

**LLOYD'S  
PRELIMINARY  
RESULTS  
2005**



# CHAIRMAN'S STATEMENT

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

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

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

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

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

And this is just the start.

## **A strategic plan to ensure our competitiveness**

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

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

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

## **Global development: a foothold in China**

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

## **Arrivals and departures**

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

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

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

## **Strongly placed to meet the challenges ahead**

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

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

**Peter Levene, Chairman** 5 April 2006

# CEO'S STATEMENT

## **Extracts from statement included in the 2005 Lloyd's Annual Report made by Luke Savage, Director, Finance and Risk Management and Acting Chief Executive Officer on 5 April 2006:**

If ever there was a year in which Lloyd's demonstrated strength in the face of adversity, it was 2005.

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

Hurricanes Katrina, Rita and Wilma were three of the 10 largest storms in US history, with an insured loss estimated at over \$65 billion. Inevitably, they had a significant impact on the financial result of the market; but the ability of all syndicates to trade forward without calling on the Central Fund is clear evidence of the progress we have made in recent years.

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

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

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

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

### **Franchise performance: a focus on underwriting profit**

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

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

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

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

### **Capital advantages**

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

### **Business process reform: much achieved, much to do**

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

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

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

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

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

### **Changes, challenges and the future**

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

- a clear and transparent performance framework;
- a strong capital framework;
- a secure, highly-rated market;
- outstanding market access; and
- efficient business processes.

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

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

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

# LLOYD'S PRELIMINARY RESULTS

Lloyd's is not an insurance company. It is a Society of members, both corporate and individual, which underwrite insurance in syndicates. These syndicates can comprise one single corporate member or any number of corporate and individual members, underwriting severally for their own account. In view of Lloyd's unique structure, these preliminary results include two sets of summarised financial statements:

- Pro forma financial statements
- Society of Lloyd's report and financial statements

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

## **Pro forma financial statements (pages 5 to 12)**

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 results of Lloyd's syndicates as reported in their own audited financial statements, members' funds at Lloyd's (FAL) and the Society of Lloyd's financial statements (as below).

The capital provided by members is held centrally as FAL, not at syndicate level, and is not, therefore, reported in the syndicate accounts. The non-technical account of the PFFS includes a notional investment return on FAL.

The Society of Lloyd's financial statements report the central resources of the Society. The syndicate accounts are prepared using UK GAAP, and, therefore, the central resources of the Society within the PFFS are also presented this way for consistency. The 'Society financial statements' are prepared using IFRS and the financial effects of the differences between the two bases of presentation are reflected in the PFFS.

The profit & loss account in the PFFS, therefore, aggregates the syndicate underwriting results, the notional investment return on members' capital (FAL) and the results of the Society of Lloyd's. The balance sheet in the PFFS aggregates the assets held at syndicate level, members' assets held as FAL and the central resources of the Society. Overall, therefore, the PFFS aggregate the results and resources of the Society. The PFFS may, therefore, be used as a reasonable presentation of the pre-tax results and state of affairs of the Lloyd's market on a basis that is broadly comparable with general insurance companies.

## **Society of Lloyd's financial statements (pages 14 to 31)**

The group financial statements of the Society of Lloyd's (the "Society") comprise the financial statements of the Society of Lloyd's and all its subsidiary undertakings, the Lloyd's Central Fund and the Society's interest in associates.

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

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

# PRO FORMA PROFIT AND LOSS ACCOUNT

for the year ended 31 December 2005

|   | 2005    |         | 2004           |         |
|---|---------|---------|----------------|---------|
|   | £m      | £m      | Restated<br>£m | £m      |
| <b>Technical account</b>  |         |         |                |         |
| Gross premiums written – continuing operations                                | 14,979  |         | 14,268         |         |
| – discontinued operations   | 3       |         | 346            |         |
|   |         | 14,982  |                | 14,614  |
| Outward reinsurance premiums  |         | (3,212) |                | (2,880) |
| Premiums written, net of reinsurance  |         | 11,770  |                | 11,734  |
| Change in the gross provision for unearned premiums                           | 230     |         | 380            |         |
| Change in provision for unearned premiums, reinsurers' share                  | (215)   |         | (317)          |         |
|   |         | 15      |                | 63      |
| <b>Earned premiums, net of reinsurance</b>                                    |         | 11,785  |                | 11,797  |
| <b>Allocated investment return transferred from the non-technical account</b> |         | 705     |                | 532     |
|   |         | 12,490  |                | 12,329  |
| <b>Claims paid</b>  |         |         |                |         |
| Gross amount  | 10,181  |         | 8,387          |         |
| Reinsurers' share   | (3,418) |         | (2,967)        |         |
|   |         | 6,763   |                | 5,420   |
| <b>Change in provision for claims</b>   |         |         |                |         |
| Gross amount  | 6,726   |         | 1,388          |         |
| Reinsurers' share   | (3,984) |         | 838            |         |
|   |         | 2,742   |                | 2,226   |
| Claims incurred, net of reinsurance   |         | 9,505   |                | 7,646   |
| Net operating expenses  |         | 3,668   |                | 3,755   |
| <b>Balance on the technical account for general business</b>                  |         | (683)   |                | 928     |
| Attributable to – continuing operations                                       |         | (538)   |                | 1,652   |
| – discontinued operations   |         | (145)   |                | (724)   |
| <b>Total</b>  |         | (683)   |                | 928     |
| <b>Non-technical account</b>  |         |         |                |         |
| <b>Balance on the technical account for general business</b>                  |         | (683)   |                | 928     |
| Syndicate investment return   | 705     |         | 532            |         |
| Notional investment return on funds at Lloyd's                                | 602     |         | 487            |         |
| Investment return & other income on Society assets                            | 191     |         | 148            |         |
|   | 1,498   |         | 1,167          |         |
| Allocated investment return to the technical account                          | 705     |         | 532            |         |
|   |         | 793     |                | 635     |
| Other expenses  |         | (213)   |                | (196)   |
| <b>Result for the financial year before tax</b>                               |         | (103)   |                | 1,367   |
| <b>Statement of total recognised gains and losses</b>                         |         |         |                |         |
| <b>Result for the financial year</b>  |         | (103)   |                | 1,367   |
| Other recognised gains and losses   |         | 42      |                | (22)    |
| <b>Total recognised gains and losses</b>                                      |         | (61)    |                | 1,345   |

# PRO FORMA BALANCE SHEET

as at 31 December 2005

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

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



Lord Levene of Portsoken, Chairman



Luke Savage, Director, Finance & Risk Management  
and acting Chief Executive Officer

# PRO FORMA CASH FLOW STATEMENT

for the year ended 31 December 2005

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

# NOTES TO THE PRO FORMA FINANCIAL STATEMENTS

for the year ended 31 December 2005

## 1. Introduction

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

## 2. Basis of preparation

### General

The PFFS include the results of Lloyd's syndicates as reported in their own financial statements, members' funds at Lloyd's (FAL) and the financial statements of the Society of Lloyd's (also known as the Corporation of Lloyd's).

The capital provided by members is held centrally as FAL, not at syndicate level, and is not, therefore, reported in the aggregate accounts. FAL represent the second link in the chain of security. The non-technical account of the PFFS includes a notional investment return on FAL.

The Society of Lloyd's audited financial statements report the central resources of the Society, which form the third link in Lloyd's chain of security.

The profit & loss account in the PFFS, therefore, aggregates the syndicate underwriting results, the notional investment return on members' capital and the results of the Society of Lloyd's. The balance sheet in the PFFS aggregates the assets held at syndicate level, members' assets held as funds at Lloyd's and the central resources of the Society. Overall, therefore, the PFFS aggregate the results and resources of the Society. The PFFS may, therefore, be used as a reasonable presentation of the results and state of affairs of the Lloyd's market on a basis that is broadly comparable with general insurance companies.

### Comparative figures for calendar year 2004

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

- The pro-forma annual accounting statements in the 2004 Annual Report were compiled from syndicate returns prepared by managing agents in accordance with instructions issued by Lloyd's. The agents were required to follow relevant accounting policies as set out in the instructions. With effect from 1 January 2005, syndicates prepare their annual accounts in accordance with UK GAAP and each business applies the accounting policies appropriate to their business. The restated figures for 2004 in the PFFS are based on the comparative figures for calendar year 2004 included in the aggregate accounts and reflect the differences arising now that full annual accounting has been adopted by syndicates. The comparative figures also include the results and net assets of ten syndicates which closed by reinsurance in 2004.
- The Society's financial statements have been restated to include the results of its two insurance subsidiary undertakings, Centrewrite Limited and Lioncover Insurance Company Limited, as required under UK GAAP from 1 January 2005 and the adoption of FRS 17 'Retirement Benefits'.

### Taxation

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

### Funds at Lloyd's

Funds at Lloyd's (FAL) comprise the capital provided by members to support their underwriting, and are the equivalent of capital shown in insurance companies' accounts. The valuation of FAL has been included in the Balance Sheet.

FAL comprise the three trust funds in which members' assets may be held: the Lloyd's deposit, the special reserve fund and the personal reserve fund held under the terms of the premiums trust deed. These are each available to meet cash calls made on the member in respect of a syndicate. The assets in funds at Lloyd's must be readily realisable, may include letters of credit and bank and other guarantees, and must be at least equivalent to the aggregate of the member's net funds at Lloyd's requirement and certain liabilities in respect of its underwriting business. Each member's net funds at Lloyd's requirement to support its underwriting at Lloyd's is determined using Lloyd's Individual Capital Assessment (ICA) capital setting methodology.

A notional investment return on FAL has been calculated, which is the equivalent of insurance companies generating investment return on the capital that they hold to support their underwriting. The notional investment return is calculated on the average value of FAL during the year, based on indices yields on each type of asset held. The typical investment return on bank deposits has been applied to FAL provided as letters of credit or bank guarantees.

### **Society of Lloyd's financial statements**

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

In order to present the Society financial information on a basis consistent with the aggregate accounts, the Society financial information is presented on a UK GAAP basis within the PFFS. The effect of restating the Society financial statements is shown in Note 8.

### **Transactions between syndicates and the Society**

- (1) Central Fund contributions, members' subscriptions and other market charges levied by the Society are reported as net operating expenses in the syndicate annual accounts and as income in the Society financial statements.
- (2) Central Fund claims and provisions to discharge the liability of members where they have unpaid cash calls and do not have the resources to meet those cash calls are reported as a profit and loss charge and balance sheet liability in the Society financial statements. The Central Fund other income includes recoveries from insolvent members. The aggregate accounts for calendar year 2005 and earlier years include those members' results and balances.
- (3) Syndicate loans to the Central Fund (and annual interest payments on the loans) are reported as assets (and accrued income) within the aggregate accounts. The Society financial statements report the loans as equity and account for interest payable when the Council formally approves interest payments.
- (4) Loans funding statutory overseas deposits are reported as assets within the syndicate annual accounts and as liabilities in the Society financial statements.

Transactions between the syndicates and the Society which have been reported within the syndicate annual accounts and the Society financial statements have been eliminated.

### **Inter-syndicate loans**

The aggregate accounts report debtor and creditor balances for inter-syndicate loans totalling £315m (2004: £245m). These amounts have been eliminated from the amounts reported in the balance sheet to provide a more meaningful presentation of the balance sheet for users of the PFFS.

### **Subordinated loan notes**

In late 2004, Lloyd's raised capital by issuing £500m of subordinated loan notes. In accordance with the terms of these notes, the capital raised is available for payment to policyholders in advance of repayment to the note holders. Accordingly, the amount of the notes is included in the 'capital, reserves and subordinated loan notes' as reported in the Balance Sheet.

## **3. Accounting Policies notes**

### **A. Syndicate annual accounts**

The accounting policies adopted in respect of the syndicate annual accounts are:

#### **General**

Under the Insurance Accounts Directive (Lloyd's Syndicates and Aggregate Accounts) Regulations 2004, managing agents must prepare the syndicate annual accounts under UK GAAP. However, where UK GAAP permits different accounting treatments, each managing agent is able to adopt the accounting policies it considers most appropriate to its syndicate. The following accounting policies are therefore of necessity 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 apportionment as appropriate.

# NOTES TO THE PRO FORMA FINANCIAL STATEMENTS continued

for the year ended 31 December 2005

## Reinsurance premium ceded

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

## Claims provisions and related recoveries

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

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

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

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

The directors of each syndicate's managing agent consider that the provisions for gross claims and related reinsurance recoveries are fairly stated on the basis of the information currently available to them. However, the ultimate liability will vary as a result of subsequent information and events and this 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 sterling using the exchange rates prevailing at the date of the transactions or the average rate may be used when this is a reasonable approximation.

Where the overseas operations for a syndicate are treated as a branch, its branch assets and liabilities are translated into sterling at the rates of exchange ruling at the balance sheet date. The exchange differences arising from the retranslation of the opening net investment in the branch are accounted for through reserves.

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

## Investments

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

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

### **Investment return**

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

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

Investment return is initially recorded in the non-technical account. A transfer is made from the non-technical account to the general business technical account. Investment return has been wholly allocated to the technical account as all investments relate to the technical account.

### **Taxation**

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

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

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

### **Operating expenses**

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

### **Profit commission**

Where profit commission is charged by the managing agent it does not become payable until after the appropriate year of account closes, normally at 36 months. The profit commission is accrued in the profit and loss account in accordance with the earned profit.

## **B. Funds at Lloyd's**

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

## **C. Society of Lloyd's**

The accounting policies adopted in the Society of Lloyd's financial statements in accordance with IFRS are set out on pages 17 to 24.

## **4. Variability**

Calendar year movements in reserves are based upon best estimates as at 31 December 2005 taking into account all available information as at the Balance Sheet date. These estimates are subject to variability until the date at which the underlying claims are settled. Such changes in best estimate are reflected in the technical account of the year in which they occur.

The effect of claims from Hurricanes Katrina, Rita and Wilma are included in the PFFS based on the disclosures reported in syndicate annual accounts.

## **5. Discontinued operations**

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

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

# NOTES TO THE PRO FORMA FINANCIAL STATEMENTS continued

for the year ended 31 December 2005

## 6. Members' funds at Lloyd's

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

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

## 7. Society of Lloyd's

The results of the group financial statements of the Society included in the profit and loss account are a net profit of £183m (2004: £2m loss) in the technical account and a net loss of £13m (2004: £36m loss) in the non-technical account.

## 8. Aggregation of results and net assets

A reconciliation between the results, statement of total recognised gains and losses and net assets reported in the syndicate annual accounts, members' funds at Lloyd's and the Society financial statements is set out below:

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

|  | 2005        | 2004           |
|--|-------------|----------------|
|  | £m          | Restated<br>£m |
| Result for the financial year                                      | (103)       | 1,367          |
| Other recognised gains and losses per syndicate annual accounts    | (14,832)    | (212)          |
| Other recognised gains and losses per Society financial statements | (1)         | 2              |
| Elimination of prior year adjustment in syndicate annual accounts  | 14,875      | 188            |
| <b>Total recognised gains and losses</b>                           | <b>(61)</b> | <b>1,345</b>   |

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

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

## 9. Financial information

The financial information set out above is derived from the pro forma financial statements for the year ended 31 December 2005 which were approved by the Council of Lloyd's on 5 April 2006. Those statements were not subject to audit but were reviewed by Ernst & Young LLP to confirm that the pro forma financial statements had been prepared in accordance with the stated basis of preparation. The review report was unqualified.

The pro forma financial statements 2005 will be included in the Lloyd's Annual Report which is expected to be available no later than 19 May 2006. Copies of the Lloyd's Annual Report may be obtained from that date by writing to the Secretary to the Council of Lloyd's, Lloyd's, 1 Lime Street, London, EC3M 7HA.

# **SOCIETY OF LLOYD'S FINANCIAL STATEMENTS**

## GROUP INCOME STATEMENT

for the year ended 31 December 2005

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

## GROUP STATEMENT OF RECOGNISED INCOME AND EXPENSE

for the year ended 31 December 2005

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

# GROUP BALANCE SHEET

as at 31 December 2005

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

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



Lord Levene of Portsoken, Chairman



Luke Savage, Director, Finance & Risk Management  
and acting Chief Executive Officer

# GROUP CASH FLOW STATEMENT

for the year ended 31 December 2005

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

# NOTES TO THE FINANCIAL STATEMENTS

as at 31 December 2005

## 1 Basis of preparation and consolidation

In 1871, by Lloyd's Act 1871, the then existing association of underwriters was incorporated as the Society and Corporation of Lloyd's (Lloyd's or the Society or the Corporation of Lloyd's). Its activities are accordingly governed by statute and, since 1982, have been managed by the Council of Lloyd's (the Council) pursuant to Lloyd's Act 1982.

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

The Society's main corporate purposes are to facilitate the carrying on of insurance business by members of Lloyd's and the advancement and protection of their interests in this context. The group financial statements of the Society comprise the financial statements of the Society of Lloyd's and all its subsidiary undertakings, the Lloyd's Central Fund and the group's interest in associates as at each balance sheet date. Subsidiary undertakings are consolidated from the date of their acquisition, being the date on which the Society obtains control, and continues to be consolidated until the date that such control ceases. The financial statements are prepared using consistent accounting policies. All intra-group balances and transactions have been eliminated in full.

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

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

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

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

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

## 2 Summary of significant accounting policies

### Adoption of IFRS

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

#### (a) Investments in associates

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

## 2 Summary of significant accounting policies continued

### Adoption of IFRS continued

#### (b) Recognition of other financial assets

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

#### (c) Cumulative translation differences

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

#### (d) Estimates

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

#### (e) Pension scheme

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

### Principal accounting policies

#### A Property, plant and equipment

Property, plant and equipment are held at cost less accumulated depreciation and any impairment in value.

Depreciation is charged on a straight line basis on the following principal categories:

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

#### B Assets classified as held for sale

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

#### C Software development

Costs incurred in acquiring and developing computer software are capitalised as intangible assets where the software supports a significant business system and the expenditure leads to the creation of an identifiable asset of value. Software development is held at cost less accumulated depreciation and any impairment in value. Capitalised software is amortised over 4 years.

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

### **D Lloyd's Collection**

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

### **E Investment in associates**

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

Under the equity method, the investment in associate is carried in the balance sheet at cost plus post-acquisition changes in the Society's share of net assets of the associate. Goodwill relating to an associate is included in the carrying amount of the investment and is not amortised. After application of the equity method, the Society determines whether it is necessary to recognise any additional impairment loss with respect to the Society's net investment in the associate. The group income statement reflects the share of the results of operations of the associate. Where there has been a change recognised directly in the equity of the associate, the group recognises its share of any changes and discloses this, when applicable, in the group statement of recognised income and expense.

### **F Impairment of assets**

The Society performs annual impairment testing to assess whether there is an indication that an asset may be impaired. If any such indication exists the Society makes an estimate of the asset's recoverable amount. An asset's recoverable amount is the higher of an asset's fair value less costs to sell and its value in use. When the carrying amount exceeds its recoverable amount, the asset is considered impaired and written down to its recoverable amount.

### **G Financial instruments**

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

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

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

**ii) Loans and receivables**

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

**iii) Other financial liabilities**

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

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

## 2 Summary of significant accounting policies continued

### G Financial instruments continued

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

#### iv) Non-hedging derivatives

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

#### v) Fair value estimation

The fair value of financial instruments traded in organised active financial markets is based on quoted market prices at the close of business on the balance sheet date. The quoted market price used for financial assets held by the Society is the current bid price; the appropriate quoted market price for financial liabilities is the current offer price.

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

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

### H Insurance contracts (liabilities and reinsurance)

In accordance with IFRS 4 'Insurance Contracts', the Society has applied existing accounting practices for insurance contracts, modified as appropriate to comply with the IFRS framework and applicable standards. This includes the application of the Statement of Recommended Practice (SORP) on accounting for insurance business issued by the Association of British Insurers in December 2005.

Insurance contracts are defined as those containing significant insurance risk if, and only if, an insured event could cause an insurer to pay significant additional benefits in any scenario, excluding scenarios that lack commercial substance, at the inception of the contract. Such contracts remain insurance contracts until all rights and obligations are extinguished or expire. Contracts can be reclassified as insurance contracts after inception if insurance risk becomes significant. Any contracts not considered to be insurance contracts under IFRS are classified as investment or service contracts.

Reinsurance assets primarily include amounts due from Equitas Reinsurance Limited arising from the reinsurance arrangements entered into by Lioncover. An impairment review is performed on all reinsurance assets when an indication of impairment occurs. Reinsurance assets are impaired only if there is objective evidence that the Society may not receive all amounts due to it under the terms of the contract and that this can be measured reliably.

### I Inventories

Inventories are stated at the lower of cost and net realisable value on a first in, first out (FIFO) basis. Net realisable value is the estimated selling price in the ordinary course of business less estimated costs necessary to make the sale.

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

### **J Employee benefits**

The Society accounts for pensions and similar benefits (principally income protection due to ill health) under IAS 19 'Employee Benefits'. The Corporation of Lloyd's operates a defined benefit pension scheme in which obligations are measured at discounted present value using the projected unit credit method, while plan assets are recorded at fair value. The operating and financing income and costs of the scheme are recognised in the group income statement. Service costs and financing income and costs are recognised in the periods in which they arise. Actuarial gains and losses are recognised in full in the group statement of recognised income and expense in the period in which they occur. Discretionary awards in respect of past service costs are recognised in the group income statement when awarded.

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

### **K Loans recoverable**

Recoverable Central Fund loans made to hardship Names are recognised at fair value. Any gains and losses arising from changes in the fair value are included in the group income statement in the period in which they arise.

### **L Taxation**

Corporation tax on the surplus or deficit for the periods presented comprises current and deferred tax. Corporation and income tax is recognised in the group income statement except to the extent that it relates to items recognised directly in equity, in which case it is recognised in equity.

Current tax is the expected tax payable on the taxable income for the year, using tax rates enacted or substantially enacted at the balance sheet date, and any adjustment to tax payable in respect of previous years.

Deferred tax liabilities are recognised for all taxable temporary differences and deferred tax assets are recognised for all deductible temporary differences and unutilised tax losses to the extent that it is probable that taxable profits will be available against which the deductible temporary differences or tax losses can be utilised.

Deferred tax is measured on an undiscounted basis at the rates that are expected to apply in the periods in which timing differences reverse, based on tax rates and laws enacted or substantially enacted at the balance sheet date.

### **M Subordinated loan notes**

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

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

### **N Cash and cash equivalents**

For the purposes of the group cash flow statement, cash comprises cash at banks and demand deposits, and cash equivalents comprise highly liquid investments that are convertible into cash with an insignificant risk of changes in value with original maturities of less than three months.

### **O Income recognition**

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

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

### **O Income recognition** continued

#### **i) Members' subscriptions, market charges and other services**

Members' subscriptions, market charges and other services are recognised in the period to which the service is provided. They are recognised on a basis that reflects the timing, nature and value of the benefits provided.

#### **ii) Central Fund contributions**

Central Fund contributions from members underwriting in the year are recognised when no significant uncertainty as to its collectibility exists.

#### **iii) Interest income**

Interest receivable is recognised in the group income statement on a time apportioned basis using the effective interest method. Any unwinding of discount is recognised as interest income.

#### **iv) Dividend income**

Dividend income from equity investments is included in the group income statement on the ex-dividend date.

#### **v) Other income**

Other income consists of market settlement recoveries which represent continuing debt recoveries from the 1996 *Reconstruction and Renewal* settlement and recoveries in respect of undertakings given by the Lloyd's Central Fund. Other income is recognised when recoverability is agreed.

### **P Insurance premiums**

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

### **Q Insurance claims**

Claims incurred in insurance related activities consist of claims and claims handling expenses paid during the year together with the movement in outstanding claims. Outstanding claims are the estimated final cost of all claims incurred but not settled at the balance sheet date, including claims incurred but not reported (IBNR). Outstanding claims are not discounted. Subsequent information and events may result in the ultimate liability being less than, or greater than, the amount provided. Any differences between the provision and subsequent settlements are reflected within the group financial statements of later years.

### **R Central Fund claims and provisions**

Central Fund claims and provisions (undertakings) are accounted for when they are approved by the Council and become contractual commitments. These undertakings are granted wholly at the discretion of the Council on an annual basis and therefore are not deemed to be constructive obligations. For those corporate members in provisional liquidation, the Council provides a supporting commitment, which will ensure that in no circumstance will an insurance creditor receive less than the amount it would have received in a winding up commencing on the date of the provisional liquidation. As the supporting undertakings are legally enforceable commitments an estimate of their value is included within provisions in the group financial statements and changes during the period are reflected in the group income statement.

Recoveries in respect of the undertakings previously given are credited to the group income statement when contractually committed to be received.

## 2 Summary of significant accounting policies continued

### S Foreign currency and derivative instruments

#### i) Functional and presentation currency

The group financial statements are presented in sterling, which is the Society's functional and presentation currency. Items included in the financial statements of each of the Society's entities are measured using the currency of the primary economic environment in which the entity operates (the functional currency).

#### ii) Transactions and balances

Transactions in foreign currencies are recorded at the exchange rate prevailing on the date of the transaction. At each balance sheet date, monetary assets and liabilities denominated in foreign currencies are retranslated at the exchange rate prevailing at the balance sheet date. Translation differences on monetary items are taken to the group income statement.

Translation differences on non-monetary items measured at fair value are reported as part of the fair value gain or loss and are included in either the group statement of recognised income and expense or the group income statement as appropriate.

The results and financial position of overseas Society operations are translated into sterling as follows:

- Assets and liabilities are translated at the closing rate at the date of that balance sheet;
- Income and expenses are translated at the average exchange rate for the year;
- All resulting exchange differences are recognised as a separate component of equity.

The Society enters into forward currency contracts to manage exposures to fluctuation in foreign exchange rates, and to provide a service to the Lloyd's market. Where contracts are entered into to cover foreign exchange exposure or provide a service to the Lloyd's market, the fair value is determined using spot amortised exchange rates at the balance sheet date. Where gains and losses are not expected to be refunded to or recovered from the Lloyd's market, these amounts are taken to the group income statement. There are no embedded derivatives separated from the host contract or that are designated as hedging instruments.

The principal year end exchange rates were:

|       | 2005 | 2004 |
|-------|------|------|
| US\$  | 1.72 | 1.92 |
| Can\$ | 2.01 | 2.30 |
| Euro  | 1.46 | 1.41 |

### T Leases

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

### U Syndicate loans

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

**2 Summary of significant accounting policies** continued**V New standards and interpretations not applied**

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

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

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

**3 Segmental analysis**

Segment information is presented in respect of the Society's business segments. The primary business segments are based on the Society's management and internal reporting structure.

Intra-segment pricing is determined on an arm's length basis.

Segment results, assets and liabilities include items directly attributable to a segment as well as those that can be allocated on a reasonable basis.

Segment capital expenditure is the total cost incurred during the year to acquire segment assets that are expected to be used for more than one period.

Segment information in respect of geographical location is not presented. The Society's main source of income is from the Lloyd's market based primarily in the UK. Assets are primarily held by the Society's UK based operations.

### 3 Segmental analysis continued

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

# NOTES TO THE FINANCIAL STATEMENTS continued

as at 31 December 2005

## 3 Segmental analysis continued

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

### 3 Segmental analysis continued

The Society's primary business segments are as follows:

- i) Corporation of Lloyd's and non-insurance related subsidiary undertakings: the main corporate purposes are to facilitate the carrying on of insurance business by members of Lloyd's and the advancement and protection of their interests in this context. The activities of authorised insurance company subsidiary undertakings are excluded from this business segment.
- ii) Lloyd's Central Fund: these funds comprising the New Central Fund and the 'Old' Central Fund are assets of the Society and are held and administered at the discretion of the Council, primarily as funds available for the protection of policyholders.
- iii) Insurance activities: the Society has two insurance company subsidiary undertakings, Centrewrite Limited and Lioncover Insurance Company Limited. Centrewrite provides Exeat insurance to resigned members participating only on run-off syndicates allowing an early exit from Lloyd's and Estate Protection Plan insurance to members. The insurance contract liabilities of Lioncover were wholly reinsured into Equitas in 1997 and the company does not accept new business.

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

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

# NOTES TO THE FINANCIAL STATEMENTS continued

as at 31 December 2005

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

The Council has given undertakings with financial limits to certain corporate members to use the New Central Fund to discharge the liability of those members where they have unpaid cash calls and do not have the resources to meet those cash calls. The purpose of these undertakings is primarily to allow valid claims made on policies underwritten by those insolvent members to continue to be paid in full. Undertakings are accounted for when they are approved by the Council and become contractual commitments. These undertakings are granted wholly at the discretion of the Council on an annual basis and therefore are not deemed constructive obligations. Unutilised undertakings as at 31 December 2005 were £163.9m. By 31 March 2006 this balance had been reduced to £4.8m by the payment of claims of £47.4m and the expiry of undertakings totalling £111.7m, which had been given in 2005. Those undertakings which expired have been replaced and further annual undertakings have been given on 5 April 2006 that total £174.9m, a net increase of £63.2m. No provision has been included in these financial statements in respect of these further undertakings.

For those corporate members in provisional liquidation, the Council has also provided a supporting commitment, which will ensure that in no circumstance will an insurance creditor receive less than the amount it would have received in a winding up commencing on the date of the provisional liquidation. As the supporting undertakings are legally enforceable commitments an estimate of their value has been included within provisions in the group financial statements and changes during the year are reflected in the group income statement, as shown in the table above.

|   | 2005<br>Undertakings<br>given to<br>insolvent<br>members<br>£000 | 2005<br>Other<br>£000 | 2005<br>Total<br>£000 | 2004<br>Total<br>£000 |
|---|--|-----------------------|-----------------------|-----------------------|
| <b>5 Provisions</b>                     |  |                       |                       |                       |
| Balance at 1 January                    | 103,219  | 5,366                 | 108,585               | 105,109               |
| Charged to the group income statement   | 217,438  | 6,043                 | 223,481               | 146,276               |
| Arising on sale of assets held for sale | –  | 1,343                 | 1,343                 | –                     |
| Utilised in the year                    | (145,587)  | (4,704)               | (150,291)             | (142,800)             |
| Balance at 31 December                  | 175,070  | 8,048                 | 183,118               | 108,585               |

#### Provision for undertakings given to insolvent members

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

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

**6 Contingent liabilities**

- A) General average guarantees have been given on behalf of, and secured by, Lloyd’s underwriters. It is estimated that the aggregate of the liabilities attaching to these guarantees at 31 December 2005 amounted to £14.3m (2004: £9.3m).
- B) The Society has taken on the responsibilities of some individual Names under hardship and other agreements. The Society has also given indemnity bonds to Lioncover Insurance Company Limited (Lioncover) and Centrewrite Limited (Centrewrite) respectively against any shortfall in their assets.

Following the implementation of *Reconstruction and Renewal*, Names underwriting in respect of 1992 and prior years, Lioncover and Centrewrite were reinsured into Equitas. If Equitas were unable to discharge in full the liabilities which it has reinsured any resulting shortfall in respect of Lioncover or Centrewrite could be met out of both the ‘Old’ Central Fund and the New Central Fund under the terms of their respective Lloyd’s bond. Both the ‘Old’ Central Fund and the New Central Fund would also be available to meet the claims of policyholders of Names who are party to hardship agreements executed before 4 September 1996, to the extent that such an event resulted in a shortfall. However, unless the members of the Society resolve in a general meeting to make the New Central Fund available, only the ‘Old’ Central Fund would be available to meet the claims of policyholders of Names who are not party to hardship agreements executed before 4 September 1996.

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

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

|  |                |                        | 2005<br>£000 | 2004<br>£000 |
|--|----------------|------------------------|--------------|--------------|
| Guarantees provided by the Corporation of Lloyd’s:                                   |                |                        |              |              |
| USA  | US \$1,500,000 | (2004: US \$1,500,000) | <b>872</b>   | 781          |
| Guarantees provided by the Corporation of Lloyd’s and Additional Securities Limited: |                |                        |              |              |
| Cayman Islands:  |                |                        |              |              |
| Letter of credit   | US \$1,000,000 | (2004: US \$1,000,000) | <b>581</b>   | 521          |

- D) The Corporation of Lloyd’s has given indemnities to certain of its subsidiary undertakings, and the directors thereof, in respect of any claims or actions which may be brought against them or any future operating losses incurred by them in connection with the companies’ activities. The Corporation of Lloyd’s has also given indemnities to and has agreed to cover certain specific costs that may be incurred by members of the Council, Lloyd’s Franchise Board, Lloyd’s Regulatory Board and Lloyd’s Market Board (the latter two boards ceased during 2002) and of their respective sub-committees, Corporation staff and also certain individuals and organisations who have been asked to carry out or provide services to the Corporation or on behalf of, or for the benefit of its members.
- E) Lloyd’s has been joined to an action brought by certain Lloyd’s underwriters against certain brokers in respect of the underwriting of insurance in Italy. Lloyd’s does not accept any liability in respect of this action.
- F) Three Names have commenced proceedings claiming misfeasance in public office against Lloyd’s in respect of an alleged failure to regulate, leading to the Names incurring underwriting losses as members of the 1993 accounts of syndicates 103 and 178, the business of which it is claimed was unauthorised and conducted fraudulently by their managing agents. Lloyd’s does not accept any liability in respect of this action.
- G) A counterclaim alleging fraud by Lloyd’s has been filed in the USA by one name, in response to Lloyd’s proceedings seeking recognition of a judgment obtained by Lloyd’s in England. Lloyd’s does not accept any liability in respect of this claim.

## **6 Contingent liabilities** continued

- H) In Quebec, proceedings have been issued by Agence Nationale D'Encadrement Du Secteur Financier as the regulator of the Quebec policyholder protection fund against Lloyd's and other parties arising out of the issue by a coverholder of purported "policies of insurance" without the authority of a Lloyd's syndicate. Lloyd's does not accept any liability in respect of this action.
- I) Two individuals have commenced an action in Alabama, USA against Lloyd's underwriters, Lloyd's and certain members and former members of the Council claiming damages in respect of an alleged wrongful failure to pay an insurance claim and failure to provide adequate supervision over certain Lloyd's underwriters. Lloyd's does not accept any liability in respect of this action.
- J) On 15 April 2005 the Lloyd's Chatham building was sold. The sale proceeds received of £9.6m are contingent on certain conditions not occurring within three years of the sale date. The maximum amount repayable is £3.6m of which £1.3m has been included in other provisions.

In respect of contingent liabilities noted above in paragraphs (A) – (I), no provision has been made in these financial statements.

## **7 Financial information**

The financial information set out above is derived from the Society of Lloyd's financial statements for the year ended 31 December 2005 which were approved by the Council of Lloyd's on 5 April 2006. The auditors' report on those financial statements was unqualified.

The 2005 Society financial statements will be included in the Lloyd's Annual Report which is expected to be available no later than 19 May 2006. Copies of the Lloyd's Annual Report may be obtained from that date by writing to the Secretary to the Council of Lloyd's, Lloyd's, 1 Lime Street, London, EC3M 7HA. The Annual General Meeting will be held at the same address on 21 June 2006.

