting and presentation of the syndicate annual accounts do not change the allocation of profits and losses to members.

THE LLOYD'S CHAIN OF SECURITY

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

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

The Chain of Security supports policies written for the 1993 and subsequent years of account for non-life business and all life business written at Lloyd's. Liabilities in relation to the 1992 and prior years of account for non-life business were reinsured into Equitas as at 31 December 1995, as part of 'Reconstruction and Renewal'. Subsequently, the 1992 and prior liabilities were subject to a statutory transfer to Equitas Insurance Limited under Part VII of the Financial Services and Markets Act in June 2009.

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

Second link – Members' funds at Lloyd's (FAL)
The capital provided by every member is assessed according to the Lloyd's Individual Capital Assessment (ICA) capital setting framework. When agreed, each ICA is then 'uplifted' (by 35% for 2012) to provide an extra buffer to support Lloyd's rating and financial strength. This uplifted ICA, which is the Economic Capital Assessment (ECA), is used to determine members' capital requirements subject to prescribed minimum levels.

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

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

THE FIRST LINK

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

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

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

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

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

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

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

The total value of all the above funds was £41,126m at 31 December 2012.

SECURITY UNDERLYING POLICIES ISSUED AT LLOYD'S CONTINUED

As at 31 December 2012

THE SECOND LINK

The second link is members' capital provided to support their underwriting. This is commonly held as FAL but from 1 July 2007 can be held by aligned corporate members within the premiums trust fund (see first link above). FAL comprise the three trust funds in which members' assets may be held: the Lloyd's deposit, the special reserve fund and the personal reserve fund. These are each available to meet cash calls made on the member in respect of a syndicate. The assets in FAL must be readily realisable, this includes letters of credit and bank and other guarantees. A member is required to have sufficient assets at least equivalent to the aggregate of the member's ECA and certain liabilities in respect of its underwriting business. The amount of FAL assets required will depend on the net open year underwriting position of the member, ie if the net open year position is a deficit then the member will be required to add additional FAL to cover this deficiency, if the net open year position is a surplus the member can use these surplus assets towards their ECA requirement thus reducing the value of their assets to be held as FAL.

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

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

At 31 December 2012, the total value of capital supporting underwriting held in trust by members amounted to £15,660m (a further £2,534m of capital supporting underwriting is held in members' premiums trust funds as part of the first link).

THE THIRD LINK

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

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

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

The net assets of the Central Fund as at 31 December 2012 were £1,459m.

In 2004 and 2007, Lloyd's issued subordinated loan notes and perpetual capital securities respectively which, as at 31 December 2012, are included as a liability of £893m within the Society's financial statements. As set out in note 17 to the Society's financial statements, payments on the notes are subordinated to certain payments which may be made out of central assets, including payments made to discharge the liabilities of an insolvent member to any person (including any policyholders) arising out of or in connection with insurance business carried on at Lloyd's by that insolvent member.

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

In addition, the other assets of the Society, totalling £133m at 31 December 2012, are available to meet underwriting liabilities in the last resort.

In aggregate, the value of the central resources of the Society (excluding the subordinated debt liability and the callable layer), amounted to £2,485m at 31 December 2012.

AGGREGATE RESOURCES

The total of syndicate assets, members' capital to support underwriting (ie funds at Lloyd's and capital held in syndicate premiums trust funds) and central resources of the Society as at 31 December 2012 was £59,271m. The total of net syndicate technical provisions at the end of 2012 was £39,078m. The total net resources of the Society and its members were therefore £20,193m (excluding the subordinated debt liability) as shown in the PFFS on page 45. The aggregated resources are based on the total of the assets and liabilities of all members and those of the Society. The aggregate declared resources of the Society do not represent a consolidated statement of the financial position of Lloyd's business taken as a single entity and, as indicated above, the first two links of the Chain of Security operate on a several, not mutual, basis.

SOLVENCY CONTROLS

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

The annual solvency process requires the managing agent of each syndicate to estimate and provide for all current and future liabilities for each year of account. These liabilities 'technical provisions for solvency' are subject to a statement of actuarial opinion. The requirement for an opinion and its required wording, that the net technical provisions for solvency are not less that the current and future liabilities, is a higher test than required in the UK company market. In the event that it is not possible for the managing agent to secure an unqualified actuarial opinion for any reason, the technical provisions for solvency would be determined by the Lloyd's Actuary, who would provide a report to the FSA. In addition, any syndicate which is not able to secure an unqualified actuarial opinion will normally be subject to a monitoring review by Lloyd's. There were no qualified actuarial opinions as at 31 December 2012.

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

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

SOLVENCY CONTROLS CONTINUED

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

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

RECAPITALISATION AT MEMBER LEVEL

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

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

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

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

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

THE LLOYD'S RETURN

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

	2012 £m	2011 £m
I Syndicate level assets (several basis)	**41,126**	41,311
II Members' funds at Lloyd's (several basis)	**15,660**	15,171
III Central assets (mutual basis)		
Net Central Fund assets	**1,459**	1,361
Subordinated debt	**503**	509
Subordinated perpetual capital securities	**390**	389
Other net assets of the Society	**133**	129
	2,485	2,388
Total resources of the Society of Lloyd's and its members	**59,271**	58,870
Net syndicate technical provisions	**(39,078)**	(39,756)
Total net resources of the Society of Lloyd's and its members	**20,193**	19,114

Notes

1. This financial summary has been compiled by aggregating the assets and liabilities of all the underlying syndicates, members' funds at Lloyd's and other net assets of the Society of Lloyd's. The statement does not purport to disclose the solvency position of each member of Lloyd's.
2. The 'total net resources of the Society of Lloyd's and its members' represents the capital, reserves and subordinated notes and securities shown in the PFFS as set out on page 45.
3. Syndicate level assets includes capital to support underwriting held by aligned corporate members in the syndicate premiums trust funds.

SOCIETY REPORT

CONTENTS

INTRODUCTION

THIS REPORT

This Report sets out the principal activities, 2012 consolidated financial statements and governance arrangements of the Society of Lloyd's.

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

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

The Society's 2012 consolidated financial statements are included in this Report together with a financial review. The financial results of the members of Lloyd's are not part of those financial statements but can be found within the market results section starting on page 44.

THE SOCIETY

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

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

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

Its principal activities are:

- To facilitate the carrying on of insurance business by members of Lloyd's, who join together as syndicates to insure and reinsure risks, and the protection of their interests in this context.
- To maintain the Lloyd's Central Fund where assets are held and administered at the discretion of the Council of Lloyd's, primarily as funds available for the protection of policyholders.

FINANCIAL HIGHLIGHTS

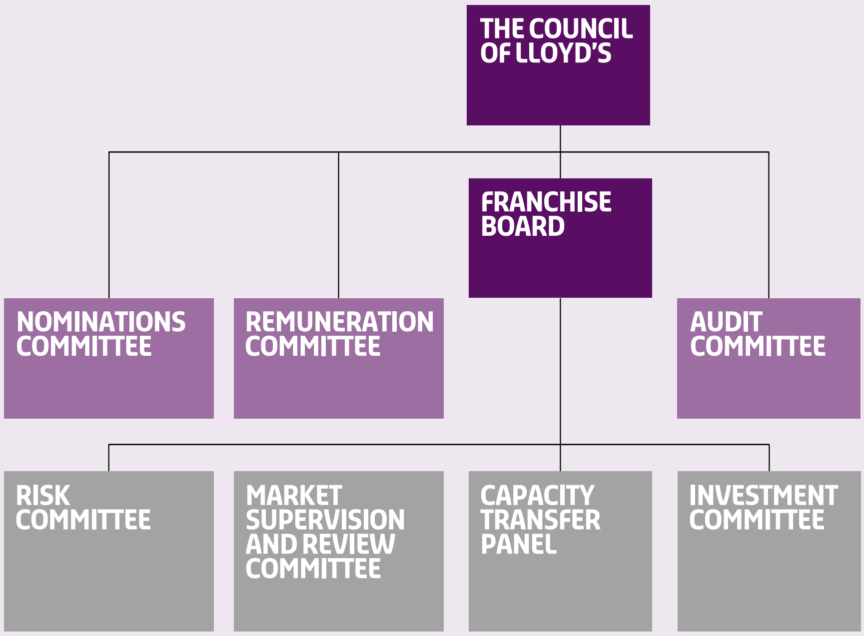
	2012 £m	2011 £m	2010 £m	2009 £m	2008 £m
Operating result					
Operating and other group income	**215**	222	427	254	248
Central Fund contributions	**105**	95	101	100	84
Total income	**320**	317	528	354	332
Central Fund claims and provisions (incurred)/released	**(26)**	(15)	34	19	6
Net insurance claims and provisions	**–**	24	17	(6)	(34)
Other group operating expenses	**(200)**	(249)	(214)	(240)	(188)
Surplus before finance, associates and tax	**94**	77	365	127	116
Net finance income and unrealised exchange differences on borrowings	**59**	36	75	70	22
Share of profits of associates	**6**	5	5	3	4
Surplus before tax	**159**	118	445	200	142
Tax charge	**(36)**	(29)	(122)	(57)	(40)
Surplus for the year	**123**	89	323	143	102
Balance sheet					
Net assets	**1,592**	1,490	1,447	1,126	990
Movement in net assets %	**6.85%**	2.97%	28.5%	13.7%	5.4%
Solvency*					
Central assets for solvency purposes	**3,215**	3,091	3,028	2,815	2,624
Solvency shortfalls	**(94)**	(115)	(123)	(59)	(134)
Excess of central assets over solvency shortfalls	**3,121**	2,976	2,905	2,756	2,490
Solvency ratio %	**3420%**	2688%	2462%	4771%	1958%
Movement in central assets for solvency purposes %	**4.0%**	2.1%	7.6%	7.3%	6.5%

* The solvency position for 2012 is estimated and will be finalised in June 2013 for submission to the FSA.

CORPORATE GOVERNANCE

Lloyd's governance structure provides challenge, clarity and accountability

Principal committees of Lloyd's (Figure 8)



THE COUNCIL AND FRANCHISE BOARD

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

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

Lloyd's is regulated by the FSA, which has direct supervision of managing agents and monitors capital and solvency. With effect from 1 April 2013, the new UK financial services regulatory regime will see the FSA split into the PRA and FCA. The Corporation is active in managing risk within the market to ensure that Lloyd's central assets, brand, licences and reputation remain protected.

The members of the Council of Lloyd's and Franchise Board are listed on **pages 70-73.**

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

CORPORATE GOVERNANCE CONTINUED

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

GOVERNING BODY: THE COUNCIL OF LLOYD'S

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

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

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

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

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

Membership

The Council comprises a maximum of 18 members, split between six working, six external and six nominated members. The biographical details of the current members of the Council (as at 26 March 2013) are listed on pages 70-71.

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

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

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

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

Chairman and Deputy Chairmen

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

The Chairman of Lloyd's is contracted to work three days a week but commits as much time as is necessary to undertake the role. The Council acknowledges that the Chairman has other commitments outside Lloyd's (see page 70) and is satisfied that these can be accommodated with the Chairmanship of Lloyd's.

Andreas Prindl (a nominated member) was appointed Senior Independent Deputy Chairman by Council in February 2012 (Lloyd's equivalent of the Senior Independent Director). Following Dr Prindl's retirement from Council, Andy Haste (a nominated member) was appointed Senior Independent Deputy Chairman with effect from 1 November 2012.

Meetings

The Council met five times in 2012. These meetings are structured to allow open discussion. At each meeting the Council receives certain regular reports – for example, a written report from the CEO and oral updates from its principal committees. It also reviews the quarterly Management Information Pack.

A table showing Council members' attendance at Council and committee meetings which they were eligible to attend is set out on pages 68-69.

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

GOVERNANCE POLICIES AND THE CONSTITUTIONAL REQUIREMENTS

The Governance Policies

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

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

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

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

The Constitutional Requirements

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

In summary, members of the Council, Franchise Board and their committees are required to act in a way which 'would be most likely to promote the success of the Society for the benefit of the members as a whole' and must have regard to:
- The likely consequences of any decision in the long term.
- The need of the Society:
  - To foster business relations with those who do business at Lloyd's.
  - To have regard to the interests of its employees.
  - To consider the impact of its operations on the community and the environment; and
  - To maintain a reputation for high standards of business conduct.

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

FRANCHISE BOARD

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

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

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

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

CORPORATE GOVERNANCE CONTINUED

FRANCHISE BOARD CONTINUED

Membership and meetings

Biographical details of the members of the Franchise Board as at 26 March 2013 are listed on pages 72-73. At the end of 2012, the Franchise Board comprised:

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

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

The Franchise Board held 11 scheduled meetings in 2012. It also held a full day offsite focusing on the next iteration of the Three-Year Plan and in particular, on Lloyd's international growth aspirations as outlined in Vision 2025. Franchise Board meetings were structured to allow open discussion. At each scheduled meeting the Franchise Board receives certain regular reports – for example, a written report from the CEO. It also reviews the quarterly Management Information Pack. The Franchise Board papers and minutes are made available to members of Council.

A table showing Franchise Board members' attendance at Franchise Board and committee meetings which they were eligible to attend is set out on pages 68-69.

THE PRINCIPAL COMMITTEES OF THE COUNCIL

Audit Committee

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

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

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

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

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

The Audit Committee is chaired by Claire Ighodaro (an independent non-executive director on the Franchise Board) and its remaining members are drawn from both the Council and the Franchise Board. A table showing Audit Committee members' attendance at Audit Committee meetings is set out on pages 68-69.

The Audit Committee met on five occasions in 2012. The Audit Committee's full report is on pages 83-84.

Nominations Committee

The Nominations Committee is responsible for making recommendations to the Council on the appointment of the Chairman, CEO, new nominated Council members, Franchise Board members (including the Director, Finance and Operations and the Director, Performance Management), members of a number of the Council and Franchise Board committees and the Secretary to the Council. The Nominations Committee is also responsible for succession planning arrangements for these positions.

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

Apart from the annual exercise of making recommendations with respect to the composition of Council and Franchise Board committees (together with any other necessary changes in composition during the year), the Nominations Committee made the following major recommendations to Council during 2012:

– To appoint Andy Haste as a Nominated member of Council and as Senior Independent Deputy Chairman. This followed a search process in which the Nominations Committee was assisted by an external search consultant (Odgers Berndtson). The search was conducted based on a role description and an evaluation of the necessary skills and experience for the role. Financial services knowledge and experience was deemed particularly important. Mr Haste's appointment is for a three-year term which commenced on 1 November 2012.

THE PRINCIPAL COMMITTEES OF THE COUNCIL CONTINUED

Nominations Committee continued

- To appoint Bruce Van Saun as an independent non-executive director on the Franchise Board. The Nominations Committee was assisted by external search consultants (The Zygos Partnership) with a brief to find a serving Chief Financial Officer from a FTSE company or equivalent. Mr Van Saun's appointment is for a three-year term which started on 3 September 2012.
- To reappoint Martin Read and Andrew Kendrick as members of the Franchise Board. Mr Read's reappointment was for a second term of three years commencing on 14 September 2012 and Mr Kendrick's reappointment was for a final term of two years and three months (taking him to nine years in total) commencing on 1 January 2013.

The Nominations Committee has also undertaken a search for a new Nominated member of the Council. The committee was assisted by external search consultants (Russell Reynolds) with a brief to find an international business figure from one of the faster growing economies.

The Nominations Committee made the following major recommendation to the Franchise Board in 2012:

- To appoint Jo Rickard as Chairman of the Market Supervision and Review Committee (MSARC). The Nominations Committee oversaw a search to find an experienced litigation lawyer, independent of the Council and the Franchise Board, to chair MSARC. External search consultants were not used but the position was advertised. Ms Rickard's appointment is for a three-year term commencing on 1 January 2013.

None of the search consultants had any connection with the Society.

The Nominations Committee's recommendations were accepted by the Council and the Franchise Board respectively.

To assist with succession planning, the Nominations Committee also considered the future skills, knowledge and experience likely to be needed by the Franchise Board and within the non-elected positions on the Council.

Diversity – The Nominations Committee is fully apprised of, and supportive of, the need for recent and relevant experience and diversity. The Franchise Board and the Council are also specifically aware of the need to increase gender diversity on both bodies. It is difficult to establish a target for the number of women on Council given that it is two-thirds elected but gender diversity will be encouraged. The Franchise Board, however, with the support of the Nominations Committee, recently established an aspirational target of 25% of the Board being women by 2016. Although this is one year later than the target date set by Lord Davies in his report *Women on Boards*, it is seen as essential if Lloyd's is to recruit the highest quality candidates.

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

A table showing Nominations Committee members' attendance at Nominations Committee meetings is set out on pages 68-69.

The Nominations Committee met on four occasions in 2012.

Remuneration Committee

The Remuneration Committee is responsible for setting remuneration arrangements for the Chairman, CEO, executive directors and the Secretary to the Council. Council considers the Remuneration Committee's proposals.

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

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

The Remuneration Committee is chaired by the Senior Independent Deputy Chairman. The Chairman is a member of the committee and its remaining members are drawn from both the Council and the Franchise Board. A table showing Remuneration Committee members' attendance at Remuneration Committee meetings is set out on pages 68-69.

The Remuneration Committee met on three occasions in 2012.

The Remuneration Committee's full report is on pages 75-82.

CORPORATE GOVERNANCE CONTINUED

THE PRINCIPAL COMMITTEES OF THE FRANCHISE BOARD

Risk Committee
This is chaired by the CEO and its other members are the executive directors. It reports quarterly to the Franchise Board. It also provides updates to the Audit Committee and Council. Its activities are set out on page 22.

A table showing the Risk Committee members' attendance at meetings is set out on pages 68-69. It met on 11 occasions in 2012.

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

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

A table showing MSARC members' attendance at MSARC meetings is set out on pages 68-69. MSARC met on four occasions in 2012.

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

A table showing CTP members' attendance at CTP meetings is set out on pages 68-69. The Panel met on two occasions in 2012.

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

The Investment Committee meets at the discretion of its Chairman. The Investment Committee submits a written report to the Franchise Board annually and may submit additional reports on matters of material concern as and when necessary. The Investment Committee is required to obtain the approval of the Franchise Board before making any decisions which may materially affect the financial risks applying to the Society or Lloyd's market entities. A table showing Investment Committee members' attendance at Investment Committee meetings is set out on pages 68-69. The Investment Committee met on four occasions in 2012.

TERMS OF REFERENCE AND APPOINTMENT TERMS

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

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

ANNUAL GENERAL MEETING

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

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

INDEMNITIES

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

COUNCIL, FRANCHISE BOARD AND COMMITTEE ASSESSMENTS

In accordance with the UK Corporate Governance Code, an external and independent evaluation of the performance of the Council and Franchise Board was undertaken by ICSA Board Evaluation at the end of 2012. The review also covered the performance of the Audit, Remuneration and Nominations Committees. The main finding of the evaluation was that the governance arrangements were operating effectively although some improvements were identified. These included more visibility around the Nominations Committee's work regarding non-executive reappointments; improvements to the Council and Franchise Board papers; and the development of a gender diversity policy for the Franchise Board and Council. The recommendations for improvement will be taken forward under the guidance of the Chairman and the Secretary to the Council.

It is intended that the next external evaluation will be undertaken in 2015. In the intervening years, the Secretary to the Council will undertake the evaluations (which was the practice before the 2012 external evaluation).

INDIVIDUAL ASSESSMENT

The Chairman meets each Non-Executive Director on the Franchise Board and each member of the Council once a year to appraise their performance. The Senior Independent Deputy Chairman also seeks the views of the Franchise Board and the Council on the performance of the Chairman. These views are conveyed to the Chairman by the Senior Independent Deputy Chairman.

TRAINING AND INDUCTION

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

In addition, new members of the Council and Franchise Board without extensive knowledge of Lloyd's are provided with an induction programme which includes briefings with senior executive management and others on Lloyd's, its operations and key issues of the day. Members of the Council and Franchise Board with pre-existing knowledge and involvement at Lloyd's are given the opportunity to receive briefings on subjects of particular interest to them.

In addition, in 2012 five briefing sessions on a range of Lloyd's related topics were made available to all members of the Council and the Franchise Board.

INDEPENDENT PROFESSIONAL ADVICE

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

CONFLICTS OF INTEREST

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

CORPORATE GOVERNANCE OF THE LLOYD'S MARKET

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

CORPORATE GOVERNANCE
CONTINUED

ATTENDANCE RECORD

	Council	Franchise Board	Audit Committee	Nominations Committee	Remuneration Committee	MSARC[1]	CTP[2]	Investment Committee	Risk Committee
Chairman of the Council of Lloyd's									
John Nelson	[a]5/5	[a]11/11		[a]4/4	3/3				
Executive Directors									
Richard Ward	5/5	11/11							[a]11/11
Tom Bolt		11/11							11/11
Luke Savage		11/11						4/4	8/11
Non-Executive Council members									
Working members									
Rupert Atkin	5/5								
Simon Beale[3]	4/4								
Christopher Harman	5/5								
Lawrence Holder[3]	4/4								
Nick Marsh	4/5								
Graham White[4]	4/4			4/4					
External members									
Lord Ashton of Hyde	5/5								
Robert Childs	5/5								
Michael Deeny	5/5								
Matthew Fosh	5/5								
Paul Jardine	5/5		4/5		2/3				
Alan Lovell	5/5				3/3		2/2		
Nominated members									
Sir Robert Finch	4/5		5/5			[a]4/4			
Andy Haste[6]	1/1			1/1				[a]1/1	
Reg Hinkley	5/5		5/5			4/4			
Sir David Manning	5/5			3/4					
Andreas Prindl[5]	4/4		3/4	3/3	[a]3/3		[a]2/2	[a]3/3	
Non-Executive Franchise Board members									
Sir Andrew Cahn		10/11							
Charles Franks		9/11	5/5						
Nick Furlonge		11/11		4/4					
Claire Ighodaro		11/11	[a]5/5						
Andrew Kendrick		10/11	2/5		3/3				
Martin Read		11/11			3/3				
Bruce Van Saun[7]		3/4	1/1						
Andre Villeneuve		9/11		4/4					

	Council	Franchise Board	Audit Committee	Nominations Committee	Remuneration Committee	MSARC[1]	CTP[2]	Investment Committee	Risk Committee
Other Committee members									
Martin Bride								4/4	
Margaret Chamberlain							2/2		
Edward Creasy						4/4			
Christine Dandridge						4/4			
Lady Delves Broughton							2/2		
David Gittings							1/2		
Michael Green								3/4	
Peter Grove						4/4			
Sue Langley									4/7
Philip Matthews[8]								2/3	
Sean McGovern									7/11
Jose Ribeiro									2/6
Ian Salter							2/2		
Paul Swain							2/2		
Vincent Vandendael									1/1
David Winkett								3/4	

[a] Chairman.

Notes

1. Market Supervision and Review Committee.
2. Capacity Transfer Panel.
3. Simon Beale and Lawrence Holder were elected to Council as from 8 February 2012.
4. Graham White was re-elected to Council as from 8 February 2012.
5. Andreas Prindl retired on 31 October 2012 as a nominated member of Council and as Senior Independent Deputy Chairman.
6. Andy Haste was appointed as a nominated member of Council and as Senior Independent Deputy Chairman on 1 November 2012.
7. Bruce Van Saun was appointed to the Franchise Board on 3 September 2012. He joined the Audit Committee on 1 December 2012.
8. Philip Matthews joined the Investment Committee on 31 July 2012. He also attended the Investment Committee meeting on 14 May as an observer (included in the statistics above).

CORPORATE GOVERNANCE CONTINUED THE COUNCIL OF LLOYD'S

The Council as at 26 March 2013.

*Considered to be an independent member of council.

JOHN NELSON

Chairman of Lloyd's (Nominated member)
Chairman of the Nominations Committee
Member of the Remuneration Committee

John Nelson was appointed Lloyd's Chairman in October 2011. He is also the Chairman of Hammerson plc, but retires in May 2013. He is a Chartered Accountant, who worked in both the UK and the US while with Kleinwort Benson. He joined Lazard in 1986, whose Vice-Chairman he became in 1990. He subsequently became Chairman of Credit Suisse First Boston (Europe), and Deputy Chairman of Kingfisher plc. In addition, he has been a Non-Executive Director of BT, Woolwich plc, JP Morgan Cazenove and Cazenove Group. He is also an Adviser to Charterhouse Capital Partners LLP and a Trustee of the National Gallery.

DR RICHARD WARD

Chief Executive Officer (Nominated member)

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

ANDY HASTE*

Senior Independent Deputy Chairman of Lloyd's (Nominated Member)
Member of the Nominations Committee
Chairman of the Remuneration Committee

Andy Haste the former Group CEO of RSA joined the Board of RSA as Group Chief Executive in April 2003 and was a member of the Group Executive Team, Investment Committee and Board Risk Committee. Prior to that he was CEO of AXA Sun Life plc and Director of AXA UK plc (life and pensions), President and Chief Executive Officer of Global Consumer Finance Europe at GE Capital UK, Western Europe and Eastern Europe (consumer financial services) and President of National Westminster Bank's US Consumer Credit Business (retail banking). He was also a member of the Board of the Association of British Insurers from 2003-11. He is currently a Non-Executive Director of ITV plc.

PAUL JARDINE

Representative of Catlin Syndicate Limited
Deputy Chairman of Lloyd's (External member)
Member of the Audit Committee
Member of the Remuneration Committee

Paul Jardine, a qualified Actuary, is Deputy Chairman of Catlin Underwriting Agencies Limited and Chief Operating Officer of Catlin Group Limited. He has over 30 years of insurance industry experience and was Chairman of the Lloyd's Market Association from 2007 to 2010.

GRAHAM WHITE

Deputy Chairman of Lloyd's (Working member)
Member of the Nominations Committee

Graham White is Chairman of Argenta Private Capital Limited and Deputy Chairman of Argenta Syndicate Management Limited. He is a Non-Executive Director of Marine Aviation and General (London) Limited and of the Newton Follis Partnership Limited. He is also a Trustee of The City Arts Trust Limited. He has worked in the Lloyd's market since 1968 as a reinsurance broker, company secretary and for members' agents and managing agents. In addition, he is a Trustee of the Lloyd's Patriotic Fund.

RUPERT ATKIN

(Working member)

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

SIMON BEALE

(Working member)

Simon Beale is the Group Chief Underwriting Officer of Amlin Plc, an Executive Director of the Amlin Plc board and Non-Executive Director of Amlin Underwriting Limited the managing agency for Syndicate 2001 of which he was joint active underwriter until 2012. He has worked in the Lloyd's market since 1984 and has served on various Lloyd's underwriting committees. He is currently a member of the Lloyd's Market Association Board.

ROBERT CHILDS

Representative of Hiscox Dedicated Corporate Member Limited (External member)

Robert Childs is the Non-Executive Chairman of Hiscox. He was Chairman of the Lloyd's Market Association from January 2003 to May 2005 and former Chairman of the Advisory Board of the School of Management of Royal Holloway University. He is currently a Trustee of Enham (a charity for the disabled) and Chairman of The Bermuda Society.

MICHAEL DEENY

Representative of The Michael Deeny LLP
(External member)
Michael Deeny is a Chartered Accountant. He was the Chairman of the Association of Lloyd's Members. His career has principally been in the music industry, where he has promoted U2, Bruce Springsteen, Nirvana and Luciano Pavarotti amongst others. He underwrites through a Limited Liability Partnership and is Deputy Chairman of the Equitas Trust. He is now a Non-Executive Director of Randall & Quilter Underwriting Management Holdings Limited.

MATTHEW FOSH

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

CHRISTOPHER HARMAN

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

DR REG HINKLEY*

(Nominated member)
Member of the Audit Committee
Reg Hinkley was Bursar at Christ's College Cambridge until 2011. Between 1981 and 2007 he worked for BP, holding a number of senior finance, planning and risk management roles, culminating in appointment as Chief Executive Officer of BP's UK Pension Fund. Before joining BP he worked at HM Treasury. He is an independent Trustee and Deputy Chairman of the Lloyd's Pension Scheme, in addition to holding other external non-executive appointments.

LAWRENCE HOLDER

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

ALAN LOVELL

Representative of Palace House International (Two) LLP (External member)
Member of the Remuneration Committee
Alan Lovell is Chairman and Chief Executive of Tamar Energy, an anaerobic digestion business, and has other green energy roles. He was previously a turnaround specialist who served as Chief Executive of Costain, Dunlop Slazenger and Jarvis and is now Chief Adviser to the restructuring practice of PwC. He is a Trustee of The Mary Rose and of Winchester Cathedral and is Chairman of the Association of Lloyd's Members.

SIR DAVID MANNING GCMG CVO*

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

NICHOLAS MARSH

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

MICHAEL WATSON

Representative of Flectat Limited
(External member)
Michael Watson is Executive Chairman of Canopius Group Limited and led the management buy-out in 2003. He has over 30 years' experience in commercial and investment banking, trade finance, stock broking, life and non-life insurance, gained in London, Bermuda and New York. He is currently a member of the Lloyd's Market Association Board and is a Chartered Accountant.

CORPORATE GOVERNANCE CONTINUED
THE FRANCHISE BOARD

The Franchise Board as at 26 March 2013.

*Considered to be an independent non-executive director.

JOHN NELSON

Chairman of Lloyd's
Biography on page 70.

DR RICHARD WARD

Chief Executive Officer
Biography on page 70.

TOM BOLT

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

SIR ANDREW CAHN KCMG*

Sir Andrew Cahn is Vice Chairman at Nomura International plc and Chairman of the Advisory Board of Huawei Technologies (UK). He is on the Board of General Dynamics (UK), TheCityUK, Institute for Government, Gatsby Charitable Foundation, Arvon Foundation, Japan Society, Advisory Board of the University of the Arts and is an Association Member of BUPA. He was previously Chief Executive of UK Trade and Investment and was on the Boards of the Foreign Office and Department for Business.

CHARLES FRANKS

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

NICHOLAS FURLONGE

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

CLAIRE IGHODARO CBE*

Chairman of the Audit Committee
Claire Ighodaro is Audit Committee Chair. She is a Board member and Audit Committee Chair of the British Council, the Lending Standards Board and the Open University. She was a senior executive at BT plc, an Independent Director at BIS and UK Trade and Investment and is a past President of CIMA (the Chartered Institute of Management Accountants). She sits on the International Ethics Standards Board for Accountants.

ANDREW KENDRICK

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

DR MARTIN READ CBE*

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

LUKE SAVAGE

Director, Finance and Operations
Luke Savage trained as a Chartered Accountant with Price Waterhouse. He joined Lloyd's in 2004 as Finance Director, subsequently assuming responsibility for Operations. Prior to joining Lloyd's he worked in the financial services sector for over 20 years, including Morgan Stanley and Deutsche Bank.

BRUCE VAN SAUN*

Member of the Audit Committee
Bruce Van Saun has served as the Group Finance Director and an Executive Director of The Royal Bank of Scotland Group since October 2009. Bruce has over 25 years of financial services experience. From 1997-2008 he held a number of senior positions with Bank of New York and later Bank of New York Mellon, most recently as Vice-Chairman and Chief Financial Officer and before that responsible for the Asset Management and Market Related businesses. Prior to that, he held senior positions with Deutsche Bank, Wasserstein Perella Group and Kidder Peabody & Co. From late 2008 until joining RBS he worked as an Advisor to US private equity firms. He is currently a Director of Direct Line Group and WorldPay and previously, in the US, served on several corporate Boards and has been active in numerous community organisations.

ANDRE VILLENEUVE*

Member of the Nominations Committee
Andre Villeneuve is the former Chairman of the City of London's International Regulatory Strategy Group. He is an Independent Director of United Technologies Corporation and a Member of the Advisory Council of TheCityUK. He served as Chairman of Euronext-LIFFE and Instinet, Non-Executive Director of Aviva and TheCityUK Board, and Executive Director of Reuters where he worked for many years.

INTERNAL CONTROL STATEMENT

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

The Audit Committee monitors and reviews the effectiveness of the system of internal control of the Society and biannual reports are provided to the Franchise Board. There is an ongoing process, in accordance with the guidance of the UK Corporate Governance Code on internal control, which has been established for identifying, evaluating and managing significant risks. Other procedures such as whistle-blowing whereby any member of staff may take matters that concern them to the Head of Internal Audit, the Legal and Compliance department or, where appropriate, to the Chairman of the Audit Committee or the FSA (from 1 April FCA), are clearly set out. Associate companies, Ins-sure Holdings Limited and Xchanging Claims Services Limited, are not dealt with as part of the group for the purposes of applying the UK Corporate Governance Code.

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

Management structure
'Lloyd's Governance Arrangements: A Guide for Members of Lloyd's Committees', reviewed and updated in 2012, outlines the governance structure and committee members' duties and responsibilities, including confidentiality and conflicts and declarations of interest.

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

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

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

Identification and evaluation of business risks
The Risk Management Framework ensures that the identification, assessment, monitoring and management of the major risks affecting the Society takes place on an ongoing basis. The Framework includes a number of risk assessment techniques, which are tailored to specific risk areas. One such technique is the comprehensive risk and control assessment procedure, which is conducted on a regular basis. This review re-assesses the existing risks and identifies any new risks. It evaluates controls in terms of adequacy of performance and also seeks to monitor the action plans in place to help manage risks. These processes are described in more detail in the Risk management section on pages 22-23.

One of the key objectives of the Lloyd's risk governance structure is to provide assurance to the Franchise Board that risks facing the Society are identified and managed in accordance with approved policy and appetite. This is achieved by the risk committees having the appropriate management information (MI) to oversee and challenge. The MI includes information from many different sources within the Risk Management and internal control frameworks, such as the various risk and control assessments, details of the operating and regulatory environment and capital management reports. The risk governance structure comprises of the Risk Committee plus three specialist sub-committees; the Syndicate Risk Committee, the Financial Risk Committee and the Corporation Risk Committee. These provide clear independent challenge to the risk takers at Lloyd's and enables tailored risk management operating models, rather than a 'one size fits all' platform. The Risk Management Framework enables Lloyd's to undertake a more forward looking assessment of risk, building in capital consideration into the decision making process and a formal Risk Appetite Framework with defined escalation routes. An Own Risk and Solvency Assessment was implemented during 2012, which brought together key risk, capital and solvency management information on a more formal basis for the Franchise Board.

A framework of regular self-certification, with targeted independent challenge, is in place and where control failures have been reported, details of the circumstances are required together with appropriate corrective actions. A summary of these reports is reviewed by the Executive Team, the Corporation Risk Committee, Franchise Board and the Audit Committee on a regular basis. Internal auditors also perform independent reviews of control activities as part of their annual programme as approved by the Audit Committee. The Head of Internal Audit and the Legal and Compliance department report to the Executive Team on a regular basis and to each Audit Committee meeting.

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

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

REPORT OF THE REMUNERATION COMMITTEE

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

COMPOSITION OF THE REMUNERATION COMMITTEE

The Remuneration Committee currently comprises six members – three members of Council, two members of the Franchise Board and the Chairman of Lloyd's. It has been chaired by Andy Haste (a Nominated member of Council and Senior Independent Deputy Chairman) since November 2012. The Remuneration Committee members for 2012 are shown in the remuneration table on page 80.

The Remuneration Committee met three times in 2012. The attendance record is set out in the Corporate Governance report, page 68. The Committee's terms of reference are available on the Lloyd's website and on request from the Secretary to the Council.

The Remuneration Committee was assisted by its remuneration consultants, Deloitte LLP, who adhere to the Code of Conduct for executive remuneration consultants. Deloitte LLP also provided other services to the Corporation during the year, including the co-sourced Internal Audit resource.

REMUNERATION AND COMPENSATION

Executive Remuneration

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

Corporation Remuneration Policy

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

Lloyd's Total Reward approach is supported by the following practices:
– We look beyond base salary to the value of the total reward package in meeting the needs of employees.
– We recognise and reward superior performance.

Lloyd's policy is therefore based on providing a package of rewards (salary plus benefits) that is business driven, competitive, fair and flexible. It is also founded on the proposition that the ultimate source of value in the business is people. Combining this creates a reward offering which:
– Emanates from business strategies and priorities.
– Is based on business success (ie our ability to pay).
– Provides a flexible mix of rewards, designed to attract, retain and motivate a performance driven workforce with the varied range of experience and skills the business requires.
– Is externally competitive.
– Rewards for performance rather than cost of living.
– Ensures employees understand the criteria by which rewards are determined and reviewed.
– Gives managers the tools to make informed decisions regarding rewarding their teams.
– Is in line with our equality and diversity policy.'

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

Annual individual performance bonus awards are discretionary.

The Corporation provides a defined benefit pension scheme. As of 1 April 2013, the scheme will be closed to new employees. The pension offering for staff joining after that date will be via a defined contribution scheme.

The policy outlined above has been applied throughout 2012. The Remuneration Committee will, however, continue to monitor its policies, particularly its arrangements for performance related pay, against evolving market practice and relevant guidelines prepared in response to the current economic climate. Many of the proposals under consideration in the wider financial services sector are aimed at curbing excessive risk-taking at financial institutions. The Corporation is focused on market oversight and promoting the attractiveness of Lloyd's. Risk-taking is primarily undertaken at syndicate level rather than within the Corporation.

REPORT OF THE REMUNERATION COMMITTEE CONTINUED

REMUNERATION AND COMPENSATION CONTINUED

CEO and Executive Directors

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

The annual salaries and bonuses of the CEO and the executive directors are reviewed by the Remuneration Committee annually.

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

In December 2011, the Remuneration Committee considered the results of an external review (undertaken by FIT Remuneration Consultants LLP, a firm with no connection to the Society) into the remuneration arrangements for the CEO and executive directors. The Remuneration Committee concluded that while overall remuneration levels – ie: fixed (non-performance related) plus variable (performance related) – were reasonable, the balance between the fixed and variable elements should be realigned by increasing the former and reducing the latter, in order to reflect better the role of the Corporation of Lloyd's and bring remuneration arrangements more in line with other organisations with a similar role.

The Remuneration Committee also agreed that more specific and measurable targets and KPIs should be established, where possible, to help determine bonus awards.

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

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

* Base salaries were increased with effect from 1 January 2012.

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

Neither the Chairman, the CEO nor any director plays a part in any discussion about his own remuneration.

The Chairman

John Nelson was appointed Chairman with effect from 17 October 2011. In addition to his salary, Mr Nelson is entitled to receive private medical insurance. Mr Nelson does not participate in the Lloyd's Performance Plan.

2013 base salaries

Given the current economic climate, the Chairman and the CEO asked the Remuneration Committee not to consider either of them or the directors for a pay rise for 2013. Salaries therefore remain at 2012 levels.

LLOYD'S PERFORMANCE PLAN

The Lloyd's Performance Plan (LPP) was introduced from 1 January 2008.

The LPP is available to all employees and has been designed to meet strategic objectives by enabling the Corporation to offer an incentive which:
- Is directly linked to the profitability of the Lloyd's market and will therefore encourage an attitude of commercial partnership with the market and align the interests of participants with capital providers.
- Will provide a competitive reward and therefore assist Lloyd's in attracting and retaining the talented individuals required to develop and support future strategy.

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

Eligibility

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

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

LLOYD'S PERFORMANCE PLAN CONTINUED

Calculation of LPP Awards

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

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

The LPP Awards are as follows:

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

Structure and timing of payments

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

Job level	Awards	Payments
CEO, directors and Level 1 employees	Any LPP Award will be notified to the employee after the PBT for the relevant year has been announced (eg the employee will be notified normally in May 2013 of any LPP Award relating to the financial year 2012). The total amount of the LPP Award will be added to the particular employee's LPP Fund.	Each October one half of the total contents of the LPP Fund will be paid to the employee.

For Level 2–4 employees, any LPP Award will be paid in full during the year in which it is notified to the employee. For example, for the financial year 2012, employees will be notified of any LPP Award normally in May 2013 (once PBT for 2012 has been announced) and the LPP Award for 2012 will be paid to these employees in full in October 2013.

LEAVING EMPLOYMENT

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

Directors and Level 1 participants

(a) If a director or Level 1 participant leaves the Corporation's employment and is classified as a 'good leaver' (as determined by the rules of the LPP) the provisions set out in paragraphs (b) and (c) below will apply.
(b) The director or Level 1 participant will receive a pro-rated LPP Award for each complete month of service in respect of his/her year of departure. The LPP Award will be notified to the employee and paid in accordance with the usual timescales.
(c) Any balance which remains in the LPP Fund for directors or Level 1 participants will be paid in full in the October at the same time as the final LPP Award which is due to the employee.
(d) If a director or Level 1 participant leaves the Corporation's employment due to any reason other than those referenced in paragraph (a) above (as determined by the Remuneration Committee acting in its absolute discretion), he/she will forfeit any and all outstanding and future LPP Awards (including, for the avoidance of any doubt, any balance of the LPP Fund) with immediate effect from the date that he/she serves or receives notice of termination.

Level 2–4 participants

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

REPORT OF THE REMUNERATION COMMITTEE CONTINUED

PENSION ARRANGEMENTS

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

Their dependants are eligible for dependants' pensions and the payment of a lump sum in the event of death in service. The pension arrangements for the Director, Finance and Operations provide for a pension at normal retirement of two-thirds base annual salary after 20 years' eligible service less any entitlement from previous pension arrangements and subject to a Scheme earnings cap of £137,400 from 6 April 2012. The pension arrangements for the CEO provide for a pension on retirement based on a standard accrual rate of one sixtieth of base annual salary subject to the Scheme earnings cap, for each year of eligible service, with the facility to increase the accrual rate to one thirtieth for an additional contribution. The pension arrangements for the Director, Performance Management provide for a pension at retirement built in annual blocks based on a standard accrual rate of one eightieth of base annual salary subject to the Scheme earnings cap in each year of eligible service with the facility to increase the accrual rate to one thirtieth for an additional contribution. No other payments to the CEO, the Director, Finance and Operations or the Director, Performance Management are pensionable.

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

The Lloyd's Pension Scheme is contributory and the Director, Finance and Operations made salary sacrifices of 10% of the earnings cap in exchange for additional employer pension contributions of the same amount. The CEO made a salary sacrifice of 5% of the earnings cap in exchange for an additional employer contribution for a sixtieth accrual rate and sacrificed an extra 25.9% of the earnings cap for the six months to 30 June 2012 in exchange for an additional employer contribution to increase the accrual rate to thirtieths. The Director, Performance Management, made a salary sacrifice of 5% of the earnings cap in exchange for an additional employer contribution for an eightieth accrual rate.

CONTRACTS OF EMPLOYMENT

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

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

	Effective date of contract	Unexpired term as at 31 December 2012	Notice period[1]
John Nelson[5]	17/10/11	21 months	12 months
Richard Ward[2]	24/04/06	rolling 1 year	12 months
Tom Bolt[3]	01/09/09	rolling 1 year	12 months
Luke Savage[4]	20/09/04	rolling 1 year	12 months

Notes

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

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

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

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

In 2012, fees for members of Council and Franchise Board were £35,700 and £56,100 per annum, respectively. The Deputy Chairmen were paid £45,900 per annum. Fees are also payable in respect of membership of a number of Council and Franchise Board committees, including a number of ad hoc committees established to consider specific issues requiring a significant time commitment. Non-employee members of the Council and Franchise Board are not eligible to join the Lloyd's Pension Scheme.

Individual remuneration of all members of the Council and Franchise Board can be found in the table on page 80.

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

INFORMATION SUBJECT TO AUDIT

Basis of preparation

The following section provides details of the remuneration of all members of the Council of Lloyd's and the Franchise Board for the year ended 31 December 2012. This section contains the following information in the form specified in Schedule 8 Part 3 of the Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008:

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

REPORT OF THE REMUNERATION COMMITTEE CONTINUED

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

Individual remuneration for the year to 31 December is shown in the table below. More detail on LPP Awards is shown on page 82.

	Salary/Fees		Taxable benefits[1]		Annual bonus		Other[2]		LPP Award		Total	
	2012 £000	2011 £000	**2012 £000**	2011 £000	**2012 £000**	2011 £000	**2012 £000**	2011 £000	**2012 £000**	2011 £000	**2012 £000**	2011 £000
Chairman of the Council of Lloyd's												
John Nelson[3,4,6,8]	**525**	111	**11**	3	**–**	–	**10**	5	**–**	–	**546**	119
Executive Directors												
Richard Ward[3,4]	**668**	556	**13**	13	**502**	752	**144**	118	**370**	–	**1,697**	1,439
Tom Bolt[3,5,7]	**577**	488	**12**	12	**315**	450	**124**	104	**320**	–	**1,348**	1,054
Luke Savage[3,5]	**518**	449	**13**	13	**250**	338	**107**	93	**287**	–	**1,175**	893
Non-Executive Council members												
Working members												
Rupert Atkin	**36**	41	**–**	–	**–**	–	**–**	–	**–**	–	**36**	41
Simon Beale[25]	**33**	–	**–**	–	**–**	–	**–**	–	**–**	–	**33**	–
Christopher Harman	**36**	36	**–**	–	**–**	–	**–**	–	**–**	–	**36**	36
Lawrence Holder[25]	**33**	–	**–**	–	**–**	–	**–**	–	**–**	–	**33**	–
Nick Marsh	**36**	36	**–**	–	**–**	–	**–**	–	**–**	–	**36**	36
Graham White, Deputy Chairman	**53**	53	**–**	–	**–**	–	**–**	–	**–**	–	**53**	53
External members												
Lord Ashton of Hyde[9]	**36**	36	**–**	–	**–**	–	**–**	–	**–**	–	**36**	36
Robert Childs[10]	**33**	–	**–**	–	**–**	–	**–**	–	**–**	–	**33**	–
Michael Deeny[11]	**36**	36	**1**	1	**–**	–	**–**	–	**–**	–	**37**	37
Matthew Fosh[12]	**36**	36	**–**	–	**–**	–	**–**	–	**–**	–	**36**	36
Paul Jardine, Deputy Chairman[13,8]	**62**	60	**–**	–	**–**	–	**–**	–	**–**	–	**62**	60
Alan Lovell[8]	**50**	50	**–**	–	**–**	–	**–**	–	**–**	–	**50**	50
Nominated members												
Sir Robert Finch	**58**	63	**–**	–	**–**	–	**–**	–	**–**	–	**58**	63
Andy Haste, Deputy Chairman[14,8]	**14**	–	**–**	–	**–**	–	**–**	–	**–**	–	**14**	–
Reg Hinkley	**54**	52	**–**	–	**–**	–	**–**	–	**–**	–	**54**	52
Sir David Manning	**43**	37	**–**	–	**–**	–	**–**	–	**–**	–	**43**	37
Non-Executive Franchise Board Members												
Sir Andrew Cahn[15]	**56**	42	**–**	–	**–**	–	**–**	–	**–**	–	**56**	42
Charles Franks[16]	**64**	–	**–**	–	**–**	–	**–**	–	**–**	–	**64**	–
Nick Furlonge	**63**	57	**–**	–	**–**	–	**–**	–	**–**	–	**63**	57
Claire Ighodaro	**71**	71	**–**	–	**–**	–	**–**	–	**–**	–	**71**	71
Andrew Kendrick[8]	**72**	72	**–**	–	**–**	–	**–**	–	**–**	–	**72**	72
Martin Read[8]	**63**	57	**–**	1	**–**	–	**–**	–	**–**	–	**63**	58
Bruce Van Saun[17]	**19**	–	**–**	–	**–**	–	**–**	–	**–**	–	**19**	–
Andre Villeneuve	**63**	57	**–**	–	**–**	–	**–**	–	**–**	–	**63**	57
Former Members of Council												
Celia Denton[18]	**–**	12	**–**	–	**–**	–	**–**	–	**–**	–	**–**	12
Ewen Gilmour[19]	**8**	45	**–**	–	**–**	–	**–**	–	**–**	–	**8**	45
Barnabas Hurst-Bannister[20]	**3**	36	**–**	–	**–**	–	**–**	–	**–**	–	**3**	36
Lord Levene of Portsoken[21,24]	**–**	441	**–**	1	**–**	–	**–**	96	**–**	–	**–**	538
Andreas Prindl[22,8]	**77**	84	**–**	–	**–**	20	**–**	–	**–**	–	**77**	104
Former Members of the Franchise Board												
David Shipley[23]	**–**	65	**–**	–	**–**	–	**–**	–	**–**	–	**–**	65

Notes

1. Taxable benefits include items such as benefit allowances, medical and life insurance.
2. For executive directors, other includes payments of 20% of annual base salary as their pension benefits are based on a maximum earnings cap, which from 6 April 2012 was £137,400. The amount stated in respect of Lord Levene for 2011 represents a cash allowance of £51,840 in lieu of pension contributions and the premium in respect of additional life cover.
3. Employee of the Corporation of Lloyd's.
4. Member of both Council and the Franchise Board for 2012.
5. Member of the Franchise Board only.
6. John Nelson's term as Chairman of Lloyd's started on 17 October 2011.
7. Tom Bolt is a non-executive director of Xchanging Claims Services. No fees are payable.
8. Member of the Remuneration Committee during 2012.
9. Representative of Faraday Capital Limited.
10. Robert Childs (as the representative of Hiscox Dedicated Corporate Member Ltd) joined Council on 1 February 2012.
11. Representative of The Michael Deeny LLP.
12. Representative of Novae Corporate Underwriting Limited.
13. Representative of Catlin Syndicate Limited.
14. Andy Haste was appointed to Council on 1 November 2012. He was also appointed as Chairman of the Remuneration Committee as from the same date.
15. Sir Andrew Cahn was appointed to the Franchise Board on 4 April 2011.
16. Charles Franks was appointed to the Franchise Board on 1 January 2012.
17. Bruce Van Saun was appointed to the Franchise Board on 3 September 2012.
18. Celia Denton retired from Council on 15 March 2011.
19. Ewen Gilmour retired from Council on 31 January 2012.
20. Barnabas Hurst-Bannister (the representative of Aprilgrange Ltd) retired from Council on 31 January 2012.
21. Lord Levene retired as Chairman on 16 October 2011, although his contract expired on 9 December 2011 and he was paid in full to that date. He was contracted to work four days per week but with effect from 1 October 2010, one of those four days was associated with duties to NBNK Investments plc and was paid directly by NBNK Investments plc. In addition to his annual salary, he was eligible for a bonus and was also entitled to receive private medical and life insurance. He also received a cash allowance in lieu of pension contributions.
22. Andreas Prindl retired from Council and as Chairman of the Remuneration Committee on 31 October 2012. For 2011, the Council agreed to award Andreas Prindl a special bonus of £20,000 for the additional work he undertook in successfully leading the search for a new Chairman.
23. David Shipley retired from the Franchise Board 31 December 2011.
24. Former employee of the Corporation.
25. Simon Beale and Lawrence Holder joined Council on 8 February 2012.

REPORT OF THE REMUNERATION COMMITTEE CONTINUED

LLOYD'S PENSION SCHEME PROVISIONS

	Salary sacrifice in year to 31 December 2012[1] £000	Age at 31 December 2012	Increase in pension in year to 31 December 2012 – actual £000	Increase in pension in year to 31 December 2012 – net of price inflation £000	Total accrued annual pension in year to 31 December 2012 £000 pa	Normal retirement age
Richard Ward	24	55	5	4	3	65
Tom Bolt	7	56	2	2	2	65
Luke Savage	14	51	6	5	4	60

Note

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

TRANSFER VALUES OF ACCRUED PENSION BENEFITS

	Transfer value of accrued pension as at 31 December 2011 £000	Transfer value of accrued pension as at 31 December 2012 £000	Movement in transfer value over the year less amounts salary sacrificed £000
Richard Ward	274	449	151
Tom Bolt	39	86	40
Luke Savage	378	619	227

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

The upward movement in the transfer values is mainly attributable to the increase in the accrued pension over the year and changes in the actuarial factors used to calculate the transfer values following the last triennial valuation.

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

	Estimated long-term bonus			
	Total award outstanding as at 31 December 2011 £000	Change in year £000	Amount paid during the year ended 31 December 2012 £000	Total award outstanding as at 31 December 2012 £000
Richard Ward	303	370	151	522
Tom Bolt	104	320	52	372
Luke Savage	260	287	130	417

Andy Haste
Chairman, Remuneration Committee

REPORT OF THE AUDIT COMMITTEE

This report sets out the role, remit and activities of the Audit Committee during 2012.

COMPOSITION OF THE AUDIT COMMITTEE

At the end of 2012, the Audit Committee comprised two nominated members of Council, one external member of the Council and four non-executive members of the Franchise Board. The Audit Committee met five times during the year. The members of the Audit Committee in 2012 and their attendance at meetings are shown in the Corporate Governance report on pages 68 and 69.

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

TERMS OF REFERENCE

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

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

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

FINANCIAL REPORTING

The Audit Committee reviewed the Lloyd's published annual and interim financial statements including the pro forma financial statements, the Aggregate Accounts, the group financial statements of the Society of Lloyd's, Lloyd's Return to the FSA and the interim management statements of the Society of Lloyd's. The Audit Committee seeks support from the external auditor to assess whether suitable accounting policies have been adopted and whether management has made appropriate estimates and judgements.
The principal issues reviewed in 2012 were:

- The notional investment return on Funds at Lloyd's and the methodology of the calculation.
- The valuation of the Lloyd's pension scheme including a review of the appropriateness of the assumptions used in the calculation. The Audit Committee also received an update on the impact of revisions to International Accounting Standard 19 Revised Employee Benefits.
- Insurance liabilities and reinsurance assets, including the impact of the novation of the reinsurance to close portfolio of Centrewrite.
- The methodology and assumptions used in the fair value calculation of recoverable Central Fund loans made to hardship members.
- Estimates of amounts to be retained by the Society in respect of Central Fund Contributions and Subscriptions.
- Provision for undertakings given to insolvent members.
- Managements' assessment of the financial position of the Society including forecasts and stress tests undertaken.

INTERNAL CONTROL

The Audit Committee reviewed and monitored the effectiveness of the systems of internal control of the Society. This was achieved through receiving regular reports from the Risk Committee (covering key aspects of the Lloyd's Risk Framework and risk reporting), Legal and Compliance department, Internal Audit including status reports of audit findings and management's self-assessment of control failures during the period. Specific issues considered during 2012 were:

- Reports from the Risk Committee on the key risk issues facing the Society, including impact analysis and mitigating actions established by management.
- Reports on compliance matters including EU Competition Study of Subscription Markets; European Commission's legislative proposals on auditing; Solvency II; and the International Association of Insurance Supervisors proposed methodology for identifying Systemically Important Financial Institutions.
- Monitoring the implementation process of Solvency II. At each meeting where Solvency II was discussed, the Committee received a report from management and Internal Audit.
- Update on the implementation of the FSA Risk Mitigation Programme.
- The results of the speaking-up survey with updates on action being taken to address any specific matters including the revised Code of Conduct and the promotion of the Speaking Up Policy.

REPORT OF THE AUDIT COMMITTEE
CONTINUED

OBJECTIVITY AND INDEPENDENCE OF THE EXTERNAL AUDITOR

The Audit Committee monitors and reviews the objectivity and independence of the external auditor. This includes having in place a policy to govern the non-audit services that may be provided by the external auditor, which sets out the circumstances in which the external auditor may be permitted to undertake non-audit services. Allowable services are pre-approved up to £100,000. Any non-audit service that exceeds these thresholds requires approval from the Chairman of the Audit Committee and must be justified and, if appropriate, tendered, before it is approved. The Audit Committee receives a regular report on engagements undertaken by the external auditor in order to monitor the types of services provided and the fees incurred. The external auditor has also provided confirmation to the Audit Committee that they believe they remain independent within the meaning of the regulations on this matter and their professional standards.

A breakdown of the fees paid to the auditor for non-audit work may be found in note 5. Significant engagements undertaken in 2012 include other services pursuant to legislation (work undertaken on the Aggregate Accounts and regulatory returns), the pro forma financial statements and external validation of aspects of the Lloyd's Internal Capital Model.

PERFORMANCE OF THE INTERNAL AUDIT AND EXTERNAL AUDIT

Internal Audit

The Audit Committee reviews and approves Internal Audit's Charter and Operating Standards and the Internal Audit Plan, which provides the three year audit cycle and details the annual scope of work and allocation of resources based on an assessment of inherent risks and existing controls.

The performance of internal audit is subject to on-going assessment and to a formal evaluation that is achieved through seeking views on performance from key stakeholders across the Society and also from departments that have been subject to an internal audit. The results of this evaluation are reported to the Audit Committee on an annual basis. The Audit Committee is satisfied with the performance of internal audit.

External Audit

The Audit Committee is responsible for monitoring the performance, objectivity and independence of the external auditor and recommend to the Council the appointment of the external auditor. The Audit Committee also approves the external audit plan to ensure the appropriate areas of focus.

The external audit was subject to a competitive tender in 2001 when Ernst & Young LLP were re-appointed, although the audit partner responsible for the audit is required to rotate every five years. With regards to auditor independence, there is a policy in place to govern non-audit services, which is described above. Ernst & Young LLP also provides specific assurance to the Audit Committee on its independence and objectivity.

The performance of external audit is subject to on-going assessment and to a formal evaluation that is achieved through seeking views on performance from key stakeholders across the Society. The results of this evaluation are reported to the Audit Committee on an annual basis and the Audit Committee is satisfied with the performance of external audit. However, as a matter of good governance the Audit Committee considers that external audit should be subject to a competitive tender during 2013.

SUPPORT

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

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

Claire Ighodaro, CBE
Chairman, Audit Committee

REPORT OF THE LLOYD'S MEMBERS' OMBUDSMAN

REPORT BY MARK HUMPHRIES, LLOYD'S MEMBERS' OMBUDSMAN

I am pleased to present the Annual Report of the Lloyd's Members' Ombudsman to the Council of Lloyd's for the year ended 31 December 2012.

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

Complaints Received

During the year one complaint was received which did not justify a finding of maladministration.

Costs

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

FINANCIAL REVIEW

This review should be read in conjunction with the financial statements of the Society on pages 93-97.

OPERATING SURPLUS

The Society of Lloyd's achieved an operating surplus for the year of £94m (2011: surplus of £77m). The operating surplus by business segment is set out below:

	Corporation of Lloyd's £m	Lloyd's Central Fund £m	Insurance activities £m	2012 Total £m	2011 Total £m
Total income	209	106	5	320	317
Central Fund claims and provisions incurred	–	(26)	–	(26)	(15)
Net insurance claims	–	–	–	–	24
Other group operating expenses	(189)	(6)	(5)	(200)	(249)
Operating surplus	20	74	–	94	77

Corporation of Lloyd's
Total income for the Corporation of Lloyd's decreased by £3m to £209m (2011: £212m) driven by the decision to waive the performance and risk management levy in 2012, partially offset by an increase in subscription income which has benefited from an increase in the level of written premium. The members' subscription rate was unchanged during 2012 at 0.5% of written premium.

Other group operating expenses decreased by £42m to £189m (2011: £231m). The 2011 comparative included a £20m contribution to the Lloyd's Pension Scheme to fund future discretionary increases to pensions in payment and a restructuring provision of £7m. After adjusting for these items, other group operating expenses have decreased by £15m driven by the cost reduction exercise announced last year.

Central Fund
Total income for the Central Fund increased by £6m to £106m (2011: £100m), the increase in Central Fund contributions, which were also boosted by the increase in the level of written premium, was partially offset by a decrease in other income. Other income mainly represents recoveries in respect of undertakings given by the Central Fund, and has declined following the closure of underwriting years in run-off in previous years. The standard Central Fund contribution rate was unchanged during 2012 at 0.5%.

Central Fund claims and provisions is a net charge for the year of £26m (2011: charge of £15m). Undertakings to meet the liabilities of insolvent members to policyholders are approved at the discretion of the Council and are normally based on anticipated cash flow requirements of insolvent members in the following 12 months. During 2012, payments made in respect of insolvent corporate members were £20m (2011: £17m) with additional payments made in respect of individual members of £nil (2011: £2,000).

Other group operating expenses decreased to £6m (2011: £8m). The 2011 comparative included foreign exchange losses and during 2012 there were recoveries from provisional liquidators in respect of fees previously paid out, excluding these items operating expenses are in line with the prior year.

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

Total income remained stable at £5m (2011: £5m) as decreases in net premium income within Centrewrite have been off set by an increase in the recoveries in respect of costs incurred by specific managing agents and the increased size of the operations in China following completion of the Direct licence project.

Net insurance claims is £nil (2011: credit of £24m). The reinsurance to close portfolio of Centrewrite was itself successfully novated from 1 January 2012, which, combined with the impact of syndicates closing in previous years on the Estate Protection Plan and Exeat portfolios, has significantly decreased the level of technical provisions held by Centrewrite. Lloyd's syndicates participate in LICCL's business by means of retrocession agreements which allows a 100% risk transfer.

INVESTMENT PERFORMANCE

	2012 £m	2011 £m
Finance income	**115**	91
Finance costs	**(62)**	(64)
Unrealised exchange gains on borrowings	**6**	5
	59	32
Surplus on subordinated debt repurchase	**–**	4
	59	36

The Society's investments returned £115m, or 4.5% during the year (2011: £91m, 3.7%). Most of the Society's investments are held within the Central Fund. Of these assets, the majority are invested in fixed interest securities of high credit quality. Despite the low level of prevailing yields, these investments produced solid returns during the period, helped by capital gains arising from further falls in 'risk free' yields as well as falling credit spreads on many corporate debt securities. Exposures to other asset classes, including global equities and high yield debt, performed strongly in the period, contributing to the satisfactory overall return on the Society's assets. A commentary on investment strategy is set out on page 89. The disposition of the Society's financial investments is set out in note 15 on pages 116 -18.

Finance costs of £62m in 2012 (2011: £64m) predominantly relate to interest on the subordinated notes and perpetual subordinated capital securities. The decrease in the level of finance costs is mainly as a result of the reduction in the level of outstanding debt securities during 2011 and the impact of foreign exchange movement.

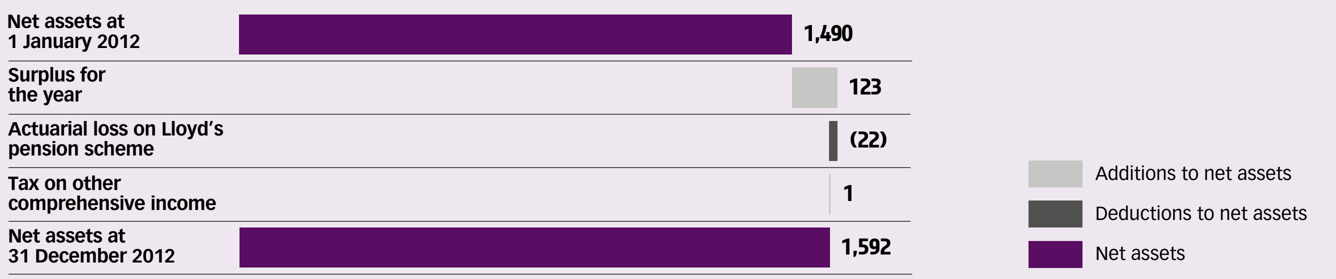
Unrealised exchange gains on borrowings reflect the impact of foreign exchange movements on the Society's outstanding debt securities. The exposure to movements in the Euro is naturally hedged through Euro-denominated investments held.

Adjusting for interest costs and foreign exchange movements results in a net investment return of £59m (2011: £32m).

TAXATION

A tax charge of £36m (2011: £29m) on the surplus before tax of £159m (2011: £118m) has been recognised for the year ended 31 December 2012. Further details are set out in note 8 on pages 109 -110.

Movement in net assets
£m



The net assets of the Central Fund are included within the above amounts and at 31 December 2012 were £1,460m (2011: £1,361m).

FINANCIAL REVIEW CONTINUED

PENSION SCHEMES

Lloyd's Pension Scheme

On an IFRS basis, the Lloyd's pension scheme valuation at 31 December 2012 was a deficit of £43m before allowance for deferred tax asset of £10m (31 December 2011: £24m deficit before allowance for a deferred tax asset of £6m).

The movement in the pension liability during the year is summarised below:

	2012 £m
Pension deficit as at 1 January 2012	(24)
Pension expense recognised in the group income statement	(2)
Employer contributions	5
Actuarial loss recognised in the group statement of comprehensive income	(22)
Pension deficit as at 31 December 2012	**(43)**

The movement in the valuation was mainly due to a fall in the discount rate from 4.9% to 4.5%, driven by lower bond yields. The actuarial valuation of liabilities is particularly sensitive to changes in market conditions, which determine the discount rate, and changes to mortality assumptions. Further details are provided in note 18 on pages 120-124 which includes the sensitivity of the valuation to changes in these assumptions.

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

Overseas Pension Schemes

Overseas pension schemes' actuarial valuation at 31 December 2012 was £1.8m (2011: £1.3m). Further details are provided in note 18.

SOLVENCY

Total assets for solvency purposes are set out below. The 2012 position is an estimate of the amount which will be finalised in June 2013 for submission to the FSA:

	2012 £m	2011 £m
Net assets at 31 December	**1,592**	1,490
Subordinated notes and perpetual subordinated capital securities	893	898
Central assets	**2,485**	2,388
Callable Central Fund contributions	745	718
Other solvency adjustments	(15)	(15)
Central assets for solvency purposes	**3,215**	3,091
Solvency shortfalls	(94)	(115)
Excess of central assets over solvency shortfalls	**3,121**	2,976

Based on central assets for solvency purposes of £3.2bn (2011: £3.1bn), the estimated solvency ratio is 3420% (2011: 2688%). In setting contribution levels, account is taken of the Society's ICA to ensure that Lloyd's is prudently but competitively capitalised. Unencumbered central assets should be at least 250% of the Society's ICA on a business as usual basis.

CASH FLOWS AND LIQUIDITY

Cash and cash equivalents increased during the year ended 31 December 2012 by £60m to £187m (2011: £127m). Cash balances are maintained at appropriate levels to meet the short-term operating expenses of the Society. Any surplus cash balances are invested and are included as financial investments within the group balance sheet.

The Corporation's free cash balances are regularly monitored. Free cash represents the amounts, both at bank and on deposit, held in the UK and available to the Corporation to meet operating expenses, including those of overseas operations, excluding any balances held in respect of insurance and arbitration activities. Free cash balances at 31 December 2012 were £119m.

The liquidity of the Central Fund is monitored separately. Cash balances are managed to meet short-term operational commitments including the payment of drawdowns. Any surplus cash balances are invested in compliance with defined investment parameters approved by the Investment Committee.

CENTRAL FUND INVESTMENT STRATEGY

Central Fund investment strategy is considered in three parts. A prudent estimate of possible net cash flow requirements is used to determine the value of assets to be maintained for liquidity purposes. These are commingled with other liquid assets of Lloyd's group companies and invested in bank deposits and other short-term securities, with maturities of up to 12 months, with the objective to optimise current income, with low risk, while ensuring that all cash flow requirements are met as they arise.

A significant element of Central Fund assets is invested in fixed interest securities of high credit quality. The financial risk exposures represented by debt securities issued by the Society are also considered when determining the disposition of fixed interest investments. The aim is to optimise investment returns in the longer term while maintaining overall financial risk within defined limits.

A proportion of investments is maintained in more volatile asset classes. Here also, the aim is to optimise investment returns in the longer term without exceeding defined risk tolerances. These investments are diversified among different asset classes to help manage risk. Current exposures include global equities, high yield bonds, global property (via property-related equity securities), commodities and hedge funds. Fixed interest assets of high credit quality are managed 'in house' by Lloyd's. Third party investment managers are retained to manage investments in other asset classes, operating within clearly defined investment parameters specified by Lloyd's, which also monitors the activity of the external managers on an on-going basis.

Subsequent to the year end, Lloyd's Franchise Board has approved an increase in the risk appetite applying to Central Fund investments. This will be utilised to achieve a marginal shift in asset dispositions, from fixed interest to more volatile asset classes. This move is an extension of the existing investment strategy. Dispositions will be amended over an extended period to minimise the impact of short-term market movements.

FINANCIAL RISK MANAGEMENT AND TREASURY POLICIES

Overview

The Society's principal financial instruments comprise cash and cash equivalents, investments, borrowings and items that arise directly from operations such as trade receivables and payables. These include assets and liabilities of the Central Fund.

The Society's treasury operations and investments are managed by reference to established policies which are reviewed regularly by the Investment Committee. Policies for managing these risks, in particular credit risk, liquidity risk and market risk, are summarised below:

Credit Risk

Credit risk represents the risk of financial loss to the Society if a counterparty, or the issuer of a security, fails to meet its contractual obligations.

Trade and other receivables

The Society has established procedures to minimise the risk of default by trade and other receivables, which are mainly in respect of the Lloyd's market, the main source of income. These procedures include minimum standard checks for new market entrants.

Financial investments

A list of permissible bank counterparties, for the purposes of money-market investment, is maintained and restricted to banks having strong balance sheets and credit ratings. Investment parameters exist for all investment assets, controlling overall credit quality and ensuring appropriate risk diversification. Permitted counterparties to capital market transactions are also carefully controlled. All applicable parameters are reviewed regularly by the Investment Committee.

Guarantees

The Society provides certain financial guarantees as security for the underwriting activities of the members of Lloyd's. Further details are provided in note 26 on page 129.

Liquidity Risk

The value and term of short-term assets are carefully monitored against those of the Society's liabilities. The Society maintains sufficient liquid assets to meet liabilities as they fall due.

The liquidity of the Central Fund is monitored separately. Cash balances are managed to meet short-term operational commitments including the payment of drawdowns. Any surplus cash balances are invested in compliance with defined investment parameters approved by the Investment Committee.

The Society had no committed borrowing facilities as at 31 December 2012 (2011: £nil).

Market Risk

Market risk represents the risk that movements in financial markets will affect the financial position of the Society. Market risks arising from the disposition of the Society's investments are monitored against defined parameters using Value at Risk (VAR) methodology. The position is reviewed regularly by the Investment Committee. As investments are actively monitored on a fair value basis, all investments are designated as fair value through profit or loss.

FINANCIAL REVIEW CONTINUED

FINANCIAL RISK MANAGEMENT AND TREASURY POLICIES CONTINUED

Foreign Currency Risk

The Society enters into a variety of foreign exchange transactions in response to the foreign currency requirements of Lloyd's group companies. In managing the exposures arising from such foreign exchange activity, which may involve transactions for forward settlement, the net risk arising from all such exposures is considered and the level of this risk is managed within defined parameters. Consequently, while some net foreign exchange exposures may accrue to the Society from time to time as a result of this activity, the level of such exposures is carefully monitored and is not significant in the context of its combined activities.

Foreign currency exposures arising from overseas investments are considered together with foreign currency liabilities of the Society, and net foreign currency exposures arising are managed through the use of forward foreign exchange contracts.

Separately, the Society provides a Currency Conversion Service (CCS) to participating Lloyd's syndicates, converting insurance premiums and claims between pounds sterling and other Lloyd's settlement currencies as required. Foreign exchange exposures arising from the provision of the CCS are again managed on a net basis, within defined parameters. The CCS is operated separately from other foreign exchange activity of the Society because, under the terms of the service, any profit (or loss) arising from CCS exposures is distributed to (or collected from) syndicates participating in the CCS. Currency exposures arising from CCS activity consequently do not, ultimately, represent risks to the Society.

Interest Rate Risk

Borrowings from the Lloyd's market for the purpose of funding statutory insurance deposits do not bear a fixed rate of interest. Instead, investment returns earned on the borrowed assets are passed on to lenders. Consequently, no interest rate risk arises on such borrowings.

Short-term assets held by the Society may be significant at certain times but such balances cannot be accurately predicted. These are invested in money market instruments of up to 12 months duration with the objective of maximising current income while meeting liquidity requirements.

Interest rate risk arising from the requirement to make fixed rate coupon payments in respect of the Lloyd's subordinated loan notes and the perpetual subordinated capital securities is considered in conjunction with the market risk arising on the Society's investments. Overall risk is managed within defined limits, specified by the Franchise Board.

Capital Management

The Society monitors its capital to ensure that it maintains sufficient assets for both operational and solvency purposes. Further disclosures with regard to financial instruments are provided in note 22 on pages 126-127.

RELATED PARTY TRANSACTIONS

Except for disclosures made in note 25 (see pages 128-129), no related party had material transactions with the Society in 2012.

GOING CONCERN STATEMENT

After making enquiries and considering management's assessment of the financial position of the Society including forecast and stress tests undertaken on the Chain of Security, the members of the Council of Lloyd's have a reasonable expectation that the Society has adequate resources to continue in operational existence for the foreseeable future. For this reason, they continue to adopt the going concern basis in preparing the Society's financial statements.

The Chain of Security is discussed in more detail in 'How Lloyd's works – Security and Ratings' on page 10 and in 'Security underlying policies issued at Lloyd's' on page 55.

STATEMENT AS TO DISCLOSURE OF INFORMATION TO AUDITORS

Having made enquiries, the Council of Lloyd's confirms that:

- To the best of each Council member's knowledge and belief there is no information relevant to the preparation of the Society Report of which the Society's auditors are unaware.
- Each Council member has taken all the steps a Council member might reasonably be expected to have taken to be aware of relevant audit information and to establish that the Society's auditors are aware of that information.

OUTLOOK

Central assets, which exclude subordinated liabilities, are expected to remain stable at £2.5bn in 2013. On 26 March 2013, the Council of Lloyd's gave further undertakings to certain corporate members to use the New Central Fund to discharge the liability of those members where they have unpaid cash calls and do not have the resources to meet those cash calls. After taking account of the expiry of unutilised undertakings, the net increase in undertakings, which will be reflected as a charge in the 2013 income statement, is £28m (see note 4 on page 107). The operating expenses for the Corporation and its subsidiaries are budgeted to be £211m in 2013 reflecting the focus on financial discipline while delivering the Lloyd's strategy.

STATEMENT OF THE COUNCIL OF LLOYD'S RESPONSIBILITIES TO THE FINANCIAL STATEMENTS

The Council of Lloyd's is responsible for preparing the group financial statements in accordance with byelaws made under Lloyd's Act 1982 and International Financial Reporting Standards (IFRS) as adopted by the European Union.

The Council of Lloyd's is required to prepare group financial statements for each financial year which present fairly the financial position of the Society and the financial performance and cash flows of the Society for that period. In preparing those group financial statements, the Council of Lloyd's is required to:
- Select suitable accounting policies and then apply them consistently.
- Present information, including accounting policies, in a manner that provides relevant, reliable, comparable and understandable information.
- Provide additional disclosures when compliance with the specific requirements in IFRS is insufficient to enable users to understand the impact of particular transactions, other events and conditions on the Society's financial position and financial performance.
- State that the Society has complied with IFRS, subject to any material departures disclosed and explained in the group financial statements.

The Council of Lloyd's is responsible for keeping proper accounting records which disclose with reasonable accuracy at any time the financial position of the Society and enable it to ensure that the group financial statements comply with Article 4 of the IAS Regulation. As the Society's subordinated debt and perpetual subordinated capital securities are admitted to trading in a regulated market in the European Union, Council has elected to comply with Article 4, which requires group financial statements to be prepared in conformity with IFRS as adopted by the European Union. The Council of Lloyd's is also responsible for safeguarding the assets of the Society and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

The Council of Lloyd's is responsible for the maintenance and integrity of the corporate and financial information included on the Society's website (www.lloyds.com). Legislation in the United Kingdom governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

The Council of Lloyd's considers that the annual report, taken as a whole, is fair, balanced and understandable and provides the information necessary for stakeholders to assess the Society's performance, business model and strategy.

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

We have audited the group financial statements of the Society of Lloyd's ('the Society') for the year ended 31 December 2012, which comprise the group income statement, group statement of comprehensive income, group statement of financial position, group statement of changes in equity, group statement of cash flows and the related notes 1 to 26. The financial reporting framework that has been applied in their preparation is applicable law and International Financial Reporting Standards (IFRSs) as adopted by the European Union.

This report is made solely to the members of Lloyd's, as a body, in accordance with the Council of Lloyd's byelaws made under the Lloyd's Act 1982 and our engagement letter dated 13 December 2011. Our audit work has been undertaken so that we might state to the members of Lloyd's as a body those matters we are required to state to them in an auditor's report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Society and the members of Lloyd's as a body, for our audit work, for this report, or for the opinions we have formed.

RESPECTIVE RESPONSIBILITIES OF THE COUNCIL OF LLOYD'S AND AUDITORS

As explained more fully in the Statement of The Council of Lloyd's Responsibilities set out on page 91, The Council of Lloyd's is responsible for the preparation of the group financial statements and for being satisfied that they give a true and fair view. Our responsibility is to audit and express an opinion on the group financial statements in accordance with byelaws made under the Lloyd's Act 1982 and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

The Society has also instructed us to:

- Report to you our opinion as to whether the Report of the Remuneration Committee has been properly prepared in accordance with the basis described therein.
- Report if, in our opinion, the Society has not kept proper accounting records and if we have not received all the information and explanations we require for our audit.

SCOPE OF THE AUDIT OF THE FINANCIAL STATEMENTS

An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of: whether the accounting policies are appropriate to the group's circumstances and have been consistently applied and adequately disclosed; the reasonableness of significant accounting estimates made by The Council of Lloyd's; and the overall presentation of the financial statements. In addition, we read all the financial and non-financial information in the reports listed on page 58 to identify material inconsistencies with the audited financial statements. If we become aware of any apparent material misstatements or inconsistencies we consider the implications for our report.

OPINION ON FINANCIAL STATEMENTS

In our opinion the group financial statements:

- Give a true and fair view, of the state of the Society's affairs as at 31 December 2012 and of its surplus for the year then ended; and
- Have been properly prepared in accordance with IFRSs as adopted by the European Union; and
- Have been prepared in accordance with Council of Lloyd's byelaws made under the Lloyd's Act 1982.

OPINION ON OTHER MATTERS

In our opinion the part of the Report of the Remuneration Committee that has been described as audited has been properly prepared in accordance with the basis of preparation as described therein;

MATTERS ON WHICH WE ARE REQUIRED TO REPORT BY EXCEPTION

We have nothing to report in respect of the following matters where the Society has requested us to report to you if, in our opinion:

- Proper accounting records have not been kept; or
- We have not received all the information and explanations we require for our audit.

Ernst & Young LLP
Statutory Auditor, London
26 March 2013

GROUP INCOME STATEMENT

For the year ended 31 December 2012

	Note	2012 £000	2011 £000
Operating income		**212,666**	215,085
Central Fund contributions		**104,959**	94,693
General insurance net premium income		**4**	523
Other group income		**2,395**	6,598
Total income	3b	**320,024**	316,899
Central Fund claims and provisions incurred	4	**(26,447)**	(15,283)
Gross insurance claims	13	**(11,695)**	22,717
Insurance claims recoverable from reinsurers	13	**11,801**	1,492
Other group operating expenses	5	**(199,849)**	(248,582)
Operating surplus		**93,834**	77,243
Finance costs	7	**(62,198)**	(64,370)
Finance income			
– surplus on subordinated debt repurchase	17	**–**	4,248
– other	7	**114,855**	90,369
Unrealised exchange gains on borrowings		**6,107**	5,428
Share of profits of associates	12A	**5,945**	4,927
Surplus before tax		**158,543**	117,845
Tax charge	8A	**(35,509)**	(28,495)
Surplus for the year		**123,034**	89,350

GROUP STATEMENT OF COMPREHENSIVE INCOME

For the year ended 31 December 2012

	Note	2012 £000	2011 £000
Surplus for the year		**123,034**	89,350
Other comprehensive income			
Unrealised gain on revaluation of Lloyd's Collection		**488**	–
Actuarial (loss)/gain on pension liabilities			
– UK	18	**(22,243)**	(56,671)
– overseas	18	**(422)**	(216)
– associates	12A	**168**	(1,273)
Tax credit relating to components of comprehensive income	8A	**1,529**	11,963
Net other comprehensive income for the year		**(20,480)**	(46,197)
Total comprehensive income for the year		**102,554**	43,153

GROUP STATEMENT OF FINANCIAL POSITION

As at 31 December 2012

	Note	2012 £000	2011 £000
Assets			
Intangible assets	9	**266**	622
Lloyd's Collection	12B	**12,507**	12,019
Plant and equipment	10	**35,147**	31,408
Deferred tax asset	8C	**6,692**	2,264
Investment in associates	12A	**6,422**	5,220
Insurance contract assets	13	**25,720**	40,572
Pension asset	18	**–**	9
Loans recoverable	14	**45,138**	45,956
Financial investments	15	**2,842,055**	2,684,285
Inventories		**236**	198
Trade and other receivables due within one year	21	**77,476**	99,604
Prepayments and accrued income		**31,323**	33,727
Forward currency contracts	22	**59,586**	45,255
Cash and cash equivalents	16	**187,074**	127,282
Total assets		**3,329,642**	3,128,421
Equity and liabilities			
Equity			
Accumulated reserve	23	**1,579,806**	1,477,740
Revaluation reserve	23	**12,507**	12,019
Total equity		**1,592,313**	1,489,759
Liabilities			
Subordinated notes and perpetual subordinated capital securities	17	**893,328**	898,416
Insurance contract liabilities	13	**26,436**	49,479
Pension liabilities	18	**45,075**	25,016
Provisions	19	**27,343**	20,460
Loans funding statutory insurance deposits		**501,846**	352,318
Trade and other payables	20	**159,654**	188,328
Accruals and deferred income		**38,148**	45,374
Tax payable		**16,574**	2,632
Forward currency contracts	22	**28,925**	56,639
Total liabilities		**1,737,329**	1,638,662
Total equity and liabilities		**3,329,642**	3,128,421

Approved and authorised by the Council of Lloyd's on 26 March 2013 and signed on its behalf by

John Nelson
Chairman

Richard Ward
Chief Executive Officer

GROUP STATEMENT OF CHANGES IN EQUITY

For the year ended 31 December 2012

	Note	Accumulated reserve £000	Revaluation reserve £000	Total equity £000
At 1 January 2011		1,434,587	12,019	1,446,606
Total comprehensive income for the year		43,153	–	43,153
At 31 December 2011		1,477,740	12,019	1,489,759
Total comprehensive income for the year		**102,066**	**488**	**102,554**
At 31 December 2012	23	**1,579,806**	**12,507**	**1,592,313**

GROUP STATEMENT OF CASH FLOWS

For the year ended 31 December 2012

	Note	2012 £000	2011 £000
Surplus before tax		**158,543**	117,845
Finance income – surplus on subordinated note repurchase	17	**–**	(4,248)
Net finance income – other	7	**(52,657)**	(25,999)
Unrealised exchange gains on borrowings		**(6,107)**	(5,428)
Share of profits of associates	12A	**(5,945)**	(4,927)
Operating surplus		**93,834**	77,243
Central Fund claims and provisions incurred	4	**26,447**	15,283
Operating surplus before Central Fund claims and provisions		**120,281**	92,526
Adjustments for:			
Depreciation of plant and equipment	10	**5,535**	5,938
Amortisation of intangible assets	9	**415**	221
Impairment losses	9/10	**312**	716
Loss on sale and revaluation of fixed assets		**511**	1,111
Operating surplus before working capital changes and claims paid		**127,054**	100,512
Changes in pension obligations		**(2,597)**	(6,743)
Decrease in receivables		**28,852**	17,129
(Increase)/decrease in inventories		**(38)**	2
(Decrease)/increase in payables		**(51,599)**	40,308
Increase in provisions other than for Central Fund claims		**567**	788
Cash generated from operations before claims paid		**102,239**	151,996
Claims paid in respect of corporate/insolvent members	19	**(20,131)**	(16,910)
Tax and interest payments in respect of corporate/insolvent members	4	**–**	(2)
Claims paid in respect of individual members	4	**–**	(2)
Claims paid in respect of Limited Financial Assistance Agreements		**–**	(1)
Cash generated from operations		**82,108**	135,081
Tax paid		**(24,425)**	(83,747)
Net cash generated from operating activities		**57,683**	51,334
Cash flows from investing activities			
Purchase of plant, equipment and intangible assets		**(10,173)**	(7,577)
Proceeds from the sale of plant, equipment and intangible assets		**17**	30
Purchase of financial investments	15A/B	**(2,191,524)**	(3,756,363)
Receipts from the sale of financial investments	15A/B	**2,015,903**	3,637,135
Decrease in short-term deposits	15B	**20,994**	26,982
Gain on investments		**8,161**	8,621
Dividends received from associates	12A	**4,870**	5,096
Interest received		**57,712**	66,301
Dividends received	7	**3,533**	3,145
Realised loss on settlement of forward currency contracts		**(1,351)**	(10,140)
Net cash used in investing activities		**(91,858)**	(26,770)
Cash flows from financing activities			
Repurchase of subordinated notes	17	**–**	(23,120)
Interest paid on subordinated notes		**(61,117)**	(64,381)
Other interest paid		**(4,514)**	(1,025)
Increase in borrowings for statutory insurance deposits		**160,516**	46,973
Net cash generated/(used) in financing activities		**94,885**	(41,553)
Net increase/(decrease) in cash and cash equivalents		**60,710**	(16,989)
Effect of exchange rates on cash and cash equivalents		**(918)**	(1,299)
Cash and cash equivalents at 1 January	16	**127,282**	145,570
Cash and cash equivalents at 31 December	16	**187,074**	127,282

NOTES TO THE FINANCIAL STATEMENTS

As at 31 December 2012

1. BASIS OF PREPARATION AND CONSOLIDATION

In 1871, by Lloyd's Act 1871, the then existing association of underwriters was incorporated as the Society and Corporation of Lloyd's (the 'Society'). Its activities are accordingly governed by statute and, since 1982, have been managed by the Council of Lloyd's (the 'Council') pursuant to Lloyd's Act 1982.

The Society's main corporate purposes are to facilitate the carrying on of insurance business by members of Lloyd's and the advancement and protection of their interests in this context. The group financial statements of the Society of Lloyd's comprise the financial statements of the Society of Lloyd's and all its subsidiary undertakings, the Lloyd's Central Fund and the group's interest in associates as at each reporting date. Subsidiary undertakings are consolidated from the date of their acquisition, being the date on which the Society obtains control, and continue to be consolidated until the date that such control ceases. The financial statements are prepared using consistent accounting policies. All intra-group balances and transactions are eliminated in full.

The group financial statements have been prepared in accordance with International Financial Reporting Standards (as adopted by the European Union) and on a historic cost basis, except for financial assets and liabilities at fair value through profit or loss and the Lloyd's Collection, which are measured at fair value. Loans and receivables and other financial liabilities are carried at amortised cost. The group financial statements are presented in sterling and all values are rounded to the nearest thousand (£000).

The Society is regulated by the FSA.

2. PRINCIPAL ACCOUNTING POLICIES

General

In preparing the financial statements significant estimates and judgements are made in respect of some of the items reported. The main accounting policies identified involving such assessments are considered to be:

- Central Fund claims and provisions – undertakings (see note 2Q and note 19).
- Employee benefits – defined benefit pension scheme (see note 2I and note 18).
- Insurance contracts – liabilities and reinsurance assets (see note 2G and note 13).
- Loans recoverable – hardship loans (see note 2J and note 14).

A. Plant and equipment

Plant and equipment are held at cost less accumulated depreciation and any impairment in value.

Depreciation is charged on a straight line basis on the following principal categories:

- Plant, vehicles and equipment are depreciated over 3 to 25 years according to the estimated life of the asset.
- Equipment on hire or lease is depreciated over the period of the lease.

B. Software development

Costs incurred in acquiring and developing computer software are capitalised as intangible assets where the software supports a significant business system and the expenditure leads to the creation of an identifiable asset of value. Software development is held at cost less accumulated depreciation and any impairment in value. Capitalised software is amortised over three years.

C. Lloyd's Collection

Lloyd's Collection represents various paintings, antiques and artefacts which are included at fair value. Any revaluation surplus or deficit is recognised in the group statement of comprehensive income and is reflected in the revaluation reserve within the group statement of changes in equity.

D. Investment in associates and joint venture

An associate is an entity in which the Society has significant influence and which is not a subsidiary undertaking or joint venture. A joint venture is a joint arrangement whereby the parties that have joint control of the arrangement have rights to the net assets of the arrangement. The Society's investment in associates and joint venture are accounted for under the equity method of accounting.

Under the equity method, the investment in associates and joint venture are carried in the group statement of financial position at cost plus post-acquisition changes in the Society's share of net assets of the associate and joint venture. Goodwill relating to an associate is included in the carrying amount of the investment and is not amortised. After application of the equity method, the Society determines whether it is necessary to recognise any additional impairment loss with respect to the Society's net investment in an associate and joint venture. The group income statement reflects its share of the results of operations of the associates and joint venture. The Society's share of associates' other comprehensive income is recognised in the group statement of comprehensive income.

2. PRINCIPAL ACCOUNTING POLICIES CONTINUED

E. Impairment of assets

The Society performs annual impairment testing to assess whether there is an indication that an asset may be impaired. If any such indication exists the Society makes an estimate of the asset's recoverable amount. An asset's recoverable amount is the higher of an asset's fair value less costs to sell and its value in use. When the carrying amount exceeds its recoverable amount, the asset is considered impaired and written down to its recoverable amount.

F. Financial instruments

Financial assets

Initial recognition

Financial assets within the scope of IAS 39 are classified as financial assets at fair value through profit or loss or loans and receivables. The Society determines the classification of its financial assets at initial recognition.

Financial assets are recognised initially at fair value plus, in the case of loans and receivables, directly attributable transaction costs.

Purchases or sales of financial assets that require delivery of assets within a time frame established by regulation or convention in the market place (regular way purchases) are recognised on the settlement date.

The Society's financial assets include loans recoverable, statutory insurance deposits and other investments designated at fair value through profit or loss, trade and other receivables, accrued income, cash and cash equivalents and derivative assets.

Subsequent measurement

The subsequent measurement of financial assets depends on their classification as follows:

(i) Financial assets at fair value through profit or loss include derivative financial assets which are classified as held for trading, and financial assets designated upon initial recognition at fair value through profit or loss. They are carried in the group statement of financial position at fair value. Gains and losses arising from changes in their fair value are included in the group income statement in the period in which they arise. When financial assets are interest-bearing, interest calculated using the effective interest method is recognised in the group income statement.

(ii) Loans and receivables are non-derivative financial assets with fixed or determinable payment that are not quoted in an active market. They arise when the Society provides money, goods or services directly to a debtor with no intention of trading the receivable. These financial assets are carried at amortised cost using the effective interest method. Gains and losses are recognised in the group income statement when the loans and receivables are derecognised or impaired, as well as through the amortisation process.

Financial liabilities

Initial recognition

Financial liabilities within the scope of IAS 39 are classified as financial liabilities at fair value through profit and loss and other financial liabilities. The Society determines the classification of its financial liabilities at initial recognition.

Financial liabilities are recognised initially at fair value and in the case of other financial liabilities, directly attributable transaction costs. The Society's financial liabilities include trade and other payables, accruals, subordinated loan notes and perpetual capital securities and derivative liabilities.

Subsequent measurement

The subsequent measurement of financial liabilities depends on their classification as follows:

(i) Financial liabilities at fair value through profit or loss include derivative financial liabilities which are classified as held for trading. Gains or losses on liabilities held for trading are recognised in the group income statement.

(ii) Other financial liabilities, which include the subordinated loan notes and the subordinated perpetual capital securities, are carried at amortised cost using the effective interest method.

NOTES TO THE FINANCIAL STATEMENTS CONTINUED

As at 31 December 2012

2. PRINCIPAL ACCOUNTING POLICIES CONTINUED

F. Financial instruments continued

Fair value of financial instruments

Financial instruments are categorised for disclosure purposes into a hierarchy consisting of three levels depending upon the source of input as required by IFRS 7 (Financial Instruments: Disclosures).

Level 1 – The fair value of financial instruments which are actively traded in organised financial markets is determined by reference to quoted market bid prices at the close of business on the reporting date. The quoted market price used for financial assets held by the Society is the current bid price; the appropriate quoted market price for financial liabilities is the current offer price.

Level 2 – The fair value of financial instruments for which quoted market prices are not used for valuation purposes are derived both directly and indirectly from observable market conditions. The fair value of forward currency contracts is calculated by reference to current forward exchange rates for contracts with similar maturity profiles. The nominal value less estimated credit adjustments of trade receivables and payables are assumed to approximate to their fair values.

Level 3 – The fair value of financial instruments for which there is no observable quoted market price is determined by a variety of methods incorporating assumptions that are based, so far as possible, on market conditions existing at each reporting date.

Amortised cost of financial instruments

Amortised cost is computed using the effective interest method less any allowance for impairment and principal repayment or reduction. The calculation takes into account any premium or discount on acquisition and includes transaction costs and fees that are an integral part of the effective interest rate.

Impairment of financial assets

The Society assesses at each reporting date whether there is an indication that an asset may be impaired. If any such indication exists, the asset is written down to its recoverable amount.

Derecognition of financial instruments

Other investments are derecognised when the right to receive cash flows from the asset have expired or, in the case of a financial liability, when the obligation under the liability is cancelled or discharged.

G. Insurance contracts (liabilities and reinsurance assets)

In accordance with IFRS 4 (Insurance contracts), the Society applies established UK accounting practices for insurance contracts, modified as appropriate to comply with the IFRS framework and applicable standards. This includes the application of the Statement of Recommended Practice (SORP) on accounting for insurance business issued by the Association of British Insurers in December 2005 (amended December 2006).

Insurance contracts are defined as those containing significant insurance risk which arises if, and only if, an insured event could cause an insurer to pay significant additional benefits in any scenario, excluding scenarios that lack commercial substance, at the inception of the contract. Such contracts remain insurance contracts until all rights and obligations are extinguished or expired.

An impairment review is performed on all reinsurance assets when an indication of impairment occurs. Reinsurance assets are impaired only if there is objective evidence that the Society may not receive all amounts due to it under the terms of the contract and this can be measured reliably.

H. Inventories

Inventories are stated at the lower of cost and net realisable value on a first in, first out (FIFO) basis. Net realisable value is the estimated selling price in the ordinary course of business less estimated costs necessary to make the sale.

I. Employee benefits

The Society accounts for pensions and similar benefits (principally income protection due to ill-health) under IAS 19 (Employee Benefits). The Society operates a number of defined benefit pension schemes in which obligations are measured at discounted present value using the projected unit credit method, while plan assets are recorded at fair value. The operating and financing income and costs of the scheme are recognised in the group income statement. Service costs, financing income (expected return on plan assets), and costs are recognised in the periods in which they arise. Actuarial gains and losses are recognised in full in the group statement of comprehensive income in the period in which they occur. Costs of discretionary awards in respect of past service are recognised in the group income statement when amounts are committed to be paid or there is a constructive liability to make awards to pensioners.

Payments to separately administered defined contribution schemes are charged to the group income statement as they fall due.

Short-term bonuses are accrued in the period to which they relate, long-term bonuses are recognised over their vesting period.

2. PRINCIPAL ACCOUNTING POLICIES CONTINUED

J. Loans recoverable

Recoverable Central Fund loans made to hardship members are managed on a fair value basis and are designated as fair value through profit or loss.

Any gains and losses arising from changes in the fair value are included in the group income statement in the period in which they arise.

Fair values are determined by reference to an estimate of the valuation of the underlying securities at the dates at which they may be exercised and discounted back to present day values. A security can normally only be exercised on the later date of death of the member or of their spouse. This date is assessed using actuarial assumptions.

K. Taxation

Corporation tax on the surplus or deficit for the periods presented comprises current and deferred tax. Corporation and income tax is recognised in the group income statement except to the extent that it relates to items recognised directly in the group statement of comprehensive income, in which case it is recognised in the group statement of comprehensive income.

Current tax is the expected tax payable on the taxable income for the year, using tax rates enacted or substantially enacted at the reporting date, and any adjustment to tax payable in respect of previous years.

Deferred tax liabilities are recognised for all taxable temporary differences and deferred tax assets are recognised for all deductible temporary differences and unutilised tax losses to the extent that it is probable that taxable profits will be available against which the deductible temporary differences or tax losses can be utilised.

Deferred tax is measured on an undiscounted basis at the rates that are expected to apply in the periods in which timing differences reverse, based on tax rates and laws enacted or substantially enacted at the reporting date.

L. Subordinated notes and perpetual subordinated capital securities

Subordinated debt is initially recognised at fair value, being the fair value of the consideration received net of issue costs associated with the borrowing.

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

M. Cash and cash equivalents

For the purposes of the group statement of cash flows, cash comprises cash at banks and demand deposits, and cash equivalents comprise highly liquid investments, that are convertible into cash with an insignificant risk of changes in value, with original maturities of less than three months.

N. Income recognition

Income, which is stated net of value added tax, comprises the fair value of amounts receivable. Income is recognised as follows:

(i) Members' subscriptions, market charges and other services
Members' subscriptions, market charges and other services are recognised in the period for which the service is provided. They are recognised on a basis that reflects the timing, nature and value of the benefits provided.

(ii) Central Fund contributions
Central Fund contributions from members underwriting in the year are recognised when no significant uncertainty as to collectability exists.

(iii) Interest income
Interest receivable is recognised in the group income statement on a time apportioned basis using the effective interest method. Any unwinding of discount is recognised as interest income.

(iv) Dividend income
Dividend income from equity investments is included in the group income statement on the ex-dividend date.

(v) Other income
Other income is recognised when recoverability is agreed.

O. Insurance premiums

Insurance premiums represent premiums on business incepting during the year, together with adjustments for premiums written in previous accounting periods. Premium income is recognised over the period of cover. Premiums written are stated before deduction of commissions but net of taxes, duties levied on premiums and other similar deductions.

NOTES TO THE FINANCIAL STATEMENTS CONTINUED

As at 31 December 2012

2. PRINCIPAL ACCOUNTING POLICIES CONTINUED

P. Insurance claims

Claims incurred in insurance related activities consist of claims and claims handling expenses paid during the year together with the movement in outstanding claims. Outstanding claims are the estimated final cost of all claims incurred but not settled at the reporting date, including claims incurred but not reported (IBNR). Outstanding claims are not discounted. Subsequent information and events may result in the ultimate liability being less than, or greater than, the amount provided. Any differences between the provision and subsequent settlements are reflected within the group financial statements of later years.

Q. Central Fund claims and provisions

Central Fund claims and provisions (undertakings) are accounted for when they are approved by the Council and become contractual commitments. These undertakings are granted wholly at the discretion of the Council for a fixed period, normally one year, and therefore are not deemed to be constructive obligations, except for renewals of those commitments previously granted. For those corporate members in provisional liquidation, the Council provides a supporting commitment, which will ensure that in no circumstance will an insurance creditor receive less than the amount it would have received in a winding up commencing on the date of the provisional liquidation. As the supporting undertakings are legally enforceable commitments, an estimate of their value is included within provisions in the group financial statements and changes during the period are reflected in the group income statement.

Recoveries in respect of undertakings previously given are credited to the group income statement when contractually committed to be received.

R. Foreign currency and derivative instruments

Foreign currency translation

(i) Functional and presentation currency
The group financial statements are presented in pound sterling, which is the Society's functional and presentation currency. Items included in the financial statements of each of the Society's entities are measured using the currency of the primary economic environment in which the entity operates (the functional currency).

(ii) Transactions and balances
Transactions in foreign currencies are recorded at the exchange rate prevailing on the date of the transaction. At each reporting date, monetary assets and liabilities denominated in foreign currencies are retranslated at the exchange rate prevailing at the reporting date. Translation differences on monetary items are taken to the group income statement.

Translation differences on non-monetary items measured at fair value are reported as part of the fair value gain or loss and included in the group income statement.

The results and financial position of overseas Society operations are translated into pound sterling as follows:

- Assets and liabilities are translated at the closing rate at the date of that statement of financial position.
- Income and expenses are translated at the average exchange rate for the year.
- Any resulting exchange differences are recognised in the group income statement.

The Society enters into forward currency contracts to manage exposures to fluctuation in foreign exchange rates, and to provide a service to the Lloyd's market. Where gains and losses are not expected to be refunded or recovered from the Lloyd's market, these amounts are taken to the group income statement.

The principal exchange rates were:

	2012	2011
US$	**1.63**	1.55
Can$	**1.62**	1.58
Euro	**1.23**	1.20

S. Leases

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

2. PRINCIPAL ACCOUNTING POLICIES CONTINUED

T. New standards and interpretations not applied

The International Accounting Standards Board and International Financial Reporting Interpretations Committee have issued the following standards and interpretations relevant to the Society. At the date these financial statements were approved, the following standards were in issue but not effective:

	Effective date (for accounting periods beginning on or after)
International Accounting Standards	
IAS 1 Presentation of Financial Statements	1 January 2013
IAS 19R Employee Benefits	1 January 2013
IFRS 9 Financial Instruments	1 January 2015
IFRS 10 Consolidated Financial Statements	1 January 2014
IFRS 11 Joint Arrangements	1 January 2014
IFRS 12 Disclosure of Interests in Other Entities	1 January 2014
IFRS 13 Fair Value Measurement	1 January 2013

With the exception of revisions to IAS 19R Employee Benefits, the Council does not consider that the adoption of the above standards will have a material impact on the Society's financial statements. IAS 19R introduces the concept of net interest whereby within the income statement the expected rate of return is restricted to the discount rate on pension obligations. It is anticipated that in 2013 the charge to the income statement will increase by £6m due to this change, which will be reported through the statement of comprehensive income.

3. SEGMENTAL ANALYSIS

Segment information is presented in respect of the Society's business segments. The primary business segments are based on the Society's management and internal reporting structure.

Intra-segment pricing is determined on an arm's-length basis.

Segment results, assets and liabilities include items directly attributable to a segment as well as those that can be allocated on a reasonable basis.

Segment capital expenditure is the total cost incurred during the year to acquire segment assets that are expected to be used for more than one period.

Segment information in respect of geographical location is not presented. The Society's main source of income is from the Lloyd's market based primarily in the UK, which includes the recovery of costs in respect of overseas operations. The recovery of overseas operating costs is collected in the UK from the Lloyd's market.

The Society's primary business segments are as follows:

(i) Corporation of Lloyd's and non-insurance related subsidiary undertakings: the main corporate purposes are to facilitate the carrying on of insurance business by members of Lloyd's and the advancement and protection of their interests in this context. The activities of authorised insurance company subsidiary undertakings are excluded from this business segment.

(ii) Lloyd's Central Fund: these funds, comprising the New Central Fund and the 'Old' Central Fund, are assets of the Society and are held and administered at the discretion of the Council, primarily as funds available for the protection of policyholders. Unless the approval of members is obtained, the New Central Fund may not be used for the purposes of extinguishing or reducing liabilities which have been reinsured by Equitas.

(iii) Insurance activities: the Society has two principal insurance company subsidiary undertakings, Centrewrite Limited and Lloyd's Insurance Company (China) Limited. Centrewrite provides Exeat insurance to resigned members participating only on run-off syndicates allowing an early exit from Lloyd's, and Estate Protection Plan insurance to members. Centrewrite has also reinsured the members of Syndicate 535 and 1204 for outstanding claims in respect of certain years of account, these contracts have been successfully novated from 1 January 2012. Lloyd's Insurance Company (China) Limited underwrites onshore reinsurance business in China and direct insurance risks in the Shanghai municipality.

NOTES TO THE FINANCIAL STATEMENTS CONTINUED

As at 31 December 2012

3. SEGMENTAL ANALYSIS CONTINUED

(a) Information by business agent	Note	2012 Corporation of Lloyd's £000	2012 Lloyd's Central Fund £000	2012 Insurance activities £000	2012 Society total £000
Segment income					
Total income	3b	208,836	105,636	5,552	320,024
Segment operating expenses					
Central Fund claims and provisions incurred	4	–	(26,447)	–	(26,447)
Gross claims incurred		–	–	(11,695)	(11,695)
Claims recoverable from reinsurers		–	–	11,801	11,801
Other group operating expenses:					
Employment (including pension costs)	6	(88,591)	–	(3,710)	(92,301)
Premises		(39,926)	–	(734)	(40,660)
Legal and professional	5	(13,166)	(598)	(306)	(14,070)
Systems and communications		(22,229)	–	(597)	(22,826)
Other		(24,592)	(5,377)	(23)	(29,992)
Total other group operating expenses		(188,504)	(5,975)	(5,370)	(199,849)
Total segment operating expenses		(188,504)	(32,422)	(5,264)	(226,190)
Total segment operating surplus		20,332	73,214	288	93,834
Finance costs	7	(77)	(62,121)	–	(62,198)
Finance income					
Surplus on subordinated debt repurchase	17	–	–	–	–
Other	7	664	113,052	1,139	114,855
Unrealised exchange losses on borrowings		–	6,107	–	6,107
Share of profits of associates	12A	5,945	–	–	5,945
Segment surplus before tax		26,864	130,252	1,427	158,543
Tax charge					(35,509)
Surplus for the year					123,034
Segment assets and liabilities					
Investment in associates		6,422	–	–	6,422
Other assets		684,039	2,442,449	190,040	3,316,528
Segment assets		690,461	2,442,449	190,040	3,322,950
Tax assets					6,692
Total assets					3,329,642
Segment liabilities		(673,279)	(954,721)	(92,755)	(1,720,755)
Tax liabilities					(16,574)
Total liabilities					(1,737,329)
Other segment information					
Capital expenditure	9/10	9,593	–	580	10,173
Depreciation	10	5,256	–	279	5,535
Amortisation of intangible assets	9	30	–	385	415
Impairment of long-term assets	9/10	312	–	–	312
Average number of UK employees (permanent and contract)		717	–	–	717
Average number of overseas employees (permanent and contract)		117	–	37	154
Average number of total employees (permanent and contract)		834	–	37	871

Average staff numbers shown above are on a full-time equivalent basis.

3. SEGMENTAL ANALYSIS CONTINUED

(a) Information by business agent continued	Note	2011 Corporation of Lloyd's £000	2011 Lloyd's Central Fund £000	2011 Insurance activities £000	2011 Society total £000
Segment income					
Total income	3b	211,676	99,739	5,484	316,899
Segment operating expenses					
Central Fund claims and provisions incurred	4	–	(15,283)	–	(15,283)
Gross claims released		–	–	22,717	22,717
Claims recoverable from reinsurers		–	–	1,492	1,492
Other group operating expenses:					
Employment (including pension costs)	6	(113,226)	–	(3,189)	(116,415)
Premises		(43,314)	–	(695)	(44,009)
Legal and professional	5	(18,441)	(1,026)	(240)	(19,707)
Systems and communications		(27,602)	–	(363)	(27,965)
Other		(28,334)	(6,755)	(5,397)	(40,486)
Total other group operating expenses		(230,917)	(7,781)	(9,884)	(248,582)
Total segment operating expenses		(230,917)	(23,064)	14,325	(239,656)
Total segment operating surplus		(19,241)	76,675	19,809	77,243
Finance costs	7	(62)	(64,308)	–	(64,370)
Finance income					
Surplus on subordinated debt repurchase	17	–	4,248	–	4,248
Other	7	1,283	85,937	3,149	90,369
Unrealised exchange losses on borrowings		–	5,428	–	5,428
Share of profits of associates	12A	4,927	–	–	4,927
Segment surplus before tax		(13,093)	107,980	22,958	117,845
Tax charge					(28,495)
Surplus for the year					89,350
Segment assets and liabilities					
Investment in associates		5,220	–	–	5,220
Other assets		535,681	2,355,433	229,823	3,120,937
Segment assets		540,901	2,355,433	229,823	3,126,157
Tax assets					2,264
Total assets					3,128,421
Segment liabilities		(521,995)	(982,941)	(131,094)	(1,636,030)
Tax liabilities					(2,632)
Total liabilities					(1,638,662)
Other segment information					
Capital expenditure	9/10	6,180	–	1,397	7,577
Depreciation	10	5,765	–	173	5,938
Amortisation of intangible assets	9	56	–	165	221
Impairment of long-term assets	9/10	716	–	–	716
Average number of UK employees (permanent and contract)		743	–	3	746
Average number of overseas employees (permanent and contract)		128	–	35	163
Average number of total employees (permanent and contract)		871	–	38	909

NOTES TO THE FINANCIAL STATEMENTS CONTINUED

As at 31 December 2012

3. SEGMENTAL ANALYSIS CONTINUED

(b) Income	Corporation of Lloyd's 2012 £000	Corporation of Lloyd's 2011 £000	Lloyd's Central Fund 2012 £000	Lloyd's Central Fund 2011 £000	Insurance activities 2012 £000	Insurance activities 2011 £000	Society total 2012 £000	Society total 2011 £000
Market charges								
Managing agents and syndicates	**83,442**	77,767	**–**	–	**5,568**	4,693	**89,010**	82,460
Members and members' agents	**10,046**	10,206	**–**	–	**–**	–	**10,046**	10,206
Performance and risk management charge	**400**	14,599	**–**	–	**–**	–	**400**	14,599
Total market charges	**93,888**	102,572	**–**	–	**5,568**	4,693	**99,456**	107,265
Members' subscriptions	**99,801**	91,610	**–**	–	**–**	–	**99,801**	91,610
Other charges	**13,429**	15,942	**–**	–	**(20)**	268	**13,409**	16,210
Total operating income	**207,118**	210,124	**–**	–	**5,548**	4,961	**212,666**	215,085
Central Fund contributions	**–**	–	**104,959**	94,693	**–**	–	**104,959**	94,693
General insurance net premium income	**–**	–	**–**	–	**4**	523	**4**	523
Other group income	**1,718**	1,552	**677**	5,046	**–**	–	**2,395**	6,598
Total income	**208,836**	211,676	**105,636**	99,739	**5,552**	5,484	**320,024**	316,899

During the year, members paid to the Corporation of Lloyd's (members' subscriptions) and to the Central Fund (Central Fund contributions from members) at 0.5% of their syndicate forecast written premium (2011: 0.5%). Central Fund contributions in the first three years of membership are charged at 2% of syndicate forecast written premium. The ultimate amounts to be retained by the Corporation of Lloyd's and the Central Fund for 2012 will be based on actual 2012 written premiums, of members, the quantification of which will not be known until 2014. The £105m (Central Fund contribution from members) and £100m (members' subscriptions) included in the group income statement are based on the present best estimates of the ultimate amounts that will be retained by the Central Fund and the Corporation of Lloyd's respectively.

Other group income includes foreign exchange gains, market settlement recoveries which represent continuing debt recoveries from the 1996 'Reconstruction and Renewal' settlement and recoveries in respect of undertakings given by the Central Fund.

4. CENTRAL FUND CLAIMS AND PROVISIONS

	Note	2012 £000	2011 £000
Net undertakings granted	19	**(26,494)**	(15,515)
Provisions released in respect of Limited Financial Assistance Agreements	19	**47**	236
Claims payable in respect of individual members		**–**	(2)
Tax and interest payable in respect of insolvent members		**–**	(2)
Central Fund claims and provisions incurred		**(26,447)**	(15,283)

The Council has given undertakings with financial limits to certain corporate members to use the New Central Fund to discharge the liability of those members where they have unpaid cash calls and do not have the resources to meet those cash calls. The purpose of these undertakings is primarily to allow valid claims made on policies underwritten by those insolvent members to continue to be paid in full. Undertakings are accounted for when they are approved by the Council and become contractual commitments. These undertakings are granted wholly at the discretion of the Council principally on an annual basis and therefore are not deemed constructive obligations (see note 19). Unutilised undertakings as at 31 December 2012 were £14m, of these £12m were called after the year end, the balance of £2m has been replaced by further annual undertakings given on 26 March 2013 that total £30m, a net increase of £28m. No provision has been included in these financial statements in respect of these further undertakings.

For those corporate members in provisional liquidation, the Council has also provided supporting commitments, which will ensure that in no circumstance will an insurance creditor receive less than the amount it would have received in a winding up commencing on the date of the provisional liquidation.

As the supporting undertakings are legally enforceable commitments, an estimate of their value, if applicable, has been included within provisions in the group financial statements and changes during the year are reflected in the group income statement, as shown in the table above.

NOTES TO THE FINANCIAL STATEMENTS CONTINUED

As at 31 December 2012

5. OTHER GROUP OPERATING EXPENSES

	Note	2012 Corporation of Lloyd's £000	2012 Lloyd's Central Fund £000	2012 Insurance activities £000	2012 Total £000
Other group operating expenses include:					
Employment costs	6	**88,591**	–	**3,710**	**92,301**
Operating lease rentals – Lloyd's 1986 building		**16,767**	–	–	**16,767**
Operating lease rentals – other		**6,946**	–	–	**6,946**
Professional fees, including legal fees and related costs		**11,688**	**397**	**286**	**12,371**
Audit		**442**	**201**	**20**	**663**
Other services pursuant to legislation payable to Ernst & Young LLP		**504**	–	–	**504**
Actuarial services payable to Ernst & Young LLP		**45**	–	–	**45**
Tax services payable to Ernst & Young LLP		**98**	–	–	**98**
Other services payable to Ernst & Young LLP		**389**	–	–	**389**
Total legal and professional fees		**13,166**	**598**	**306**	**14,070**
Charitable donations		**292**	–	–	**292**

	Note	2011 Corporation of Lloyd's £000	2011 Lloyd's Central Fund £000	2011 Insurance activities £000	2011 Total £000
Other group operating expenses include:					
Employment costs	6	113,226	–	3,189	116,415
Operating lease rentals – Lloyd's 1986 building		16,767	–	–	16,767
Operating lease rentals – other		9,400	–	–	9,400
Professional fees, including legal fees and related costs		17,252	797	198	18,247
Audit		357	229	42	628
Other services pursuant to legislation payable to Ernst & Young LLP		449	–	–	449
Actuarial services payable to Ernst & Young LLP		50	–	–	50
Tax services payable to Ernst & Young LLP		65	–	–	65
Other services payable to Ernst & Young LLP		268	–	–	268
Total legal and professional fees		18,441	1,026	240	19,707
Charitable donations		618	–	–	618

Other services pursuant to legislation payable to Ernst & Young LLP includes work undertaken on the Aggregate Accounts, pro forma financial statements and regulatory returns.

6. EMPLOYMENT

	Note	2012 £000	2011 £000
Salaries and wages (including performance-related bonus)		**60,898**	62,351
Lloyd's Performance Plan (excluding social security costs – note 19)		**6,912**	316
Lloyd's Pension Scheme costs	18	**2,195**	24,511
Other pension costs		**1,565**	1,584
Social security costs		**6,573**	6,994
Severance costs		**86**	5,044
Contract and agency staff		**5,736**	7,042
Other employment costs		**8,336**	8,573
		92,301	116,415

The emoluments of the Chairman, CEO, members of the Council and Franchise Board are included in the report of the Remuneration Committee on page 80.

7. FINANCE

	Note	2012 Corporation of Lloyd's £000	2012 Lloyd's Central Fund £000	2012 Insurance activities £000	2012 Total £000	2011 Total £000
Finance costs						
Interest payable on financial liabilities measured at amortised cost		–	**(61,103)**	–	**(61,103)**	(63,268)
Other interest payable and similar charges		**(77)**	–	–	**(77)**	(62)
Amortisation of issue costs and discount		–	**(1,018)**	–	**(1,018)**	(1,040)
Total interest payable on financial liabilities	3a	**(77)**	**(62,121)**	–	**(62,198)**	(64,370)
Finance income						
Interest and similar income		**1,496**	**53,703**	**2,399**	**57,598**	64,393
Dividends received		–	**3,533**	–	**3,533**	3,145
Realised and unrealised returns on investments designated at fair value through profit or loss		**(931)**	**22,078**	**(1,260)**	**19,887**	48,209
Unrealised fair value movement of forward contracts held for trading		**99**	**31,994**	–	**32,093**	(10,306)
Realised fair value movement of forward contracts held for trading		–	**(1,351)**	–	**(1,351)**	(10,140)
Increase/(decrease) in valuation of loans recoverable designated at fair value through profit or loss		–	**3,095**	–	**3,095**	(4,932)
Total finance income	3a	**664**	**113,052**	**1,139**	**114,855**	90,369

8. TAXATION

A. Tax analysis of charge in the year

	Note	2012 £000	2011 £000
Current tax:			
Corporation tax based on profits for the year at 24.5% (2011: 26.5%)		**(37,041)**	(30,031)
Adjustments in respect of previous years		**(1,132)**	1,719
Foreign tax suffered		**(194)**	(1,799)
Total current tax		**(38,367)**	(30,111)
Deferred tax:			
Origination and reversal of timing differences			
current year		**2,906**	1,944
prior year		**(48)**	(328)
Tax charge recognised in the group income statement	8B	**(35,509)**	(28,495)
Analysis of tax charge recognised in the group statement of comprehensive income:			
Deferred tax:			
Unrealised gain on revaluation of Lloyd's Collection		**128**	–
Tax credit/(charge) on actuarial loss on pension liabilities:			
group		**1,442**	11,626
associates		**(41)**	337
Tax credit recognised in the group statement of comprehensive income		**1,529**	11,963
Total tax charge		**(33,980)**	(16,532)

NOTES TO THE FINANCIAL STATEMENTS CONTINUED

As at 31 December 2012

8. TAXATION CONTINUED

B. Reconciliation of effective Tax rate

	Note	2012 %	2012 £000	2011 %	2011 £000
Surplus on ordinary activities before tax			**158,543**		117,845
Corporation tax at 24.5% (2011: 26.5%)		**24.5%**	**(38,843)**	26.5%	(31,229)
Expenses not deductible for tax purposes		**0.3%**	**(459)**	2.6%	(3,112)
Utilisation of tax credits		**(0.1%)**	**170**	(0.0%)	50
Overseas tax		**0.1%**	**(194)**	0.7%	(788)
Other		**(1.1%)**	**1,717**	(1.4%)	1,700
Deferred tax adjustment relating to change in tax rate		**(2.0%)**	**3,280**	(3.0%)	3,494
Deferred tax prior year adjustments		**0.0%**	**(48)**	0.3%	(329)
Adjustments in respect of previous years		**0.7%**	**(1,132)**	(1.5%)	1,719
Tax charge	8A	**22.4%**	**(35,509)**	24.2%	(28,495)

C. Deferred tax

	2012 Balance at 1 January £000	2012 Income Statement £000	2012 Equity £000	2012 Balance at 31 December £000
Plant and equipment	**4,867**	**(1,022)**	**–**	**3,845**
Loans recoverable	**(4,302)**	**1,334**	**–**	**(2,968)**
Financial investments	**(2,530)**	**(1,448)**	**–**	**(3,978)**
Pension liabilities	**5,920**	**2,583**	**1,442**	**9,945**
Other employee benefits	**1,316**	**1,411**	**–**	**2,727**
Other items	**(3,007)**	**–**	**128**	**(2,879)**
	2,264	**2,858**	**1,570**	**6,692**

In 2012, there were no unrecognised deductible temporary differences (2011: nil).

On 21 March 2012, the Chancellor announced that the corporation tax rate from 1 April 2012 would be 24%. The previously enacted corporation tax rate reduction from 26% to 25% was reflected in the deferred tax calculations as at 31 December 2011. A further reduction to the corporation tax rate to 23%, with effect from 1 April 2013, was enacted by Finance Act 2012 in July 2012. The effect of this further 1% reduction in the tax rate on the deferred tax balances has been reflected in the amounts recognised at 31 December 2012.

On 5 December 2012, the Chancellor announced as part of the autumn statement his intention to make a further 2% reduction in the tax applicable from 1 April 2014. In addition to this, in the Budget on 20 March 2013 the Chancellor also announced his intention to make a further reduction in the rate of UK corporation tax to 20% from April 2015. The reductions down to 21% and 20% were not substantively enacted at 31 December 2012 and are therefore not reflected in the amounts recognised at that date. The impact of the announced rate change from 23% to 20% on the deferred tax asset is estimated to be a reduction of approximately £833k.

	2011 Balance at 1 January £000	2011 Income Statement £000	2011 Equity £000	2011 Balance at 31 December £000
Plant and equipment	5,496	(629)	–	4,867
Loans recoverable	(5,808)	1,506	–	(4,302)
Financial investments	(4,184)	1,654	–	(2,530)
Pension (assets)/liabilities	(5,996)	290	11,626	5,920
Other employee benefits	2,760	(1,444)	–	1,316
Other items	(3,245)	238	–	(3,007)
	(10,977)	1,615	11,626	2,264

9. INTANGIBLE ASSETS – SOFTWARE DEVELOPMENT

	£000
Cost:	
At 1 January 2011	4,511
Additions	1,086
Disposals	(664)
At 31 December 2011	4,933
Additions	**172**
Disposals	**(286)**
At 31 December 2012	**4,819**
Amortisation:	
At 1 January 2011	4,185
Charge for the year	221
Impairment losses	3
Disposals	(98)
At 31 December 2011	4,311
Charge for the year	**415**
Impairment losses	**–**
Disposals	**(173)**
At 31 December 2012	**4,553**
Net book value at 31 December 2012	**266**
Net book value at 31 December 2011	622

Impairment losses
As part of an assessment of the carrying value of assets, £nil was written off in 2012 (2011: £3,000). The impairment and amortisation charges are included within other group operating expenses.

10. PLANT AND EQUIPMENT

	£000
Cost:	
At 1 January 2011	70,256
Additions	6,491
Disposals	(7,065)
At 31 December 2011	69,682
Additions	**10,001**
Disposals	**(3,767)**
At 31 December 2012	**75,916**
Depreciation and impairment:	
At 1 January 2011	38,113
Depreciation charge for the year	5,938
Impairment losses	713
Disposals	(6,490)
At 31 December 2011	38,274
Depreciation charge for the year	**5,535**
Impairment losses	**312**
Disposals	**(3,352)**
At 31 December 2012	**40,769**
Net book value at 31 December 2012	**35,147**
Net book value at 31 December 2011	31,408

NOTES TO THE FINANCIAL STATEMENTS CONTINUED

As at 31 December 2012

10. PLANT AND EQUIPMENT CONTINUED

Impairment losses

Impairment reviews are undertaken annually in which assets within plant and other assets have their recoverable amounts reassessed. As part of this assessment of the carrying value of assets, £312,000 was written off in 2012 (2011: £713,000). The charge is included within other group operating expenses.

11. INVESTMENTS IN SUBSIDIARY UNDERTAKINGS AND ASSOCIATES

Entity	Nature of business	Proportion of equity capital held
Principal subsidiary undertakings		
Additional Securities Limited	Provision of deposits overseas on behalf of Lloyd's underwriters to comply with local insurance regulations	100%
Centrewrite Limited	Authorised UK insurance company	100%
Lloyd's Insurance Company (China) Limited	Authorised insurance company in China (incorporated in 2007 with a share capital of Rmb 200,000,000)	100%
Associates and Joint Venture		
Ins-sure Holdings Limited	Provision of premiums and claims accounting and settlement, policy production and ancillary insurance services principally to the London insurance market	25%
Xchanging Claims Services Limited	Provision of claims and recoveries services	50%
The Message Exchange Limited	Provision of messaging infrastructure to the London insurance market	Limited by Guarantee 25%

The issued share capital of Ins-sure Holdings Limited is £4,000. There are three classes of shares. The Society holds 1,000,000 B shares of 0.1p each that have the right to participate in 25% of any profits available for distribution.

The issued share capital of Xchanging Claims Services Limited is £4,001. There are three classes of shares. The Society holds 1,000 A shares of £1 each and 2,001 C shares of £1 each. The A and C shares have the following rights with respect to dividends:

(a) The C shares carry a right to a fixed cumulative preference dividend of 5% calculated on the nominal capital and a variable participating dividend calculated by reference to trading profits.

(b) The A shares participate in 50% of any profits available for distribution after taking account of the dividend rights outlined above.

The Society entered into a joint venture agreement with International Underwriting Association; London and International Brokers' Association; and Lloyd's Market Association for an equal participation in The Message Exchange Limited (TMEL) which was incorporated on 27 August 2010.

TMEL operates The Exchange – a simple messaging hub provided to the London insurance market to support its efforts to extend the use of electronic processing of business. As at 31 December 2012, the net assets of TMEL have no material impact on the Society accounts.

Welcome to Lloyd's
Strategic overview
Market performance
Market results
Society report

12. INVESTMENTS

A. Investments in associates

	2012 £000	2011 £000
At 1 January	**5,220**	6,325
Share of operating profits	**8,048**	6,712
Share of interest income	**38**	66
Share of tax on profit on ordinary activities	**(2,141)**	(1,851)
Total share of profits of associates	**5,945**	4,927
Share of actuarial gain/(loss) on pension liability	**168**	(1,273)
Share of tax on items taken directly to equity	**(41)**	337
Dividends received	**(4,870)**	(5,096)
At 31 December	**6,422**	5,220

Summary financial information for associates – 100%:

	Assets £000	Liabilities £000	Revenues £000	Profit after tax £000
2012				
Ins-sure Holdings Limited	**33,127**	**(20,977)**	**81,179**	**12,526**
Xchanging Claims Services Limited	**19,313**	**(12,540)**	**44,308**	**6,374**
	52,440	**(33,517)**	**125,487**	**18,900**
2011				
Ins-sure Holdings Limited	28,162	(18,540)	73,809	10,485
Xchanging Claims Services Limited	17,386	(11,754)	43,677	5,445
	45,548	(30,294)	117,486	15,930

B. Lloyd's Collection

The Lloyd's Collection represents various paintings, antiques and artefacts. The collection was valued at £12.5m by Gurr Johns Limited, valuers and fine art consultants in November 2012, on the basis of open market auction value assuming all items are not sold at the same time taking into account the nature, age, condition and quality of each chattel. This resulted in a revaluation gain of £0.5m.

NOTES TO THE FINANCIAL STATEMENTS CONTINUED

As at 31 December 2012

13. INSURANCE ACTIVITIES

For insurance contracts, claims provisions (comprising provisions for claims reported by policyholders and claims incurred but not reported) are established to cover the ultimate cost of settling the liabilities in respect of claims that have occurred and are estimated based on known facts at the reporting date. Outstanding claims provisions are not discounted for the time value of money.

	2012 £000	2011 £000
Insurance claims		
Gross claims:		
Claims paid	**(29,734)**	(13,762)
Change in provisions for claims	**18,039**	36,479
	(11,695)	22,717
Claims recoverable from reinsurers:		
Claims recovered from reinsurers	**21,667**	13,002
Change in reinsurance contract assets	**(9,866)**	(11,510)
	11,801	1,492

Centrewrite Limited

Centrewrite Limited's principal activities in 2012 were to underwrite the Lloyd's Members' Estate Protection Plan, to reinsure individual members of Lloyd's participations on syndicates for underwriting years of account which have not been closed and to provide reinsurance to close to syndicates with no successor syndicate.

Centrewrite has a structured approach to pricing, which is approved by the Centrewrite board in respect of the insurance contracts it underwrites. For reinsurance to close contracts, prior to the contract being quoted Centrewrite considers and does actuarial analysis upon the underlying historical data in respect of the performance of the syndicate. This data includes that in respect of claims development, major claims outstanding, exposure to further claims development, future run-off costs and reinsurance cover. The reinsurance to close contracts mainly relate to liability and energy risks written between 1993 and 2001.

Centrewrite regularly monitors the performance of its business, including that in respect of outstanding claims exposure and reinsurance recoveries through a sub-committee of the Board.

Due to the uncertainty in the timing of large claims payments, Centrewrite invests in assets that can be readily realised to meet these liabilities as they fall due. Centrewrite regularly reviews the security of its reinsurance assets and makes provision for amounts which are not considered to be recoverable, based on default rates used by the Lloyd's market.

Lloyd's Insurance Company (China) Limited

Lloyd's Insurance Company (China) Limited (LICCL) is a wholly owned subsidiary undertaking of the Society of Lloyd's. The company's principal activity during 2012 was the reinsurance of non-life business in the China insurance market and direct non-life insurance in the Shanghai municipality. Lloyd's syndicates participate in LICCL's business by means of retrocession agreements which allow a 100% risk transfer.

Insurance contract liabilities may be analysed as follows:

	2012 Insurance contract liabilities £000	2012 Reinsurer's share of liabilities £000	2012 Net £000	2011 Insurance contract liabilities £000	2011 Reinsurer's share of liabilities £000	2011 Net £000
Provision for claims reported	**8,647**	**(8,126)**	**521**	45,460	(34,194)	11,266
Provision for IBNR claims	**13,956**	**(13,761)**	**195**	(3,677)	1,300	(2,377)
	22,603	**(21,887)**	**716**	41,783	(32,894)	8,889
Unearned premiums	**3,833**	**(3,833)**	**–**	7,696	(7,678)	18
Insurance contract liabilities	**26,436**	**(25,720)**	**716**	49,479	(40,572)	8,907

13. INSURANCE ACTIVITIES CONTINUED

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

	2012 Insurance contract liabilities £000	2012 Reinsurer's share of liabilities £000	2012 Net £000	2011 Insurance contract liabilities £000	2011 Reinsurer's share of liabilities £000	2011 Net £000
At 1 January	**41,783**	**(32,894)**	**8,889**	77,201	(43,630)	33,571
Claims incurred/(released)	**11,695**	**(11,801)**	**(106)**	(22,717)	(1,492)	(24,209)
Claims paid (see below)	**(29,734)**	**21,667**	**(8,067)**	(13,762)	13,002	(760)
Effect of exchange rates	**(1,141)**	**1,141**	**–**	1,061	(774)	287
At 31 December	**22,603**	**(21,887)**	**716**	41,783	(32,894)	8,889

Claims incurred consist of claims and claims handling expenses paid during the year, together with the movement in outstanding claims. Full provision is made, on the basis of available information, for the estimated ultimate cost of claims notified but not settled as at the date of the statement of financial position, after taking into account handling costs and settlement trends. A provision for claims incurred but not notified is also established as at that date on a statistical basis. The provision also reflects claims settlement expenses and anticipated reinsurance and other recoveries. The provision for outstanding claims is based on information available at the reporting date. Subsequent information and events may result in the ultimate liability being less than, or greater than, the amount provided. Any differences between the provision and subsequent settlements are dealt with in the group income statements of later years.

Claims development table

The table below shows the development of claims over a period of time on a gross basis. The claims development table shows the cumulative incurred claims, including both notified and IBNR claims for each successive year, together with cumulative claims at the current reporting date.

	2008 and prior £000	2009 £000	2010 £000	2011 £000	2012 £000	Total £000
At end of underwriting year	180,709	9,673	15,724	20,370	**12,394**	
One year later	169,051	8,789	17,512	22,685		
Two years later	148,075	2,662	15,260			
Three years later	112,022	2,534				
Four years later	104,793					
Current estimate of cumulative claims	104,793	2,534	15,260	22,685	**12,394**	
Cumulative payments to date	(103,664)	(1,956)	(13,140)	(14,196)	**(2,107)**	
Insurance contract liabilities	1,129	578	2,120	8,489	**10,287**	**22,603**

The incurred claims from 2008 include amounts relating to the reinsurance of members of Syndicate 535. The incurred claims from 2009 include amounts relating to the reinsurance of members of Syndicate 1204.

NOTES TO THE FINANCIAL STATEMENTS CONTINUED

As at 31 December 2012

14. LOANS RECOVERABLE

	2012 £000	2011 £000
At 1 January	**45,956**	54,371
Recoveries during the year	**(3,913)**	(3,483)
Fair value movements recognised during the year	**3,095**	(4,932)
At 31 December	**45,138**	45,956

None of the change in valuation of loans recoverable during 2012 or 2011 relates to changes in credit risk. The Society's loans recoverable are categorised as fair value Level 3 for disclosure purposes. All fair value movements are recognised as finance income or finance costs in the group income statement and relate solely to the revaluation of hardship and LFAA assets.

15. FINANCIAL INVESTMENTS

	Note	2012 £000	2011 £000
Statutory insurance deposits	15A	**508,463**	361,817
Other investments	15B	**2,333,592**	2,322,468
		2,842,055	2,684,285

A. Statutory insurance deposits

	2012 Securities £000	2012 Deposits £000	2012 Total £000	2011 Total £000
Market value at 1 January	**132,016**	**229,801**	**361,817**	311,756
Additions at cost	**427,383**	**330,520**	**757,903**	766,294
Disposal proceeds	**(462,311)**	**(140,031)**	**(602,342)**	(724,274)
Surplus on the sale and revaluation of investments	**(4,448)**	**(4,467)**	**(8,915)**	8,041
Market value at 31 December	**92,640**	**415,823**	**508,463**	361,817

Analysis of securities at year end:	2012 Cost £000	2012 Valuation £000	2011 Cost £000	2011 Valuation £000
Government	**92,379**	**92,640**	135,383	132,016
	92,379	**92,640**	135,383	132,016

Finance is arranged by advances from syndicates in the Lloyd's market. These advances are renewed annually. By agreement with the lenders, investment returns earned on these assets are paid, in appropriate proportions, to the lenders. In this way, the Society avoids any risk arising from a mismatch between borrowing and lending terms. Book cost is stated at historical exchange rates, market value is quoted at year end exchange rates.

The provision of funds by members in respect of the establishment and maintenance of overseas deposits is a condition of permission to underwrite insurance business at Lloyd's.

15. FINANCIAL INVESTMENTS CONTINUED

B. Other investments

	2012 Corporation of Lloyd's £000	2012 Central Fund £000	2012 Insurance activities £000	2012 Total £000	2011 Total £000
Market value at 1 January	13,321	2,214,893	94,254	2,322,468	2,236,884
Additions at cost	–	1,339,579	94,042	1,433,621	2,990,069
(Decrease)/increase in short-term deposits	(10,897)	(10,619)	522	(20,994)	(26,982)
Disposal proceeds	–	(1,309,599)	(103,962)	(1,413,561)	(2,912,861)
Surplus on the sale and revaluation of investments	–	13,317	(1,259)	12,058	35,358
Market value at 31 December	**2,424**	**2,247,571**	**83,597**	**2,333,592**	2,322,468
Analysis of securities at year end:					
Listed securities					
Fixed interest:					
Government	–	964,436	67,777	1,032,213	1,057,990
Corporate securities	–	823,519	10,820	834,339	814,882
Emerging markets	–	56,677	–	56,677	46,172
High yield	–	38,011	–	38,011	39,280
	–	1,882,643	78,597	1,961,240	1,958,324
Equities:					
Global	–	174,141	–	174,141	152,068
Emerging markets	–	45,476	–	45,476	37,354
	–	219,617	–	219,617	189,422
Total listed securities	–	**2,102,260**	**78,597**	**2,180,857**	2,147,746
Unlisted securities:					
Hedge funds	–	75,402	–	75,402	75,453
Commodities	–	40,713		40,713	41,655
Short-term deposits	2,424	9,196	5,000	16,620	37,614
Security deposits (see below)	–	20,000	–	20,000	20,000
Total unlisted securities	**2,424**	**145,311**	**5,000**	**152,735**	174,722
Market value	**2,424**	**2,247,571**	**83,597**	**2,333,592**	2,322,468
Analysis of corporate securities:					
AAA	–	316,713	5,736	322,449	327,871
AA	–	367,870	4,769	372,639	328,149
A	–	138,936	315	139,251	155,830
Other	–	–	–	–	3,032
	–	823,519	10,820	834,339	814,882

Security deposits

Tutelle Limited

In 1996 the Council set aside, under a Lloyd's special account, £20m of the 'Old' Central Fund to secure the Society's obligations under staff indemnities and certain indemnities which have been given by Lloyd's to certain individuals and advisers in respect of the 'Reconstruction and Renewal' plan. These include members of the Reserve Group, directors and officers of Equitas, members of the Council, Lloyd's Regulatory Board, Lloyd's Market Board (the latter two boards ceased during 2002) and of their respective sub-committees and Corporation staff.

Unless and until there is any default under the security documentation, interest earned on the trust fund is paid to the 'Old' Central Fund. The security was deposited for an initial period of two years and the Council exercised its discretion to renew this in June 1998. The Council further amended the period of the deposit, in November 1998, so that the security could only be released if the Council was satisfied that there was no reasonable prospect of a claim being made under these indemnities. Tutelle's position is under biennial review and, having been reviewed in July 2012, will be reviewed again in July 2014. The security may continue for a period of up to 80 years. Any of the funds remaining after this period will be repaid to the 'Old' Central Fund.

NOTES TO THE FINANCIAL STATEMENTS CONTINUED

As at 31 December 2012

15. FINANCIAL INVESTMENTS CONTINUED

C. Fair value hierarchy

	Notes	2012 Level 1 £000	2012 Level 2 £000	2012 Level 3 £000	2012 Total £000
Financial investments at fair value through profit or loss					
Statutory insurance deposits	15A				
Listed securities		–	2,729	–	2,729
Unlisted securities		–	89,911	–	89,911
Deposits with credit institutions		–	415,823	–	415,823
Other investments	15B				
Listed securities		1,126,901	834,339	–	1,961,240
Equity investments		219,617	–	–	219,617
Unlisted securities		–	116,115	–	116,115
Deposits with credit institutions		36,620	–	–	36,620
Market value at 31 December		1,383,138	1,458,917	–	2,842,055

	Notes	2011 Level 1 £000	2011 Level 2 £000	2011 Level 3 £000	2011 Total £000
Financial investments at fair value through profit or loss					
Statutory insurance deposits	15A				
Listed securities		–	2,869	–	2,869
Unlisted securities		–	129,147	–	129,147
Deposits with credit institutions		–	229,801	–	229,801
Other investments	15B				
Listed securities		1,143,442	814,882	–	1,958,324
Equity investments		189,422	–	–	189,422
Unlisted securities		–	117,108	–	117,108
Deposits with credit institutions		57,614	–	–	57,614
Market value at 31 December		1,390,478	1,293,807	–	2,684,285

Level 1

Inputs to Level 1 fair values are quoted prices in active markets for identical assets. An active market is one in which transactions for the asset occur with sufficient frequency and volume to provide pricing information on an ongoing basis. Examples are listed debt securities in active markets, listed equities in active markets, listed deposits held with credit institutions in active markets.

Level 2

Inputs to Level 2 fair values are inputs other than quoted prices included within Level 1 that are observable for the asset, either directly (ie as prices) or indirectly (ie derived from prices) and fair value is determined through the use of models or other valuation methodologies. Level 2 inputs include; quoted prices for similar (ie not identical) assets in active markets, quoted prices for identical or similar assets in markets that are not active or in which little information is released publicly, unlisted deposits held with credit institutions in active markets, low volatility hedge funds where tradeable NAVs are published.

The fair value movements during the year are recognised as finance income or finance cost in the group income statement.

16. CASH AND CASH EQUIVALENTS

	2012 £000	2011 £000
Cash at banks	73,289	53,412
Short-term deposits	113,785	73,870
	187,074	127,282

Cash at banks earns interest at floating rates based on daily bank deposit rates. Short-term deposits are made for varying periods of between one day and three months, depending on the immediate cash requirements of the Society and earn interest at the respective short-term deposit rates. The fair value of cash and cash equivalents is £187m (2011: £127m).

Welcome to Lloyd's
Strategic overview
Market performance
Market results
Society report

17. SUBORDINATED NOTES AND PERPETUAL SUBORDINATED CAPITAL SECURITIES

	2012 £000	2011 £000
Details of loans payable wholly or partly after more than five years:		
6.875% subordinated notes of £300m maturing 17 November 2025	**300,000**	300,000
5.625% subordinated notes of €253m maturing 17 November 2024	**204,935**	211,063
7.421% perpetual subordinated capital securities of £392m redeemable on 21 June 2017	**392,013**	392,013
	896,948	903,076
Less issue costs to be charged in future years	**(3,079)**	(3,880)
Less discount on issue to be unwound in future years	**(541)**	(780)
	893,328	898,416

Subordinated debt issued in 2004
The Sterling Notes mature on 17 November 2025, although the Society may redeem them on 17 November 2015 and 17 November 2020. In the event that the Society does not redeem the Sterling Notes on 17 November 2015, the rate of interest payable will be the rate per annum which is the aggregate of the Gross Redemption Yield on the relevant Benchmark Gilt (a UK government security having a maturity date on or nearest to the next reset date) plus a margin of 3.07%.

The Euro Notes mature on 17 November 2024, although the Society may redeem them on 17 November 2014 or on any interest payment date thereafter.

In the event that the Society does not redeem the Euro Notes on 17 November 2014, the rate of interest payable will be three month Euribor plus a margin of 2.72%.

The Notes are subordinated obligations of the Society. Each tranche of the Notes will rank pari passu with the other in a winding-up of the Society. Upon the occurrence of any winding-up proceedings of the Society, payments on the Notes will be subordinated in right of payment to the prior payment in full of all other liabilities of the Society, except for liabilities which rank equally with or junior to the Notes. Payments on the Notes will also be subordinated to certain payments which may be made out of central assets including payments made to discharge the liabilities of an insolvent member to any person (including any policyholders) arising out of or, in connection with insurance business carried on at Lloyd's by that insolvent member and payments made in respect of the costs required by or under any insolvency procedure to which the Society or the Lloyd's market may be subject. However, in the event of a winding-up of the Society, the claims of the holders of the Notes rank senior to the distribution of any central assets to members of Lloyd's generally (other than payments made to members in their capacity as senior creditors of the Society).

Subordinated debt issued in 2007
The perpetual subordinated capital securities ('capital securities') are perpetual securities and have no fixed redemption date. However, they are redeemable in whole on 21 June 2017 at the option of the Society or on any interest payment date thereafter provided certain conditions have been met by the Society. The capital securities bear interest at a rate of 7.421% per annum until 20 June 2017, payable annually in arrears on 21 June in each year, and thereafter at a rate per annum reset semi-annually of 2.41% per annum above the London interbank offered rate for six-month sterling deposits, payable semi-annually in arrears on the interest payment dates falling on 21 June and 21 December in each year.

The capital securities are subordinated obligations of the Society. Upon the occurrence of any winding-up proceedings of the Society, the claims of the holders of the capital securities will rank junior to all other claims of creditors of the Society (including any creditor who is the holder of any of the Sterling or Euro Notes issued by the Society in 2004) except for those creditors having claims which rank equally with or junior to the claims of the holders of the capital securities. The claims of the holders of the capital securities will also rank junior to any payments made to discharge the liabilities of a member in connection with insurance business carried on at Lloyd's by that member and also to the claims of any person in respect of whom a New Central Fund undertaking has been made. However, in the event of a winding-up of the Society, the claims of the holders of the capital securities rank senior to the distribution of any central assets to members of Lloyd's generally (other than payments made to members in their capacity as senior creditors of the Society).

Subordinated debt repurchases
During 2011, the Society of Lloyd's repurchased a principal amount of £27,368,000 of its 2007 perpetual subordinated capital securities at a cost of £23,120,000. The Society additionally paid accrued interest on the purchased securities. The profit on the repurchase was £4,248,000.

NOTES TO THE FINANCIAL STATEMENTS CONTINUED

As at 31 December 2012

18. PENSION SCHEMES

The Society operates a number of defined benefit and defined contribution pension schemes. The principal scheme is the Lloyd's Pension Scheme which is a defined benefit scheme. Other schemes have been established for certain employees based overseas.

These schemes are generally funded by the payment of contributions to separately administered funds.

Defined benefit plans

The pension surplus/(deficits) of the schemes at 31 December 2012 are as follows:

	2012 £000	2011 £000
Schemes in surplus:		
Overseas pension schemes	–	9
	–	9
Schemes in deficit:		
Lloyd's Pension Scheme	(43,234)	(23,679)
Overseas pension schemes	(1,841)	(1,337)
	(45,075)	(25,016)

The amounts charged to the group income statement and group statement of comprehensive income, in respect of defined benefit plans are as follows:

	2012 £000	2011 £000
Group income statement:		
Lloyd's Pension Scheme	2,195	24,511
Overseas pension schemes	1,565	1,584
	3,760	26,095
Group statement of comprehensive income:		
Lloyd's Pension Scheme actuarial loss	22,243	56,671
Overseas pension schemes	422	216
	22,665	56,887

Lloyd's Pension Scheme

The Lloyd's Pension Scheme is a defined benefit pension scheme with assets held in a separately administered fund. For the purposes of determining the funding position of the scheme and future contributions, a formal actuarial valuation of the scheme was carried out by Towers Watson, actuaries and consultants, as at 30 June 2010 using the projected unit credit method. The principal actuarial assumptions adopted in the valuation were:

- Assumed future price inflation of 3.5% per annum.
- Pensions would increase in payment at 3.5% per annum (relating to benefits accrued between 6 April 1997 and 5 April 2005) or 2.5% per annum (benefits accrued post 5 April 2005).
- Total pensionable remuneration would increase by 4.5% per annum.
- The rate of return on investments held at the valuation date and on future contributions receivable after the valuation date was assumed to be 6.8% per annum for periods before benefits come into payment and 4.7% per annum for periods after benefits come into payment.
- Mortality assumptions were based on 110% of SAPS light tables for males/105% SAPS light tables for females, with allowance for future improvements in line with CMI 2009 core projects with a trend improvement of 1.5% per annum.
- An allowance was made for commutation at retirement, assuming 20% of member pension commuted at retirement, on terms mid-way between current actual terms and 'cost neutral' on TP basis.

The next formal actuarial valuation will be carried out as at 30 June 2013.

The total market value of the scheme's assets at the date of valuation was £418m, and the total value of accrued liabilities was £488.3m showing a shortfall of £70.3m. These figures exclude both liabilities and the related assets in respect of money purchase AVCs. To eliminate the funding shortfall, the Trustees have agreed a Recovery Plan with Lloyd's. Lloyd's paid additional contributions of £45m to the Scheme in December 2010, and will make fixed additional monthly contributions from July 2014 to June 2020 inclusive to eliminate the remaining deficit.

18. PENSION SCHEME CONTINUED

Defined benefit plans continued

No allowance was made for discretionary increases to pre 6 April 1997 benefits when in payment. In 2003, the Society instructed Towers Watson not to allow for such increases in calculating the scheme's liabilities for future actuarial valuations. Such increases have always been payable at the discretion of the Society and will continue to be considered on the basis of affordability, but are not taken into account by the actuary in determining the funding level.

In recent years, in order to mitigate exposure to pension scheme liabilities several changes have been made to the Lloyd's Pension Scheme. From February 2005 the senior management section of the scheme was closed to new entrants and the normal retirement age for joiners was increased from 60 to 65. The final salary scheme was closed to new joiners at the end of June 2006. New entrants from July 2006 have been eligible to join the Lloyd's Pension Scheme but accrue benefits on an 80ths career average basis and are contracted-in to the State Second Pension.

Employee contributions at 5%, or 10% for members of the senior management section, of pensionable earnings up to the Scheme earnings cap where applicable, have been introduced from July 2006. Normally, instead of making an employee contribution, employees make a salary sacrifice of the appropriate percentage of their salary and Lloyd's make an additional employer contribution of the same amount. Following the 2010 actuarial valuation employer contributions as a percentage of basic salaries are 21.7% for pre-February 2005 final salary members, 12.9% for post-January 2005 entrants and 6.5% for members accruing benefits on a career average basis.

Principal actuarial assumptions in respect of IAS 19

The demographic assumptions which are the most financially significant are those relating to the longevity of retired members. The assumptions for the purposes of the IAS 19 valuation as at 31 December 2012 are as applied in the triennial actuarial valuation as at 30 June 2010.

These assumptions are equivalent to expected longevity at age 60 approximately as follows:
- For pensioners currently aged 60: ranging from 28 years to 30 years (2011: 28 years to 30 years).
- For non-pensioners currently aged 45: ranging from 30 years to 32 years (2011: 30 years to 32 years).

The other major financial assumptions used by the actuary as at 31 December 2012 for the purposes of IAS 19 were:

	2012 % per annum	2011 % per annum	2010 % per annum	2009 % per annum	2008 % per annum
General salary and wage inflation	**4.0%**	4.1%	4.5%	4.6%	4.9%
Rate of increase in pensions in payment					
pre 6 April 1997 (in excess of GMP's)	**–**	–	–	–	–
6 April 1997 to 5 April 2005	**3.0%**	3.1%	3.5%	3.6%	3.0%
post 5 April 2005	**2.5%**	2.5%	2.5%	2.5%	2.5%
Increases to deferred pensions	**2.2%**	2.1%	3.0%	3.6%	3.0%
Discount rate	**4.5%**	4.9%	5.5%	5.7%	6.4%
Price inflation	**2.2%**	2.1%	3.0%	3.6%	3.0%

An allowance is made for members commuting 20% (2011: 20%) of their pension on retirement.

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

Sensitivity of pension obligation to changes in assumptions

The actuarial valuation of liabilities under IAS 19 is particularly sensitive to changes in market conditions, which determine the rate at which pension liabilities are discounted.

A change of 0.1% pa in the discount rate as at 31 December 2012 would result in a change to the pension liabilities at that date of around 2%, or approximately £12m.

A change in the mortality assumptions could have a significant impact on the pension liability. For instance, use of the core projection model with 2% p.a. long-term improvement for future mortality improvements could add around another 2% to the balance sheet liabilities.

NOTES TO THE FINANCIAL STATEMENTS CONTINUED

As at 31 December 2012

18. PENSION SCHEMES CONTINUED

Amounts for the current and previous years were:

Asset/(liability) analysis of the scheme	2012 Fair value £000	2011 Fair value £000	2010 Fair value £000	2009 Fair value £000	2008 Fair value £000
Bonds	**184,521**	181,293	161,806	147,066	127,304
Equities	**290,657**	251,898	292,533	268,347	198,037
Property	**70,025**	66,555	15,368	–	–
Cash and net current assets	**32,184**	38,727	46,249	20,195	22,306
Total market value of assets	**577,387**	538,473	515,956	435,608	347,647
Actuarial value of scheme liabilities	**(620,621)**	(562,152)	(490,043)	(456,899)	(379,632)
(Deficit)/surplus in the scheme	**(43,234)**	(23,679)	25,913	(21,291)	(31,985)

Changes in the present value of the defined benefit obligations are:

	2012 £000	2011 £000
Actuarial value of scheme liabilities at 1 January	**562,152**	490,043
Interest cost on pension scheme liabilities	**27,020**	26,718
Current service cost (net of employee contributions)	**7,046**	6,291
Past service cost	**–**	30,233
Employee contributions	**2,643**	2,700
Benefits paid	**(22,113)**	(18,724)
Experience losses arising in scheme liabilities	**861**	4,852
Change in assumptions underlying the present value of the scheme liabilities	**43,012**	20,039
Actuarial value of scheme liabilities at 31 December	**620,621**	562,152

Changes in fair value of plan assets were:

	2012 £000	2011 £000
Fair value of scheme assets at 1 January	**538,473**	515,956
Expected return on pension scheme assets	**31,871**	35,031
Employer contributions		
normal	**4,883**	4,790
special	**–**	30,500
Employee contributions	**2,643**	2,700
Benefits paid	**(21,440)**	(18,272)
Actuarial gain/(loss) on scheme assets	**21,630**	(31,780)
Administrative expenses	**(673)**	(452)
Fair value of scheme assets at 31 December	**577,387**	538,473

The special contribution of £30.5m in 2011 was made to the pension scheme to meet future discretionary increases. The Society expects to contribute approximately £4.8m in normal contributions to the pension scheme in 2013.

18. PENSION SCHEMES CONTINUED

Analysis of the amount recognised in the group statement of comprehensive income

	2012 £000	2011 £000
Actual return on pension scheme assets	**53,501**	3,251
Less expected return on pension scheme assets	**(31,871)**	(35,031)
Actual return less expected return on pension scheme assets	**21,630**	(31,780)
Experience losses arising on scheme liabilities	**(861)**	(4,852)
Changes in the assumptions underlying the present value of the scheme liabilities	**(43,012)**	(20,039)
Actuarial loss recognised in the group statement of comprehensive income	**(22,243)**	(56,671)

The cumulative actuarial loss recognised in the group statement of comprehensive income since 1 January 2004 is £111.2m (2011: £89.0m actuarial loss).

Analysis of the amount charged to the group income statement (recognised in other group operating expenses)

	2012 £000	2011 £000
Current service cost	**7,046**	6,291
Past service accrual	**–**	26,533
Expected return on pension scheme assets	**(31,871)**	(35,031)
Interest on pension scheme liabilities	**27,020**	26,718
Total operating charge	**2,195**	24,511

The Society recognises the cost of discretionary increases to pre 6 April 1997 benefits in payment when there is a constructive liability to make such increases. In 2007 the Society provided £10.0m to meet future discretionary increases, this amount has been notionally segregated from the scheme's other assets (the 'notional fund') and its investment performance will be tracked on the assumption that it is invested in the same way as the scheme's other assets. The notional fund will be used to facilitate the award of future discretionary pension increases when the Society carries out its annual review of pensions in accordance with the Scheme's Definitive Trust Deed. As long as there is a notional fund set aside for this purpose, discretionary increases will continue to be made. Past service costs of £26.5m in 2011 represent the costs of an increase for 2012 of £6.5m and a further £20.0m to meet future discretionary increases which was paid into the notional fund in December 2011. As at 31 December 2012 the value of the notional fund was £32.6m (2011: £31.2m).

The measurement bases set by IAS 19 are likely to give rise to significant fluctuations to the scheme's assets and liabilities. However, this may not necessarily require changes to the contribution rate, as recommended by the independent actuary, which is based on expected long-term rates of return.

History of experience gains and losses

	2012 £000	2011 £000	2010 £000	2009 £000	2008 £000
Difference between the expected and actual return on scheme assets:					
Amount	**21,630**	(31,780)	16,715	54,517	(116,429)
Percentage of scheme assets	**3.7%**	(5.9%)	3.2%	12.5%	(33.5%)
Experience (losses)/gains on scheme liabilities:					
Amount	**(861)**	(4,852)	(2,249)	3,850	(2,170)
Percentage of the present value of the scheme liabilities	**(0.1%)**	(0.9%)	(0.5%)	0.8%	(0.6%)
Total amount recognised in the group statement of comprehensive income:					
Amount	**(22,243)**	(56,671)	(1,271)	(10,552)	(67,855)
Percentage of the present value of the scheme liabilities	**(3.6%)**	(10.1%)	(0.3%)	(2.3%)	(17.9%)

NOTES TO THE FINANCIAL STATEMENTS CONTINUED

As at 31 December 2012

18. PENSION SCHEMES CONTINUED

Overseas pension schemes

The Society operates a number of defined benefit plans for qualifying employees based overseas. The actuarial valuations of these pension schemes at 31 December 2012 was a deficit of £1.8m (2011: £1.3m). The total expense recognised in other operating expenses of £0.4m (2011: £0.3m) represents the related current service cost of these schemes. An actuarial loss of £0.4m has been recognised in the group statement of comprehensive income (2011: actuarial loss of £0.2m).

Defined contribution plans

The Society operates a number of defined contribution retirement benefit plans for qualifying employees based overseas. The assets of the plans are held separately from those of the Society in funds under the control of the trustees.

In some countries, employees are members of state-managed retirement benefit plans. The Society is required to contribute a specified percentage of payroll costs to fund these benefits. The only obligation of the Society with respect to the retirement benefit plan is to make the specified contributions.

The total expense recognised in the group income statement of £0.4m (2011: £0.3m) represents contributions payable to these plans by the Society at rates specified in the rules of these plans.

19. PROVISIONS

	2012 Undertakings given to insolvent members £000	2012 Limited Financial Assistance Agreements £000	2012 Income support schemes £000	2012 Lloyd's performance plan £000	2012 Restructuring £000	2012 Total £000	2011 Total £000
Balance at 1 January	**7,665**	**47**	**4,245**	**1,859**	**6,644**	**20,460**	21,305
Charged in the year	**26,494**	**(47)**	**–**	**6,912**	**(443)**	**32,916**	22,280
Utilised in the year	**(20,131)**	**–**	**(390)**	**(1,367)**	**(4,145)**	**(26,033)**	(23,125)
Balance at 31 December	**14,028**	**–**	**3,855**	**7,404**	**2,056**	**27,343**	20,460

Provision for undertakings given to insolvent members

The Council has given undertakings with financial limits to certain corporate members to use the New Central Fund to discharge the liability of those members where they have unpaid cash calls and do not have the resources to meet those cash calls.

The purpose of these undertakings is primarily to allow valid claims made on policies underwritten by those insolvent members to continue to be paid in full. For those corporate members in provisional liquidation, the Council has also provided a supporting commitment, which will ensure that in no circumstance will an insurance creditor receive less than the amount it would have received in a winding-up commencing on the date of the provisional liquidation.

	Note	2012 £000	2012 £000	2011 £000	2011 £000
Provisions for amounts payable at 1 January			**7,665**		9,060
Undertakings granted in the year	4		**26,494**		15,515
Analysis of paid undertakings by member:					
Flectat Limited		**(3,044)**		(7,450)	
Ebury Underwriting Limited		**(4,160)**			
Kite Dedicated Capital Limited (formerly Goshawk Dedicated (No 2) Limited)		**–**		(9,456)	
Hermanus Underwriting Limited		**(3,463)**		–	
ACAL Underwriting Limited		**(9,464)**		–	
Other corporate members		**–**		(4)	
Paid during the year			**(20,131)**		(16,910)
Undertakings given to insolvent members at 31 December			**14,028**		7,665

19. PROVISIONS CONTINUED

Limited financial assistance agreements (LFAAs)

The first LFAAs were provided to individual members in 2005 to meet their outstanding underwriting liabilities. Further LFAAs were provided in 2010. Assistance is provided to individuals who are reliant on their funds at Lloyd's (FAL) either because it is in the form of a bank guarantee secured on their sole residence or because they are reliant on the income generated by their FAL. All costs are funded by the New Central Fund.

Income support schemes

Hardship income top-up scheme

The Hardship Scheme was created in 1989 to assist individual members who had reduced means as a result of high underwriting losses. Members in the Scheme are eligible to receive ex-gratia top-up income payments from Lloyd's by virtue of having a Hardship Trust Fund (HTF) or having been awarded litigation recoveries used in 'Reconstruction and Renewal' to pay Equitas premiums. The Hardship Scheme is permanent and non-discretionary, but the granting of Hardship Income Top-up payments is at Lloyd's discretion. All costs are currently funded by the 'Old' Central Fund.

Income and Housing Support Scheme (IHSS Scheme)

The IHSS Scheme was established in 1996 to provide financial assistance to individual members who accepted the 'Reconstruction and Renewal' Settlement offer, to ensure that their housing and income requirements were maintained at a reasonable level. The payments under the scheme are discretionary and are currently funded by the 'Old' Central Fund.

Income Assistance Scheme

The Income Assistance Scheme is effective from 1 January 2010 and replaces both the Hardship Income Top-up payments and the IHSS. The Income Assistance Scheme is permanent, replacing the discretionary nature of the previous schemes, and guarantees ongoing payment other than in the event that Lloyd's faces severe financial stress.

Lloyd's Performance Plan (LPP)

The Society introduced a performance plan for all employees, effective from 1 January 2008 that is related to the results of the Lloyd's market. Details of the plan and the transitional arrangements for executive directors and senior employees are outlined in the report of the Remuneration Committee on pages 75 to 82. Included within the charge for the year and provision utilised are National Insurance contributions of £0.9m (2011: £0.5m).

Restructuring provisions

The provision is mainly in respect of obligations towards former employees arising from the restructuring programme.

20. TRADE AND OTHER PAYABLES

	2012 £000	2011 £000
Due within one year:		
Trade and other creditors	**39,356**	33,852
Insurance and reinsurance payables	**64,893**	81,671
Members' subscriptions and contributions repayable	**30,166**	47,290
Taxation and social security	**2,305**	2,361
Arbitration awards	**3,361**	3,567
Interest payable on subordinated loan notes	**19,573**	19,587
	159,654	188,328

21. TRADE AND OTHER RECEIVABLES

	2012 £000	2011 £000
Due within one year:		
Trade (net of allowance for impairment)	**2,608**	1,200
Insurance and reinsurance receivables	**44,209**	63,524
Interest receivable	**21,551**	21,665
Taxation and social security	**1,768**	1,447
Overseas office deposits	**2,123**	3,586
Amounts due from underwriters	**3,727**	5,228
Other receivables	**1,490**	2,954
	77,476	99,604

NOTES TO THE FINANCIAL STATEMENTS CONTINUED

As at 31 December 2012

22. FINANCIAL INSTRUMENTS

Explanations of the Society's financial instrument risk management objectives, policies and strategies are set out in the discussion of the Society's financial risk management and treasury policies on pages 89 and 90 of the Financial Review.

Fair values and credit risk

The methods and assumptions used in estimating the fair value of financial instruments are detailed in note 2F on pages 99 and 100.

The fair value (based on the quoted offer prices) of subordinated debt is £965.9m (2011: £839.5m) against a carrying value measured at amortised cost of £893.3m (2011: £898.4m). All other financial instruments are either held at fair value or at an amount that approximates fair value.

At the reporting date there were no significant concentrations of credit risk. The maximum exposure to credit risk is represented by the carrying value of each financial asset, including derivative financial instruments, in the group statement of financial position. Exposures under guarantees entered into by the Society are detailed in note 26.

Impairment losses

Trade receivables

The ageing of trade receivables as at 31 December 2012 was as follows:

	2012 Gross £000	2012 Impairment £000	2012 Net £000	2011 Gross £000	2011 Impairment £000	2011 Net £000
Not past due	**1,630**	**–**	**1,630**	712	–	712
Past due 31-120 days	**823**	**–**	**823**	393	–	393
More than 120 days	**501**	**(346)**	**155**	582	(487)	95
Total	**2,954**	**(346)**	**2,608**	1,687	(487)	1,200

The Society's normal credit terms are 30 days. Receivables of more than 120 days represent amounts due from members no longer underwriting in respect of Society charges.

The movement in the allowance for impairment in respect of trade receivables during the year was as follows:

	2012 £000	2011 £000
Balance at 1 January	**487**	630
Additional allowances during the year charged to the group income statement	**29**	52
Allowances released during the year credited to the group income statement	**(98)**	–
Recoveries during the year	**(72)**	(195)
Balance at 31 December	**346**	487

Sensitivity analysis

Foreign currency exposure

Currency risk is the risk that the sterling value of the Society's assets and liabilities will fluctuate due to changes in foreign exchange rates. The Society's exposure to the risk of changes in the foreign exchange rates relates primarily to retranslating foreign currency subordinated notes, revaluation of loans recoverable and changes in the fair value of foreign currency denominated investments and forward contracts.

Sensitivity analysis

Debt securities sensitivities

The value of the Society's investments in debt securities is affected by changes in the level of yields, as determined by the financial markets.

As at 31 December 2012, a consistent increase of 100 basis points in the yields applicable to all relevant securities would have reduced the surplus before tax by approximately £58m (2011: £69m). This analysis assumes that all other variables, in particular foreign currency exchange rates, remain constant. In practice, actual results may differ.

Equity price risk

Equity price risk is the risk that the market values of equity investments fall. At 31 December 2012, a 15% fall in the value of all the Society's equity investments would have reduced the surplus before tax by approximately £33m (2011: £28m). This analysis assumes that all other variables, in particular foreign currency exchange rates, remain constant. In practice, actual results may differ.

22. FINANCIAL INSTRUMENTS CONTINUED

Liquidity risk

The table below summarises the maturity profile of the Society's non-derivative financial liabilities as at 31 December 2012 based on undiscounted contractual cash flows:

As at 31 December 2012	Carrying amount £000	Contractual cash flows £000	Within 1 year £000	1-2 years £000	2-5 years £000	More than 5 years £000
Subordinated loan notes	503,322	(589,866)	(32,153)	(237,088)	(320,625)	–
Perpetual subordinated capital securities	390,006	(537,469)	(29,091)	(29,091)	(479,287)	–
Loans funding statutory insurance deposits	501,846	(501,846)	(501,846)	–	–	–
Trade and other payables	159,654	(159,654)	(159,654)	–	–	–
	1,554,828	(1,788,835)	(722,744)	(266,179)	(799,912)	–

As at 31 December 2011	Carrying amount £000	Contractual cash flows £000	Within 1 year £000	1-2 years £000	2-5 years £000	More than 5 years £000
Subordinated loan notes	508,860	(629,180)	(32,497)	(32,497)	(564,186)	–
Perpetual subordinated capital securities	389,556	(566,561)	(29,091)	(29,091)	(87,274)	(421,105)
Loans funding statutory insurance deposits	352,318	(352,318)	(352,318)	–	–	–
Trade and other payables	188,328	(188,328)	(188,328)	–	–	–
	1,439,062	(1,736,387)	(602,234)	(61,588)	(651,460)	(421,105)

The contractual cash flows have been based on the expectation, but not the obligation, that the subordinated loan notes and perpetual subordinated capital securities are redeemed at the first option date.

Forward currency contracts are settled gross; notional amounts are a close proxy for gross cash flow amounts. Further details regarding the subordinated loan notes and the perpetual subordinated capital securities can be found in note 17 on page 119. Information regarding financial guarantees, all of which could theoretically be called on within one year, can be found in note 26 on page 129.

Derivative financial instruments

The Society enters into forward currency contracts to manage exposures to fluctuation of exchange rates and to provide a service to the Lloyd's market. The Society's derivative financial instruments are categorised as fair value Level 2 for disclosure purposes.

Analysis of forward currency contracts:	2012 £000	2011 £000
Outstanding forward foreign exchange gains	59,586	45,255
Outstanding forward foreign exchange losses	(28,925)	(56,639)

The fair value and notional amounts of forward currency contracts, all of which mature within one year, are analysed as follows:

	2012 Assets		2012 Liabilities	
As at 31 December 2012	Fair value £000	Notional £000	Fair value £000	Notional £000
Currency Conversion Service (CCS)	12,254	244,621	(13,696)	(246,063)
Other forward foreign exchange contracts	47,332	1,414,611	(15,229)	(1,382,508)
	59,586	1,659,232	(28,925)	(1,628,571)

	2011 Assets		2011 Liabilities	
As at 31 December 2011	Fair value £000	Notional £000	Fair value £000	Notional £000
Currency Conversion Service (CCS)	18,434	276,773	(19,528)	(278,258)
Other forward foreign exchange contracts	26,821	1,621,307	(37,111)	(1,620,972)
	45,255	1,898,080	(56,639)	(1,899,230)

NOTES TO THE FINANCIAL STATEMENTS CONTINUED

As at 31 December 2012

23. EQUITY

Accumulated reserves

	2012 £000	2011 £000
Attributable to:		
Corporation of Lloyd's and non-insurance related subsidiary undertakings	**29,944**	33,357
Central Fund	**1,459,883**	1,361,110
Insurance related subsidiary undertakings	**83,557**	78,053
Associates	**6,422**	5,220
	1,579,806	1,477,740

Revaluation reserve

The revaluation reserve is used to record increases in the fair value of the Lloyd's Collection and decreases to the extent that such decreases relate to the amount previously recognised in the group statement of comprehensive income.

24. COMMITMENTS

A. Capital expenditure commitments

Capital expenditure commitments contracted but not provided in the accounts totalled £78,000 (2011: £3,536,000).

B. Operating lease commitments

	2012 £000	2011 £000
Non-cancellable operating lease rentals are payable as follows:		
Within one year	**24,942**	27,107
After one year but not more than five years	**80,670**	88,731
More than five years	**74,610**	88,698

Commitments outstanding under the terms of the lease for the Lloyd's 1986 building have been included at the current rental value (£16.8m per annum) to the first break of the lease in 2021. The lease was subject to a rent review in October 2012, the next review will be undertaken in March 2016.

The Lloyd's Chatham building is included at the current rental value (£0.4m per annum). The lease expires in September 2016 with Lloyd's able to apply for a new lease under the Landlord and Tenant Act.

During the year ended 31 December 2012 Lloyd's entered into a new lease for the Lloyd's Datacentre in Redhill. The lease was subject to a rent free period in the first year. The lease expires in September 2023.

Subsidiary undertakings are party to a number of small operating leases mainly for property rental and small machinery. The commitments outstanding have been included at the current rental value to the first break in the lease. These arrangements do not impose any significant restrictions on the Society.

During the year ended 31 December 2012, £23.7m (2011: £26.2m) was recognised as an expense in the group income statement in respect of operating leases.

25. DISCLOSURE OF RELATED PARTY TRANSACTIONS

The group financial statements include the financial statements of the Society and all of its subsidiary undertakings, the Lloyd's Central Fund and the group's interests in its associates and joint venture as listed in note 11.

Services provided to Ins-sure Holdings Limited group in the year ended 31 December 2012 included operating systems support and development, premises and other administrative services.

Services provided to Xchanging Claims Services Limited group in the year ended 31 December 2012 included premises and other administrative services.

Services provided to the Message Exchange Limited in the year ended 31 December 2012 included the provision of messaging infrastructure.

25. DISCLOSURE OF RELATED PARTY TRANSACTIONS CONTINUED

The following table provides the total amount of transactions that have been entered into with related parties for the relevant financial years together with information regarding the outstanding balances at 31 December 2012 and 2011.

	Sales to related parties		Purchases to related parties		Amounts owed by related parties		Amounts owed to related parties	
	2012 £000	2011 £000	**2012 £000**	2011 £000	**2012 £000**	2011 £000	**2012 £000**	2011 £000
Associates:								
Ins-sure Holdings Limited	**358**	293	**735**	922	**4**	21	**–**	–
Xchanging Claims Services Limited	**107**	74	**36**	307	**41**	8	**5**	–
Joint Venture:								
The Message Exchange Limited	**–**	–	**942**	541	**25**	33	**75**	68

Transactions with associates and joint arrangements are priced on an arm's-length basis.

Michael Watson, a member of Council from February 2013, is also a Director of Flectat Limited which benefited from undertakings given by the Council in 2012 to meet unpaid cash calls. Amounts paid under these undertakings during the period are disclosed in note 19.

In the normal course of business, the Society may enter into transactions with Lloyd's market businesses in which members of Council and the Franchise Board may have an interest. Such transactions are on an arm's-length basis.

26. 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 2012 amounted to £24.4m (31 December 2011: £24.3m).

(b) The Society has taken on the responsibilities of some individual members under hardship and other agreements.

In connection with the statutory transfer to Equitas Insurance Limited on 30 June 2009 of the non-life business underwritten at Lloyd's and allocated to 1992 or prior years of account, the Society has entered into undertakings for the benefit of certain policyholders of Equitas Insurance Limited (former policyholders of PCW syndicates or of members who at the material time still have the benefit of hardship or other agreements with the Society), under which the Society would meet any shortfall in recoveries by such policyholders from Equitas Insurance Limited on the occurrence of an 'Equitas Insolvency Event'.

The Society has also given an unlimited undertaking to its subsidiary undertaking Centrewrite Limited to meet any shortfall in its cash flow or assets (including any shortfall arising from an insufficiency of recoveries from Equitas Reinsurance Limited under its reinsurance of the obligations of Centrewrite to Equitas Insurance Limited).

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

	2012 £000	2011 £000
Guarantees provided by the Society:		
USA: US$1,500,000 (2011: US$1,500,000)	**923**	965

In respect of all contingent liabilities disclosed as at 31 December 2012, no provision has been made in the Society financial statements.

FIVE YEAR SUMMARY

	2012 £000	2011 £000	2010 £000	2009 £000	2008 £000
Operating income	**212,666**	215,085	210,193	195,043	177,542
Central Fund contributions	**104,959**	94,693	100,858	99,687	84,294
General insurance net premium income	**4**	523	1,463	6,992	37,937
Other group income	**2,395**	6,598	215,822	52,048	32,397
Total income	**320,024**	316,899	528,336	353,770	332,170
Central Fund claims and provisions (incurred)/released	**(26,447)**	(15,283)	34,245	19,586	6,349
Gross insurance claims (incurred)/released	**(11,695)**	22,717	11,602	(6,714)	(77,314)
Insurance claims recoverable from reinsurers	**11,801**	1,492	4,864	302	42,806
Other group operating expenses:					
Employment (including pension costs)	**(92,301)**	(116,415)	(92,464)	(92,030)	(86,491)
Premises	**(40,660)**	(44,009)	(42,755)	(39,056)	(36,637)
Legal and professional	**(14,070)**	(19,707)	(18,835)	(19,089)	(16,944)
Systems and communications	**(22,826)**	(27,965)	(27,920)	(21,936)	(21,267)
Other	**(29,992)**	(40,486)	(32,509)	(67,951)	(26,364)
Total other group operating expenses	**(199,849)**	(248,582)	(214,483)	(240,062)	(187,703)
Surplus before finance, associates and tax	**93,834**	77,243	364,564	126,882	116,308
Finance costs	**(62,198)**	(64,370)	(66,143)	(69,345)	(74,405)
Finance income – surplus on subordinated debt repurchase	**–**	4,248	1,470	36,205	–
Finance income – other	**114,855**	90,369	131,436	79,555	165,008
Unrealised exchange gains/(losses) on borrowings	**6,107**	5,428	7,954	23,003	(69,233)
Share of profits of associates	**5,945**	4,927	5,084	3,363	3,930
Surplus before tax	**158,543**	117,845	444,365	199,663	141,608
Tax charge	**(35,509)**	(28,495)	(121,752)	(56,596)	(39,620)
Surplus for the year	**123,034**	89,350	322,613	143,067	101,988

MANAGING AGENTS AND SYNDICATES

The table shows the key characteristics for managing agents and syndicates active as at 31 December 2012. In 2012, Lloyd's wrote gross premiums of £25,500m.

Managing agent	Managed syndicate(s)	2012 GWP* £m	2011 GWP* £m	Owned share of syndicate(s) %
ACE Underwriting Agencies Limited	2488	352	371	100%
Advent Underwriting Limited	0780	158	204	100%
AEGIS Managing Agency Limited	1225	371	330	100%
Alterra at Lloyd's Limited	1400	198	167	100%
Amlin Underwriting Limited	2001	1,470	1,303	100%
	6106	36	40	0%
Antares Managing Agency Limited	1274	197	175	90%
ANV Syndicate Management Limited	1861	142	116	100%
	1969	104	88	0%
Arch Underwriting at Lloyd's Limited	2012	169	142	100%
Argenta Syndicate Management Limited	1110	67	45	0%
	2121	255	222	43%
Argo Managing Agency Limited	1200	375	337	89%
Ark Syndicate Management Limited	4020	341	312	93%
	6105	8	8	0%
Ascot Underwriting Limited	1414	654	563	100%
Aspen Managing Agency Limited	4711	267	227	100%
Asta Managing Agency Limited	1910	262	64	0%
	1945	44	5	0%
	2015	82	25	0%
	2525	35	34	0%
	2526	43	49	0%
	4242	75	67	0%
Atrium Underwriters Limited	0609	353	238	26%
Barbican Managing Agency Limited	1955	220	199	100%
Beaufort Underwriting Agency Limited	0318	163	157	89%
Beazley Furlonge Limited	0623	231	217	7%
	2623	1,045	922	100%
	3622	13	9	100%
	3623	113	111	100%
	6107	9	11	0%
Brit Syndicates Limited	2987	1,089	940	100%
Canopius Managing Agents Limited	0260	47	40	90%
	0958	231	266	51%
	4444	648	614	91%
Capita Managing Agency Limited	2232	69	56	0%
Cathedral Underwriting Limited	2010	285	279	58%
	3010	29	24	100%
Catlin Underwriting Agencies Limited	2003	1,836	1,726	100%
	2088	48	–	0%
	3002	10	6	100%
	6111	71	–	0%
	6112	32	–	100%
Chaucer Syndicates Limited	1084	906	885	96%
	1176	28	26	56%
	1301	82	91	100%
Chubb Managing Agent Limited	1882	79	78	100%
Equity Syndicate Management Limited	0218	449	545	65%
Faraday Underwriting Limited	0435	277	288	100%
Hardy (Underwriting Agencies) Limited	0382	290	289	90%
HCC Underwriting Agency Limited	4141	91	105	100%

* See Glossary on page 133.

MANAGING AGENTS AND SYNDICATES CONTINUED

Managing agent	Managed syndicate(s)	2012 GWP* £m	2011 GWP* £m	Owned share of syndicate(s) %
Hiscox Syndicates Limited	0033	825	786	73%
	3624	245	190	100%
	6104	44	31	0%
Jubilee Managing Agency Limited	0779	26	26	19%
	5820	129	113	77%
Liberty Syndicate Management Limited	4472	1,107	1,080	100%
Managing Agency Partners Limited	2791	307	242	21%
	6103	27	19	0%
Markel Syndicate Management Limited	3000	386	352	100%
Marketform Managing Agency Limited	2468	179	179	61%
Mitsui Sumitomo Insurance Underwriting at Lloyd's Limited	3210	302	258	100%
Montpelier Underwriting Agencies Limited	5151	155	146	100%
Munich Re Underwriting Limited	0457	494	465	100%
Navigators Underwriting Agency Limited	1221	231	200	100%
Newline Underwriting Management Limited	1218	116	121	100%
Novae Syndicates Limited	2007	612	624	100%
Pembroke Managing Agency Limited	4000	226	183	0%
	6110	19	–	0%
QBE Underwriting Limited	0386	444	443	70%
	2999	1,155	1,117	100%
R&Q Managing Agency Limited	1897	51	22	8%
	3330	–	–	100%
R. J. Kiln & Co. Limited	0308	30	24	50%
	0510	1,153	950	55%
	0557	34	33	0%
	1880	240	231	100%
Renaissance Re Syndicate Management Limited	1458	98	70	100%
RITC Syndicate Management Limited	5678	1	2	100%
Riverstone Managing Agency Ltd	3500	39	73	100%
S.A. Meacock & Company Limited	0727	93	83	16%
Sagicor at Lloyd's Limited	0044	7	6	100%
	1206	194	280	100%
Shelbourne Syndicate Services Limited	2008	194	64	100%
Sportscover Underwriting Limited	3334	87	63	94%
Starr Managing Agents Limited	1919	255	322	100%
	2243	81	59	0%
Talbot Underwriting Limited	1183	681	632	100%
Travelers Syndicate Management Limited	5000	320	331	100%
W R Berkley Syndicate Management Limited	1967	116	92	100%
XL London Market Limited	1209	321	328	100%
All other syndicates and RITC adjustment		27	221	
Total		25,500	23,477	

As at 31 December 2012

Name changes and managing agent changes during 2012 or after:
Syndicate 958, previously managed by Omega Underwriting Agents Limited, transferred to Canopius Managing Agents Limited
Syndicate 1967, previously managed by Asta Managing Agency Limited, transferred to W R Berkley Syndicate Management Limited
Syndicate 4242, previously managed by Chaucer Syndicates Limited, transferred to Asta Managing Agency Limited
Flagstone Syndicate Management Limited changed to ANV Syndicate Management Limited
Whittington Capital Management Limited changed to Asta Managing Agency Limited
The following syndicate ceased trading at 31 December 2012
Starr Managing Agents Limited 2243

As at 26 March 2013 the following syndicates commenced trading for the 2013 year of account:
R&Q Managing Agency Limited 1991
Barbican Managing Agency Limited 6113
Canopius Managing Agents Limited 6115

* See Glossary on page 133.

GLOSSARY OF TERMS

Set out below is a guide to insurance and Lloyd's-related terms. These are not precise definitions but are included to provide assistance to readers as to the general meaning of terms commonly used in the Lloyd's market. Formal definitions are set out in the definitions byelaw.

Accident year ratio
The accident year ratio is calculated as expenses and incurred losses (paid and reserves) for claims occurring in the year as a proportion of net premiums earned during the year. It excludes movements during the calendar year on claims, expenses and premium estimates for previous years.

Active underwriter
A person employed by a managing agent with principal authority to accept insurance and reinsurance risks on behalf of the members of a syndicate.

Binding authority
An agreement between a Lloyd's managing agent and a coverholder under which the Lloyd's managing agent delegates its authority to enter into a contract or contracts of insurance to be underwritten by the members of a syndicate.

Calendar year ratio
This is the combined ratio (see below) and is the sum of the accident year ratio (see above) and the prior years' reserve movements (see below).

Callable layer
Central Fund assets may be supplemented by a 'callable layer' of up to 3% of members' overall premium limits in any one calendar year. These funds would be drawn from premium trust funds.

Capacity
In relation to a member, it is the maximum amount of insurance premiums (gross of reinsurance but net of brokerage) which a member can accept. In relation to a syndicate it is the aggregate of each member's capacity allocated to that syndicate.

Central assets
The net assets of the Society including the Central Fund, but excluding the subordinated debt liability and the callable layer.

Central Fund
The fund financed by (among other things) contributions from Lloyd's members and administered by the Council primarily as a fund for the protection of policyholders, and includes both the 'Old' Central Fund and the New Central Fund.

Combined ratio
A measure of an insurer's underwriting profitability based on the ratio of net incurred claims plus net operating expenses to net earned premiums. A combined ratio of 100% is break even (before taking into account investment returns). A ratio less than 100% is an underwriting profit.

Corporate member
A company incorporated with limited liability, a Scottish limited partnership or a limited liability partnership, admitted to membership of the Society.

Council
Created by Lloyd's Act 1982, the Council has the management and superintendence of the affairs of the Society and the power to regulate and direct the business of insurance at Lloyd's.

Coverholder
A firm either in the UK or overseas that is authorised by a managing agent under the terms of a binding authority to enter into contracts of insurance to be underwritten by members of a syndicate managed by the managing agent. A Lloyd's broker may act as a coverholder.

Financial Services Authority (FSA)
The body that regulates the financial services industry in the UK. With effect from 1 April 2013, the UK financial services regulatory regime will see the FSA split into the Prudential Regulatory Authority (PRA) and the Financial Conduct Authority (FCA).

Franchise Board
The board established by the Council with responsibility for creating and maintaining a commercial environment at Lloyd's in which the long-term return to all capital providers is maximised. This includes setting the Risk Management Framework and profitability targets for the market.

Funds at Lloyd's (FAL)
Capital lodged and held in trust at Lloyd's as security for the policyholders and to support a member's overall underwriting business.

Gross Written Premiums (GWP)
Written insurance premiums, gross of reinsurance and acquisition costs.

Integrated Lloyd's Vehicle (ILV)
An arrangement in which a syndicate's capital is wholly provided by corporate members that are under the same ownership and control as the syndicate's managing agent.

Managing agent
An underwriting agent responsible for managing a syndicate, or multiple syndicates.

Member (of the Society)
A person admitted to membership of the Society.

Name
A member of the Society who is an individual and who trades on an unlimited basis.

New Central Fund
The New Central Fund constituted by and governed by the New Central Fund Byelaw (No. 23 of 1996).

Premiums Trust Funds (PTF)
The premiums and other monies that members receive in respect of their underwriting at Lloyd's are held by their managing agents in trust for them subject to the discharge of their underwriting liabilities.

The premiums trust funds comprise a sterling fund, Lloyd's American Trust Fund, Lloyd's Dollar Trust Funds, Lloyd's Canadian Trust Fund and the Lloyd's Asia trust funds (which cover general business written through coverholders in Singapore). These premiums trust funds are available to fund overseas regulatory deposits, claims, return premiums, underwriting expenses and any profit that is payable to the member after providing for all future liabilities.

Prior years' reserve movements
This is calculated as movements in reserves established for claims that occurred in previous accident years as a proportion of net premiums earned during the year.

GLOSSARY OF TERMS
CONTINUED

Realistic Disaster Scenarios (RDS)
A series of scenarios, both natural and man-made, which are used to assess the market's risk profile to a variety of different catastrophes to enable better risk management practices within Lloyd's.

Reinsurance to close (RITC)
A reinsurance agreement under which members of a syndicate for a year of account to be closed are reinsured by members who comprise that or another syndicate for a later year of account against all liabilities arising out of insurance business written by the reinsured syndicate.

Reinsurance to close (RITC) syndicate
A syndicate set up solely to underwrite the Reinsurance to Close of other syndicates.

Service company
A service company means an approved coverholder that (a) is associated with a managing agent by reason of it being a wholly owned subsidiary of the managing agent; or being a wholly owned subsidiary of the managing agent's holding company; or such other matters as the Franchise Board may determine in any particular case or generally; and (b) will be authorised by its associated managing agent to enter into contract(s) of insurance to be underwritten only by members of a syndicate managed by the associated managing agent or an insurance company which is a member of the same corporate group.

Special Purpose Syndicate (SPS)
A syndicate set up solely to underwrite a quota share reinsurance of another syndicate's business for a year of account.

Spread Syndicate
A syndicate whose capital is provided by a number of different members, including members that have separate ownership and control, to the syndicate's managing agent.

Spread vehicle
A corporate member underwriting on a number of different syndicates.

Syndicate
A member, or group of members, underwriting insurance business at Lloyd's through the agency of a managing agent.

Tier 1 capital
The core measure of an insurer's financial strength from the viewpoint of the FSA. It consists of the most reliable and liquid assets. The perpetual securities issued in 2007 qualify as tier 1 capital as the proceeds of the debt issue are fully paid and immediately available; debt holders are sub-ordinate to payment of claims.

Traditional Syndicate
A syndicate whose members underwrite insurance business at Lloyd's for the current year of account and which is neither an SPS syndicate or an RITC syndicate.

Year of account
The year to which a risk is allocated and to which all premiums and claims in respect of that risk are attributed. The year of account of a risk is usually determined by the calendar year in which the risk incepts. A year of account is normally closed by reinsurance at the end of 36 months.

NOTES

NOTES
CONTINUED

The cover and text pages of this report are printed on Amadeus 50% recycled Silk, a recycled paper containing 50% recovered waste, 50% virgin fibre and is certified as an FSC mixed sources grade. Amadeus 50% recycled Silk is manufactured to the certified environmental management system ISO 14001. Designed by Addison www.addison.co.uk. Printed by Park Communications Ltd.

Lloyd's One Lime Street London EC3M 7HA Telephone +44 (0)20 7327 1000 Fax +44 (0)20 7626 2389 www.lloyds.com