

## **GLOBALS**

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# Global Results 2002

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Lloyd's,  
the  
world's  
leading  
insurance  
market

# Chairman's Statement

'We are presented with the opportunity to enhance the Lloyd's brand for the 21st century, to entrench Lloyd's international position, to bolster its global importance, and to embed a culture of profitability.'

Learning about the market from an external perspective has given me a rather different view from that of my predecessors, who had spent most of their careers in the underwriting Room. Outsiders know Lloyd's as an iconic institution that insures pretty much anything, and which pays claims. Insiders understand Lloyd's as a marketplace of exceptional underwriting skill and genuine risk appetite, deployed by independent underwriters, each with unique talents and style.

Both views are broadly accurate, and they go some way towards explaining the unparalleled recognition of the Lloyd's brand around the world. In all my years of travelling, I have never come across an organisation that is as well known in every country as Lloyd's of London. The market's amazing capacity for regeneration is another factor behind Lloyd's success, for although more than 300 years old, Lloyd's remains fresh and continues to be a global leader.

Meanwhile, as every market participant knows, the achievements of the past and of today, when Lloyd's is again profitable and vibrant, do not signal the end of our market's need to evolve. We are presented with the opportunity to enhance the Lloyd's brand for the 21st century, to entrench Lloyd's international position, to bolster its global importance, and to embed a culture of profitability. We have the support we need, demonstrated first by the confidence in our market and its underwriters that is shown every day by insurance buyers around the world. Today 93%<sup>1</sup> of companies included in the Dow Jones Industrial Average and 96%<sup>1</sup> of the FTSE 100 are insured at Lloyd's, as are the world's top ten pharmaceutical companies<sup>1</sup> and its top ten banks<sup>1</sup>. I can think of few other institutions, even among those of a comparable size to Lloyd's, that can claim such a significant market share across such a wide spectrum of the world economy.

The fact that the market now has capacity of some £14.4 bn<sup>2</sup>, an all-time record, indicates the confidence and support which Lloyd's has engendered within the insurance industry itself and its investors as a whole. Lloyd's has taken an increasingly active role in managing its capacity and its current level must be seen as a direct result of the continuing hard market, though in the future capacity levels will fluctuate in accordance with external market conditions. Through corporate membership, the world's leading insurers have shown themselves prepared, along with longer-standing underwriting Members, to commit their precious capital to Lloyd's. It is our responsibility to ensure that their confidence is not misplaced, and that Lloyd's is able to manage its way through the cyclical downturns that the sector may face in years to come.

The financial strength of the market has in the past been doubted by some pundits, but in fact it has never faltered. As hundreds of competitors have come and gone over the decades, Lloyd's continues. Lloyd's ongoing financial strength has been recognised and its rating affirmed by leading rating agencies; this has been supported by the market's strong underwriting performance in 2002, giving rise to profits of £834m on a pro forma annual accounting basis, in contrast to a declared loss of £3.1bn in 2001. This dramatic turnaround has been achieved despite declining capital markets and the serious loss events of previous years. Premium income has grown in virtually all classes of business and territories and terms and conditions have been tightened through renewed underwriting discipline. On the traditional three year accounting basis, the closing of the 2000 year of account has resulted in a loss to the market of £2.4bn, which includes ongoing reserving in respect of the difficult years of the late 1990s. Although Lloyd's is not immune from developing claims in US casualty business, we are less affected than our peers.

<sup>1</sup> FTSE 100, DOW Jones IA, Fortune 500 and Lloyd's statistics, November 2002.

<sup>2</sup> Lloyd's Members' Services Unit January 2003.

<sup>3</sup> Lloyd's Market Reporting, 31 December 2002.



'The fact that the market now has capacity of some £14.4bn, an all-time record, indicates the confidence and support which Lloyd's has engendered within the insurance industry itself and its investors as a whole.'

The United States of America is Lloyd's largest single market, contributing 35%<sup>3</sup> of our total premium income. Our US underwriting also represents a very substantial proportion of insurance placed in America, an unusual phenomenon often said to stem from Lloyd's steadfast reaction to the San Francisco earthquake of 1906. Today it is much more likely that Lloyd's importance there arises from our market's unwavering reaction to the terrible losses of September 11, with Lloyd's bearing the largest share of the gross loss. I believe that one hundred years from now, September 11 will be mentioned in conjunction with Lloyd's in the same way that the San Francisco earthquake is today.

I have been fortunate in inheriting two legacies. The first is that the industry is at a very strong stage in its business cycle. This attractive prospect signals the need to ensure that if and when the cycle turns, Lloyd's has done everything possible to shield the market from the worst aspects of a downturn. The second advantage is that I benefit from the work of my immediate predecessor, Sax Riley, who together with the Council of Lloyd's tackled the very difficult task of working to shape the Society for the 21st Century. He took on this post with the intention of staying only a short time, but stayed longer than he had intended, and achieved an agreed forward policy that many people believed to be impossible. We all owe him a great debt of gratitude.

The outcome of the efforts that Sax led through the Chairman's Strategy Group is a new structure for Lloyd's, one which will stand us in good stead as the world's leading insurance market. Some of the core elements of the Lloyd's Franchise include the introduction of modern business structures such as the Risk Management Division, the refocusing of the Corporation of Lloyd's on its core competencies and joint venturing the rest, and the modernisation of Lloyd's procedures and service standards. These are essential elements in preserving and enhancing the market's profitability, and ensuring that the Lloyd's brand continues to transcend traditional limitations.

I would like to thank John Young, Chairman of the Lloyd's Regulatory Board and other retiring Council members for their contribution to the Society and I wish them well in the future.

Finally, I would like to pay tribute to the unstinting work of my colleagues at Lloyd's. I consider myself fortunate to have found a group of experienced, dedicated and skilled professionals. Their single-mindedness in working for the future success and profitability of Lloyd's, and that of all those who are part of the market, has produced a very firm foundation for Lloyd's continued success.

**Peter Levene**

Chairman

2 April 2003

# Franchise Implementation

In September 2002, Lloyd's Members assembled for an Extraordinary General Meeting and voted overwhelmingly in favour of a series of proposals made by the Chairman's Strategy Group (CSG) to implement a new franchise system for the market. The primary goal of the Franchise is to improve profitability and returns to capital providers. Since the proposals were adopted, Lloyd's has worked vigorously to put in place the fundamental elements of the Franchise outlined in the Chairman's Strategy Group Consultation Document.

## Franchise Board

Establishing the correct infrastructure is of paramount importance to the success of the Franchise. The first step has been the introduction of a new governance structure, replacing the Lloyd's Market Board and the Lloyd's Regulatory Board with the new Lloyd's Franchise Board, at the end of 2002. The Franchise Board's primary focus and that of its principal committees (for example the Market Supervision Advisory Committee, the Capacity Transfer Panel and the Underwriting Advisory Committee) were set and approved by the Council of Lloyd's, which remains the statutory body responsible for the management and supervision of the Society (for a full description of the new governance arrangements see pages 26 and 27). At the same time, Corporation executives have worked with the Lloyd's Market Association and the Lloyd's Motor Underwriters Association to strengthen working relationships and ensure market practitioners (franchisees) are able to have input into the operation of the Franchise.

The Franchise Board is primarily responsible for decisions relating to strategic and policy issues but also has some key operational responsibilities. It will guide the commercial management of the market as well as setting market supervision and solvency policy, in compliance with the requirements of the UK Financial Services Authority. The Board will oversee the admission and removal of organisations operating under the Lloyd's brand, and will work to ensure that the market's business processes are much more efficient and attractive to policyholders, brokers and capital providers. Recognising one of the chief aims of the Franchise, the Board will set a long-term profitability target for the market as a whole.

Early identification of systemic and structural risks to the market and addressing those risks before they cause damage, is a primary responsibility of the Franchise Board. By continuing to enhance risk management procedures at franchise level, as well as seeking to ensure that franchisees are skilled at identifying and managing risks within their own organisations, Lloyd's can strengthen its potential for continued profitability.

## Performance monitoring

To implement the performance-related aspects of the Franchise proposals, Lloyd's has established the Franchise Performance Directorate and appointed Rolf Tolle as its Director, with a view to focusing on franchisee performance. This work began in 2002, as part of a more formal business planning and monitoring process, when Lloyd's met with representatives of each Managing Agent to review and understand their syndicates' 2003 business plans. The aim being to help ensure that franchisees' 2003 business plans followed as closely as possible the new Guidelines for Franchisees, set out in the CSG Consultation Document. These Guidelines incorporate high level risk management and underwriting performance criteria which all Lloyd's franchisees must follow. To ensure continuous improvement, the Franchise Board may refine the Guidelines for 2004, based on experience in 2003.

Quarterly reviews of franchisees' performance against their business plans is also being introduced. This process is intended to be facilitative, but the Franchise Board will not shirk from more authoritative action, which for persistently underperforming franchisees could ultimately include exclusion from the Franchise. All well-managed businesses within the market welcome such decisive action to prevent future damage to the Lloyd's brand and its resources.

The implementation of the Franchise will impact on nearly all parts of the Lloyd's market. Some of the wide range of projects currently underway include:

#### **Annual accounting**

An important objective is to move Lloyd's from its existing three-year accounting system to annual accounting, which allows easier comparison of Lloyd's to its peers. Lloyd's aims to complete the move to annual accounting by 2005.

#### **Run-off years of account**

Lloyd's is also focused on closing run-off syndicate underwriting years of account that have been left open after 36 months rather than being reinsured to close in the normal way. To date, the closure of the four oldest open years of account through reinsurance to close has enabled 3,300 Names with Centrewrite Exeat policies to cease their membership of Lloyd's and opened the way for more than 2,000 additional Names to cease. This process is continuing into 2003, both to facilitate closure of further open years and to help ensure that all Lloyd's run-offs are well managed.

#### **Business processes**

The Franchise Board will also work to improve the market's business processes including policy production, premium payment and claims payment. This work will be accomplished in part through the broader London market principles (LMP) project. Lloyd's continues to support fully the LMP project, and will encourage the further use of the LMP slip, an insurance placement document designed to improve market-wide standards. If use of the LMP slip is deemed to have reached critical mass and quality, the Franchise Board may consider making its use mandatory.

The implementation of the Lloyd's Franchise has only just begun, and much work remains. However, significant accomplishments were realised during the year, which will improve the efficiency and effectiveness of the market, contribute to the management and mitigation of risk and help secure Lloyd's continued profitability.

# The Franchise Board

The goal of the Franchise Board is to create and maintain a commercial environment at Lloyd's, in which the long-term return to all capital providers is maximised.



Peter Levene  
(Chairman of Lloyd's)



Stephen Catlin



Roy Brown



Edward Creasy



Judith Hanratty‡



Andrew Kendrick



Nick Prettejohn  
(Chief Executive Officer, of Lloyd's)



Stephen Hodge\*



Andrew Moss  
(Director, Finance, Risk Management  
& Operations, of Lloyd's)



Jim Stretton



Rolf Tolle  
(Franchise Performance Director, of Lloyd's)

‡ Member of the Nominations, Appointments and Compensation Committee.

\* Member of the Audit Committee.

# The Council

The Council is the Society's governing body although it will act by The Franchise Board in respect to the majority of its functions.



Peter Levene Working member  
(Chairman of Lloyd's)



Stephen Catlin<sup>‡</sup> Working member



John Coldman<sup>‡</sup> Working member  
(Deputy Chairman of Lloyd's)



David Shipley Working member



Bronek Masojada<sup>†‡</sup> Working member  
(Deputy Chairman of Lloyd's)



David Robson<sup>†</sup> Working member



Wellington (Five) Limited External member  
(Represented by Julian Avery)



Limit (No.2) Limited External member  
(Represented by Steven Burns\*)



Brian Pomeroy\* Nominated member



Paul Kelly† External member



Liberty Corporate Capital Limited  
External member  
(Represented by Sean Dalton)



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



Amlin Corporate Member Limited  
External member  
(Represented by Charles Philipps)



Judith Hanratty‡ Nominated member



Alastair Ross Goobey‡ Nominated member



AJSLP 9 External member  
(Represented by Peter Morgan\*‡)



Bill Knight†‡ Nominated member  
Deputy Chairman of the Council of Lloyd's

One nominated member yet to be appointed.  
† Member of the Compliance Committee.  
\* Member of the Audit Committee.  
‡ Member of the Nominations, Appointments and Compensation Committee.

# The insurance environment in 2002

Lloyd's leading positions increased across most lines of business, and underwriters were able to reassess and re-price significant portions of the world's insured risk.

2002 was a year of turmoil for the international insurance and reinsurance industry, as companies faced multiple challenges. Investment returns fell further, making the need to achieve real underwriting profits even more important. Ratings agencies implemented an unprecedented downgrading of their assessments of the industry's financial strength. Losses under policies written in the latter years of the 1990s, as well as multiplying claims for asbestos-related injuries, required insurers and reinsurers to make substantial reserve additions for old-year exposures, some in the billions of dollars. The new awareness of risks arising from potential terrorist acts threw many insurers' traditional pricing methodologies out of order. Some companies failed, others withdrew, and a clutch of new competitors joined the global market. Some capital providers fled the sector; others redoubled their commitments.

All the news was not bad, however. In general, the global loss experience was relatively benign in 2002, as catastrophic events were limited. Rates across a wide range of classes increased dramatically, and underwriting principles were re-evaluated. New players in the global marketplace exercised a measure of discipline during 2002, and helped to show that the insurance industry is not only resilient, but able to regenerate in difficult times, with over \$45bn<sup>1</sup> of completed and pending capital raised by the sector in the aftermath of September 11.

## Lloyd's at the fore

Against this tumultuous backdrop, Lloyd's flourished. It faced many of the challenges that dogged its competitors, but the market has come through this troubled period stronger than ever in its recent history. As competitors suffered financial strength rating downgrades during 2002, Lloyd's rating remained stable. To the credit of the market's many underwriters, as competitors regrouped following the losses of September 11, Lloyd's continued unwaveringly to underwrite, quickly assessing and pricing new risk exposures, and providing much-needed solutions to existing and new clients who found that their incumbent insurers or reinsurers were unable or unwilling to provide the cover they required.

As a result of these conditions Lloyd's underwriters report that prices in the international market have reached their highest levels since 1993, and in 2002 the market is set to record its highest ever level of premium income. Since Lloyd's was fully operational when its customers most needed the market, it was able to enhance its role as one of the world's leading risk underwriting institutions. Lloyd's leading positions increased across most lines of business, and underwriters were able to reassess and re-price significant portions of the world's insured risk.

Lloyd's was particularly responsive to unusual risks requiring significant capacity. For smaller risks, Lloyd's continued to benefit from its strong relationships with US coverholders permitted to accept business on behalf of syndicates, and its strong UK broker relationships. Increasing vigilance has improved the quality of this delegated authority business significantly.

<sup>1</sup> Morgan Stanley: Insurance property and casualty report, July 12 2002

2002 Annual Accounting Result

98.6%

combined ratio

vs 140.3% in 2001

### Capital inflow

With Lloyd's capacity sought after by the world's major insurance clients and their broker representatives, the market's free capital base – measured based on stringent risk-based capital ratios tested through the modelling of realistic disaster scenarios – could have proved insufficient to meet insurance demand, forcing Lloyd's underwriters to leave potentially profitable business on the table. However, substantial new capital was raised by the market both directly and indirectly. Several quoted Lloyd's companies raised money through conventional fundraising avenues, while many others expanded their underwriting capacity by obtaining qualifying quota share reinsurance treaties from highly capitalised reinsurers, including Berkshire Hathaway and some of Bermuda's newly launched reinsurers. By mid-year these arrangements had given Lloyd's underwriters the capacity they required to meet clients' needs world-wide.

Notwithstanding such qualifying quota share arrangements, improved underwriting conditions and the robust response of Lloyd's capital providers have encouraged many syndicates to reduce their dependence on conventional reinsurance, which will result in more of the profits from underwriting in 2002 flowing to Lloyd's capital providers. Reinsurance coverage has become increasingly expensive, and coverage restricted.

### Syndicate performance

The majority of Lloyd's syndicates performed commendably in 2002, as underwriters reaped the benefits of the most attractive international opportunities seen in many years. Lloyd's combined ratio of 98.6% for 2002 is a significant achievement, and highlights the ability of Lloyd's to outperform its peers.

Despite favourable market conditions, the wide divergence in syndicate results continued in 2002, albeit less dramatically than during many previous years. This performance differential continues to be of paramount concern to Lloyd's. In 2003, for the first time, Lloyd's as Franchisor will seek to influence positively the results of market participants who underperform. Lloyd's has commenced a process of relative performance benchmarking which seeks to identify the factors underlying poor results and to raise the standards of market businesses. This will be a key role for the Franchise Performance Directorate going forward.

# Property and casualty



Lloyd's is an important global underwriter of specialty non-marine insurance lines, covering property/casualty risks ranging from microchip manufacturers to hospitals' liability. The market is a leading insurer of the world's largest global corporations and institutions, of primary industries such as mining and forestry, of companies carrying out highly technical and high-risk processes, of large properties, major events, transportation risks and emerging perils... indeed the entire gamut of complicated and unusual risks.

Prices were high across non-marine classes in 2002, with rates increasing in nearly all lines and regions. Lloyd's breadth of expertise in diverse commercial sectors worked to its advantage during the year, as many competing insurers around the world shrank from providing coverage in challenging classes of insurance. Lloyd's underwriters stepped in, using their skill and experience to re-price and redefine coverage, creating sustainable insurance products.

The phenomenon was most apparent in the US and the UK, Lloyd's largest non-marine insurance markets. In the US, unprecedented industry losses related to September 11 accelerated the reduction in the capacity available to underwrite large risks. Some insurers withdrew, others shrank from non-standard underwriting. This increased the trend of specialist business moving to the 'surplus lines' market. In the UK, as domestic competitors' risk appetites contracted, Lloyd's increased its premium income for mid-sized and large commercial property risks. Rates rose in all classes, and acquisition costs remained stable as brokers switched from commission to fee-based charging for some risks.

## insuring the world's top



banks\*

The market covers a steadily increasing portfolio of specialty risks from the European Union. Australia's local market continued to suffer distress, which drove increased volumes of business into Lloyd's.

By and large, underwriters gained greater control of exposures through sub-limits and exclusions, and eliminated additional coverage previously included at no extra cost. Meanwhile, customers opted to increase their levels of retention, seeking insurance protection only for more serious losses. Average market rates for US property risks have more than doubled since their low point in 1999, and have increased even more in the UK.

September 11 presented Lloyd's underwriters with substantial claims and will have a heavy impact on the non-marine market. The market's incurred aggregate loss remained relatively static during 2002, although some underwriters have reduced their September 11 loss estimates to reflect positive development of business interruption claims, which could impact on some syndicates' calendar year results for 2003.

The global reach of Lloyd's brokers enables the market to trade in almost every country in the world. Limited growth was achieved in continental Europe. Nonetheless, the market covered a steadily increasing portfolio of specialty risks from the European Union. Australia's local market continued to suffer distress, which drove increased volumes of business into Lloyd's. Underwriters saw more attractive business from South America, as global reinsurers cut back their proportional treaty support of local insurers. Overall, 2002 catastrophe and industrial losses fell well within annual expectations, and Lloyd's non-marine property underwriting during the year is set to yield substantial profits.

Lloyd's performance is less clear-cut in casualty lines, where claims can take many years to finalise. A dramatic improvement in underwriting conditions took place throughout the year, as headlines proclaimed crises in some liability classes. Many soft-market policies written under three-year terms expired in 2002, and many underwriters of expiring policies were unwilling or unable to renew the cover.

The near complete withdrawal of Lloyd's syndicates from directors and officers cover for listed US companies has resulted in a substantial change in the market's mix of casualty exposures, reducing volatility and improving overall pricing.

# Aviation



Lloyd's provides cover to almost every major airline, airport, commercial satellite launch, aircraft manufacturer, and air traffic control system in the world. With its global market share of about one fifth, Lloyd's has benefited from the strong dynamics of the global aviation market in 2002. Action to correct the inadequate pricing of the soft market cycle has been successful.

Policies protecting major airlines attracted substantial premiums in 2002. From a cyclical low of about \$800m<sup>1</sup> globally in 1998, when aggregate premiums world-wide were about half the total average claims, prices rose steadily during 2000 and 2001. They reached record highs in the months after the September 11 loss, an event which changed insurers' awareness of the possibility of multiple concurrent aviation losses, and thus accelerated pricing trends.

Total airline premium written in 2002 reached around \$3bn<sup>1</sup>, of which as much as half related to the introduction in 2001 of a surcharge for aviation war liability risk. Airline pricing peaked in 2001 for the largest buyers of such cover, in part due to the absorption of the surcharge. Rising prices attracted new capital, and by the year end aggressive competition from some markets outside Lloyd's had tempered prices for the largest airlines.

However, underwriting discipline was maintained. The aviation reinsurance market environment contributed to this discipline; the availability of low-level reinsurance covering original losses below \$150m was extremely restricted following the collapse of a major US reinsurance agency. The shortage has made such reinsurance unaffordable for many insurers, and forced the Lloyd's market – like the rest of the aviation market – to underwrite for gross, rather than net profits.

There was a better than average loss experience in 2002. Total hull and liability losses for airlines insurance were about \$975m<sup>2</sup>, roughly 40% below the 10-year average (excluding liability reserves for September 11). Few losses, if any, will impact aviation excess of loss reinsurances written by Lloyd's, although below-average losses may exert downward pressure on rates in 2003. Nonetheless, they are not expected to fall to anywhere near the depths of the soft market cycle of the 1990s.

<sup>1</sup> Marsh, Aviation news, January/February 2003.

<sup>2</sup> Marsh, Aviation news, December 2002.

A better than average loss experience in 2002 complemented the market's sound underwriting. Total hull and liability losses for airlines insurance were about \$975m<sup>2</sup>, 40% below the ten-year average.

Competition was less intense in the more specialised aerospace lines, for which Lloyd's is the premier global market. Lloyd's aviation underwriters typically split their aviation underwriting about equally between airlines, aviation products liability, and airports and air traffic control (although sharp rises in airline premium upset the balance in 2002). Market prices for the specialist covers increased throughout the year, and continued rising into 2003, as competitors proved less inclined to compete for this more complicated business.

Lloyd's is a leading global market for the extremely specialised insurance of satellites. 2002 saw the withdrawal of a major competitor from this volatile line, where launch risks are so few in number that premium levels can be difficult to assess. Nonetheless, prices increased during the year for both launch and in-orbit risks, a trend sustained by three substantial losses in the fourth quarter. The price for insurance covering complicated or high-risk launches is now satisfactory, and more importantly, improvements have been made to the terms of space insurance contracts, reversing coverage extensions granted by insurers during the soft market. However, the closing 2000 year was impacted by reserving for satellite failures which could bring a global market loss of up to \$1.6bn, and a gross loss to Lloyd's of as much as \$400m.

## insuring the world's top

# seven

airlines\*

# Marine



Lloyd's has always been and continues to be a key player in the marine insurance market. This position has proved a mixed blessing in recent years, since 'hard market' conditions in the international insurance sector have not yet extended to all areas of marine insurance. Global supply continued to exceed demand in 2002.

Lloyd's remains the principal international market for marine hull insurance. Lloyd's syndicates remain popular leaders, particularly among Greek shipowners, because of the market's superior claims service. However, Lloyd's share of most policies has fallen, because cheaper supporting capacity can be found elsewhere.

Headline losses to the global insurance market include extensive fire damage to the uncompleted cruise ship *Diamond Princess*, the loss of the tanker *Prestige*, the grounding of the car carrier *HUAL Europe* in Tokyo Bay, and later the loss of *Tricolor* in the English Channel. The number of total and major partial losses among modern tonnage in 2002 is a concern, since these vessels are perceived to be lower-risk, and were thus 'competitively' priced.

War risk rates remained strong in 2002 despite increased competition, although the overall loss arising from the bombing of the French tanker *Limberg* in October will consume significant premium income.

Lloyd's is the world's premier market for shipping liabilities, leading the reinsurance of the shipping sector's mutual International Group of Protection & Indemnity Clubs. The programme, which contributes perhaps a quarter of Lloyd's marine liability income, has been significantly re-priced on renewal in February 2003 compared with its expiring three year contract.

Over the years Lloyd's underwriters have accumulated a detailed knowledge of the various commodities traded worldwide. That legacy, and Lloyd's exceptional service, have helped the market retain the world's largest portfolio of international cargo insurance. It is supplemented by income from proportional reinsurance of foreign insurers. Cargo underwriters achieved improved rating levels in 2002. The specie account, covering property such as precious metals, fine art, and vault contents, has also performed well.

Lloyd's remains the principal international market for marine hull insurance.

Aviation war insurance, traditionally led by the Lloyd's marine market, suffered a heavy loss in 2001 from the terrorist destruction of several Sri Lankan commercial airliners. Prices increased nearly tenfold as capacity was withdrawn, but competition returned in the last months of 2002. Lloyd's marine market is a leading global underwriter of political risk insurance, covering perils such as contract frustration and asset seizure. The development of global events will have a significant impact on these lines of business in 2003.

The availability of marine reinsurance has not yet been constrained sufficiently to limit direct insurance supply. Most marine insurers, including Lloyd's insurers, have increased their retentions dramatically, as non-proportional reinsurers have withdrawn from working layers. Thus a large proportion of the marine losses of 2002 will be retained. Lloyd's inwards marine reinsurance portfolio has been mixed. Marine specific and whole account excess of loss reinsurance is expected to perform well in 2002, as will proportional treaties supporting domestic markets in Japan, Korea, and elsewhere in the Far East.

## Lloyd's insures



of the world's top 10 marine transportation companies\*

# Energy



Lloyd's expertise in the specialised area of energy insurance allowed it to reinforce its position as a key world player in 2002, particularly of offshore and other upstream, pre-refinery risks. The market's leaders were able to complete a major re-underwriting of the world's oil wells, drilling rigs, and other petroleum exploration and production infrastructure, with the expectation of returning to profitability a category of insurance that has suffered from severe underpricing driven by excessive capacity for several years.

Premium levels for all energy insurance exposures increased dramatically in 2002, in some cases by multiples, following significant rises in 2001. This swift correction has brought market rates to more acceptable levels, continuing a rising trend which began modestly in late 2000, and was given significant impetus by the sinking of the Petrobras P-36 offshore platform in early 2001. The loss, with an insured value of \$500m<sup>1</sup>, encouraged some insurers to exit the line. Meanwhile increasing reinsurance costs forced underwriters to exercise greater discipline.

Rising prices were further accelerated by September 11 which led to more insurers withdrawing substantial capacity from the energy market. Lloyd's was invited to set leading terms on US and Canadian business previously underwritten by domestic markets. Underwriters were able to completely re-rate these risks, improving contract conditions while increasing prices, in some cases tenfold.

## insuring the world's top

five

## oil refining companies\*

## Lloyd's underwriters have an expectation of a profit arising from energy underwriting in 2002.

The reduction of capital supporting energy underwriting was essential. Global capacity for offshore property risks, for example, was \$1.66bn in 1993, but had risen to \$4.082bn<sup>2</sup> by 2000, substantially exceeding estimated demand. Over the same period, premium income fell by about half, and rating levels by two thirds. Following the withdrawals, Lloyd's chief competition in 2002 was from mutual insurers and non-traditional energy risk carriers. However, they too increased their rating levels considerably.

Despite the impact of Hurricane Lili, which swept over the Gulf of Mexico in October 2002, Lloyd's upstream energy underwriting in 2002 should produce profits. Global capacity began to increase over the course of 2002, as former incumbents slowly returned, and new ventures entered the line, although during renewals for 2003 the new and returning players showed support for terms and conditions set by Lloyd's.

Upstream liability exposures were somewhat more competitive in 2002. Some insurers persisted in offering coverage under contract terms unacceptable to Lloyd's underwriters, and price rises were more moderate for this small component of Lloyd's upstream energy portfolio. The market faces growing competition in downstream energy, particularly from major US and continental European insurers and reinsurers, and thus has limited its exposure. However, global capacity fell dramatically following the September 11 tragedy.

Energy reinsurance prices increased significantly in 2002, decreasing insurers' reliance on reinsurance. Energy insurers have traditionally been heavily reliant on reinsurance, but most have increased net retentions significantly. Lloyd's syndicates were able to obtain the reinsurance required to assume significant risks, but most now retain attritional and mid-sized losses, such that, for example, little of the loss arising from Hurricane Lili will fall to reinsurers. This greater participation in losses is another driver of increased insurance prices.

Lloyd's underwriters have an expectation of a profit arising from energy underwriting in 2002. A cohesive and disciplined approach to underwriting remains, although many insurers from both inside and outside the Lloyd's market may wish to increase the size of their energy account in the coming year, which will exert downward pressure on pricing.

\* FTSE 100, Dow Jones 1A, Fortune 500 and Lloyd's statistics, November 2002.

<sup>1</sup> Swiss Re Sigma No1/2002.

<sup>2</sup> IUMI, Energy and Offshore Committee, September 2002.

# Motor



Lloyd's is an important motor insurer in Great Britain, providing cover for private cars, motor cycles and a range of commercial vehicles. It is a lead underwriter of affinity schemes, and the premier insurer of specialty UK motor lines such as coaches, taxi fleets, and other commercial vehicles.

The pricing of UK motor policies, which comprise the majority of Lloyd's motor business, is heavily influenced by cyclical fluctuation. Since 2000 the motor market has emerged from a severe downturn, and prices for most types of motor policy reached profitable levels in 2001 and 2002. By year end, however, price competition had returned to many areas of the market, leading to the view that the pricing cycle reached its peak during the year.

Private car insurance contributes the largest portion of Lloyd's motor income. Prices had levelled by year end, as increased capacity was deployed by competing UK motor insurers. Others sought market share by offering lower prices through retail partners such as supermarkets. These familiar influences accelerated the pricing cycle in private motor. Slow cyclical deterioration may be halted if one of the major composites withdraws, although sufficient capacity would remain among the incumbents to prevent a shortage.

Underwriting in 2002 is set to yield a profit, as rate increases over the period as a whole exceeded claims inflation, and were sufficient to finance the UK government's 2001 decision to actively recoup from insurers the National Health Service's costs related to motor accidents. Accident frequency reduced slightly, reflecting both mild weather conditions during the winter and the general phenomenon of falling claims during times of peak motor insurance pricing.

Happily the longstanding downward trend in major accident frequency has continued, due mainly to improved vehicle construction. Similarly, the incidence of car theft has decreased. However, these trends have been offset somewhat by an increasing number of claims for minor personal injuries, and significantly increased awards and settlements for those accident victims suffering the most serious injuries. Meanwhile the propensity to claim for injuries continues to increase, encouraged by claims management firms, and by solicitors' no-win, no-fee services. These trends are set to continue, and will eventually erode private car insurers' profit margins, unless corresponding rate increases are achieved.

Underwriting in 2002 is set to yield a profit, as rate increases over the period as a whole exceeded claims inflation.

Motor underwriters at Lloyd's typically split their portfolio between personal lines and commercial business. Lloyd's excels in the latter, supported by a strong broker distribution network. Commercial policies continued to attract rises throughout the year, although price competition for less complex risks began by year end, and brought rate increases down to inflationary levels. Nonetheless, specialty business including coaches, haulage and taxi fleet continued to rise throughout the year.

Motor insurers have been affected by other influences. Declining capital markets have reduced insurers' ability to rely on investment income to compensate for underwriting losses. Reinsurance costs and conditions have strengthened, requiring motor insurers to retain a greater proportion of large losses. These factors should ensure that the market continues to focus on underwriting for profit.

## Lloyd's insures



eight

of the world's top 10 motor  
vehicle manufacturers\*

# Reinsurance

Lloyd's risk appetite against the backdrop of a wave of rating downgrades in the reinsurance sector remained strong, while its financial strength rating was affirmed.

Lloyd's is a global reinsurance leader, ranked as the sixth largest reinsurance group in the world by net reinsurance premium<sup>1</sup>. It is an important underwriter of catastrophe reinsurance, and of excess of loss contracts covering insurers' specific, complex portfolios. The market's unique subscription system allows individual syndicates to combine their capital and compete with the largest of the world's reinsurers, yet their responsiveness and short decision-making hierarchy give Lloyd's a strong competitive advantage.

Following a prolonged downturn, reinsurance prices began to rise in 2000, reaching a high level by 2002. The international market was unsettled during the year, as one major reinsurer closed down, and others limited their underwriting. In response to widespread market losses and the multi-billion-dollar reserve additions made by some of Lloyd's competitors, major financial ratings agencies reassessed the overall financial strength of the reinsurance sector, and instigated a wave of rating downgrades.

Against this backdrop Lloyd's risk appetite remained strong, while its financial strength rating was affirmed. Lloyd's underwrote significant volumes of catastrophe excess of loss reinsurance in North America, Japan, Europe and the UK, and of risk excess reinsurance, particularly in the US.

The responsiveness and technical knowledge of Lloyd's underwriters proved invaluable to US insurers, as the domestic reinsurance market retrenched following September 11. US premium accounted for about half of Lloyd's reinsurance income in 2002. Rate increases were supported by rising prices for underlying insurance policies.

## Lloyd's is the world's

sixth

largest reinsurance group<sup>\*</sup>

Supply of underwriting capacity had an increasing influence as the year progressed. Rising rates in the first half levelled off in later months, halted by increasing competition, particularly from start-up companies. Capacity was ample by year-end for exposures where computer loss modelling sets indicative prices, such as natural catastrophe and workers' compensation, although only adequately priced reinsurance contracts, which could also demonstrate above average loss records, attracted sufficient underwriting support. Competition was markedly less intense for more complex business, such as risk excess reinsurance. Lloyd's has a disproportionately large global market share in this speciality, due to the skill and experience of its underwriters, and rate increases on risk excess treaties were sustained.

US property losses were relatively low in 2002. Natural catastrophes were well within expected annual averages, despite the impact of insured losses of \$650m<sup>1</sup> arising from Hurricane Lili. As would be expected, losses arising from September 11 will lead to heavy reinsurance losses, although some syndicates have been able to reduce reserves for business interruption claims.

US casualty reinsurance underwriting was less positive during the period, as litigation and awards continued to escalate. While policies underwritten in 2002 attracted increased premium levels, deterioration of the 2000 and 2001 casualty reinsurance account has continued. Many Lloyd's underwriters have now withdrawn from the most problematic lines, such as directors and officers reinsurance.

Competition among reinsurers was less marked in Europe. Several companies withdrew or cut back, while newly launched reinsurers found the market difficult to penetrate. Leading Lloyd's reinsurers were invited by brokers to increase their European exposure. Much of Lloyd's European reinsurance covers catastrophic events, and thus a portion of the \$2.5bn<sup>1</sup> insured loss arising from August 2002 floods in central Europe will fall to Lloyd's, alongside some claims arising from Windstorm Jeanette. However, the total cost to Lloyd's is relatively small and loss ratio targets were generally met. Lloyd's is an important reinsurer of Japanese catastrophe exposures and retained its position in 2002 as the domestic insurance market completed a long round of consolidation.

Lloyd's plays a leading international role in marine and aviation reinsurance. Neither portfolio was impacted significantly by losses in 2002; the aviation loss experience was well below average, and few of the numerous marine casualties were sufficiently costly to seriously impact excess of loss reinsurers. Marine reinsurance rates rose substantially during the first half as insurers' retentions increased. Aviation reinsurance premium income was substantial and sustained throughout the year, although losses arising from September 11 have impacted the 2001 reinsurance account.

Lloyd's has strengthened its presence in many markets during the tumultuous market conditions of 2002. Rate rises continued during renewals for 2003, while underwriters were able to maintain favourable contract terms and conditions.

\* Standard & Poor's – Global Reinsurance Highlights, 2002 edition.

<sup>1</sup> Swiss Re Sigma No2/2003.

# September 11

Since September 11, Lloyd's has met all of the requirements that have been placed on it: maintaining a stable gross loss figure and fulfilling its trust fund reserving requirements.

The international insurance and reinsurance community faced its greatest challenge following September 11. Lloyd's, a principal insurer of US risks, was confronted with its largest ever loss, but the market's reaction was swift and positive. Lloyd's established a comprehensive and effective project to co-ordinate exposure to this loss and ensure that valid claims would be paid in an orderly and timely manner.

More than a year has passed since September 11 and in that time Lloyd's has met all of its commitments, including the gross funding of its September 11 liabilities. The market's ability to do so before drawing on the support of its reinsurers emphasises the resilience and flexibility of Lloyd's capital base.

Lloyd's continues to monitor potential new exposures, and continuously assess and manage the risks associated with existing obligations. Lloyd's will continue to proactively manage the issues arising from this tragic loss.

## Current loss estimate

At December 31, 2002, the market estimates its gross ultimate loss, excluding inter-syndicate reinsurance, as £5.43bn<sup>1</sup> (US\$ 8.75bn). The corresponding net ultimate loss, after reinsurance recoveries, is £2.02bn<sup>1</sup> (US\$ 3.26bn).

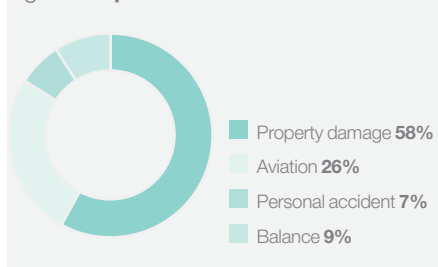
Given the beneficial impact of exchange rates during 2002 and the substantial portion of the loss either paid or deposited in US\$ trust funds, the underlying trend in the market's estimated loss is more accurately reflected by movements in the US\$ estimates. Here the market estimate shows considerable stability at a gross level, with a 2% decrease and relative stability, with a 12% increase on a net basis. The primary drivers of changes in the net loss being the loss adjustment process and the notification of attritional reinsurance claims.

Despite the stability seen during 2002, the ultimate total cost to Lloyd's is still subject to uncertainty, since development of this complex loss is still at a relatively early stage.

## Composition of the loss

Over 80% of the market's total estimated September 11 loss arises from claims against property and aviation policies, as shown in figure 1. The majority of the loss to Lloyd's – over 60% – relates to cover granted under reinsurance treaties. The total loss is highly concentrated: ten insureds account for over 80% of the total direct incurred loss, and ten reinsurance groups account for over 50% of Lloyd's September 11 inwards reinsurance exposure.

Fig 1 Composition of the loss



<sup>1</sup> Exchange rate £1: US\$1.61 December 31 2002  
Exchange rate £1: US\$1.46 December 31 2001

Fig 2 **Claims Notifications** at 31/12/2002

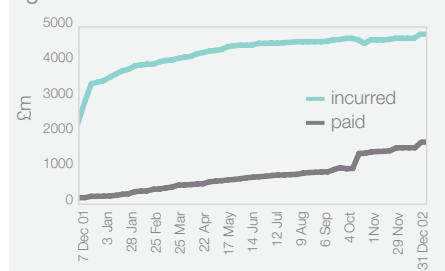
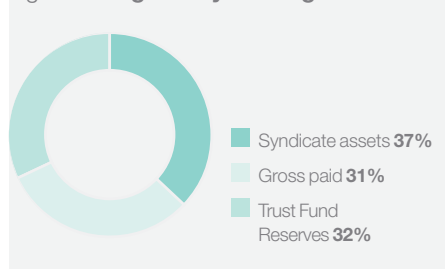


Fig 3 **Outwards Reinsurance Recoverables**



Fig 4 **US Regulatory funding**



**Claims notification**

Lloyd's dedicated September 11 Office monitors claims development on a monthly basis. By 31 December 2002 Lloyd's had paid September 11-related claims totalling £1.74bn, (US\$ 2.8bn<sup>1</sup>) excluding inter-syndicate reinsurance, or 32% of its estimated gross ultimate loss. The corresponding percentage for 31 December 2001 was 4%. The progress of paid claims development reflects the complexity of the major losses, with a consequential impact on the large percentage of claims arising under reinsurance contracts.

**Outwards reinsurance**

Lloyd's regularly reviews the security of syndicates' reinsurance assets. At year end over 89% of the market's remaining external reinsurance asset was placed with reinsurers now rated A or above. The market has recovered and collateralised 37% of its total reinsurance asset, compared to 32% of gross claims paid to date. The reduction of the market's gross exposure through the collection of its reinsurance asset is of prime importance. A strong start has been made, and the September 11 Office continues to work with syndicates and its major reinsurers to ensure that momentum is maintained.

**US regulatory funding**

Lloyd's met its increased US regulatory funding obligations related to September 11 claims at the end of March 2002. On 31 December 2002 over \$3bn was held in these funds to cover liabilities related to September 11. At the year end 63% of the gross ultimate loss had either been paid or remained deposited in US trust funds.

**Conclusion**

The September 11 loss was costly to the insurance industry as a whole in both financial and human terms. Many firms participating in the Lloyd's market lost colleagues that day, but the event has provided a dynamic illustration of the market's inherent strength and resilience. Since September 11, Lloyd's has met all of the requirements that have been placed on it. As Lloyd's moves forward, it will continue to manage September 11 claims with all of the swift service and claims paying ability on which its reputation is built.

## Corporate governance

### The Lloyd's market

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

Lloyd's brokers bring business to the market. The risks shown to underwriters originate from clients and other brokers and intermediaries all over the world. The global results aggregate the financial performance of all the underwriting syndicates operating at Lloyd's.

Together, the syndicates underwriting at Lloyd's form one of the world's largest commercial insurers and a leading reinsurer. For the 2003 year of account, they have the capacity to accept insurance premiums of £14.4bn<sup>1</sup> (approximately US\$23bn).

### Governing body

Under Lloyd's Act 1982, the governing body of the market is the Council of Lloyd's. Under that Act, the Council has the management and superintendence of the affairs of the Society and the power to regulate and direct the business of insurance at Lloyd's. In addition, the Council also has the power to make byelaws for the proper and better execution of the Lloyd's Acts and the furtherance of the objects of the Society, and for various specific purposes set out in the 1982 Act.

Council members for 2003 are listed on pages 8 and 9. The Council comprises six working and six external members, together with six nominated members whose appointment is confirmed by the Governor of the Bank of England. This latter group includes the Lloyd's Chief Executive Officer. The working and external members of the Council are generally elected for terms of three years by the working and external members of the Society, respectively. The Chairman and Deputy Chairmen of Lloyd's are elected annually by the Council from among the working members of the Council.

In the elections for working members of the Council, voting operates on a one-member, one-vote basis. In the elections for external members of the Council the voting entitlement of an external member of the Society is based on the member's total open allocated capacity and is allocated in accordance with the Council and Committee Byelaw (number 18 of 1996), as amended. The Council reports to the members annually at the annual general meeting. Voting entitlement at general meetings is capacity-based for both external and working members, except at general meetings called on the requisition of members under section 6(4) of the Lloyd's Act 1982 for the purpose of revoking or annulling byelaws, at which each member has one vote.

The Council generally meets 10 times a year.

The Council in some cases discharges its functions, in particular the function of making byelaws and certain other rules and requirements, directly by resolutions and decisions of the Council itself. In relation to other functions, in 2002, it acted through committees, sub-committees and officers and employees of the Society; in particular through the Lloyd's Regulatory Board (in discharging its regulatory functions in relation to the Society and the Lloyd's market) and through the Lloyd's Market Board (in exercising various functions for promotion of the commercial business of the Society and the market).

### Franchise Board

Last year, the Chairman's Strategy Group recommended that the Council implement a new governance structure to replace the Lloyd's Regulatory Board, the Lloyd's Market Board and a large number of sub-committees.

The members approved the new governance proposals in September 2002 and the Council established the Franchise Board as from 1 January 2003. The Council will act by the Franchise Board in respect of the majority of its functions, except those that it has reserved to itself, such as the making of byelaws.

The Council has set a goal for the Franchise Board: 'to create and maintain a commercial environment at Lloyd's in which the long-term return to all capital providers is maximised'. The Council has also set Franchise Principles within which the Board will operate to achieve the Franchise Goal. The Franchise Principles cover three main areas: the overriding principles (relating to legal, regulatory and corporate governance); the capital principles (which emphasise equity between capital providers and prudence in capital setting); and the operating principles (including setting the market supervision framework in accordance with the Financial Services Authority (FSA) requirements).

The members of the Franchise Board are listed on pages 6 and 7. The Franchise Board generally meets monthly.

The Franchise Board has four main committees. These are:

**Market Supervision Advisory Committee (MSAC):** MSAC provides advice on decisions relating to the business conduct of participants in the Lloyd's market. MSAC will also take decisions regarding the exercise of Lloyd's enforcement powers including the institution of formal inquiries and disciplinary proceedings. MSAC generally meets monthly.

**Capacity Transfer Panel:** The Capacity Transfer Panel has been established to exercise Council's powers in relation to mandatory offers and minority buy-outs. The Panel will meet at appropriate times during the capacity transfer season.

**Underwriting Advisory Committee (UAC):** The UAC has been established to provide the Franchise Board and the executive with an internally and externally informed view on the insurance cycle and strategic underwriting and risk issues. It will meet at approximately quarterly intervals.

<sup>1</sup> Lloyd's Members' Service Unit, January 2003. Exchange rates £1: US \$1.61

**Investment Committee:** The committee sets Lloyd's investment objectives and monitors and advises on Lloyd's investment operations. It meets at approximately quarterly intervals.

#### **Other Committees of Council**

**Compliance Committee:** The committee's role is to examine the effectiveness of the Franchise Board in performing its functions and exercising its powers in accordance with its terms of reference; to ensure that the Franchise Board is in compliance with the Financial Services and Markets Act 2000 and the FSA Handbook; and to ensure that the Franchise Board is operating in accordance with the Franchise Principles. The committee will ordinarily meet nine times a year.

**Audit Committee:** The committee's role includes ensuring that the financial activities of Lloyd's are subject to independent review and audit. The Committee also reviews Lloyd's annual financial statements, the global results and principal regulatory filings. The Chief Executive Officer, the Director of Finance, Risk Management and Operations, the Financial Controller and the external and internal auditors attend meetings as appropriate. Reports from internal and external auditors on aspects of internal control are reviewed by the Audit Committee and appropriate action taken. The committee meets at least four times a year.

**Nominations, Appointments and Compensation Committee:** The committee is responsible for making recommendations to the Council on the appointment of the Chairman, Chief Executive Officer, new nominated Council members and members of the Franchise Board and other committees, as well as the remuneration of members of such committees and the Chairman and Chief Executive Officer. It meets as necessary.

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

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

#### **Corporate governance of the Lloyd's market**

Lloyd's is committed to the principle of improved and strengthened corporate governance arrangements and the Council supports the Combined Code published by the Committee on Corporate Governance. However, the recommendations for corporate governance incorporated in the Combined Code and the Turnbull Committee's report on internal control were formulated for public limited companies, while Lloyd's is a market of separate, competing entities.

The corporate governance of each entity within the Lloyd's market is the responsibility of that entity. The Council of Lloyd's provides, through the Corporation of Lloyd's, a framework for the governance of these businesses including the assessment of capital adequacy through the Risk Based Capital programme, market supervision (including inspections, visits and audits of market entities) and Guidelines and Codes of Practice, which are issued to all Lloyd's market entities setting out best practice for the management of underwriting, credit and investment risk.

## Pro forma annual accounting statement

The information on pages 30 to 35 does not form part of the global results as required under the Lloyd's Sourcebook issued by the Financial Services Authority under the Financial Services and Markets Act 2000. It is included in order to present the aggregated results of the Lloyd's market on a basis that is comparable with general insurance companies.

Under current legislation Lloyd's is obliged to account on a three-year basis. While this basis is appropriate to the annual venture structure under which Lloyd's currently trades, and forms the basis of the distribution of profits and collection of losses, it does mean that the market results are not readily comparable with those of insurance companies. Lloyd's therefore requires syndicates to provide results on an annual accounting basis, as well as the statutory three-year basis. The annual accounting figures have been produced based on underlying data that is designed primarily to produce the three-year funded accounts.

In the balance sheet the shareholders' funds attributable to equity interests is replaced with 'Balance due to/(from) members' and 'Funds at Lloyd's'. Balance due to/(from) members represents syndicate results declared on an annual accounting basis, which have not yet been distributed to members. Funds at Lloyd's are described in detail in the section 'Security underlying policies issued at Lloyd's' (pages 47 to 51). These items reflect key differences between Lloyd's and unitary insurance companies.

While Lloyd's considers the pro forma results presented to be a reasonable representation of the financial results for the calendar year 2002, it is possible that the market result would be different if a full annual accounting regime were adopted.

There is still a substantial degree of uncertainty attaching to the ultimate gross and net liabilities arising from the catastrophic loss on September 11, though in 2002 the market's estimates have shown considerable stability on a gross basis and relative stability on a net basis. A number of syndicate auditors' opinions reflect this uncertainty, although all of them were unqualified. This is to be expected, since Lloyd's, together with the rest of the industry, is particularly faced with uncertainties arising from related legal disputes, reinsurance collectability issues and the emergence of further information as well as the impact of future economic conditions when establishing reserves in respect of this loss.

Lloyd's has made central adjustments in preparing the pro forma annual accounting results in order that these results may bear more realistic comparison to general insurance companies. They include a notional investment return on funds at Lloyd's and a reflection of the transactions and net assets of the Lloyd's Central Fund and the Corporation of Lloyd's. These adjustments are explained in *note 1C* on page 33.

## Report of Ernst & Young LLP to the Council of Lloyd's on the pro forma annual accounting statement

We have reviewed the balance sheet, technical and non-technical accounts, segmental reporting, the basis of preparation notes and the accounting policy notes (taken together the Pro Forma Annual Accounting Statement – PFAAS) in respect of business transacted by Lloyd's for the year ended 31 December 2002.

The PFAAS, which has been prepared under the historical cost convention (as modified by the valuation of investments at market value) includes the results and the financial position at 31 December 2002 of all syndicates which transacted business during the year and is based on returns from those syndicates as set out in notes 1A and 1B, together with central adjustments in relation to the capital base, investment income and expenses as set out in note 1C.

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

### Responsibilities of the Council of Lloyd's and Ernst & Young LLP

The Council of Lloyd's is responsible for the preparation of the PFAAS.

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

### Basis of review opinion

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

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

### Opinion

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

### Ernst & Young LLP

London  
2 April 2003

## Pro forma annual accounting result

for the year ended 31 December 2002

	2002		2001	
	£m	£m	£m	£m
<b>Pro forma annual accounting technical account</b>				
Gross premiums written – continuing operations		15,539		14,761
– discontinued operations		664		1,351
		16,203		16,112
Outward reinsurance premiums		(5,043)		(5,040)
Premiums written, net of reinsurance		11,160		11,072
Change in the gross provision for unearned premiums	(568)		(1,579)	
Change in provision for unearned premiums, reinsurers' share	77		395	
		(491)		(1,184)
<b>Earned premiums, net of reinsurance</b>		10,669		9,888
<b>Investment return</b>		644		638
		11,313		10,526
<b>Claims paid</b>				
Gross amount	10,086		10,106	
Reinsurers' share	(4,610)		(3,840)	
		5,476		6,266
<b>Change in the provision for claims</b>				
Gross amount	(518)		8,949	
Reinsurers' share	1,694		(4,883)	
		1,176		4,066
Claims incurred, net of reinsurance		6,652		10,332
Acquisition costs	2,681		2,970	
Administrative expenses	790		583	
(Profit)/loss on exchange	401		(12)	
Operating expenses		3,872		3,541
<b>Balance on the technical account for general business</b>		789		(3,347)
Attributable to:				
Continuing operations		1,057		(2,031)
Discontinued operations		(268)		(1,316)
<b>Total</b>		789		(3,347)
<b>Pro forma annual accounting non-technical account</b>				
<b>Balance on the technical account for general business</b>		789		(3,347)
Syndicate investment return	644		638	
Investment return on funds at Lloyd's	160		274	
Other investment returns & other income	98		186	
		902		1,098
Allocated investment return to the technical account	(644)		(638)	
		258		460
Other expenses		(213)		(223)
<b>Pro forma profit/(loss) on ordinary activities before tax</b>		834		(3,110)

## Pro forma annual accounting balance sheet

as at 31 December 2002

	2002		2001	
	£m	£m	£m	£m
<b>Financial investments</b>				
Shares and other variable yield securities	979		500	
Debt securities and other fixed income securities	10,198		7,956	
Participation in investments pools	364		248	
Loans and deposits with credit institutions	724		780	
Deposits with ceding undertakings	20		22	
Members' funds at Lloyd's	8,968		7,704	
Other investments	270		146	
Total investments		21,523		17,356
<b>Reinsurers' share of technical provisions</b>				
Claims outstanding	12,108		14,486	
Unearned premiums	1,585		1,564	
		13,693		16,050
<b>Debtors</b>				
Debtors arising out of direct operations	4,492		4,511	
Debtors arising out of reinsurance operations	4,327		3,574	
Other debtors	365		571	
		9,184		8,656
<b>Other assets</b>				
Tangible assets	16		15	
Cash at bank and in hand	1,944		1,968	
Overseas deposits	1,045		972	
Other	227		122	
		3,232		3,077
<b>Prepayments and accrued income</b>				
Accrued interest and rent	43		37	
Deferred acquisition costs	1,422		675	
Other prepayments and accrued income	199		562	
		1,664		1,274
<b>Total assets</b>		49,296		46,413
<b>Balance due to/(from) members</b>		(2,022)		(4,015)
<b>Members' funds at Lloyd's</b>		8,968		7,704
<b>Central reserves</b>		563		363
<b>Technical provisions</b>				
Provision for unearned premiums	7,517		7,227	
Claims outstanding	29,573		30,561	
		37,090		37,788
<b>Deposits received from reinsurers</b>		221		125
<b>Creditors</b>				
Creditors arising out of direct insurance operations	599		911	
Creditors arising out of reinsurance operations	3,116		2,217	
Amounts owed to credit institutions	18		155	
Other creditors	587		1,125	
		4,320		4,408
<b>Accruals and deferred income</b>		156		40
<b>Total liabilities</b>		49,296		46,413

Signed on behalf of the Council of Lloyd's on 2 April 2003

**Lord Levene of Portsoken** Chairman

**NET Prettejohn** Chief Executive Officer

## Segmental Reporting

as at 31 December 2002

	Direct						Life £m	Other £m	Total direct £m	Reinsurance accepted £m	Total £m
	Accident and Health £m	Motor third party liability £m	Motor other classes £m	Marine, aviation and transport £m	Fire and other damage to property £m	Third party liability £m					
<b>2002</b>											
Gross premiums written	<b>632</b>	<b>310</b>	<b>1,201</b>	<b>2,292</b>	<b>3,510</b>	<b>3,777</b>	<b>48</b>	<b>428</b>	<b>12,198</b>	<b>4,005</b>	<b>16,203</b>
Gross premiums earned	615	418	1,287	2,125	2,977	3,529	45	406	<b>11,402</b>	4,233	<b>15,635</b>
Gross claims incurred	221	308	1,001	1,309	1,510	2,812	25	347	<b>7,533</b>	2,035	<b>9,568</b>
Gross operating expenses	228	78	285	489	794	929	14	130	<b>2,947</b>	925	<b>3,872</b>
Gross technical result	<b>166</b>	<b>32</b>	<b>1</b>	<b>327</b>	<b>673</b>	<b>(212)</b>	<b>6</b>	<b>(71)</b>	<b>922</b>	<b>1,273</b>	<b>2,195</b>
Reinsurance balance	(122)	(37)	33	(354)	(508)	(409)	(7)	(62)	<b>(1,466)</b>	(584)	<b>(2,050)</b>
Net technical result	<b>44</b>	<b>(5)</b>	<b>34</b>	<b>(27)</b>	<b>165</b>	<b>(621)</b>	<b>(1)</b>	<b>(133)</b>	<b>(544)</b>	<b>689</b>	<b>145</b>
Allocated investment return											<b>644</b>
Balance on technical account											<b>789</b>
Net technical provisions, excluding equalisation reserves	842	564	1,666	2,898	3,454	6,808	54	706	<b>16,992</b>	<b>6,405</b>	<b>23,397</b>
<b>2001</b>											
Gross premiums written	<b>586</b>	<b>505</b>	<b>1,491</b>	<b>2,143</b>	<b>2,831</b>	<b>3,741</b>	<b>50</b>	<b>523</b>	<b>11,870</b>	<b>4,242</b>	<b>16,112</b>
Gross premiums earned	628	510	1,286	1,937	2,644	3,243	54	487	<b>10,789</b>	3,744	<b>14,533</b>
Gross claims incurred	573	448	994	2,270	3,459	4,297	33	557	<b>12,631</b>	6,424	<b>19,055</b>
Gross operating expenses	181	107	300	439	582	817	16	114	<b>2,556</b>	985	<b>3,541</b>
Gross technical result	<b>(126)</b>	<b>(45)</b>	<b>(8)</b>	<b>(772)</b>	<b>(1,397)</b>	<b>(1,871)</b>	<b>5</b>	<b>(184)</b>	<b>(4,398)</b>	<b>(3,665)</b>	<b>(8,063)</b>
Reinsurance balance	(15)	1	(109)	255	764	1,067	(4)	50	<b>2,009</b>	2,069	<b>4,078</b>
Net technical result	<b>(141)</b>	<b>(44)</b>	<b>(117)</b>	<b>(517)</b>	<b>(633)</b>	<b>(804)</b>	<b>1</b>	<b>(134)</b>	<b>(2,389)</b>	<b>(1,596)</b>	<b>(3,985)</b>
Allocated investment return											<b>638</b>
Balance on technical account											<b>(3,347)</b>
Net technical provisions, excluding equalisation reserves	820	630	1,608	2,299	3,230	6,152	47	601	<b>15,387</b>	<b>6,351</b>	<b>21,738</b>

# Notes to the pro forma annual accounting statement

as at 31 December 2002

## 1 Basis of preparation notes

### A Basis of reporting

The purpose of the Pro Forma Annual Accounting Statement (PFAAS) is to present a technical and a non-technical account and a balance sheet on a basis generally comparable with the insurance industry. The result of the Lloyd's market on an annual accounting basis for the year ended 31 December 2002 shown in the PFAAS has been determined by aggregating the results as reported separately by all syndicates in their returns. The result does not present a consolidated view of the results of Lloyd's business taken as a single entity and, in particular, it does not eliminate inter-syndicate reinsurances. The result presented is before tax and does not include any adjustments that would be necessary to disclose a post-tax position.

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

### B Aggregation process

The PFAAS has been compiled from syndicate returns prepared by managing agents and reported on by syndicate auditors, and other information for central adjustments. The reports by syndicate auditors on the syndicate returns are required to state whether those returns have been properly prepared in accordance with the instructions issued by Lloyd's and are free from material misstatement. Relevant accounting policies which were included within the instructions are set out in *note 2* on page 34.

### C Central adjustments

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

- *Return on funds at Lloyd's:* Syndicates' investment return has been wholly credited to the technical account. A notional investment return on average funds at Lloyd's during the period has been included in the non-technical account. This notional investment return is based on returns applicable to different classes of assets held as funds at Lloyd's and reflect negative returns where applicable. This adjustment resulted in the inclusion of an investment return of £160m (2001: £274m) in the non-technical account.
- *Inclusion of the transactions and net assets of the Lloyd's Central Fund and the Corporation of Lloyd's:* The Central Fund is described in the section 'Security underlying policies issued at Lloyd's' but in summary has been established to meet policyholders' claims in the event of members being unable to meet their underwriting liabilities. The PFAAS result for the Lloyd's market includes the transactions of the Central Fund. The financial statements of the Corporation of Lloyd's demonstrate its income and expenditure and financial position to the members. The PFAAS result reflects the overall performance of the market and all its activities and has, therefore, been adjusted to include the Corporation's results. These adjustments have resulted in an additional net profit of £652m (2001: £320m) in the technical account and a net loss of £115m (2001: £38m loss) in the non-technical account. As further described in *note 7* on page 96 of the Central Fund financial statements, the insurers of the Central Fund are currently disputing their liability under the terms of the policy for recovery of the sums claimed. Lloyd's does not accept that the insurers have grounds for disputing their liability. Accordingly, the recoveries under this contract have been included in the PFAAS at their full amount.
- *Adjustment made in relation to the 2001 result as at 31 December 2001:* At 31 December 2001 an adjustment was made to the technical account for the year ended 31 December 2000, increasing the loss by £363m, and there was a corresponding decrease in the loss reported for the year ended 31 December 2001. The adjustment was required to ensure that the 31 December 2001 Lloyd's annual accounting result more accurately reflected the overall 2001 position. No adjustment was required for the 2002 results.

### D Variability

Calendar year movements in reserves are based upon best estimates as at 31 December 2002 taking into account all available information as at the balance sheet date. These estimates will be subject to variability until the date at which the underlying claims are settled. Such changes in best estimate will be reflected in the technical account of the year in which they occur.

### E Balance due to/(from) members

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

## Notes to the pro forma annual accounting statement continued

### 1 Basis of preparation notes continued

#### F Discontinued operations

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

#### G September 11

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

#### H Balance sheet comparatives

For the 31 December 2002 year end additional information has been provided by syndicates to enable separate balance sheet disclosure of the reinsurers' share of unearned premiums and of deferred acquisition costs. The equivalent information has been provided as at 31 December 2001 and the comparative balance sheet reflects this additional disclosure.

### 2 Accounting policies

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

#### Premiums

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

#### Unearned premiums

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

#### Deferred acquisition costs

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

#### Claims

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

#### Unexpired risk provision

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

#### Profit commission

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

#### Exchange rates

Syndicate assets, liabilities, income and expenditure expressed in US dollars and Canadian dollars, and other non-sterling settlement currency, are translated at the rates of exchange ruling at the year end. Underwriting transactions in other foreign currencies are included at historical rates. All differences on the translation of foreign currency amounts are dealt with in the technical account.

#### Investments

Listed investments are shown at market value.

#### Investment return

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

As explained in *note 1C*, the non-technical account includes a calculated notional return on funds at Lloyd's.

#### Taxation

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

## Report of Ernst & Young LLP to the Council of Lloyd's on the 2002 global results

We have reviewed the global results for the year ended 31 December 2002 which comprise the global balance sheet, the underwriting account for the 2000 and prior years of account, and the underwriting accounts for the 2000, 2001 and 2002 years of account respectively, and the related notes 1 to 16. These global results have been prepared on the basis of the accounting policies set out therein.

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

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

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

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

### **Basis of review opinion**

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

### **Opinion**

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

### **Ernst & Young LLP**

London  
2 April 2003

## Global balance sheet

as at 31 December 2002

2001 £m		Notes	2002 £m
<b>Assets</b>			
9,177	Financial investments	3	<b>11,750</b>
21	Deposits with ceding undertakings		<b>21</b>
4,302	Debtors	4	<b>4,503</b>
2,908	Other assets	6	<b>3,149</b>
95	Prepayments and accrued income		<b>98</b>
16,503	<b>Total assets</b>		<b>19,521</b>
<b>Liabilities</b>			
(1,891)	Result for the 2000 year of account	7	<b>(2,203)</b>
(61)	Result for the 1999 and prior run-off years of account	8	<b>(194)</b>
(1,952)			<b>(2,397)</b>
83	Balance of net uncalled deficiency on run-off years of account		<b>(10)</b>
Balances on open years of account:			
8,234	Balance on 2001 year of account		<b>9,909</b>
3,251	Balance on 2002 year of account		<b>4,300</b>
1,977	Reserves retained in respect of run-off years of account		<b>2,969</b>
125	Deposits received from reinsurers		<b>221</b>
4,745	Creditors	9	<b>4,460</b>
40	Accruals and deferred income		<b>69</b>
16,503	<b>Total liabilities</b>		<b>19,521</b>

Signed on behalf of the Council of Lloyd's on 2 April 2003

### Lord Levene of Portsoken

Chairman

### NET Prettejohn

Chief Executive Officer

## 2000 and prior years of account

as at 31 December 2002

1999 and prior years of account Total £m		2000 year of account		1999 and prior years of account	Total £m
		Pure year result £m	Movement on years of account reinsured therein £m	Calendar year movement on run-off years of account £m	
9,055	Gross premiums written (net of brokerage)	9,524	98	71	<b>9,693</b>
3,270	Outward reinsurance premiums	3,338	81	58	<b>3,477</b>
5,785	Net premiums	6,186	17	13	<b>6,216</b>
5,604	Reinsurance to close premiums received from earlier years of account	–	5,270	–	<b>5,270</b>
680	Amounts retained to meet all known and unknown outstanding liabilities brought forward	–	–	1,868	<b>1,868</b>
12,069		6,186	5,287	1,881	<b>13,354</b>
9,909	Gross claims paid	6,335	2,448	945	<b>9,728</b>
3,739	Reinsurers' share	1,991	1,166	438	<b>3,595</b>
6,170	Net claims	4,344	1,282	507	<b>6,133</b>
5,651	Reinsurance premiums paid to close the year of account	2,446	3,722	207	<b>6,375</b>
1,977	Amounts retained to meet all known and unknown outstanding liabilities carried forward	1,190	366	1,413	<b>2,969</b>
13,798		7,980	5,370	2,127	<b>15,477</b>
(1,729)	<b>Underwriting result</b>	(1,794)	(83)	(246)	<b>(2,123)</b>
(1,729)		(1,877)		(246)	<b>(2,123)</b>
(25)	Profit/(loss) on exchange		(15)	10	<b>(5)</b>
(551)	Syndicate operating expenses		(575)	(15)	<b>(590)</b>
(2,305)	<b>Balance on technical account</b>		(2,467)	(251)	<b>(2,718)</b>
518	Investment income		484	52	<b>536</b>
(9)	Investment expenses and charges		(10)	(1)	<b>(11)</b>
78	Investment gains less losses		66	6	<b>72</b>
(1,718)	<b>Result before personal expenses</b>		(1,927)	(194)	<b>(2,121)</b>
(234)	<b>Personal expenses</b>		(276)	–	<b>(276)</b>
(1,952)	<b>Result after personal expenses</b>		(2,203)	(194)	<b>(2,397)</b>

## Underwriting account for the 2000 year of account

after three years as at 31 December 2002

1999 at 36 months £m		at 24 months £m	2000 Change in calendar year £m	at 36 months £m
9,870	Syndicate allocated capacity	10,045	–	<b>10,045</b>
9,015	Gross premiums written (net of brokerage)	9,582	40	<b>9,622</b>
3,230	Outward reinsurance premiums	3,243	176	<b>3,419</b>
5,785	Net premiums	6,339	(136)	<b>6,203</b>
5,604	Reinsurance to close premiums received from earlier years of account	5,521	(251)	<b>5,270</b>
11,389		11,860	(387)	<b>11,473</b>
9,581	Gross claims paid	4,328	4,455	<b>8,783</b>
3,572	Reinsurers' share	1,229	1,928	<b>3,157</b>
6,009	Net claims	3,099	2,527	<b>5,626</b>
5,582	Reinsurance premiums paid to close the year of account	–	6,168	<b>6,168</b>
1,439	Amounts retained to meet all known and unknown outstanding liabilities	–	1,556	<b>1,556</b>
13,030		3,099	10,251	<b>13,350</b>
(1,641)	<b>Underwriting balance/result</b>	8,761	(10,638)	<b>(1,877)</b>
(28)	Profit/(loss) on exchange	(6)	(9)	<b>(15)</b>
(545)	Syndicate operating expenses	(498)	(77)	<b>(575)</b>
(2,214)	<b>Balance on technical account</b>	8,257	(10,724)	<b>(2,467)</b>
492	Investment income	207	277	<b>484</b>
(9)	Investment expenses and charges	(6)	(4)	<b>(10)</b>
74	Investment gains less losses	37	29	<b>66</b>
(1,657)	<b>Balance/result before personal expenses</b>	8,495	(10,422)	<b>(1,927)</b>
(234)	<b>Personal expenses</b>	(261)	(15)	<b>(276)</b>
–	<b>Balance after personal expenses</b>	8,234	(10,437)	<b>–</b>
(1,891)	<b>Result after personal expenses</b>	–	–	<b>(2,203)</b>

## Underwriting account for the 2001 year of account

after two years as at 31 December 2002

2000 at 24 months £m		at 12 months £m	2001 Change in calendar year £m	at 24 months £m
10,045	Syndicate allocated capacity	11,058	–	<b>11,058</b>
9,582	Gross premiums written (net of brokerage)	7,389	3,529	<b>10,918</b>
3,243	Outward reinsurance premiums	2,793	1,039	<b>3,832</b>
6,339	Net premiums	4,596	2,490	<b>7,086</b>
5,521	Reinsurance to close premiums received from earlier years of account	–	6,195	<b>6,195</b>
11,860		4,596	8,685	<b>13,281</b>
4,328	Gross claims paid	1,403	3,859	<b>5,262</b>
1,229	Reinsurers' share	673	1,803	<b>2,476</b>
3,099	Net claims	730	2,056	<b>2,786</b>
8,761	<b>Underwriting balance</b>	3,866	6,629	<b>10,495</b>
(6)	Profit/(loss) on exchange	(3)	(20)	<b>(23)</b>
(498)	Syndicate operating expenses	(391)	(164)	<b>(555)</b>
8,257	<b>Balance on technical account</b>	3,472	6,445	<b>9,917</b>
207	Investment income	50	186	<b>236</b>
(6)	Investment expenses and charges	(4)	(6)	<b>(10)</b>
37	Investment gains less losses	5	36	<b>41</b>
8,495	<b>Balance on open year of account</b>	3,523	6,661	<b>10,184</b>
(261)	<b>Personal expenses</b>	(272)	(3)	<b>(275)</b>
8,234	<b>Balance after personal expenses</b>	3,251	6,658	<b>9,909</b>

The balance on the 2001 year of account is prepared on the three-year accounting method described in *note 2A* and excludes any estimation for future claims and hence does not purport to show a profit or loss.

## Underwriting account for the 2002 year of account

after one year as at 31 December 2002

2001 at 12 months £m		2002 at 12 months £m
11,058	Syndicate allocated capacity	13,239
7,389	Gross premiums written (net of brokerage)	8,514
2,793	Outward reinsurance premiums	3,169
4,596	Net premiums	5,345
–	Reinsurance to close premiums received from earlier years of account	175
4,596		5,520
1,403	Gross claims paid	510
673	Reinsurers' share	90
730	Net claims	420
3,866	<b>Underwriting balance</b>	<b>5,100</b>
(3)	Profit/(loss) on exchange	9
(391)	Syndicate operating expenses	(487)
3,472	<b>Balance on technical account</b>	<b>4,622</b>
50	Investment income	50
(4)	Investment expenses and charges	(5)
5	Investment gains less losses	5
3,523	<b>Balance on open year of account</b>	<b>4,672</b>
(272)	<b>Personal expenses</b>	<b>(372)</b>
3,251	<b>Balance after personal expenses</b>	<b>4,300</b>

The balance on the 2002 year of account is prepared on the three-year accounting method described in *note 2A* and excludes any estimation for future claims and hence does not purport to show a profit or loss.

## Notes to the global results

### 1 Basis of preparation of global results

#### A Basis of reporting

The global results, comprising the underwriting accounts and the balance sheet, have been compiled from syndicate returns prepared by managing agents and reported on by syndicate auditors and other information and comply with the requirements of the Lloyd's Sourcebook.

#### B Aggregation of syndicate results

The global results of the Lloyd's market as at 31 December 2002 shown in the global results are determined by aggregating the results as reported by all syndicates in their returns. The global results do not present a consolidated view of Lloyd's business. These results include 124 syndicates which underwrote for the 2000 year of account (1999: 140 syndicates) together with the calendar year results of 75 prior years of account in run-off during 2002 (2001: 39 run-off accounts).

The global results show the balances on the open years 2001 and 2002. In keeping with the three-year accounting method described in *note 2A* below, these balances exclude any estimation for future claims, and hence do not purport to show a profit or loss. Consequently, the impact of September 11 claims are not fully reflected in the open year balances. Further details of the September 11 claims can be found on pages 24 and 25.

### 2 Statement of accounting policies

#### A Three-year accounting method

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

#### B Premiums

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

#### C Claims

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

#### D Reinsurance to close

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

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

Where substantial uncertainties affect the assessment of the outstanding liabilities, a year of account might not be closed. In such cases, an amount to meet all known and unknown outstanding liabilities is retained at each year-end until the year of account is finally closed. Such an account is referred to as a run-off year of account. As at 31 December 2002 there were 98 years of account in run-off; these are mainly in relation to syndicates which had ceased trading by 31 December 2002.

#### F Return on investments

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

### G Syndicate operating expenses

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

### H Basis of currency translation

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

### I Taxation

The results are disclosed gross of all direct taxation. Capital appreciation is taxed as trading income without deduction for indexation relief. Currently, managing agents are not required to deduct basic rate income tax from trading income of syndicates and all the basic rate tax deducted at source from syndicates' investment income is recoverable by the managing agents and included in the amounts distributable to members. Consequently no charges to UK taxation are shown in the global results.

### J Underwriting account for run-off years

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

<b>3 Financial investments</b>	<b>2002 £m</b>	2001 £m
Shares and other variable-yield securities	<b>866</b>	369
Debt securities and other fixed-income securities	<b>9,575</b>	7,815
Participation in investment pools	<b>364</b>	248
Loans guaranteed by mortgage	<b>11</b>	53
Deposits with credit institutions	<b>741</b>	608
Other	<b>193</b>	84
	<b>11,750</b>	9,177

<b>4 Debtors</b>	<b>2002 £m</b>	2001 £m
Brokers' balances	<b>3,713</b>	3,065
Reinsurance to close premiums receivable from other Lloyd's syndicates	<b>398</b>	1,008
Inter-syndicate balances	<b>187</b>	108
Unpaid cash calls	<b>36</b>	30
Other debtors	<b>169</b>	91
	<b>4,503</b>	4,302

### 5 Reinsurance bad debts

The global result at 31 December 2002 for the 2000 and prior years of account is shown after providing £420m (2001: £439m) in respect of reinsurance bad debts, analysed into £174m (2001: £139m) arising on reinsurers' share of claims paid and £246m (2001: £300m) relating to recoveries included within reinsurance to close and amounts retained to meet liabilities on run-off years. The balances due from reinsurers on paid claims are included in brokers' balances in *note 4* and are shown net of the bad debt provision.

<b>6 Other assets</b>	<b>2002 £m</b>	2001 £m
Cash at bank and in hand	<b>2,110</b>	1,936
Overseas deposits	<b>1,039</b>	972
	<b>3,149</b>	2,908

Notes to the global results continued

<b>7 Result for the 2000 year of account</b>		<b>2002 £m</b>	<b>2001 £m</b>
Life syndicates		<b>6</b>	1
Other syndicates		<b>(2,209)</b>	(1,892)
		<b>(2,203)</b>	(1,891)

<b>8 Result for 1999 and prior run-off years of account</b>		<b>2002 £m</b>	<b>2001 £m</b>
Life syndicates		<b>-</b>	-
Other syndicates		<b>(194)</b>	(61)
		<b>(194)</b>	(61)

<b>9 Creditors</b>		<b>2002 £m</b>	<b>2001 £m</b>
Brokers' balances		<b>1,803</b>	1,231
Advance cash calls made		<b>1,811</b>	1,441
Reinsurance to close premiums payable to other Lloyd's syndicates		<b>398</b>	1,008
Reinsurance to close premiums payable to the 2003 year of account		<b>-</b>	15
Inter-syndicate balances		<b>187</b>	108
Taxation		<b>14</b>	-
Other creditors and accruals		<b>247</b>	942
		<b>4,460</b>	4,745

<b>10 Personal expenses</b>		<b>2000 year of account £m</b>	<b>1999 year of account £m</b>
Annual subscriptions		<b>27</b>	35
Central Fund contributions		<b>100</b>	99
Managing agents' fees		<b>111</b>	66
Members' agents' fees		<b>23</b>	26
Managing agents' profit commission		<b>15</b>	8
		<b>276</b>	234

The personal expenses included above are broadly proportional to members' participation on syndicates underwriting for the 2000 year of account.

The managing agents' profit commission of £15m is in respect of 19 of the 25 syndicates which made a profit on the 2000 year of account (1999: £8m in respect of 20 of the 25 syndicates).

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

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

The global results are stated before deduction of members' agents' profit commission, which is only known once the distribution exercise is completed. The aggregate amount chargeable in respect of the 2000 year of account is estimated at less than £1m (1999 year of account: less than £1m).

<b>11 Members' qualifying assets</b>	<b>2002 £m</b>	2001 £m
Lloyd's deposits	<b>8,552</b>	7,178
Personal reserve funds	<b>393</b>	489
Special reserve funds	<b>23</b>	37
	<b>8,968</b>	7,704
Other qualifying assets	<b>281</b>	327
	<b>9,249</b>	8,031

The Lloyd's deposits, personal reserve funds and special reserve funds shown as at 31 December 2002 represent the total assets lodged at Lloyd's by all members to support underwriting at Lloyd's. The 'other qualifying assets' of £281m relate to other personal wealth declared by individual members. Certain corporate members may have other assets, beyond their funds at Lloyd's, which may be available to support their underwriting; these assets are not included in the above table.

## 12 Lloyd's central resources

Lloyd's central resources as at 31 December 2002 totalled £563m (2001: £418m as restated) as follows:

- A The net assets of the Central Fund as at 31 December 2002 amounted to £476m (2001: £327m, as restated) as shown in the Central Fund financial statements on page 90.
- B The net assets of the Corporation of Lloyd's amounted to £87m as at 31 December 2002 (2001: £91m, as restated), as shown in the Corporation of Lloyd's financial statements on page 66.

## 13 Inter-syndicate premiums and claims

No adjustment has been made in the underwriting accounts for inter-syndicate reinsurance premiums amounting to £874m for the 2002 calendar year (2001: £631m) and inter-syndicate claims paid in 2002 amounting to £523m (2001: £632m).

## 14 Average rate of commission and brokerage

The average deduction for brokerage and commission across all markets by agents and brokers at Lloyd's has been estimated at 19.9% (2001: 20.1%).

## 15 Members' premium income limit

The maximum annual premium income limit of members at Lloyd's is calculated by reference to the value of their funds at Lloyd's. Individual members are permitted to take credit for demonstrated personal wealth up to certain limits. Further details concerning the relationship between members' premium income limits and their capital provided are set out in the 'Security underlying policies issued at Lloyd's' section (pages 47 to 51).

## 16 Technical provisions for long-term insurance business

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

## Lloyd's market statistics

as at 31 December 2002

<b>Summary of results by year of account</b>	1994 £m	1995 £m	1996 £m	1997 £m	1998 £m	1999 £m	<b>2000 £m</b>
Net premiums	5,690	5,893	4,810	4,709	4,869	5,785	<b>6,203</b>
Underwriting result:							
– pure year	1,604	1,515	575	4	(904)	(1,563)	<b>(1,794)</b>
– prior years	58	87	160	159	127	(166)	<b>(329)</b>
– total	1,662	1,602	735	163	(777)	(1,729)	<b>(2,123)</b>
Gross investment return (before expenses)	509	609	591	398	520	596	<b>608</b>
Result after personal expenses	1,095	1,149	606	(209)	(1,065)	(1,952)	<b>(2,397)</b>
Exchange rate at close of account:							
£1 = US\$	1.71	1.65	1.66	1.61	1.49	1.46	<b>1.61</b>
£1 = CAN\$	2.35	2.35	2.56	2.34	2.24	2.32	<b>2.54</b>

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

<b>Market capacity by year of account</b>	1997	1998	1999	2000	2001	2002	<b>2003</b>	
Total number of underwriting members participating:								
Individual	9,958	6,825	4,503	3,317	2,848	2,466	<b>2,198</b>	
Corporate	202	435	668	853	895	837	<b>762</b>	
Total market capacity								
Individual	£m	5,824	4,105	2,700	2,003	1,800	1,766	<b>1,844</b>
Corporate	£m	4,500	6,064	7,170	8,042	9,258	11,473	<b>12,552</b>
Total	£m	10,324	10,169	9,870	10,045	11,058	13,239	<b>14,396</b>

<b>Comparative information by year of account</b>	1996		1997		1998		1999		2000	
	£m	%	£m	%	£m	%	£m	%	£m	%
Net premiums	4,810	100.0	4,709	100.0	4,869	100.0	5,785	100.0	<b>6,203</b>	<b>100.0</b>
Direct syndicate expenses	231	4.8	291	6.2	339	7.0	378	6.6	<b>379</b>	<b>6.1</b>
Corporation charges	83	1.7	70	1.5	72	1.5	71	1.2	<b>83</b>	<b>1.3</b>
Premium levy	–	–	72	1.5	82	1.7	96	1.7	<b>113</b>	<b>1.8</b>
Members' subscriptions (excluding Central Fund)	50	1.1	68	1.4	51	1.0	35	0.6	<b>27</b>	<b>0.5</b>
Central Fund contributions	88	1.8	102	2.2	132	2.7	99	1.7	<b>100</b>	<b>1.6</b>
Agents' fees	108	2.2	103	2.2	98	2.0	92	1.6	<b>134</b>	<b>2.2</b>
Managing agents' profit commission	143	3.0	68	1.4	21	0.4	8	0.1	<b>15</b>	<b>0.2</b>
Total market costs	703	14.6	774	16.4	795	16.3	779	13.5	<b>851</b>	<b>13.7</b>

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

## Security underlying policies issued at Lloyd's

as at 31 December 2002

### Summary

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

There are 71 syndicates registered to conduct business at Lloyd's in 2003. Each syndicate is managed by an underwriter. The underwriters write insurance business on behalf of the member(s) of the syndicate, who receive profits or bear losses in proportion to their share in the syndicate.

Every member underwriting at Lloyd's in 2003 is subject to an annual risk assessment, based on Lloyd's risk-based capital methodology. This determines a member's capital requirement subject to prescribed minimum levels.

### The Lloyd's chain of security

The great majority of claims are met from what is described below as the first link in the Lloyd's chain of security. However, the resources described in each further link are also available to ensure that all valid claims by Lloyd's policyholders are met in full. Although aggregate numbers are shown below, the first three links each operate on a several basis: each member's resources are only available to meet his share of claims. The fourth link is a fund available to meet the liabilities of any member on a mutual basis. The key features of the chain of security are summarised on the right and the sections which follow describe each of these links in greater detail.

The description of the chain of security set out below relates to the support of policies written for the 1993 and subsequent years of account for non-life business and all life business written at Lloyd's. Liabilities in relation to the 1992 and prior years of account for non-life business were reinsured into Equitas as at 31 December 1995, as part of *Reconstruction & Renewal*.

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

#### First Link

All premium receipts and reserves at syndicate level are held in premiums trust funds or overseas regulatory deposits. Profits are distributed when a year of account is closed, normally after three years.

Premiums Trust Funds\*: £17,178m

#### Second Link

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

Capital held at Lloyd's\*: £8,968m

#### Third Link

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

Individual members' other declared assets\*: £281m

#### Fourth Link

The Central Fund is available to meet any portion of any member's liabilities that the member is unable to meet in full. In addition to the net assets of £476m, the fund is supported by a £500m five-year insurance programme. Claims have been made under the policy with respect to 2002, totalling £350m. The Council is also able to call from members' premiums trust funds (first link) an amount up to 3% of members' premium limits in aggregate, in any one year. In addition, the other assets of the Corporation, totalling £87m, are available to meet underwriting liabilities in the last resort.

Lloyd's central assets\*: £563m

\* as at 31 December 2002.

## Security underlying policies issued at Lloyd's continued

### The first link

The first link in the chain of security is the member's premiums trust funds, and other assets held in trust at syndicate level. To protect the interest of policyholders, all premiums and other monies received or receivable in connection with the member's underwriting business are initially paid into the premiums trust funds, managed by the managing agent of the syndicate concerned. Payments from these funds may only be made to meet permitted trust outgoings: claims, reinsurance premiums, underwriting expenses and the like, including funding overseas regulatory deposits. Profit is not distributed to members until the underwriting account for the year has closed at the end of the three years when provision must be made for all outstanding liabilities.

There are separate premiums trust funds for life business and non-life general business. There is a further segregation in that a number of the premiums trust funds are exclusively available to support certain overseas underwriting of members. The Lloyd's Dollar Trust Funds (LDTF) receive premiums in respect of US dollar denominated non-life business underwritten or incepting on or after 1 August 1995. Receipts of non-life US dollar denominated business originally written and incepting before that date are held in the Lloyd's American Trust Fund (LATF) of each member, in New York. There are separate LATFs in New York for US dollar denominated life business, whenever written or incepting.

The other overseas premiums trust funds are the Lloyd's Canadian Trust Fund (LCTF) in Canada, comprising members' underwriting receipts in respect of Canadian situs business and, with effect from February 2002, new 'Lloyd's Asia' trust funds for general business written by members through service companies in Singapore.

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

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

The total value of all the above funds was £17,178m in aggregate, at 31 December 2002.

### The second link

The second link is a member's funds at Lloyd's. Funds at Lloyd's comprise the three trust funds in which members' assets may be held: the Lloyd's deposit, the special reserve fund and the personal reserve fund held under the terms of the premiums trust deed. The assets in funds at Lloyd's must be readily realisable, may include letters of credit and bank and other guarantees, and must be at least equivalent to the aggregate of the member's net funds at Lloyd's requirement and certain liabilities in respect of his underwriting business. Each member's net funds at Lloyd's requirement to support his underwriting at Lloyd's is determined using Lloyd's risk-based capital methodology. As at 31 December 2002, the total value of funds at Lloyd's held in trust by members amounted to £8,968m in the aggregate.

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

### The third link

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

Individual members who show a minimum level of personal wealth (i.e. funds at Lloyd's and other personal wealth) of £350,000 may reduce their net funds at Lloyd's requirement by the amount of declared other personal wealth. This credit is limited to 20% of the member's net funds at Lloyd's requirement and must not reduce the net funds at Lloyd's below 35% of premium limit. The aggregate value of personal wealth declared to Lloyd's by individual members, not counting their funds at Lloyd's, was £281m at 31 December 2002. In addition, individual members of Lloyd's have other assets, not declared to Lloyd's, which are available to meet claims.

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

### The fourth link

The fourth link includes the Central Fund assets resulting from annual contributions made by all members. The New Central Fund has been established to be available, at the discretion of the Council of Lloyd's, to meet policyholders' claims in the event of members being unable to meet their underwriting liabilities relating to 1993 and post non-life business and all life business. The net assets of the Central Fund as at 31 December 2002 were £476m. In addition, from 1999 the fund is supported by a five-year insurance programme, whereby the insurers will meet unrecovered losses to the New Central Fund where it has been applied to meet members'

cash calls, up to a ceiling of £350m per annum where such calls exceed £100m in any one calendar year. The aggregate maximum payout over the lifetime of the policy is £500m. As at 31 December 2002, claims had been made on the policy amounting to £350m, of which £134m had been received by the year end. Further claims are expected to be made in 2003. However, the insurers have indicated that they 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 has commenced arbitration proceedings under the terms of the policy for recovery of the sums claimed from the insurers. This is described in *note 7* of the Central Fund financial statements on page 96. Central Fund assets may be supplemented by an extra 3% of members' overall premium limits callable from members' premium trust funds (described and included in the first link). Additional information regarding the Central Fund is contained on pages 88 to 100.

In addition, the other assets of the Corporation, totalling £87m at 31 December 2002, are available to meet underwriting liabilities in the last resort. The Council has continued to levy a premium charge on all premiums (with effect from 1 January 2002, 1% on life and motor business and 2% on other business).

In aggregate, the value of Lloyd's central assets amounted to £563m at 31 December 2002.

### Aggregate resources

Taken together with the total declared members' qualifying assets, the aggregate resources of all members of Lloyd's and those of the Society declared as at 31 December 2002 were £27.0bn. The total amount of estimated current and future liabilities at the end of 2002, was £18.2bn. The aggregate declared resources of the Society and its members were equivalent to 149% of the provision for current and future liabilities.

As stated in *note 1B* to the global results, the global results on which the aggregated resources are based are determined by aggregating the assets and liabilities of all members and those of the Society. The aggregate declared resources of the Society do not represent a consolidated statement of financial position of Lloyd's business taken as a single entity and as indicated above the first three links of the chain of security operate on a several, not mutual basis.

### Solvency controls

One of the most important controls on the solvency of the members of Lloyd's is the annual solvency test. Each member trades for his own account, and Lloyd's has, since the beginning of the last century, required an annual report of each member's underwriting position.

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

The annual solvency process requires the managing agent of each syndicate to estimate and provide for all current and future liabilities for each year of account. These liabilities (i.e. solvency reserves) are subject to a statement of actuarial opinion. In the event that it is not possible for the managing agent to secure an unqualified actuarial opinion for any reason, the solvency reserves would be determined by the Lloyd's Actuary, who would provide a report to the Financial Services Authority (FSA). In addition, any syndicate which is not able to secure an unqualified actuarial opinion will normally be subject to a monitoring review by Lloyd's. There were no qualified actuarial opinions at 31 December 2002.

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

Firstly, each member's solvency position is calculated. Each member must have sufficient assets – those held in the premiums trust funds, overseas regulatory deposits and his funds at Lloyd's – to cover his underwriting liabilities and on top of this an additional solvency margin. The solvency margin is calculated separately for each member, determined essentially as the greater of 16% of total annual premium income or 23% of average claims incurred over a three-year period. Where a member's assets are not sufficient to cover the aggregate of his underwriting liabilities and his solvency margin, the member has a solvency shortfall.

The second part of the solvency test calculation requires that Lloyd's central assets must be sufficient to cover the aggregate of all members' shortfalls calculated at the solvency test date. Central assets include the value of the Central Fund and Corporation net assets, including the amount of the callable layer referred to previously – for this purpose the 'effective' callable layer, i.e. that part of the callable layer not attributed to members with a solvency shortfall – and also recoveries expected to be received in connection with the Central Fund insurance programme.

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

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

Each year previously Lloyd's has filed a statutory solvency return with the FSA, known as the Statutory Statement of Business (SSOB). For 31 December 2002 and onwards Lloyd's will file a new return – the Lloyd's Return – with the FSA. This return supersedes the SSOB and brings Lloyd's regulatory reporting requirements significantly closer to those required from other UK insurers. This return reports the results of Lloyd's solvency test.

## Security underlying policies issued at Lloyd's: financial data

as at 31 December 2002

	2002 £m	2001 £m
<b>I Calendar year premium income</b>		
Before ceded reinsurance		
a) before brokerage and commission ( <i>note 2</i> )	<b>15,365</b>	13,611
b) after brokerage and commission ( <i>note 3</i> )	<b>12,314</b>	10,878
After ceded reinsurance		
a) before brokerage and commission	<b>11,388</b>	10,073
b) after brokerage and commission	<b>8,337</b>	7,340
<b>II Balances on open underwriting and run-off years</b>		
Valuations at year end of:		
Lloyd's American Trust Funds US\$780m (2001: US\$1,005m) ( <i>note 4</i> )	<b>485</b>	691
Lloyd's Dollar Trust Funds US\$3,825m (2001: US\$1,679m)	<b>2,376</b>	1,150
Lloyd's Canadian Trust Funds CAN\$1,132m (2001: CAN\$1,032m) ( <i>note 4</i> )	<b>445</b>	444
Lloyd's Canadian Margin Fund CAN\$221m (2001: CAN\$176m)	<b>87</b>	76
Illinois Trust Fund US\$459m (2001: US\$385m)	<b>285</b>	265
Joint Asset Trust Funds US\$433m (2001: US\$409m) ( <i>note 4</i> )	<b>269</b>	281
Credit for Reinsurance and Surplus Lines Trust Funds US\$11,280m (2001: US\$8,502m)	<b>7,007</b>	5,823
Kentucky Trust Fund US\$72m (2001: US\$85m)	<b>45</b>	58
Lloyd's Australian Trust Funds Aus\$674m (2001: Aus\$544m)	<b>236</b>	191
Lloyd's South African Trust Funds Rand739m (2001: Rand788m)	<b>53</b>	45
	<b>11,288</b>	9,024
Sterling Premiums Trust Funds ( <i>note 5</i> )	<b>5,890</b>	4,438
Balances on open underwriting and run-off years ( <i>note 6</i> )	<b>17,178</b>	13,462
<b>III Members' qualifying assets</b>		
Funds at Lloyd's:		
Deposits	<b>8,552</b>	7,178
Personal reserves	<b>393</b>	489
Special reserves	<b>23</b>	37
	<b>8,968</b>	7,704
Analysed by:		
Individual members	<b>1,542</b>	1,737
Corporate members	<b>7,426</b>	5,967
	<b>8,968</b>	7,704
Members' other qualifying assets	<b>281</b>	327
Total members' qualifying assets	<b>9,249</b>	8,031
<b>IV Total net resources of the Society of Lloyd's and its members</b>		
Balances on open underwriting and run-off years ( <i>note 6</i> )	<b>17,178</b>	13,462
Total members' qualifying assets	<b>9,249</b>	8,031
Total resources of members	<b>26,427</b>	21,493
Net Central Fund assets ( <i>note 7</i> )	<b>476</b>	327
Net assets of the Corporation of Lloyd's	<b>87</b>	91
Total resources of the Society of Lloyd's and its members	<b>26,990</b>	21,911
Provision for current and future liabilities ( <i>note 8</i> )	<b>(18,172)</b>	(17,624)
Total net resources of the Society of Lloyd's and its members	<b>8,818</b>	4,287
<b>V Ratios</b>		
Total net resources as a percentage of premium income (before brokerage and after ceded reinsurance)	<b>77%</b>	43%
Total resources as a percentage of provision for liabilities (see aggregate resources note on page 49)	<b>149%</b>	124%

## Notes

### Note 1

Basis of preparation – the statement of financial data has been compiled by aggregating the assets and liabilities of all the underlying syndicates, the declared members' qualifying assets and other net assets of the Society of Lloyd's. The statement does not purport to disclose the solvency position of each member of Lloyd's.

### Note 2

Calendar year premium income is arrived at after deducting inter-syndicate reinsurances of £874m (2001: £631m). The inter-syndicate claims paid were £523m (2001: £632m).

### Note 3

The average deduction for brokerage and commission across all markets has been estimated at 19.9% (2001: 20.1%).

### Note 4

The trustee of the Lloyd's American Trust Funds, the US Situs Trust Funds and the Joint Asset Trust Funds is Citibank, NA. The trustee of the Lloyd's Canadian Trust Funds is the Royal Trust Corporation of Canada.

### Note 5

The amount shown in the various US and Canadian dollar trust funds relates purely to the financial investments and other liquid assets held within those funds at the year end. All other assets and liabilities (excluding insurance reserves) of these funds are accounted for in the balance reported for the Sterling Premiums Trust Funds.

### Note 6

Balance on open underwriting and run-off years

	2002 £m	2001 £m
Balance on open underwriting accounts	<b>14,209</b>	11,485
Balance on run-off years of account	<b>2,969</b>	1,977
	<b>17,178</b>	13,462

The balances on open underwriting years consist of the underwriting balances in respect of the two open years of account, including the premiums received for the reinsurance to close earlier years of account and are stated after deduction of personal expenses relating to these years. The balances on run-off years of account represent reserves retained at 31 December 2002 in respect of these years.

### Note 7

The net Central Fund assets at 31 December 2002 of £476m (2001: £327m as restated) are as shown in the Central Fund accounts (see page 90).

### Note 8

The provision for current and future liabilities includes a provision for amounts which have been called by 31 December 2002 but remain outstanding of £36m (2001: £30m).

## Lloyd's in the community

Lloyd's believes a commitment to social responsibility is a critical characteristic of any healthy organisation. The market and its members, practitioners and participants have a long and strong tradition of compassionate work in the local and international communities, by combining financial and voluntary support.

Through its diverse, multiple good works Lloyd's aims to make a real difference in the lives of individuals in need, especially young people and the aged, by offering the helping hand that may allow them to reach their maximum potential. The Lloyd's Community Programme and the market's four registered charities have made real strides in improving the quality of life of disadvantaged individuals, sometimes directly, and in other cases through support of community programmes which benefit many.

The reach of Lloyd's charitable work begins within the market itself, extends to individuals living in East London, reaches outwards from Lloyd's to individuals throughout the United Kingdom, and stretches across borders as far away as China and South Africa. The market musters an effort which is both physical and financial: through the Community Affairs Department, volunteering is encouraged alongside cash donations from the hundreds of companies which comprise the market.

### Lloyd's Community Programme

The Lloyd's Community Programme (LCP) is focused close to home, aiming to improve the quality of life of individuals in the neighbouring London borough of Tower Hamlets. In 2002 LCP received income of £83,491, of which more than 97% was donated over the year by LCP member companies. Most of that money was immediately disbursed, funding organisations that LCP has worked closely with for many years. LCP was instrumental in establishing the Tower Hamlets Education Business Partnership in 1991, and in 2002 continued to support its work to change the lives of children in this deprived neighbourhood. Over 300 volunteers from 41 companies in the Lloyd's market gave their time to assist its work. Nearly 200 people spent one lunch hour each week helping children improve their literacy. Others worked with children and young adults on numeracy, IT, and employment skills. In addition, LCP sponsors the Tower Hamlets College Key Skills for Technology Project, which helps students develop basic communication, numeracy and IT skills. LCP also sponsors the Tower Hamlets Business Mentoring Programme, and has recruited 33 volunteers from the market to act as business mentors in 2002.

The East London Small Business Centre encourages individual enterprise by providing training, advice, and support. LCP has worked with the Centre since 1987, when it established the Lloyd's Loan Fund, and in 2002 LCP made grants to the Centre totalling £20,000. The cash was used to support the Centre's training initiatives for individuals running their own businesses, to help the Centre deliver post-start-up support, and to administer the Loan Fund.

### Lloyd's Charities Trust

The Lloyd's Charities Trust is a UK Registered Charity which focuses primarily on providing money to other UK charitable organisations to extend the reach of Lloyd's community work. It is currently funded by an annual donation of £180,000 from the Corporation of Lloyd's, which was approved by the Council of Lloyd's for a three-year period to 2003. Through careful selection of partner charities, the trustees have used the funds to improve the lives of individuals around the world.

In 2002 the Trust granted £140,000 to three charities. It provided £50,000 to Help the Aged, the second instalment of a £150,000 three-year commitment to fund Handy Van services and safety devices for the elderly in Hackney, East London. Two projects carried out by Save the Children were supported by the Trust, which in 2002 granted £25,000 (of a £75,000 commitment) towards the charity's HIV/AIDS project benefiting young children in South Africa, and £50,000 (of a £100,000 commitment) for Save the Children's China project, which assists children with disabilities. Closer to home, the Trust granted £15,000 of its three-year, £45,000 commitment to Addaction. The money is being used to implement the group's Impact Project, which is focused on preventing drug misuse among young children in the London boroughs of Camden and Islington.

In 2002, the Lloyd's Charities Trust has also made ad hoc donations from its general fund totalling £163,936. The money was spent primarily on helping individuals by supporting various charities' programmes to provide housing, support the homeless, develop communities, advance national medical projects, and to benefit children and young people. In addition, the Trust administers the £1.6m Cuthbert Heath Centenary Fund, which in 2002 awarded bursaries totalling £57,000 to students in nine nominated schools.

### Lloyd's Patriotic Fund

In 2002 the Patriotic Fund, established in 1803, granted financial assistance totalling £82,091 to former servicemen and women, their widows, and their dependants. The Fund works with The Soldiers, Sailors, Airmen and Families Association – Forces Help to identify individuals in need. Much of the assistance is delivered through grants to cover the purchase of essential domestic items and/or wheelchairs, but occasionally the Fund provides annuities to top-up an individual's income, perhaps to cover nursing home fees.

### Lloyd's Tercentenary Foundation

The Lloyd's Tercentenary Foundation was established to support the advancement of medical, scientific, technical and business-related education and research. It manages an invested fund of £2.6m, and each year awards a limited number of research fellowships in the fields of engineering, medicine, healthcare, safety or environmental studies, science and technology, and PhD Scholarships in business studies. In 2002 the Fund granted fellowships totalling £113,354.

### Lloyd's Benevolent Fund

The Lloyd's Benevolent Fund was founded in 1829 to assist all those individuals in need who work or previously worked within the Lloyd's community, but were not Underwriting Members of Lloyd's. It is managed by trustees who are current or former Lloyd's members, subscribers, or substitutes, and offers not only financial assistance, but also practical help and encouragement to those unable to cope with everyday problems.

### Lloyd's Community Programme member companies 2002

Ace Global Markets Ltd  
 Alexander Forbes  
 Amlin plc  
 Aon Ltd  
 Atrium  
 BF Caudle Agencies Ltd  
 Ballantyne, McKean & Sullivan Ltd  
 Barlow Lyde & Gilbert  
 Benfield Group Ltd  
 Bowood Partners Ltd  
 Catlin Underwriting Agencies Ltd  
 Chaucer Syndicates Ltd  
 Corporation of Lloyd's  
 Denis M Clayton & Co Ltd  
 Ernst & Young LLP  
 Euclidian Group plc  
 Faraday Ltd  
 Goshawk Syndicate Management Ltd  
 Greenwich Services Ltd  
 HSBC Insurance Brokers Ltd  
 Hardy Underwriting Group plc  
 Hiscox plc  
 Ince and Co  
 Xchanging Ins-sure Services  
 Jardine Lloyd Thompson Group  
 Heath Lambert Group  
 Liberty Syndicate Management Ltd  
 Limit Underwriting Ltd  
 Marsh Ltd  
 Mazars Neville Russell  
 Miller Insurance Group Ltd  
 Munich Re Underwriting Ltd  
 Navigators Underwriting Agency Ltd  
 Omega Underwriting Agents Ltd  
 PricewaterhouseCoopers  
 R J Kiln & Co Ltd  
 St Paul Syndicate Management Ltd  
 Talbot Underwriting Ltd  
 Walsham Brothers & Co Ltd  
 Wellington Underwriting plc

## 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 2002.

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

During the year I received two new complaints; six fewer than the previous year. In both cases I decided, in the exercise of my discretion and after making preliminary enquiries, to take no further action, as I was satisfied that considerations of maladministration did not arise. In each case I explained to the complainant why this was so, with a detailed letter of response.

During 2002 I have also been required to consider further representations concerning five complaints that were referred to me in earlier years. In each of these cases it had been my original decision not to uphold the member's complaint, as I was satisfied that considerations of maladministration did not arise. After consideration of the new representations, I was not minded to alter my view in any of these cases.

The expenses incurred by my office amounted to £31,158.

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