

Lloyd's **Annual Report**
2003



LLOYD'S

Annual report

Regulatory disclaimer for use on lloyds.com

1. The communication of information and services on the lloyds.com site is not intended for distribution to, or use by, any person or entity in any jurisdiction or country where such distribution or use would be contrary to local law or regulation. In particular, the contents and/or subject matter of the lloyds.com site does not constitute an offer of information, products or services to U.S. persons or in the United States, or in any other jurisdictions where such an offer may be unlawful.
2. Furthermore, the lloyds.com site and attached communications do not represent a prospectus or invitation in connection with any solicitation of capital. Nor does it constitute an offer to sell securities or insurance, a solicitation of an offer to buy securities or insurance, or a distribution of securities in the United States or to a U.S. person, or in any other jurisdiction where it is contrary to local law. Such persons should inform themselves about and observe any applicable legal requirement.
3. No responsibility or liability is accepted by the Society of Lloyd's, the Council, any Committee or Board constituted by the Society of Lloyd's or the Council or any of their respective members, officers or advisors for any loss occasioned to any person acting or refraining from action as a result of any statement, fact, figure or expression of belief contained in this document or communication.
4. Applicants and potential applicants should take steps to understand Lloyd's, the Lloyd's market and the implications of participating in it. Applicants should understand that risk is the nature of insurance business and is inherent in the business underwritten at Lloyd's.
5. Lloyd's provides the material contained in this document or communication for general information purposes only. Lloyd's accepts no responsibility and shall not be liable for any loss which may arise from reliance upon the information provided.

Lloyd's 2003 Annual Report

Corporation of Lloyd's

55	Chief Executive Officer's report
58	Operating and financial review
62	Report of the Nominations, Appointments and Compensation Committee
69	Lloyd's Members' Ombudsman's report
70	Statement of Lloyd's responsibilities in respect of the financial statements
70	Independent auditor's report to the members of Lloyd's
71	Consolidated revenue account
71	Consolidated statement of total recognised gains and losses
72	Consolidated balance sheet
73	Consolidated cash flow statement
74	Notes to the financial statements
92	Five year summary

Lloyd's Central Fund

93	Summary
94	Independent auditor's report to the Council of Lloyd's
95	Balance sheet
96	General fund account
97	Cash flow statement
98	Notes to the financial statements

Chief Executive Officer's report

'We must now build on the foundations laid down in the last couple of years to provide an enduring, distinctive and attractive marketplace for brokers, policyholders and capital providers.'

In 2003, the Lloyd's market continued to trade strongly and remained focused upon maximising the opportunities afforded by excellent trading conditions. This resulted in another year of substantial profits and continuing high levels of premium income justified by the strong premium rating environment. The market is well positioned to trade forward successfully.

While there were significant shifts in the financial strength ratings of several of the world's highest rated reinsurers and insurers, Standard & Poor's and AM Best both affirmed their financial strength ratings of the Lloyd's market at A (Strong) and A- (Excellent) respectively. Lloyd's is proud to have maintained stable security during a time of considerable upheaval for insurance buyers and cedants.

Evolution of the Franchise

The Corporation of Lloyd's provides the physical, supervisory, operating and financial infrastructure for the Lloyd's market. Its function has continued to evolve in the last year from traditional statutory regulator to encompass a wider new role of protecting and enhancing the Franchise. As Franchisor, it has the overriding goal of creating and maintaining a sound commercial environment in which the profitability of the market can be maximised.

2003 was a successful year for Lloyd's in achieving a number of its strategic objectives with the implementation of a number of key initiatives.



Chief Executive Officer's report continued

Franchise Performance Directorate

The Lloyd's Franchise Board, created in 2002 to replace the Lloyd's Market Board and the Lloyd's Regulatory Board, oversees the development, implementation and ongoing management of the Franchise. One of the key objectives of the Franchise Board was to establish a new Franchise Performance Directorate. This Directorate, under the leadership of Rolf Tolle, now operates as a core unit of the Franchisor and has recruited a strong team with relevant underwriting and market knowledge. The unit has successfully completed the first stage of the Franchisee business planning cycle through its review of syndicate business plans for the 2004 year of account.

Risk management

A robust risk management capability is central to the security and profitability of the Franchise. A risk management framework for Lloyd's has been developed. A number of departments across the organisation have worked together to identify, prioritise and address those risks that could threaten the achievement of Franchise objectives. This process will need regular update and review and this will continue under the direction of the Franchise Board during 2004.

The Risk Management Division has undergone significant change during 2003. It has developed its role to focus on providing a top quality risk management function. The Division has established links with the wider risk management community which have been mutually beneficial. A strengthened loss-modelling team has worked with market experts both to overhaul the market's realistic disaster scenario reporting and to improve the consistency and accuracy of monitoring underwriting aggregation risks by syndicates and the Franchise.

Licence, service and brand strategy

We continue to develop Lloyd's as the marketplace of choice for policyholders, brokers, underwriters and capital providers. During the year we have carried out a detailed assessment of the relative value and competitiveness of Lloyd's international trading platform. The findings are being used to inform future brand, customer service and licence development strategy.

In relation to the latter, China continued to be a key focal point and a milestone was reached in July when Lloyd's submitted an application to the Chinese regulator to obtain approval in principle for a local establishment that would provide Chinese insurers with access to Lloyd's reinsurance capacity in local currency. We are working hard with the authorities in China to progress this.

The promotion of Lloyd's worldwide continued throughout the year, in particular in the United States, Europe and Asia, supported by a comprehensive programme of structured visits to Lloyd's by international producer groups and overseas journalists.

We recently launched a project to define what the brand stands for now and what it should stand for in the future. A brand specialist was appointed to head up the Brand Strategy team to develop and protect the Lloyd's brand in all its markets and with all stakeholder groups.

Annual accounting

The year has seen significant progress in Lloyd's move to annual accounting as the main statutory reporting regime for the market. This project is integral to the development and modernisation of Lloyd's. As part of the European Commission's work to modernise the Insurance Accounts Directive, amendments were made to the directive and this now provides the necessary

framework to enable Lloyd's to adopt annual accounting for statutory reporting purposes. The move to annual accounting represents a considerable step forward in the creation of a modern and transparent marketplace and will increase clarity and comparability of performance with our global peers. Much work remains to be done during 2004 to ensure a smooth transition to UK GAAP.

Process reform

Lloyd's is also fundamentally committed to the reform of market practices to ensure that it maintains its position as the pre-eminent market for the placement of global, commercial and specialist risks. Through its drive for improved efficiencies, contract clarity and reduced operating costs, Lloyd's will provide a framework for a thriving marketplace. The appointment of a Head of Business Process Reform, Iain Saville who brings significant experience of process change in the securities market, will ensure that all reform activities are co-ordinated at the highest level.

In 2003 the Lloyd's Franchise Board mandated a standard slip for the placement of risks at Lloyd's and is in the process of implementing a compliance framework to ensure that all business placed at Lloyd's conforms to the standard. Work is also in hand to develop an internationally recognised standard to support the electronic placement of risks and to provide the technology to enable the electronic processing of claims.

Kinnect, formerly 'Project Blue Mountain', has started to process underwriting risks. This Lloyd's funded initiative to introduce an industry wide platform to facilitate the electronic flow of risk information between brokers and underwriters remains key to Lloyd's agenda for industry reform. Lloyd's will continue to invest in Kinnect while it

achieves demonstrable progress with its current partners and engages with key brokers and underwriting customers.

Research has also begun into developing strategies for the management of claims and reinsurance for the Franchise. The initial work will concentrate on identifying potential opportunities for economies of scale, improvements in service levels and reduction in processing cost.

A significant threat to the Central Fund is posed by exposures generated by open and run-off years. We have become more proactive in the management of run-off syndicates by strengthening management reporting and developing outsourcing solutions in order to improve run-off performance.

Central Fund

The Central Fund grew by £235m to £711m in 2003, achieving the target set immediately after September 11, 2001 to increase central assets to over \$1bn by the end of 2003. This allowed us to cease the 2% premium income levy. Market losses, principally in 2001, resulted in claims against the Central Fund with £466m being paid in 2002 and a further £191m in 2003. These claims have triggered coverage under the Central Fund insurance and the amounts recoverable have been accounted for at full value.

As advised last year, the insurers dispute their liability to meet claims made under the policy. Lloyd's does not accept that the insurers have any grounds for disputing liability and in April 2003 commenced arbitration proceedings to secure full payment under the terms of the policy. These proceedings are expected to be concluded in 2004.

Confidence in the future

Assisted by very favourable trading conditions, Lloyd's has achieved much in 2003. However this should not give us cause for complacency; if we are to achieve our goals of a strong and stable marketplace there is still much to be done. We must now build on the foundations laid down in the last couple of years to develop the dynamic entrepreneurial environment that will provide a distinctive and attractive marketplace for brokers, policyholders and capital providers.

I am very pleased that our capital providers demonstrated their continued confidence in the market by providing capacity of £15bn for the 2004 year. Equally, the market must be prepared to reduce its underwriting when conditions are less favourable.

It goes without saying that without the dedicated, professional and enthusiastic commitment of all Corporation staff, many of the achievements I have reported above would not have been possible. I would like to offer them my sincere thanks. Finally I would like to pay particular tribute to Andrew Moss who will be leaving us in May to become Group Finance Director of Aviva plc. He has made an outstanding contribution during his three and a half years at Lloyd's, not least at the time of September 11 and in the work of the Chairman's Strategy Group and its implementation, and we wish him well for the future.



Nick Prettejohn

Chief Executive Officer
7 April 2004

Operating and financial review

Operating review

The objective of the operations function, created last year, continues to be the provision of value for money services to the market, including those relating to information technology, facilities and administrative and other services to members.

Strong focus is placed on the maintenance of an effective commercial relationship with suppliers following the successful implementation over the last five years of Lloyd's outsourcing strategy. In particular, considerable work was undertaken in 2003 to clarify and improve the relationship between Lloyd's, the market and the new Xchanging companies: XIS (Xchanging Ins-sure) and XCS (Xchanging Claims Services). This enabled a full service level agreement to be established to cover the services provided by XIS and XCS to the market and to Lloyd's. In addition, a new supplier management framework was designed to ensure all parts of the Franchisor improve their management of suppliers and this is being implemented during 2004.

Significant improvements were made to Lloyd's business continuity arrangements. Infrastructure improvements, including new communication links between Lloyd's sites in London and Chatham, were delivered on time and within budget. New relationships were established with providers of back-up facilities for both the Franchisor and the Underwriting Room. Lloyd's will be working closely with the market and broking communities to design and test recovery facilities and arrangements during 2004.

Information technology

Lloyd's Information Technology Group continued to provide infrastructure and application services to a wide variety of internal and market customers during 2003, successfully meeting all service level agreements. It further capitalised on revised contract terms with its key suppliers and reduced staff headcount by 15%, which enabled a significant reduction in operational costs and continued the downward cost trend of the previous two years.

The standardisation and upgrade of the Lloyd's desktop office environment to current levels of software was completed successfully, leading to reduced support costs and an opportunity for user productivity gains over time.

An information management programme was established with a workplan focused on the improved collection, storage and distribution of data used by Lloyd's in the management of its business. A centrally managed data warehouse will be established during 2004 and incrementally populated from the key Lloyd's data sources to enable better access to information.

Property

Property Services have maintained the quality of building and facilities services during 2003 and have undertaken a number of operational assessments to identify methods of further enhancing services. In particular, a customer survey of users of the Underwriting Room was completed late in 2003 and the results of this survey will form the basis of improvements to be implemented during 2004.

The level of physical security for the Lloyd's 1986 building remained under constant review throughout 2003 with the support of the appropriate sections of the City of London Police. When necessary, building security has been supplemented in response to the prevailing threat level.

Members' Services

2003 has been a year of significant change for Members' Services. A number of projects have been successfully delivered to ensure that the pace of improvement is maintained. The number of members served by Members' Services fell from 14,500 to 10,000 as a result of the closure of some run-off syndicates. This significant fall in customer numbers will reduce income in 2004 and make a price rise unavoidable in order to cover Members' Services' costs. Alongside this price rise, the method of applying charges to members has been updated both to streamline the process and to ensure better alignment to the 'user pays' principle.

Financial review

Overall operating expenses from continuing operations in 2003 have increased by less than 1% from £159.2m to £160.3m. Increased operating income, principally as a result of the effect of increased market capacity on members' subscriptions, has reduced the group operating deficit to £26.8m for the year from a deficit of £29.9m in 2002.

The overall deficit for the year after taxation is £17.3m, before taking account of a further unrealised gain of £0.5m relating to the disposal of LPSO Limited in 2001, reducing the Corporation's net assets to £70.4m as at 31 December 2003 from £87.2m at the end of 2002.

The Corporation's share of operating profits from its interests in XIS and XCS, before taxation and amortisation of goodwill, is £3.4m (2002: £2.9m) reflecting the continued financial success of these ventures. This enabled the Corporation to pay £2.1m to the Lloyd's market in 2003 effectively as a rebate of charges that have been paid to XIS and XCS.

Centrewrite, a group company which is not consolidated, has declared a dividend of £7.49m for 2003 (2002: £2.75m). The dividend reflects the company's ability to release reserves as open years of account close, facilitated by the Lloyd's run-off and open years project.

Operating income from continuing operations has increased in 2003 to £133.5m from £129.3m in 2002. This includes an increase in the amount received from members' subscriptions of £4.5m, which is based on premium limits. The rate at which members' subscriptions have been charged was 0.25% of premium limits. The Lloyd's market was notified in 2003 that this charge, which had been unchanged since 2000, was increased to 0.5% for 2004. This will increase the Corporation's resources and flexibility in 2004 and will specifically provide funding for Kinnect in 2004 which has been set at £15m, contingent upon successful achievement of performance milestones and in particular the engagement of key brokers and underwriting customers.

Control of the Corporation's operating expenses in 2003 has restricted the increase during the year to £1.1m, or less than 1%. Total operating expenses include the development costs of Kinnect of £17.9m in 2003 (2002: £19.9m) and the costs of the new Franchise Performance Directorate of £3.2m.

In setting its budgets for 2004 the Corporation is seeking to report at least a break even operating result, with costs being constrained by the level of charges, principally members' subscriptions, that are borne by the Lloyd's market. A significant element of the budget is allocated to initiatives such as Kinnect, which represents an investment for the future, and to other projects to meet the Franchise Board's strategic imperatives.

The Lloyd's market has since 1997 been subject to a premium levy. This levy ceased at the end of 2003. The levy was initially used to repay a £285m syndicated bank loan required as part of the market's contribution to the 1996 Reconstruction & Renewal settlement. However, post September 11, 2001, in order to boost the central assets of the Society, the Council decided to continue the premium levy in 2002 and 2003 at an increased rate of 2% for most classes of business, except for life and UK motor business which was reduced to 1%. Contributions to the Lloyd's New Central Fund total £279.5m for 2003, representing all premium levy collections received and an accrual for amounts receivable after the end of the year. Since September 11 transfers to the Lloyd's New Central Fund, including cash reserves of the Corporation as well as premium levy receipts, have exceeded £600m.

Market settlement recoveries in 2003 were £7.9m (2002: £5.6m) arising principally from debt recovery activity. Lloyd's remains determined to secure the maximum amount available from those Names with outstanding liabilities and who have the ability to pay.

Cash flows and liquidity

Net funds increased during 2003 from £42.6m to £55.9m. There are no bank borrowings.

Accounting policies

The Corporation's accounting policies are set out in the financial statements and are consistent with the prior year.

The Accounting Standards Board has deferred mandatory implementation of FRS 17 'Retirement Benefits', and this Standard has not been adopted by the Corporation. However, transitional disclosures are included in the notes to the financial statements.

Under the valuation bases required by FRS 17, the Lloyd's Pension Scheme shows a net deficit of £36m, after allowance for deferred taxation, as at 31 December 2003. This is reduced from a net deficit of £47m as at 31 December 2002.

An interim actuarial review of the scheme was undertaken in 2003. With respect to the scheme's liabilities, a change in the assumptions has been made. In the past the actuary had allowed for discretionary increases to pre 6 April 1997 benefits in excess of the Guaranteed Minimum Pension to increase in line with inflation. However, the actuaries, Watson Wyatt LLP, were instructed not to allow for such increases in calculating the scheme's liabilities when carrying out the interim review and for future actuarial valuations.

Such increases have always been payable at the discretion of Lloyd's and will continue to be considered on the basis of affordability, but are no longer taken into account by the actuary in determining the funding level. In November 2003, a discretionary increase of 2.8% was awarded for 2004.

Following the interim actuarial review in 2003, contributions to the scheme have recommenced in January 2004 at 17% of pensionable salaries. An asset-liability modelling study of the scheme was undertaken during 2002. The objective of the long term asset allocation strategy is to minimise the potential volatility of future contributions.

Operating and financial review continued

Treasury policies

The Corporation's objectives and policies for holding financial instruments and similar contracts, and the strategies for achieving those objectives, are described below.

Interest rate risk

Borrowings from the Lloyd's market for the purpose of funding insurance deposits do not bear a fixed rate of interest. Instead, investment returns earned on the borrowed assets are passed on to lenders. Consequently, no interest rate risk arises on such borrowings. The Corporation had no other significant borrowings at 31 December 2003. Short term assets held by the Corporation, and related companies, may be significant at certain times but such balances cannot be accurately predicted. These are invested in money-market instruments of up to 12 months in duration with the objective of maximising current income whilst meeting liquidity requirements.

Liquidity risk

The value and term of short term assets are carefully monitored against those of the Corporation's liabilities. The Corporation aims to maintain sufficient liquid assets to meet liabilities as they fall due. However, a total of £40m of standby committed borrowing facilities, negotiated with leading international banks, was also available to the Corporation as at 31 December 2003. There are no plans to utilise these facilities, which are available to meet unforeseen short term requirements and are renewed annually.

Foreign currency risk

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

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

Credit risk

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

Corporate governance

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

The Audit Committee, on behalf of Council, monitors the effectiveness of the system of internal control of the Corporation. Lloyd's maintains an internal audit function that reports to the Audit Committee. The external auditors also contribute an independent perspective on aspects of financial control and annually report their findings to the Audit Committee and the Council.

An annual budget for the Corporation is reviewed in detail by the executive team and during 2003 was considered and approved by the Franchise Board. Monthly financial reports compare actual performance with the annual budget and management action is taken where variances arise. Revised forecasts are prepared at least quarterly.

The operation of effective risk management is the responsibility of all managers. This is kept under review by the Executive Committee which is responsible for ensuring that the Corporation maintains effective and efficient internal control, and compliance with Financial Services Authority (FSA) and related requirements. In 2003, internal audit services were provided to the Corporation by KPMG LLP. As part of these arrangements KPMG LLP provides a full-time Head of Internal Audit. The Corporation is committed to the highest standards of business conduct and has a clearly defined organisational structure.

Going concern

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

Employment policy

Communications and employee involvement

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

Equal opportunities

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

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

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

Training and development

The Corporation actively encourages employees to obtain relevant qualifications and to develop their full potential. Training and development is available to all staff. A system of internal job advertising is in place and internal transfer and promotion fill many vacancies. Training is provided to facilitate the implementation of Lloyd's values and capabilities aimed at promoting a more commercial culture and improved performance.

Report of the Nominations, Appointments and Compensation Committee

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

Composition of the NACC

The Nominations, Appointments and Compensations Committee (NACC) currently comprises two nominated, two external and three working members of the Council. These members are indicated within the remuneration table on pages 66 and 67.

Nominations and appointments

The NACC is responsible for making recommendations to Council on the appointment of the Chairman, Chief Executive Officer (CEO), nominated Council members, Franchise Board members and members of a number of Council and Franchise Board committees. Other than the annual exercise of making recommendations with respect to the composition of Council and Franchise Board committees, the NACC made recommendations to Council during 2003 with respect to the appointment of one new nominated member of Council and a new non-executive director of the Franchise Board. The nominations were accepted by Council.

To assist it with its work in this area, the NACC employs external search consultants from time to time as well as making use of its own resources and expertise. The vacancy on the Franchise Board related to one of the three non-executive directors who are insurance professionals connected to the Lloyd's market. In this case, the NACC considered it had sufficient knowledge and expertise to propose a candidate to the Council who met the criteria for non-executive directors of the Franchise Board.

Remuneration and compensation

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

In determining their recommendations for the year, the NACC consulted with the Chairman and the CEO about its proposals as well as engaging the assistance of remuneration advisers, Deloitte & Touche LLP.

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

Lloyd's remuneration policy for all current and future employees is set out in the Employee Handbook as follows:

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

Our total remuneration approach is supported by the following practices:

- we look beyond base salary to the value of the total reward package;
- we recognise and reward superior performance.

Lloyd's policy is therefore based on providing a package of rewards (salary plus benefits) that is business driven, competitive, fair and flexible. The remuneration policy is also founded on the proposition that the ultimate source of value is people, which means a reward system that responds creatively to employee needs as well as those of the business. This means a policy which:

- emanates from business strategies and goals;
- is based on business success (ability to pay);
- provides a flexible mix of rewards which will attract, retain and motivate the high calibre people we need with the varied range of experience and skills the business requires;
- is externally competitive and regularly monitored by means of remuneration surveys;
- rewards for performance not cost of living or position in hierarchy;
- ensures employees understand the criteria by which rewards are determined and reviewed;
- gives managers as much freedom as possible in deciding the rewards of their teams;
- is in line with our equal opportunities and diversity policy.'

Remuneration

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

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

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

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

Long Term Incentive Plan

As part of the culture change proposed following the adoption of the Franchise, it was proposed by the Chairman's Strategy Group that the Corporation would more closely align its remuneration structures with the Franchise objective of 'creating and maintaining conditions in which long term return to capital providers can be maximised'.

In this context, during 2003 the NACC reviewed the current long term incentive arrangements which apply to the CEO and other senior executives of the Corporation. The NACC has concluded that it is appropriate to introduce a new long term incentive plan (the '2004 LTIP'). LTIP awards will be based on the profitability of the Lloyd's market over three years, so that both profits and losses over a three year period are taken into account in determining an LTIP award. Pooling profits and losses in this way means that awards may be made in loss making years. The first year of operation of the new plan will be the financial year ending 31 December 2004. The LTIP that is applicable for the year ended 31 December 2003 is outlined below in section A; the principles of the 2004 LTIP are described in more detail in section B.

A. Long Term Incentive Plan applicable for the year ended 31 December 2003

Objectives

An LTIP was established in 1998 and is tied to the interests of the Lloyd's market, the principal measure of those interests being market profitability. The plan is operated at the discretion of the NACC and can be terminated at any time.

Operation of the plan

A cash reward is given to the participants for each profitable underwriting year (on a three year accounting basis) based on the pre-tax profit after personal expenses of members for that year. One third of the bonus is paid on a discretionary basis (the discretionary performance bonus) to reflect individual performance over the period, while two-thirds (the long term bonus) is based on a percentage of the participant's salary as set out within the terms of the plan.

The LTIP award for the 2003 year of account is calculated as 0.05% of the aggregate pre-tax profit (on a three year accounting basis) of Lloyd's members after deducting personal expenses for the relevant year of account for each £1 million (or pro-rata) of the total of the participants annual salary. Projections of pure year profit provided by the market are used during the first two years after the end of the underwriting year due to the three year accounting cycle currently used by the Lloyd's market.

The discretionary performance bonus is payable in March following the end of the underwriting year. The long term bonus is payable in three instalments commencing in October following the underwriting year and annually thereafter. The long term bonus instalments are adjusted for revisions to profit projections during this three year cycle.

Eligibility

The CEO, Director, Finance, Risk Management & Operations and Franchise Performance Director are participants of the plan. In addition, other Directors and senior employees of the Corporation in role level 1 are also eligible to participate in the LTIP.

Joining employment

Participants who became eligible for the 2003 LTIP award during the year will be given awards on a pro-rata basis.

Leaving employment

Participants who leave Lloyd's will normally lose their entitlement to any bonuses or bonus instalments that have not been paid. However, any participants who leave after the end of the underwriting year in which a bonus was earned due to retirement, redundancy, disability or ill-health will be entitled to receive any remaining instalments on the normal payment dates and on a pro-rata basis for the year in which they left. The estate of any participant who dies will receive any remaining instalments on the same basis.

Report of the Nominations, Appointments and Compensation Committee continued

B. Long Term Incentive Plan to be implemented during 2004

Objectives

The 2004 LTIP has been designed to meet key strategic objectives by enabling the Corporation to offer a long term incentive which:

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

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

Operation of the plan

Three Year Pooling Principle

LTIP awards will be based on the profitability of the Lloyd's market over three years, so that both profits and losses over a three year period are taken into account in determining an LTIP award. The awards for 2004, subject to transitional arrangements, will be calculated by reference to results for 2004, 2003 and 2002.

The principle of pooling means that any losses made in the three year period will offset profits when determining payments, thus encouraging prudent behaviour. Pooling also means that awards may be made in loss making years. This would be the case if the aggregate profits outweighed the aggregate losses over the relevant three year period.

The three year pool will be calculated each year on a rolling basis.

Profit/Loss

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

Eligibility

Selected senior permanent employees of the Corporation will be eligible for the scheme which will include the CEO, Directors and existing staff in role level 1. The NACC retains absolute and sole discretion as to who participates in the LTIP in any particular year.

Calculation of award

The LTIP award will be calculated as a percentage of the aggregate profit of the Lloyd's market for the relevant three year period for each £1 million aggregate of LTIP participant salary. For the CEO and other directors, this percentage has initially been set at 0.008%, although it will be reviewed annually. For other participants, the percentage used to calculate an LTIP award will normally be lower.

For example, if the aggregate pooled profit over three years is £3,000 million, the award for the CEO will be calculated as:

$$\text{£3,000 million} \times 0.008\% \times \frac{\text{salary of CEO}}{\text{£1 million}}$$

The percentage has been set by reference to external market data on remuneration levels as measured against other organisations of similar complexity and size.

Limits

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

Timing of payments

Awards will be paid out to participants in three instalments, with two thirds of the award deferred, subject to the participant's continued employment with the Corporation.

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

Transitional measures

During the first year of operation (2004), in order to assist transition from the current LTIP, an LTIP award under the 2004 LTIP will not be lower than the award that would have been made under the previous LTIP.

Joining employment

Executives who are newly recruited or promoted may be made an LTIP award on a pro-rated basis. When this occurs, awards will normally be pro-rated in relation to the number of full months of employment during the thirty-six month period to which the three year pool relates.

Leaving employment

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

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

Pension arrangements

The CEO, Director, Finance, Risk Management & Operations and Franchise Performance Director are members of the Lloyd's Pension Scheme. Their dependants are eligible for dependants' pensions and the payment of a lump sum in the event of death in service. The pension arrangements provide for a pension on retirement of two-thirds basic annual salary after 20 years eligible service subject to an earnings cap, which is a restriction on the amount of pay that can be used to calculate pensions payable from a UK tax approved pension scheme. No other payments to the CEO, Director, Finance, Risk Management & Operations and Franchise Performance Director are pensionable.

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

A pension contribution of £38,206 was payable in respect of the Chairman for 2003.

Contracts of employment

The Chairman has a three year service agreement, which may be extended by mutual agreement and is subject to a 12 month notice period.

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

Details of the directors' contracts are summarised in the table below:

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

	Contract Date	Unexpired Term as at 31 December 2003	Notice Period ⁽ⁱ⁾
Lord Levene of Portsoken	01/11/2002	22 months	12 months
Nick Prettejohn ⁽ⁱⁱ⁾	27/03/1995	rolling 1 year	12 months
Andrew Moss ⁽ⁱⁱⁱ⁾	04/11/2000	rolling 1 year	12 months
Rolf Tolle ^(iv)	03/03/2003	14 months	14 months

(i) Employment contracts do not contain provisions for compensation payable upon early termination.

(ii) Nick Prettejohn was appointed CEO on 01/07/1999.

(iii) Andrew Moss was appointed to the Franchise Board on 01/01/03.

(iv) Rolf Tolle was appointed to the Franchise Board on 03/03/03.

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

Individual remuneration, excluding LTIP awards, for the year to 31 December is shown in the table below. LTIP awards are shown on page 68.

	Salary/Fees		Taxable Benefits(i)		Annual Bonus		Other(xi)		Total (excluding LTIP awards)	
	2003 £000	2002 £000	2003 £000	2002 £000	2003 £000	2002 £000	2003 £000	2002 £000	2003 £000	2002 £000
Nominated members										
Judith Hanratty ^{(viii) (x)}	64	58	-	-	-	-	-	-	64	58
Bill Knight, Deputy Chairman of the Council of Lloyd's ^(x)	41	39	-	-	-	-	-	-	41	39
Brian Pomeroy	42	42	-	-	-	-	-	-	42	42
Andreas Prindl ^(xiii)	2	-	-	-	-	-	-	-	2	-
Non-Executive Franchise Board Members										
Roy Brown	38	-	-	-	-	-	-	-	38	-
Edward Creasy	38	-	-	-	-	-	-	-	38	-
Stephen Hodge	41	-	-	-	-	-	-	-	41	-
Jim Stretton	48	-	-	-	-	-	-	-	48	-
Former members										
Alastair Ross Goobey ^(xiv)	37	32	-	-	-	-	-	-	37	32
Andrew Kendrick ^(xv)	28	-	-	-	-	-	-	-	28	-

(i) Taxable Benefits include items such as company car or car allowance, medical and life insurance.

(ii) Employee of the Corporation of Lloyd's.

(iii) Representative of Wellington (Five) Limited.

(iv) Representative of Amlin Corporate Member Limited.

(v) Representative of AJSLP 9.

(vi) Representative of Limit (No 2) Limited.

(vii) Representative of Liberty Corporate Capital Limited.

(viii) Member of both Council and the Franchise Board.

(ix) Member of the Franchise Board only.

(x) Member of the Nominations, Appointments and Compensations Committee.

(xi) Other includes payments into a Funded Unapproved Retirement Benefit Scheme (FURBS) of 20% of executive directors' total salary.

This is grossed up for tax in respect of Nick Prettejohn only. In 2003 Rolf Tolle received a payment of £220k in respect of accepting office as an executive director. The amount stated in respect of the Chairman represents pension contributions to a personal pension scheme.

(xii) Steven Burns was appointed a member of the Franchise Board on 3 December 2003.

(xiii) Andreas Prindl was appointed a member of Council on 21 November 2003.

(xiv) Alastair Ross Goobey's term of office as Council member expired on 25 November 2003, until that date he was also a member of NACC.

(xv) Andrew Kendrick resigned as member of the Franchise Board on 25 September 2003.

(xvi) Andrew Moss became member of the Franchise Board on 1 January 2003.

(xvii) Rolf Tolle became member of the Franchise Board on 3 March 2003.

(xviii) Lloyd's paid £83k to Rolf Tolle's previous employer in respect of the assignment of a property lease to Lloyd's. The lease expires in August 2004 and the property is occupied by Rolf Tolle. This amount is not included in the table above.

Report of the Nominations, Appointments and Compensation Committee continued

Lloyd's Pension Scheme provisions

	Contributions in year to 31 December 2003(i) £000	Age at 31 December 2003	Increase in pension in year to 31 December 2003 actual £000	Increase in pension in year to 31 December 2003 net of price inflation £000	Total accrued annual pension as at 31 December 2003 £000 pa	Retirement Age
Nick Prettejohn	n/a	43	3	2	22	60
Andrew Moss	n/a	45	2	2	7	60
Rolf Tolle	n/a	56	3	3	3	60

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

Transfer values of accrued pension benefits

	Transfer value of accrued pension as at 31 December 2002 £000	Transfer value of accrued pension as at 31 December 2003 £000	Increase in transfer value over the year less director's own contributions £000
Nick Prettejohn	157	194	37
Andrew Moss	44	71	27
Rolf Tolle	n/a	39	39

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

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

	Award year	Discretionary Performance Bonus £000	Estimated Long Term Bonus			Total £000	Amount paid during the year ended 31 December 2002 £000	Amount paid during the year ended 31 December 2003 £000	Total award outstanding as at 31 December 2003 £000
			As at 31 December 2002 £000	Change in year £000	As at 31 December 2003 £000				
Nick Prettejohn	2002	110	203	25	228	338	–	177	161
	2003	135	–	267	267	402	–	–	402
Andrew Moss	2002	80	148	(99)	49	129	–	129	–
	2003	–	–	–	–	–	–	–	–
Rolf Tolle	2003	125	–	250	250	375	–	–	375



Bill Knight

Chairman

Nominations, Appointments and Compensation Committee

Lloyd's Members' Ombudsman's report

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

I am pleased to present the annual report of the Lloyd's Members' Ombudsman to the Council of Lloyd's for the year ended 31 December 2003.

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

During the year I received 11 new complaints, nine more than the previous year.

In one case, I determined, in the exercise of my discretion and after making preliminary enquiries, that the Corporation department concerned was guilty of maladministration. A choice between two methods of compensation was offered to the member concerned, but a definitive response has yet to be received.

In another case I decided, after conducting the necessary investigations, to take no further action, as I was satisfied that considerations of maladministration did not arise. In this case I explained to the complainant why this was so with a detailed letter of response.

Three cases fell outside my jurisdiction and one complaint was withdrawn before my investigations had been completed. There are five complaints still under investigation.

The expenses incurred by my office during 2003 amounted to £32,516.

Statement of Lloyd's responsibilities in respect of the financial statements

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

- select suitable accounting policies and then apply them consistently;
- make judgements and estimates that are reasonable and prudent;

- state whether applicable accounting standards have been followed, subject to any material departures disclosed and explained in the financial statements; and
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the Corporation will continue in business.

Lloyd's is responsible for keeping proper accounting records which disclose with reasonable accuracy at any time the financial position of the Corporation. The Council is responsible for safeguarding the assets of the Corporation and hence taking reasonable steps for the prevention and detection of fraud and other irregularities.

Independent auditor's report to the members of Lloyd's

We have audited the financial statements for the year ended 31 December 2003, which comprise the consolidated revenue account, consolidated balance sheet, consolidated cash flow statement, consolidated statement of total recognised gains and losses and the related notes 1 to 28. These financial statements have been prepared on the basis of the accounting policies set out therein. We have also audited the information in the Report of the Nominations, Appointments and Compensation Committee that is described as audited.

This report is made solely to the members of Lloyd's, as a body, in accordance with the Council of Lloyd's instructions to us as set out under 'Respective responsibilities of Lloyd's and auditors' below. Our audit work has been undertaken so that we might state to the members of Lloyd's, as a body, those matters we are required to state to them in this report in accordance with the Council's instructions and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the members of Lloyd's, as a body, for our audit work, for this report, or for the opinions we have formed.

Respective responsibilities of Lloyd's and auditors

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

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

Basis of audit opinion

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

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

Opinion

In our opinion:

- the financial statements give a true and fair view of the state of affairs of the Corporation as at 31 December 2003 and of its deficit for the year then ended; and
- the section of the Report of the Nominations, Appointments and Compensation Committee to be audited has been properly prepared in accordance with the basis of preparation described therein.

Ernst & Young LLP

Ernst & Young LLP

Registered Auditor

London

7 April 2004

Consolidated revenue account

for the year ended 31 December 2003

	Note	2003 £000	2003 £000	2002 £000	2002 £000
Operating income	3		133,501		129,263
Operating expenses	4		(160,267)		(159,154)
Group operating deficit			(26,766)		(29,891)
Share of operating profits of associates	14	3,440		2,873	
Amortisation of goodwill of associates	14	(118)		(118)	
Total share of associates' results			3,322		2,755
Total operating deficit			(23,444)		(27,136)
Profit on sale of the Lloyd's 1958 building	12		-		1,926
Profit on disposal of discontinued operations	25		1,702		-
Deficit on ordinary activities before interest			(21,742)		(25,210)
Interest and dividend income					
Dividends receivable from non-consolidated subsidiaries	14		7,490		2,750
Interest income:	7				
Group		6,484		5,022	
Associates		99		174	
Interest payable:	7				
Group		(5,552)		(3,322)	
			1,031		1,874
Deficit on ordinary activities after net interest and dividends			(13,221)		(20,586)
Premium levy income	8	260,858		256,147	
Market settlement recoveries	8	7,919		5,633	
Transfers to Lloyd's New Central Fund	9	(279,493)		(246,809)	
			(10,716)		14,971
Deficit before taxation			(23,937)		(5,615)
Taxation credit	10		6,651		1,498
Deficit for the year			(17,286)		(4,117)

Consolidated statement of total recognised gains and losses

for the year ended 31 December 2003

	Note	2003 £000	2002 £000
(Deficit)/surplus for the year:			
Group		(19,673)	(6,157)
Associates		2,387	2,040
Total deficit for the financial year		(17,286)	(4,117)
Unrealised gain on disposal of subsidiaries	25	500	554
Total recognised losses relating to the year	24	(16,786)	(3,563)

Consolidated cash flow statement

for the year ended 31 December 2003

	Note	2003 £000	2002 £000
Cash flow from operating activities	22	3,307	(25,429)
Dividends received from associates		2,086	–
Returns on investments and servicing of finance	22	3,549	1,733
Taxation		1,161	1,228
Capital expenditure and financial investment	22	(1,211)	(1,943)
Acquisitions and disposals	22	1,702	–
Cash inflow/(outflow) before use of liquid resources and financing		10,594	(24,411)
Management of liquid resources	22	(48,567)	18,640
Financing	22	53,410	6,142
Increase in cash in the year		15,437	371
Reconciliation of net cash flow to movement in net funds (note 22)			
Increase in cash in the year		15,437	371
Cash inflow from movement in financing		(53,410)	(6,142)
Cash outflow/(inflow) from movement in liquid resources		48,567	(18,640)
Change in net funds resulting from cash flows		10,594	(24,411)
Other movements	22	2,660	641
Movement in net funds in the year		13,254	(23,770)
Net funds at 1 January		42,637	66,407
Net funds at 31 December	22	55,891	42,637

Notes to the financial statements

as at 31 December 2003

1 Purpose of financial statements

Basis of preparation and consolidation

The Corporation of Lloyd's was incorporated by Lloyd's Act 1871 and is subject to the provisions of Lloyd's Acts 1871 to 1982.

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

Funds administered by the Corporation of Lloyd's, as trustee or held at the Council's direction as part of the security underlying policies issued at Lloyd's, are not included in the financial statements.

Except for the matters described above, the financial statements have been prepared under the historical cost convention as modified by the revaluation of investments and, in all material respects, in accordance with applicable accounting standards.

FRS 13 'Derivatives and other financial instruments – disclosures' has not been adopted as it does not apply to the Corporation. However, certain voluntary disclosures have been given in note 23.

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

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

2 Principal accounting policies

A Tangible fixed assets and depreciation

Fixed assets are included at cost.

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

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

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

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

B Investments

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

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

Other investments represent Lloyd's collection of various paintings, antiques and artefacts gifted to or acquired by the Society and are included at market valuation. The collection will be revalued at least every three years.

2 Principal accounting policies continued

C Acquisitions and disposals

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

D Stocks

Stocks are stated at the lower of cost, on a first-in first-out basis, and net realisable value.

E Income

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

Income, which is stated net of value added tax, represents amounts invoiced for goods and services provided, including members' subscriptions and application fees for corporate members.

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

F Pension costs

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

G Taxation

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

H Foreign currency and derivative instruments

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

The Corporation and its consolidated subsidiaries enter into forward currency contracts to manage exposures to fluctuation in foreign exchange rates, and to provide a service to the Lloyd's market.

Where contracts are entered into to cover foreign exchange exposure, any variances between closing and contracted rates are included in the consolidated balance sheet.

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

The principal year end exchange rates were:

	2003	2002
US\$	1.79	1.61
Can\$	2.31	2.54
Euro	1.42	1.53

Notes to the financial statements continued

3 Operating income	2003 £000	2002 £000
Market charges		
Managing agents and syndicates	53,624	51,853
Members and members' agents	14,913	15,182
Regulatory levy	8,921	8,798
Total market charges	77,458	75,833
Members' subscriptions	36,142	31,600
Other income		
Rent and building service charges	6,707	6,555
Charges to associates	6,891	10,238
Charges to Lloyd's Central Fund	3,465	1,958
Income from other services	2,838	3,079
Total other income	19,901	21,830
Total operating income	133,501	129,263

4 Operating expenses	2003 Corporation £000	2003 Kinnect Limited £000	2003 Total £000	2002 Corporation £000	2002 Kinnect Limited £000	2002 Total £000
Operating expenses include:						
Employment costs (note 5)	45,902	7,581	53,483	39,865	7,377	47,242
Overseas operating expenses (note 6)	21,524	–	21,524	21,497	–	21,497
Professional fees, including legal fees and related costs	15,073	716	15,789	17,477	1,490	18,967
Operating lease rentals – land and buildings	16,767	–	16,767	16,867	–	16,867
Provisions for travel insurance dispute (note 21)	–	–	–	100	–	100
Audit services	109	14	123	95	13	108
Further assurance services payable to Ernst & Young LLP	670	10	680	1,098	–	1,098
Tax services payable to Ernst & Young LLP	31	–	31	95	–	95
Other services payable to Ernst & Young LLP	430	23	453	692	75	767
Depreciation (note 11)	2,590	30	2,620	2,425	18	2,443
Charitable donations	199	–	199	255	–	255

The costs of Kinnect Limited during 2003 total £17.9m (2002: £19.9m) and include, in addition to the costs itemised above, systems and communications costs of £7.9m (2002: £10.7m).

5 Employment	2003 £000	2002 £000
Salaries and wages (including performance-related bonus)	29,557	27,355
Long term incentive plan (excluding social security costs – see note 21)	4,643	3,100
Pension costs	536	578
Social security costs	3,986	3,154
Severance costs	1,818	950
Contract and agency staff	8,442	7,619
Other employment costs	4,501	4,486
	53,483	47,242

	2003 Number	2002 Number
Average number of employees during the year	582	589

The emoluments of the Chairman, Chief Executive Officer, members of Council and Franchise Board are included within the report of the Nominations, Appointments and Compensation Committee on pages 66 to 68.

6 Overseas operating expenses		2003	2002
		£000	£000
Expenses in connection with underwriting activities in the following areas:			
USA		8,146	8,714
Canada		4,433	5,056
Asia		3,692	3,579
Europe		3,560	3,061
Africa, Australasia, Central and South America		1,693	1,087
		21,524	21,497
Operating expenses include:			
Employment		5,258	5,125
Legal and professional		5,822	6,214
Systems and communications		3,099	4,444
Premises		1,471	1,673
Other expenses		5,874	4,041
		21,524	21,497

Local premium taxes amounting to £19.2m in 2003 (2002: £17.7m) have been excluded on the basis that the Corporation of Lloyd's is acting only as intermediary between the Lloyd's market and overseas statutory bodies.

7 Interest		Other interest	Statutory insurance deposits	2003 Total	2002 Total
		£000	£000	£000	£000
Group		1,164	5,320	6,484	5,022
Associates		99	-	99	174
Total interest receivable		1,263	5,320	6,583	5,196
Interest payable:					
Group	Bank loans/overdrafts	(59)	-	(59)	(129)
	Other loans	-	(5,474)	(5,474)	(3,127)
	Foreign exchange movement	-	(19)	(19)	(66)
Total interest payable		(59)	(5,493)	(5,552)	(3,322)

8 Premium levy income and market settlement recoveries		2003	2002
		£000	£000
Premium levy income:			
Receivable at 1 January		(18,635)	(9,297)
Levy collections		264,374	250,926
Receivable at 31 December		19,641	18,635
Refundable in respect of return premiums at 31 December		(4,522)	(4,117)
		260,858	256,147

The premium levy was originally required to repay a syndicated bank loan. The Council of Lloyd's agreed to continue to collect the premium levy after the syndicated bank loan was fully repaid in September 2001. In 2002 the premium levy was increased to 2% of premiums received for most classes of business (1% for UK motor and life business). All premium levy collections in respect of 2003, net of amounts refundable in respect of return premiums, have been, or will be when received, transferred to the Lloyd's New Central Fund (see note 9).

Included within premium levy income for the year ended 31 December 2003 is £12.3m in relation to motor business, of which £3.1m related to policies signed in 2002 and not accrued at the prior year end, and £2.1m in relation to levy on premiums with regard to policies signed in 2003 not collected prior to the year end.

The premium levy ceased at the end of 2003 having achieved its objective of increasing central assets.

Notes to the financial statements *continued*

8 Premium levy income and market settlement recoveries <i>continued</i>	2003	2002
	£000	£000
Market settlement recoveries	7,919	5,633

During 1997 Lloyd's discharged its obligation to fund Equitas in accordance with the *Reconstruction & Renewal* Completion Agreement dated 3 September 1996. The market settlement has continued to generate recoveries in 2003, principally from debt recovery activity, which have been credited to income.

9 Transfers to Lloyd's New Central Fund

Premium levy collections received or accrued during the year net of any amounts to be refunded total £279.5m (2002: £246.8m). These amounts have been, or will be when received, transferred to the Lloyd's New Central Fund.

10 Taxation

(a) Analysis of charge in the year	2003	2002
	£000	£000
<i>Current tax:</i>		
UK corporation tax based on profits for the year at 30% (2002: 30%)	–	–
Current year group tax relief	3,660	(1,738)
Adjustments in respect of previous years	2,065	4,624
Foreign tax suffered	(26)	(26)
Share of associate undertakings' current tax	(1,034)	(889)
Total current tax (note 10(b))	4,665	1,971
<i>Deferred tax:</i>		
Origination and reversal of timing differences	1,986	(473)
Taxation credit	6,651	1,498

(b) Factors affecting current tax charge	2003	2002
	£000	£000
The tax assessed for the year is lower than the standard rate of corporation tax in the UK of 30%		
The differences are explained below:		
Deficit on ordinary activities before tax	(23,937)	(5,615)
Deficit on ordinary activities multiplied by standard rate of corporation tax in the UK of 30%	7,181	1,685
Expenses not deductible for tax purposes	(4,526)	(5,544)
Non-taxable income	2,247	825
Additional deductions	30	–
Capital allowances for the year in excess of depreciation	999	407
Surrender of tax losses	(3,305)	–
Overseas tax	(26)	(26)
Prior year adjustments	2,065	4,624
Current tax credit (note 10(a))	4,665	1,971

(c) Deferred tax	2003	2002
	£000	£000
A deferred tax asset has been recognised in respect of the following timing differences:		
Accelerated capital allowances	594	682
Other	2,074	–
Deferred tax asset at 31 December	2,668	682
At 1 January	682	1,155
Deferred tax credit/(charge) in consolidated revenue account (note 10(a))	1,986	(473)
At 31 December (see note 17)	2,668	682

11 Fixed assets	Freehold land and buildings £000	Plant and other fixed assets £000	Total £000
Cost:			
At 31 December 2002	10,413	45,024	55,437
Additions	–	1,975	1,975
Disposals	–	(2,091)	(2,091)
At 31 December 2003	10,413	44,908	55,321
Depreciation:			
At 31 December 2002	3,301	35,917	39,218
Charge for the year	125	2,495	2,620
Disposals	–	(1,540)	(1,540)
At 31 December 2003	3,426	36,872	40,298
Net book value:			
At 31 December 2003	6,987	8,036	15,023
At 31 December 2002	7,112	9,107	16,219

Included in freehold land and buildings is land valued at £2.5m (2002: £2.5m) which has not been depreciated in the year.

12 Profit on sale of the Lloyd's 1958 building

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

The sale agreement provides for Lloyd's to benefit from any enhanced value as a result of the site being redeveloped.

13 Principal investments in subsidiary companies and associates

Entity	Nature of business	Proportion of equity capital held
Subsidiaries		
Additional Securities Limited	Provision of deposits overseas on behalf of Lloyd's underwriters to comply with local insurance regulations	100%
Centrewrite Limited	Authorised UK insurance company	100%
Lioncover Insurance Company Limited	Authorised UK insurance company	100%
Kinnect Limited	An electronic platform that enables trading partners in commercial line insurance to store and exchange commercial terms, insuring clauses and risk data quickly and securely, to support placing and subsequent processing	100%
Associates		
Ins-sure Holdings Limited	Provision of premiums and claims accounting and settlement, policy production and ancillary insurance services principally to the London insurance market	25%
Xchanging Claims Services Limited	Provision of claims and recoveries services	50%

Notes to the financial statements continued

13 Principal investments in subsidiary companies and associates continued

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

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

The issued share capital of Ins-sure Holdings Limited is £4,000. There are three separate classes of shares. The Corporation holds 1,000,000 B shares of 0.1p each that have the following rights with respect to dividends:

- The B shares participate in 25% of any profits available for distribution.
- In addition, the B shares carry a right to the first £3,000,000 of dividends that would have accrued to the holders of the C shares, of which £1,722,499 was received during 2003.

The issued share capital of Xchanging Claims Services Limited is £4,001. There are three separate classes of shares. The Corporation holds 1,000 A shares of £1 each and 2,501 C shares of £1 each. The A and C shares have the following rights with respect to dividends:

- The C shares carry a right to a fixed cumulative preference dividend of 5% calculated on the nominal capital and a variable participating dividend calculated by reference to trading profits.
- A maximum dividend accrual right of £1,500,000 accrued to the A shares following a capital reduction by LCO Marine Limited. This was received during 2003.
- The A shares participate in 50% of any profits available for distribution after taking account of the dividend rights outlined above.

14 Investments

	Goodwill £000	Share of other net assets £000	2003 £000	2002 £000
a) Investments in associates				
At 1 January	979	5,052	6,031	3,991
Share of operating profits	–	3,440	3,440	2,873
Dividends received	–	(2,086)	(2,086)	–
Amortisation of goodwill	(118)	–	(118)	(118)
Share of interest income	–	99	99	174
Share of tax on profit on ordinary activities	–	(1,034)	(1,034)	(889)
At 31 December	861	5,471	6,332	6,031

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

	2003 £000	2002 £000
b) Subsidiary companies not consolidated		
Shares of non-consolidated subsidiary companies at cost	44	44
Current accounts	111	46
	155	90

Non-consolidated insurance related subsidiaries 2003 balance sheet summary	Centrewrite £000	Lioncover £000	Total £000
Investments	37,793	–	37,793
Current assets	25,480	16	25,496
Current liabilities	(8,730)	(15)	(8,745)
	54,543	1	54,544
Insurance fund	(25,792)	–	(25,792)
Shareholders' funds at 31 December 2003	28,751	1	28,752
Shareholders' funds at 31 December 2002	32,610	1	32,611
Retained loss for the year	(3,859)	–	(3,859)

Dividends amounting to £7.49m have been proposed by Centrewrite in respect of the year ended 31 December 2003 (2002: £2.75m).

14 Investments continued**Centrewrite Limited**

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

Lioncover Insurance Company Limited

Lioncover, an authorised UK insurance company, was formed to reinsure the liabilities of Names on syndicates formerly managed by PCW Underwriting Agencies Limited, WMD Underwriting Agencies Limited and Richard Beckett Underwriting Agencies Limited, and on syndicates 2 and 49 (collectively referred to as the PCW syndicates). On 18 December 1997 all of Lioncover's reinsurance liabilities were reinsured to Equitas Reinsurance Limited.

The financial statements for Lioncover are prepared as at 31 March. As these financial statements are not yet available the above figures have been produced from the management accounts as at 31 December 2003.

c) Other investments

Other investments represent Lloyd's collection of various paintings, antiques and artefacts gifted to or acquired by the Society. They have been included in the balance sheet at 31 December 2003 at an open market valuation of £6.9m (2002: £6.9m). The collection was valued on 8 March 2002 on the basis of open market auction value assuming all items are not sold at the same time taking into account the nature, age, condition and quality of each chattel, by L&J Gull Fine Arts Limited, professional valuers and consultants.

15 Statutory insurance deposits	2003 £000	2002 £000
Held by subsidiary companies:		
Statutory insurance deposits	111,594	67,016
Funding provided by syndicates	(107,871)	(61,586)
	3,723	5,430

Statutory insurance deposits	Securities £000	Cash deposits £000	2003 Total £000	2002 Total £000
Market value at 1 January	40,533	26,483	67,016	57,757
Additions at cost	35,038	244,891	279,929	93,019
Disposal proceeds	(28,692)	(202,194)	(230,886)	(86,180)
Net gain/(loss) on disposal	794	(371)	423	(1,890)
Year end revaluation	(2,004)	(2,884)	(4,888)	4,310
Market value at 31 December	45,669	65,925	111,594	67,016

Notes to the financial statements continued15 Statutory insurance deposits continued

	2003 Cost £000	2003 Valuation £000	2002 Cost £000	2002 Valuation £000
Analysis of securities at year end – statutory insurance deposits				
Listed on:				
London Stock Exchange	–	–	1,009	992
Overseas stock exchanges	40,093	40,268	33,899	35,920
	40,093	40,268	34,908	36,912
Unlisted:				
Fixed interest	5,609	5,401	3,235	3,621
	45,702	45,669	38,143	40,533

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

Unlisted fixed interest securities are valued as follows:

	2003 £000	2002 £000
Foreign treasury bills – at market value	4,634	3,076
Foreign government debentures – at par and market value	767	545
	5,401	3,621

Funding provided by syndicates

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

	2003 £000	2002 £000
Lloyd's market – deposits	(107,871)	(61,586)
Allocated:		
Financing of underwriting deposits	(102,669)	(56,384)
Working capital	(5,202)	(5,202)
	(107,871)	(61,586)

Finance is arranged by advances from syndicates in the Lloyd's market. These advances are renewed annually. By agreement with the lenders, investment returns earned on these assets, are paid, in appropriate proportions, to the lenders. In this way, the Corporation avoids any risk arising from a mismatch between borrowing and lending terms (see note 23).

The terms and conditions of these advances are governed by the Overseas Underwriting Byelaw (No.1 of 2004) which enables the Council of Lloyd's to vary the amount, term and rate of interest of these loans, as appropriate. The provision of funds by members under this Byelaw is in respect of the establishment and maintenance of overseas deposits and is a condition of permission to underwrite insurance business at Lloyd's.

16 Stocks	2003 £000	2002 £000
Consumables	467	467
17 Debtors and prepayments		
Due within one year:		
Trade and other debtors	41,770	43,737
Forward foreign exchange asset	3,233	708
Group tax relief receivable	7,692	3,189
Corporation tax receivable	9	–
Prepayments and accrued income	15,543	17,494
Deferred taxation (see note 10)	2,668	682
	70,915	65,810
Due after more than one year:		
Other debtors	–	778
Pension scheme prepayment	24,318	24,318

18 Pension scheme

The Corporation of Lloyd's operates a defined benefit pension scheme with assets held in a separately administered fund. The last formal actuarial valuation of the scheme was carried out by Watson Wyatt Partners, consulting actuaries, as at 30 June 2001 using the projected unit method. The principal actuarial assumptions adopted in the valuation were that (in real terms relative to retail price inflation), present and future pensions in payment would remain constant whilst total pensionable remuneration would increase by 1.8% per annum. The real rate of return on investments held at the valuation date was assumed to be approximately 3.65%. The market value of the scheme's assets at the date of valuation were £301m, which equates to some 117% of the value placed on the benefits that had accrued to members, after allowing for assumed future increases in pensionable remuneration.

Investment returns have been lower than assumed in the 2001 valuation, due primarily to the fall in equity prices. Consequently, an interim review of the pension scheme was carried out by Watson Wyatt LLP, consulting actuaries, as at 30 June 2003. This was not a formal actuarial valuation but rather an update of the results of the 2001 valuation using revised assumptions. The principal actuarial assumptions adopted for the interim review were that (in real terms relative to retail price inflation), pensions in payment accrued after 5 April 1997 would remain constant whilst total pensionable remuneration would increase by 1.75% per annum. The real rate of return on investments held as at 30 June 2003 was assumed to be approximately 3.85% per annum. These assumptions reflected one particular change with respect to the scheme's liabilities. In the past the actuary had allowed for discretionary increases to pre 6 April 1997 benefits in excess of the Guaranteed Minimum Pension in line with inflation. However, Lloyd's instructed Watson Wyatt LLP not to allow for such increases in calculating the scheme's liabilities when carrying out the interim review and for future actuarial valuations. Such increases have always been payable at the discretion of Lloyd's and will continue to be considered on the basis of affordability, but are no longer taken into account by the actuary in determining the funding level. In November 2003, a discretionary increase of 2.8% for 2004 was awarded, which was funded out of the scheme surplus revealed by the interim review using the above assumptions.

The market value of the scheme's assets were £225m as at 30 June 2003, which, for the purposes of SSAP24, equated to 121% of the benefits accrued to members, after allowing for assumed future increases in pensionable remuneration but excluding discretionary increases referred to above. These figures exclude both liabilities and the related assets in respect of money purchase AVCs and in respect of the accrued benefits of scheme members employed by LPSO Limited, LCO Marine Limited and LCO Non-Marine and Aviation Limited as these companies ceased to be subsidiaries during 2001. Notwithstanding the calculated surplus for SSAP24 purposes as at 30 June 2003, the Corporation of Lloyd's has agreed to recommence its contributions to the scheme from 1 January 2004 at a rate of 17% of pensionable salaries.

The liabilities of the scheme were valued using a discount rate which reflected market levels at the date of the interim review. The estimate of the cost of providing the pension benefits promised is also based on the interim review. The cost will be reassessed following the next formal valuation, anticipated to take place as at 30 June 2004.

Notes to the financial statements *continued***18 Pension scheme** *continued*

The disclosures required in relation to the transitional arrangements within FRS 17 'Retirement Benefits' have been based on the most recent formal actuarial review as at 30 June 2001 updated to 31 December 2003, and taking account of the results of the interim review as at 30 June 2003. The major financial assumptions used by the actuary as at 31 December 2003 for the purposes of FRS 17 were as follows:

	2003 % per annum	2002 % per annum
General salary and wage inflation	4.50%	4.10%
Rate of increase in pensions in payment		
– pre 6 April 1997 (in excess of GMPs)	0.00%	2.30%
– post 5 April 1997	2.70%	2.30%
Increases to deferred pensions	2.70%	2.30%
Discount rate	5.50%	5.75%
Price inflation	2.70%	2.30%

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

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

	2003 Expected rate of return % per annum	2003 Fair value £m	2002 Expected rate of return % per annum	2002 Fair value £m
Asset analysis of the scheme and expected returns as at 31 December 2003				
Bonds	5.1%	101	5.0%	59
Equities	8.3%	140	8.3%	160
Cash and net current assets	3.7%	1	3.8%	1
Total market value of assets		242		220
Actuarial value of liability		(293)		(287)
Deficit in the scheme		(51)		(67)
Related deferred tax asset		15		20
Net pension liability		(36)		(47)

The table below shows the total reserves of the Corporation as disclosed in the consolidated balance sheet adjusted for the requirements of FRS 17 as at 31 December 2003:

	2003 £m	2002 £m
Total reserves	70	87
Exclude SSAP24 pension scheme prepayment	(24)	(24)
Net pension liability under FRS 17	(36)	(47)
Total reserves including pension liability	10	16

Movement in deficit during the year	2003 £m	2002 £m
Deficit in scheme at beginning of the year	(67)	(8)
Movement in the year:		
Current service cost	(5)	(5)
Past service cost	(1)	(1)
Other finance income	–	4
Actuarial gain/(loss) recognised in statement of recognised gains and losses (STRGL)	22	(57)
Deficit in scheme before tax	(51)	(67)
Deferred tax	15	20
Deficit in scheme at end of the year after tax	(36)	(47)

18 Pension scheme continued

Analysis of the amount that FRS 17 would require to be recognised in the statement of total recognised gains and losses (STRGL)	2003 £m	2002 £m
Actual return less expected return on pension scheme assets	19	(60)
Experience losses arising on the scheme liabilities	(3)	(9)
Changes in the assumptions underlying the present value of the scheme liabilities	6	12
Actuarial gain/(loss)	22	(57)
Deferred tax movement during the year	(5)	18
Actuarial gain/(loss) net of deferred tax recognised in the STRGL	17	(39)

The decrease in the pension scheme deficit during the year results from an increase in the market value of assets. The measurement bases set by FRS 17 are likely to give rise to significant fluctuations to the scheme's assets and liabilities. However this may not necessarily require changes to the contribution rate, as recommended by the independent actuary, which is based on expected long term rates of return.

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

Analysis of the amounts charged to operating profit	2003 £m	2002 £m
Current service cost	5	5
Past service cost	1	1
Total operating charge	6	6

Analysis of the amount credited to other finance income	2003 £m	2002 £m
Expected return on pension scheme assets	16	20
Interest on pension scheme liabilities	(16)	(16)
Net return	-	4

History of experience gains and losses (current point only)	2003	2002
Difference between the expected and actual return on scheme assets:		
Amount (£m)	19	(60)
Percentage of scheme assets	7.9%	(27.0%)
Experience gains and losses on scheme liabilities:		
Amount (£m)	(3)	(9)
Percentage of the present value of the scheme liabilities	(1.0%)	(3.2%)
Total amount recognised in statement of total recognised gains and losses:		
Amount (£m)	22	(57)
Percentage of the present value of the scheme liabilities	7.6%	(19.9%)

19 Current asset investments

Short term deposits and certificates of deposit	2003 £000	2002 £000
	5,134	5,610

Included in the table above are money market instruments not repayable on demand without penalty.

Notes to the financial statements *continued*

	2003 £000	2002 £000
20 Creditors – due within one year		
Accruals and deferred income	46,698	32,360
Forward foreign exchange liability	3,127	496
Trade and other creditors	44,966	32,838
Taxation and social security	6,292	3,969
Arbitration awards	1,170	2,186
	102,253	71,849

It is the Corporation's policy that payments to suppliers are made in accordance with those terms and conditions agreed between the Corporation and its suppliers, provided that all trading terms and conditions have been complied with.

At 31 December 2003, the Corporation had an average of 22 days purchases outstanding in trade creditors (2002: 25 days).

	Long term incentive plan £000	Travel insurance dispute £000	Other provisions £000	2003 Total £000	2002 Total £000
21 Provisions for liabilities and charges					
Balance at 1 January	3,500	463	300	4,263	7,436
Charged to consolidated revenue account	5,278	–	–	5,278	3,600
Credited to unrealised gain on disposal of subsidiaries	–	–	–	–	(554)
Utilised in the year	(1,863)	(241)	(41)	(2,145)	(6,219)
Balance at 31 December	6,915	222	259	7,396	4,263

Long term incentive plan

A long term incentive plan was introduced in 1998 for executive directors and senior employees that is related to the results of the Lloyd's market. This scheme helps to ensure that the objectives of directors and employees are aligned with those of the Lloyd's market. The provision, including employers' National Insurance contributions, for estimated amounts due in respect of the plan is as follows:

	Balance at 1 January 2003 £000	Paid in the year £000	Charged/ (credited) in the year £000	Balance at 31 December 2003 £000
2002 Long term incentive plan	3,500	(1,863)	(16)	1,621
2003 Long term incentive plan	–	–	5,294	5,294
Total provisions	3,500	(1,863)	5,278	6,915

Included within the charge for the year are National Insurance contributions of £0.6m (2002: £0.4m).

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

A new long term incentive plan is to be introduced for 2004, the provisions of which are outlined in the report of the Nominations, Appointments and Compensation Committee on pages 64 and 65.

Travel insurance dispute

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

Other provisions

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

22 Notes to the cash flow statement

A Reconciliation of operating deficit to operating cash flows	2003 £000	2002 £000
Operating deficit	(26,766)	(29,891)
Depreciation charges	2,620	2,443
Profit on sale of fixed assets	(39)	(190)
(Profit)/loss on disposal of insurance deposits	(423)	1,890
Loss/(profit) on revaluation of insurance deposits	4,888	(4,310)
(Profit)/loss on revaluation of underwriting loans	(7,125)	1,779
Increase in stocks	-	(13)
Decrease in debtors	8,385	405
Increase/(decrease) in creditors	6,741	(4,673)
Increase/(decrease) in provisions	3,133	(2,619)
	(8,586)	(35,179)
Premium levy collection	264,374	250,926
Market settlement recoveries	7,919	5,633
Transfers to Lloyd's New Central Fund	(260,400)	(246,809)
Net cash inflow/(outflow) from operating activities	3,307	(25,429)
B Analysis of cash flows for headings netted in the cash flow statement	2003 £000	2002 £000
Returns on investments and servicing of finance:		
Dividends received	2,750	-
Interest received	6,477	5,258
Interest paid	(5,678)	(3,525)
	3,549	1,733
Capital expenditure and financial investment:		
Purchase of tangible fixed assets	(1,801)	(2,321)
Sale of tangible fixed assets	590	378
	(1,211)	(1,943)
Acquisitions and disposals of business operations:		
Additional proceeds on sale of businesses	1,702	-
Management of liquid resources:		
Purchase of cash deposits	(244,891)	(61,583)
Purchase of securities	(35,038)	(31,436)
Sale of cash deposits	202,670	82,845
Sale of securities	28,692	28,814
	(48,567)	18,640
Financing:		
Increase in borrowings for insurance deposits	53,410	6,142
	53,410	6,142

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

Notes to the financial statements continued**22 Notes to the cash flow statement** continued

C Analysis of net funds	At 01.01.03 £000	Cash flow £000	Other movements £000	At 31.12.03 £000
Cash in hand, at bank	31,597	15,437	–	47,034
Overnight deposit (see below, b)	3,101	1,504	–	4,605
	34,698	16,941	–	51,639
Current asset investments (see below, a)	5,610	(476)	–	5,134
Other deposits (see below, b)	63,915	47,539	(4,465)	106,989
Debt due within one year:				
Funding of statutory insurance deposits	(61,586)	(53,410)	7,125	(107,871)
	42,637	10,594	2,660	55,891

- a) Current asset investments comprise short term deposits and certificates of deposit that are not repayable on demand without penalty.
- b) Overnight deposits and other deposits relating to the funding of subsidiaries are included in the balance sheet under statutory insurance deposits.

23 Interest rate exposure of financial assets and liabilities as at 31 December 2003

	Financial assets			Financial liabilities			Net financial assets/ (liabilities) £000
	Fixed rate £000	Floating rate £000	Total £000	Fixed rate £000	Floating rate £000	Total £000	
Sterling	–	13,263	13,263	–	–	–	13,263
United States dollar	–	8,221	8,221	–	(2,898)	(2,898)	5,323
Canadian dollar	–	3,195	3,195	–	–	–	3,195
Japanese yen	–	13,471	13,471	–	(1,042)	(1,042)	12,429
Australian dollar	862	70	932	–	(915)	(915)	17
Switzerland franc	39,211	14,628	53,839	–	(54,132)	(54,132)	(293)
Singapore dollar	–	19,496	19,496	–	(19,569)	(19,569)	(73)
Hong Kong dollar	–	18,301	18,301	–	(12,885)	(12,885)	5,416
South African rand	–	1,446	1,446	–	–	–	1,446
Cyprus pound	249	2,806	3,055	–	(10,353)	(10,353)	(7,298)
Others	5,347	23,196	28,543	–	(6,077)	(6,077)	22,466
	45,669	118,093	163,762	–	(107,871)	(107,871)	55,891
Of which:							
Unhedged statutory insurance deposits	45,669	65,925	111,594	–	(107,871)	(107,871)	3,723
Investments	–	5,134	5,134	–	–	–	5,134
Cash and deposits	–	47,034	47,034	–	–	–	47,034
	45,669	118,093	163,762	–	(107,871)	(107,871)	55,891

Short term debtors and creditors, including outstanding foreign exchange transactions, have been excluded from the above table.

At 31 December 2003 the asset value, relating to outstanding foreign exchange transactions, included within debtors amounted to £3,233,000 (2002: £708,000) and the liability value of such transactions, within creditors amounted to £3,127,000 (2002: £496,000) giving a net unrealised foreign exchange gain of £106,000 (2002: £212,000 gain).

There are no hedged statutory insurance deposits at 31 December 2003 (2002: £nil).

24 Reserves	Revaluation reserve £000	Accumulated reserve £000	Total reserves £000
Balance at 1 January	6,913	80,238	87,151
Total recognised losses for the year	–	(16,786)	(16,786)
Balance at 31 December	6,913	63,452	70,365

Accumulated reserves attributable to:	2003 £000	2002 £000
Corporation of Lloyd's	89,754	94,724
Consolidated subsidiaries	(30,392)	(16,189)
Associates	4,090	1,703
	63,452	80,238

25 Sale of business operations

In 2001 Lloyd's transferred its wholly owned subsidiary LPSO Limited to Ins-sure Holdings Limited. LCO Marine Limited and LCO Non-Marine and Aviation Limited were also transferred to Xchanging Claims Services Limited. During 2003 a tax repayment of £1.7m has been received as additional proceeds arising on the disposal of LPSO Limited.

A further unrealised gain of £0.5m on the disposal of LPSO Limited has been recognised in the consolidated statement of total recognised gains and losses. This relates to the future dividends receivable under the terms of the sale agreement.

26 Commitments

a) Capital expenditure commitments

No contractual commitments exist at 31 December 2003 other than those included within the financial statements. The same applied at 31 December 2002.

b) Operating lease commitments	2003 Land and buildings £000	2002 Land and buildings £000
The annual commitments under non-cancellable operating leases are as follows:		
Leases expiring:		
Over five years	16,767	16,767

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

27 Disclosure of related party transactions

In accordance with the exemption allowed by FRS 8 'Related Party Disclosures', transactions with entities within the group have not been disclosed.

Services provided to Ins-sure Holdings Limited group in the year ended 31 December 2003 included operating systems support and development, premises and other administrative services. The total value of the services provided was £4,738,000 (2002: £7,714,000). In addition, Ins-sure Holdings Limited group have charged the Corporation £1,077,000 for services provided in the same period (2002: £1,005,000).

At 31 December 2003 there was a balance of £921,000 (2002: £nil) owing from Ins-sure Holdings Limited group to the Corporation. The Corporation owed £8,000 to Ins-sure Holdings Limited at the same date (2002: £166,000).

Services provided to Xchanging Claims Services Limited group in the year ended 31 December 2003 included premises and other administrative services. The total value of the services provided was £2,153,000 (2002: £2,524,000). In addition, Xchanging Claims Services Limited group have charged the Corporation £177,000 for services provided in the same period (2002: £267,000).

Notes to the financial statements continued

27 Disclosure of related party transactions continued

At 31 December 2003 there was a balance of £225,000 (2002: £262,000) owing from Xchanging Claims Services Limited group to the Corporation. The Corporation owed £5,000 to Xchanging Claims Services Limited at the same date (2002: £nil).

Services provided to Centrewrite Limited in the period ended 31 December 2003 included premises and other administrative services. The total value of the services provided was £488,000 (2002: £559,000). Centrewrite Limited did not charge the Corporation for any services in the same period. The same applied for 2002.

At 31 December 2003 there was a balance of £111,000 (2002: £46,000) owing from Centrewrite Limited to the Corporation.

Services provided to Lioncover Insurance Company in the period ended 31 December 2003 included accounting and audit services. The total value of the services provided was £13,000 (2002: £13,000). Lioncover Insurance Company Limited did not charge the Corporation for any services in the same period. The same applied for 2002.

At 31 December 2003 there were no amounts due from Lioncover Insurance Company Limited to the Corporation. The same applied for 2002. The Corporation owed £15,000 (2002: £28,000) to Lioncover Insurance Company Limited at the same date.

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

There were no other related party transactions in 2003.

28 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 2003 amounted to £6.4m (2002: £7.6m).

B The Corporation of Lloyd's has given indemnities to Lioncover Insurance Company Limited, Centrewrite Limited and to certain Names under hardship and other agreements in respect of their underwriting losses. The Council has determined that any losses resulting from such indemnities will be met by the Central Fund. The financial statements of the Central Fund on pages 93 to 104 give further details of the indemnities and the exposures arising.

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

			2003 £000	2002 £000
Guarantees provided by the Corporation of Lloyd's:				
USA	US\$1,500,000	(2002: US\$1,500,000)	838	932
Guarantees provided by the Corporation of Lloyd's and Additional Securities Limited:				
Cayman Islands:				
liability	US\$1,000,000	(2002: US\$1,000,000)	559	621
Hong Kong:				
liability	HK\$58,757,501	(2002: HK\$291,500,000)	4,228	23,219
Malta:				
liability	GBP 1,941,435	(2002: GBP 1,506,465)	1,941	1,506

The Corporation of Lloyd's has established uncollateralised US\$20.0m and US\$9.6m letter of credit arrangements on behalf of two insolvent corporate members. The purpose of the letter of credit facility is to ensure that the insolvent corporate members meet their US Trust Fund funding obligations. The two letters of credit are in favour of Citibank N.A. the trustee of the US Surplus Lines Trust Funds, and expire on 30 April 2004 and 22 December 2004 respectively.

28 Contingent liabilities continued

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

E The claim in the Jaffray action that Lloyd's, between the years 1978 and 1988, made fraudulent misrepresentations which induced Names to become members of Lloyd's and continue underwriting was dismissed by the Court of Appeal on 26 July 2002 and the House of Lords has refused permission to appeal. Names have obtained permission to amend their pleadings in this action alleging negligent misrepresentation. Lloyd's does not accept any liability in respect of this action.

F In Australia one Name has commenced proceedings alleging similar claims of fraud as in the Jaffray action and breach of Australian statutes. Lloyd's does not accept any liability in respect of this action.

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

Five year summary

	1999 £000	2000 £000	2001 £000	2002 £000	2003 £000
Consolidated revenue account					
Operating income	164,406	146,240	143,169	129,263	133,501
Operating expenses:					
Employment	(70,316)	(53,195)	(44,793)	(47,242)	(53,483)
Premises	(24,551)	(27,874)	(37,853)	(30,244)	(30,127)
Overseas operating expenses	(17,401)	(18,136)	(22,112)	(21,497)	(21,524)
Other expenses	(60,975)	(71,961)	(72,586)	(60,171)	(55,133)
Operating expenses	(173,243)	(171,166)	(177,344)	(159,154)	(160,267)
Operating deficit	(8,837)	(24,926)	(34,175)	(29,891)	(26,766)
Share of operating profits of associates before exceptional items	–	–	216	2,873	3,440
Share of exceptional items of associates	–	–	(495)	–	–
Amortisation of goodwill of associate	–	–	(78)	(118)	(118)
Total operating deficit	(8,837)	(24,926)	(34,532)	(27,136)	(23,444)
Profit on sale of the Lloyd's 1958 building	–	–	25,069	1,926	–
Profit on disposal of businesses	–	319	–	–	1,702
Dividends receivable	–	–	7,300	2,750	7,490
Net interest income/(expenditure)	(13,092)	(7,064)	2,505	1,874	1,031
Market settlement net	97,607	132,089	137,993	261,780	268,777
Transfers to Lloyd's New Central Fund	–	–	(80,000)	(246,809)	(279,493)
Taxation credit/(charge)	1,191	18,198	(491)	1,498	6,651
(Deficit)/surplus for the year	76,869	118,616	57,844	(4,117)	(17,286)
	Number	Number	Number	Number	Number
Average number of employees during the year	1,645	1,176	825	589	582

Lloyd's Central Fund

Purpose of the Fund

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

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

The balance of the 'Old' Central Fund will eventually be transferred into the New Central Fund.

The New Central Fund was established with a transfer of £110m from the 'Old' Central Fund following authorisation by the Council on 4 June 1997. Members contribute to the New Central Fund each year based on a percentage of their allocated overall premium limit. The rate for 2003 was 1% for all members (2002: 1%).

As part of Lloyd's solvency procedures, certain assets of the Fund may be used at the discretion of the Council of Lloyd's to cover solvency deficiencies of members at the preceding 31 December to enable Lloyd's to meet the solvency requirements of the Financial Services Authority. Assets may be made available to discharge the underwriting liabilities of members in the event of default.

Financial commentary

At 31 December 2003, the combined assets of the Lloyd's Central Fund amounted to £711.0m, an increase of £234.8m since reported last year.

The New Central Fund has been supported by a five year insurance contract, which commenced in 1999, with six insurers whereby the insurers will meet unrecovered losses to the New Central Fund where it has been applied to meet members' cash calls. The insurers of the policy, and their respective shares, are as follows: SR International Business Insurance Company Limited 32.50%, Employers Reinsurance Corporation 20.00%, St. Paul International Insurance Company Limited 20.00%, International Insurance Company of Hannover Limited 15.00%, XL Mid Ocean Reinsurance Limited 10.00% and Federal Insurance Company 2.50%. The aggregate maximum payment over the lifetime of the policy is £500m. Claims made under the policy total £350m in respect of 2002. It is expected that claims in respect of 2003 will increase to £150m during 2004 as unpaid cash calls that were made in 2003 are met by the New Central Fund on behalf of insolvent corporate members or individuals. However, the insurers dispute their liability to meet the claims made under the policy. Lloyd's does not accept that the insurers have grounds for disputing liability and commenced arbitration proceedings on 2 April 2003 under the terms of the policy for recovery of the sums claimed from the insurers. This is described in note 7 to the financial statements.

Lloyd's New Central Fund insurance premiums for 2003 were £16.7m (2002: £16.7m).

Contributions from members to the Lloyd's New Central Fund amounted to £159.9m in 2003 and £40.0m was refunded in respect of members' special contributions in accordance with *Reconstruction & Renewal*. Contributions from the Corporation of Lloyd's representing the premium levy collections received or accrued during the year, net of any amounts to be refunded, total £279.5m (2002: £246.8m). These amounts have been, or will be when received, transferred to the New Central Fund. The premium levy was charged on substantially all premiums received at 2% for most classes of business (1% for UK motor and life business). The premium levy ceased at the end of 2003 having achieved its objective of increasing central assets.

New Central Fund contributions for 2004 are to increase to 1.25% of the overall allocated premium limits for all members. In addition, in 2004 new corporate members underwriting on new syndicates will be required to make contributions at double the annual rate for their first three years of operations at Lloyd's. Contributions received on 1 April 2004 totalled £187.5m.

Lloyd's Central Fund – Independent auditor's report to the Council of Lloyd's

We have audited the financial statements for the year ended 31 December 2003 which comprise the balance sheet, general fund account, cash flow statement and the related notes 1 to 17. These financial statements have been prepared on the basis of the accounting policies set out therein.

This report is made solely to the Council of Lloyd's in accordance with its instructions to us as set out under the 'Respective responsibilities of the Council of Lloyd's and auditors' below. Our audit work has been undertaken so that we might state to the Council those matters we are required to state in this report in accordance with the Council's instructions and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Council for our audit work, for this report, or for the opinions we have formed.

Respective responsibilities of the Council of Lloyd's and auditors

The Council is responsible for the administration of the Fund and approval of the financial statements prepared by Lloyd's. You have instructed us to audit the financial statements in accordance with United Kingdom Auditing Standards and report to you our opinion as to whether the financial statements give a true and fair view. We also report to you if, in our opinion, Lloyd's has not kept proper accounting records, or if we have not received all the information and explanations we require for our audit.

Basis of audit opinion

We conducted our audit in accordance with United Kingdom Auditing Standards issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the financial statements. It also includes an assessment of the significant estimates and judgements made by or on behalf of the Council in the preparation of the financial statements, and of whether the accounting policies are appropriate to the Fund's circumstances, consistently applied and adequately disclosed.

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

Fundamental uncertainty

In forming our opinion we considered the adequacy of the disclosures made in note 7 concerning the possible outcome of the arbitration between Lloyd's and the insurers of the New Central Fund insurance contract. The financial statements have been drawn up on the basis that the arbitration will be concluded in favour of Lloyd's. Should the arbitration be concluded in favour of one or more of the insurers, the recoveries that the New Central Fund will be able to make from the policy will be reduced. Details of the circumstances relating to this fundamental uncertainty are described in note 7. Our opinion is not qualified in this respect.

Opinion

In our opinion the financial statements give a true and fair view of the financial transactions of the Fund for the year ended 31 December 2003 and of the disposition at that date of its assets and liabilities.

Ernst & Young LLP

Ernst & Young LLP

Registered Auditor
London
7 April 2004

Lloyd's Central Fund balance sheet

as at 31 December 2003

	Note	2003 £000	2002 £000
New Central Fund		674,889	444,751
'Old' Central Fund		36,156	31,486
Total Fund balance	12	711,045	476,237
Represented by:			
Investments			
Listed:			
United Kingdom		162,205	120,124
Overseas		163,797	120,593
Short term deposits		164,987	100,181
	6	490,989	340,898
Current assets			
Debtors	7	358,353	245,297
Cash		48	28
		358,401	245,325
Total assets		849,390	586,223
Current liabilities			
Creditors	10	(58,516)	(24,876)
Total assets less current liabilities		790,874	561,347
Provisions for liabilities and charges			
Undertakings given to insolvent members	11	(79,829)	(85,110)
Net assets		711,045	476,237

Signed on behalf of the Council of Lloyd's on 7 April 2004



Lord Levene of Portsoken
Chairman



Nick Prettejohn
Chief Executive Officer

Lloyd's Central Fund general fund account

for the year ended 31 December 2003

	Note	New Central Fund 2003 £000	'Old' Central Fund 2003 £000	Total 2003 £000	Total 2002 £000
Income					
Contributions from members of Lloyd's	5	159,923	–	159,923	134,467
Contributions from Corporation of Lloyd's	5	279,493	–	279,493	246,809
Profit from sale of investments		1,181	–	1,181	205
Dividends and interest		13,455	2,022	15,477	14,409
Recoveries		106	5,359	5,465	8,830
		454,158	7,381	461,539	404,720
Expenditure					
Refunds of members' special contributions		(39,988)	–	(39,988)	(46,591)
Income Support Schemes		–	(1,622)	(1,622)	(1,713)
Loss from sale of investments		(261)	–	(261)	(6,174)
Other claims and provisions	8	(79,669)	–	(79,669)	(87,726)
Run off project costs (incl. provisional liquidators' fees)		(3,421)	–	(3,421)	(1,343)
Insurance premiums and brokerage fees		(16,706)	–	(16,706)	(16,706)
Legal and professional fees		(1,282)	–	(1,282)	(25)
Administrative expenses		(490)	(327)	(817)	(828)
Loss on exchange		(2,445)	–	(2,445)	(2,955)
		(144,262)	(1,949)	(146,211)	(164,061)
Surplus before taxation		309,896	5,432	315,328	240,659
Taxation charge	9	(87,246)	(1,629)	(88,875)	(70,612)
Net surplus for the year		222,650	3,803	226,453	170,047
Increase/(decrease) in valuation of investments during the year					
Unrealised exchange loss	6	(3,957)	–	(3,957)	(11,916)
Unrealised increase/(decrease) in market valuation of investments	6	18,320	867	19,187	(20,069)
Deferred taxation (charge)/credit	9	(6,875)	–	(6,875)	11,346
		7,488	867	8,355	(20,639)
Increase in general fund for the year		230,138	4,670	234,808	149,408

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

Lloyd's Central Fund cash flow statement

for the year ended 31 December 2003

	Note	2003 £000	2002 £000
Cash inflow from operating activities before claims paid and insurance recoveries			
	13	396,228	360,480
Claims paid in respect of corporate members	11	(191,137)	(465,533)
Claims paid in respect of individual members	8	(4,447)	(2,231)
Insurance recoveries	11	-	133,777
Cash inflow from operating activities		200,644	26,493
Taxation paid		(64,238)	(6,129)
Cash inflow before use of liquid resources and financing		136,406	20,364
Management of liquid resources	14	(136,119)	(20,567)
Increase/(decrease) in cash in the year		287	(203)
Reconciliation of net cashflow to movement in net funds			
Increase/(decrease) in cash in the year		287	(203)
Cash outflow from movement in liquid resources	14	136,119	20,567
Change in net funds resulting from cash flows		136,406	20,364
Profit/(loss) from sale of investments	6	920	(5,969)
Loss on exchange		(2,445)	(2,955)
Movement in valuation of investments	6	15,230	(31,985)
Movement in net funds in the year		150,111	(20,545)
Net funds at 1 January		340,926	361,471
Net funds at 31 December	15	491,037	340,926

Lloyd's Central Fund notes to the financial statements

as at 31 December 2003

1 Purpose of financial statements

Basis of preparation

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

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

These financial statements summarise the income, expenditure, assets and liabilities of the Fund at 31 December 2003. The liabilities of the Fund include those amounts contractually committed by the Fund and exclude provision for future discretionary payments. The financial statements therefore do not take account of claims approved after the balance sheet date or future payments that may be made to cover underwriting losses of individual Names except to the extent that the Central Fund is contractually committed to make such payments under hardship and other agreements. No value has been assumed for the assets pledged by hardship Names under the terms of their hardship agreements.

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

2 Principal accounting policies

A Investments

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

B Dividends and interest

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

C Claims and recoveries

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

Insurance recoveries arise from the operation of the New Central Fund insurance contract, which is described in note 7. The contract provides that where the New Central Fund has been applied to meet members' cash calls in respect of any one year, the New Central Fund is entitled to a matching recovery of the claim paid (a 'qualifying debt'), subject to the policy terms. Consequently, insurance recoveries are accounted for when a qualifying debt has been paid or is expected to be paid when undertakings (see note 3) have been given, in accordance with the principles of the Statement of Recommended Practice on Accounting for Insurance Business. The New Central Fund insurance contract commenced in 1999.

Recoveries, other than insurance recoveries, in respect of claims approved are credited to the general fund account when received.

D Loans and provisions

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

E Foreign currency

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

F Taxation

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

3 Solvency shortfalls

As part of Lloyd's solvency procedures, wherever there is a shortfall in comparing a member's Lloyd's assets with liabilities at the preceding year end, sufficient central and other assets are identified to enable Lloyd's to meet the solvency requirements of the Financial Services Authority under the Lloyd's Sourcebook. The results of the 2003 solvency test will not be determined until June 2004.

The Council of Lloyd's has given undertakings with financial limits to certain corporate members to use the New Central Fund to discharge the liability of those members where they have unpaid cash calls and do not have the resources to meet those cash calls. The purpose of these undertakings is primarily to allow valid claims made on policies underwritten by insolvent members to continue to be paid in full as and when the claims fall due. Provision has been made for these undertakings on the basis that they represent contractual commitments (see note 11). Unutilised undertakings as at 31 December 2003 were £79.8m. Since the year end further undertakings of £34.4m have been given and payments of claims total £34.0m. On 1 April 2004 undertakings of £74.4m expired reducing the balance to £5.8m. Those undertakings which expired have been replaced and further undertakings have been given on 7 April 2004 that total £137.8m, a net increase of £63.4m. No provision has been included in these financial statements in respect of these further undertakings given in 2004. When they are charged to the general fund account in 2004 it is assumed that further insurance recoveries of £34m will be accounted for. However, as described in note 7, insurers have indicated that they dispute their liability to meet claims under the contract.

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

4 Contingent liabilities

The Society of Lloyd's has taken on the responsibilities of some individual Names under hardship and other agreements. The Society has also given indemnity bonds to Lioncover Insurance Company Limited (Lioncover) and Centrewrite Limited (Centrewrite) respectively against any shortfall in their assets. The Council has determined that any losses resulting from such indemnities will be met by the Central Fund.

Following the implementation of *Reconstruction & Renewal*, Names underwriting general business in respect of 1992 and prior years, Lioncover and Centrewrite have been reinsured into Equitas Reinsurance Limited (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 1992 or prior year general business claims of policyholders of Names who are not party to hardship agreements executed before 4 September 1996.

The Corporation of Lloyd's has established uncollateralised US\$20m and US\$9.6m letter of credit arrangements on behalf of two insolvent corporate members. The purpose of the letter of credit facility is to ensure that the insolvent corporate members meet their US Trust Fund funding obligations. The two letters of credit are in favour of Citibank N.A., the trustee of the US Surplus Lines Trust Funds, and expire on 30 April 2004 and 22 December 2004 respectively. No provision has been included in these financial statements in respect of these contingent liabilities.

5 Contributions to New Central Fund

New Central Fund contributions from members amounted to £159.9m in 2003 (2002: £134.5m). Contributions from the Corporation of Lloyd's representing the premium levy collections received or accrued during the year, net of any amounts to be refunded, total £279.5m (2002: £246.8m). These amounts have been, or will be when received, transferred to the New Central Fund. The premium levy was charged on substantially all premiums received at 2% for most classes of business (1% for UK motor and life business). The premium levy ceased at the end of 2003 having achieved its objective of increasing central assets.

Contributions from members:	2003 £000	2002 £000
Individual members	18,374	17,929
Corporate members	141,549	116,538
	159,923	134,467

Lloyd's Central Fund notes to the financial statements *continued*

6 Investments	2003 £000	2002 £000
Movement in the year:		
Market value at 1 January	340,898	360,905
Additions at cost	117,270	153,316
Increase in short term deposits	64,806	12,890
Proceeds from disposals	(48,135)	(148,259)
Net gain/(loss) on disposals	920	(5,969)
Increase/(decrease) in valuation of investments during the year:		
Unrealised exchange loss	(3,957)	(11,916)
Unrealised increase/(decrease) in market valuation	19,187	(20,069)
Market value at 31 December	490,989	340,898
Analysis of securities at year end:		
Listed on London Stock Exchange:		
Fixed interest	60,513	57,558
Equities	101,692	62,566
	162,205	120,124
Listed on overseas stock exchanges:		
Fixed interest	72,763	70,100
Equities	91,034	50,493
	163,797	120,593
Short term deposits	164,987	100,181
	490,989	340,898

Basis of valuation: all securities are valued at their quoted market price at the balance sheet date.

7 Debtors	2003 £000	2002 £000
Interest and dividends receivable	3,050	2,835
Prepaid insurance premiums	–	8,428
Insurance policy claim receivable (see note 11)	326,538	216,223
Deferred taxation (see note 9)	6,840	13,715
Other debtors and prepayments	21,925	4,096
	358,353	245,297

The New Central Fund has been supported by a five year insurance contract, which commenced in 1999 and expired on 31 December 2003, with six insurers whereby the insurers are to meet losses to the New Central Fund where it has been applied to meet members' cash calls, up to a maximum of £350m per annum, where such losses exceed £100m in respect of cash calls made in any one year. The aggregate maximum payment over the lifetime of the policy is £500m.

Insurers dispute their liability to meet the claims made under the policy. As described in note 2C, insurance recoveries are accounted for when qualifying debts have been paid or are expected to be paid when undertakings have been given, subject to the policy terms. On this basis insurance recoveries of £461m in respect of cash calls made in 2002 and 2003 have been accounted for as at 31 December 2003. The insurers paid £134m during 2002, subject to reservation of rights made by certain of the insurers in respect of these claims. The balance outstanding of £327m is included as a debtor as at 31 December 2003. It is expected that a further £39m insurance recoveries will be recognised in 2004 relating to cash calls made in 2003. Lloyd's does not accept that the insurers have grounds for disputing liability and commenced arbitration proceedings on 2 April 2003 under the terms of the policy for recovery of the sums claimed from the insurers. The arbitration hearing is scheduled to commence on 31 August 2004. If the arbitration is not settled entirely in Lloyd's favour and, in the worst case of a range of possible outcomes, the insurance policy were avoided, the estimated effect on the financial statements as at 31 December 2003 would be to decrease the net assets of the Central Fund from £711m to £449m and to reduce the surplus for the year from £235m to a deficit of £27m. This reduction of £262m would reflect the write off of the insurance claim receivable included in debtors, the recognition of a liability to return insurance claims paid by the insurers, the return of insurance premiums paid and consequent tax adjustments.

These financial statements include at full value both the receipt of £134m in 2002 and the sum of £327m in respect of losses for cash calls made in 2002 and 2003. Further claims will be made under the policy in 2004.

8 Other claims and provisions	2003	2002
	£000	£000
Provision for amounts paid and payable under undertakings given to insolvent members (see note 11)	75,541	100,533
Claims paid in respect of individual members	4,447	2,231
Release of provision against loans to syndicates	(319)	(15,038)
	79,669	87,726

9 Taxation	New Central Fund 2003	'Old' Central Fund 2003	Total 2003	Total 2002
	£000	£000	£000	£000
(a) Analysis of charge in the year				
<i>Current tax:</i>				
UK corporation tax based on surplus for the year at 30% (2002: 30%)	(84,683)	–	(84,683)	(26,301)
Current year group relief	(2,030)	(1,629)	(3,659)	–
Adjustments in respect of previous years	(533)	–	(533)	–
Overseas tax charge	–	–	–	(27)
Total current tax (note 9(c))	(87,246)	(1,629)	(88,875)	(26,328)
<i>Deferred tax:</i>				
Origination and reversal of timing differences	–	–	–	(44,284)
Taxation charge	(87,246)	(1,629)	(88,875)	(70,612)
(b) Analysis of charge in the year – based on unrealised increase or decrease in valuation of investments for the year				
<i>Deferred tax arising on movement in valuation of investments during the year</i>				
Origination and reversal of timing differences	(6,875)	–	(6,875)	11,346
Deferred taxation (charge)/credit	(6,875)	–	(6,875)	11,346
(c) Factors affecting tax charge for the year				
The tax assessed for the year is lower than the standard rate of corporation tax in the UK of 30%				
The differences are explained below:				
Surplus before taxation	309,896	5,432	315,328	240,659
Surplus before taxation multiplied by standard rate of corporation tax in the UK of 30% (2002: 30%)	(92,969)	(1,629)	(94,598)	(72,198)
Expenses not deductible for tax purposes	(4,309)	–	(4,309)	(2,230)
Non-taxable income	7,757	–	7,757	608
Additional (income)/deductions	(511)	–	(511)	3,208
Utilisation of tax losses	3,319	–	3,319	44,284
Prior year adjustments	(533)	–	(533)	–
Current tax charge for year (note 9(a))	(87,246)	(1,629)	(88,875)	(26,328)
(d) Provision for deferred tax				
Revaluation of investments	6,840	–	6,840	13,715
Deferred tax asset at 31 December	6,840	–	6,840	13,715
At 1 January	13,715	–	13,715	46,653
Deferred tax charge based on the result for the year (note 9(a))	–	–	–	(44,284)
Deferred tax (charge)/credit on revaluation of investments (note 9(b))	(6,875)	–	(6,875)	11,346
At 31 December (see note 7)	6,840	–	6,840	13,715

Lloyd's Central Fund notes to the financial statements *continued*

10 Creditors	2003 £000	2002 £000
Hardship Names	–	1,214
Corporation tax	37,170	19,343
Group tax relief payable	7,666	856
Other creditors and accruals	11,945	1,631
Income Support Schemes	1,735	1,832
	58,516	24,876

Under the terms of the Income Support Scheme and the Hardship Income Top-Up Scheme, the Central Fund has a commitment in respect of Support Scheme payments approved by Lloyd's Franchise Board for 2004.

11 Provision for undertakings given to insolvent members

The Council of Lloyd's has given undertakings with financial limits to certain corporate members to use the New Central Fund to discharge the liability of those members where they have unpaid cash calls and do not have the resources to meet those cash calls. The purpose of these undertakings is primarily to allow valid claims made on policies underwritten by those insolvent members to continue to be paid in full. For those corporate members in provisional liquidation, the Council has also provided a supporting commitment, which will ensure that in no circumstance will an insurance creditor receive less than the amount it would have received in a winding up commencing on the date of the provisional liquidation. Although the supporting undertaking is a legally enforceable commitment, it is acknowledged that it is not practicable to estimate a value to that commitment. Furthermore, whilst the Society is solvent the likelihood of the supporting undertaking being called upon is extremely remote.

The aggregate amount of all undertakings (excluding the supporting commitment) given by the Council at 31 December 2003 was £776m of which £696m had been paid by that date. Of the £191m paid during 2003, £87m is recoverable under the New Central Fund insurance policy.

Undertakings	2003 £000	2003 £000	2002 £000	2002 £000
Provisions at 1 January		85,110		204,443
Undertakings given in the year (net of re-assessment of undertakings)		185,856		346,200
Analysis of paid undertakings by member:				
Blodget and Hazard Limited	(3,160)		–	
Cotesworth Capital Limited (in provisional liquidation)	(50,920)		(139,689)	
Crowe Corporate Capital Limited	(2,284)		(9,764)	
Crowe Dedicated Limited	(29,462)		(33,044)	
Duncanson & Holt Underwriters Limited	(51,921)		(54,654)	
Margent Capital Management Limited (in provisional liquidation)	(500)		(10,227)	
Newmarket Corporate Member Limited (in provisional liquidation)	(19,580)		(73,643)	
North American London Underwriters Limited	(6,443)		(6,713)	
Riverside Corporate Underwriters Limited (in provisional liquidation)	(1,007)		(13,410)	
Shrewsbury Underwriting Capital (Bermuda) Limited and Shrewsbury Underwriting Capital Limited	(15,903)		(122,297)	
Standfast Corporate Underwriters Limited*	(7,757)		(656)	
Other corporate members	(2,200)		(1,436)	
Paid during the year		(191,137)		(465,533)
Provision for amounts payable at 31 December		79,829		85,110

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

11 Provision for undertakings given to insolvent members continued	2003 £000	2003 £000	2002 £000	2002 £000
Insurance policy claim receivable				
At 1 January		216,223		104,443
Undertakings given during the year	185,856		346,200	
Less: drawdowns made against undertakings during the year under the 2003 policy excess where not previously provided	(14,890)		–	
Less: drawdowns made against undertakings during year in excess of 2002 policy limits	(4,085)		(15,533)	
Less: balance of undertakings falling due after 31 December either not subject to the insurance policy or up to the amount of the insurance policy excess	(56,566)		(85,110)	
		110,315		245,557
		326,538		350,000
Less: insurance claim recoveries in the year		–		(133,777)
Insurance policy claim receivable at 31 December (note 7)		326,538		216,223
Charge to general fund account				
Drawdowns made against undertakings during the year under the 2003 policy excess where not previously provided		14,890		–
Drawdowns made against undertakings during the year in excess of 2002 policy limits		4,085		15,533
Balance of undertakings falling due after 31 December under the Central Fund insurance policy excess		56,566		85,110
Less: recoveries		–		(110)
		75,541		100,533

The New Central Fund insurers have disputed their liability to meet claims made under the policy. As a consequence Lloyd's commenced arbitration proceedings on 2 April 2003 to recover amounts due, as described in note 7.

12 Total Fund balance	New Central Fund £000	'Old' Central Fund £000	Total £000
Balance at 1 January 2003	444,751	31,486	476,237
Increase in general fund for the year	230,138	4,670	234,808
Balance at 31 December 2003	674,889	36,156	711,045

13 Reconciliation of operating surplus to operating cash flows before claims paid and insurance recoveries	2003 £000	2002 £000
Surplus before taxation	315,328	240,659
Undertakings given to insolvent members	185,856	346,200
Increase in insurance claim receivable	(110,315)	(245,557)
Claims paid in respect of individual members	4,447	2,231
(Profit)/loss on sale of investments	(920)	5,969
Loss on exchange	2,445	2,955
(Increase)/decrease in accrued investment income	(215)	1,288
(Increase)/decrease in other debtors	(9,401)	6,053
Increase in creditors	9,003	682
Net cash inflow from operating activities before claims paid and insurance recoveries	396,228	360,480

Lloyd's Central Fund notes to the financial statements *continued*

	2003 £000	2002 £000
14 Analysis of cash flows for headings netted in the cash flow statement		
Management of liquid resources:		
Purchase of government securities	(128,371)	(87,361)
Purchase of equities	(55,883)	(82,267)
Sale of government securities	48,135	89,213
Sale of equities	–	59,848
Net cash outflow from management of liquid resources	(136,119)	(20,567)

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

	At 01.01.03 £000	Cash flow £000	Other movements £000	At 31.12.03 £000
15 Analysis of net funds				
Cash at bank	28	287	(267)	48
Current investments	340,898	136,119	13,972	490,989
	340,926	136,406	13,705	491,037

Other movements include realised and unrealised exchange differences arising on the revaluation of foreign currency operating cashflows and investments.

16 Tutelle Limited

In 1996 the Council set aside, under a Lloyd's special account, £20m of the 'Old' Central Fund to secure the Society's obligations under staff indemnities and certain indemnities which have been given by Lloyd's to certain individuals and advisers in respect of the *Reconstruction & Renewal* plan. These include members of the Reserve Group, directors and officers of Equitas, members of the Council, Lloyd's Regulatory Board, Lloyd's Market Board (the latter two boards ceased during 2002) and of their respective sub-committees and Corporation staff.

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

The security was deposited for an initial period of two years and the Council exercised its discretion to renew this in June 1998. The Council further amended the period of the deposit, in November 1998, so that the security could only be released if the Council was satisfied that there was no reasonable prospect of a claim being made under these indemnities.

Tutelle's position is under biennial review and, having been reviewed in June 2002, will be reviewed again in June 2004. The security may continue for a period of up to 80 years. Any of the funds remaining after this period will be repaid to the 'Old' Central Fund.

17 Lioncover Insurance Company Limited

In 1999, Lloyd's assigned to Lioncover £1m of the 'Old' Central Fund by way of security for a period of 10 years for its obligations to Lioncover under the indemnity bond referred to in note 4. The security was provided as consideration to those individual Names whose underwriting liabilities are reinsured by Lioncover for the release of Lloyd's syndicate 9001, for which Lioncover was substituted as direct reinsurer to close of those Names. Any of the funds remaining after this period will be repaid to the 'Old' Central Fund.

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