

# THE MARKET'S FINANCIAL RESULTS

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# REPORT OF ERNST & YOUNG LLP TO THE COUNCIL OF LLOYD'S ON THE 2008 LLOYD'S PRO FORMA FINANCIAL STATEMENTS

We have examined the Lloyd's pro forma financial statements ('PFFS') for the year ended 31 December 2008, which comprise the pro forma profit and loss account, the pro forma statement of total recognised gains and losses, the pro forma balance sheet and the pro forma cash flow statement and the related notes 1 to 17 which have been prepared on the basis set out in note 2.

This report is made solely to the Council of Lloyd's in accordance with its instructions to us. 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 conclusions we have formed.

## RESPECTIVE RESPONSIBILITIES OF THE COUNCIL OF LLOYD'S AND ERNST & YOUNG LLP

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

Our responsibility is to examine the PFFS and to report to you whether the PFFS have been properly prepared in accordance with the basis of preparation set out in note 2.

## BASIS OF CONCLUSION

The PFFS have been compiled in part from an aggregation of financial information extracted from the balance sheet and profit and loss account included in syndicate annual accounts by the managing agent of each syndicate, which has been submitted to the Council of Lloyd's and on which the auditors of each syndicate have reported. We have relied absolutely on those reports by syndicate auditors. We have not audited those extractions. Our work is solely intended to enable us to make this report.

Our work, which has been carried out in accordance with International Standard on Assurance Engagements, ISAE 3000, 'Assurance Engagements other than audits or reviews of Historical Financial Information', consisted principally of making enquiries of the Council of Lloyd's and applying analytical procedures to the financial information and underlying financial data. It excludes audit procedures such as tests of controls and verification of assets, liabilities and transactions as included in the PFFS. We have also carried out such investigations and examined such evidence, on a test basis, as we considered necessary to form an opinion as to whether the PFFS have been properly prepared in accordance with the basis of preparation note 2.

However, our work provides less assurance than an audit or a review in accordance with International Auditing Standards. We have not performed an audit and, consequently, we do not express an audit opinion on the financial information set out in the PFFS.

## CONCLUSION

In our opinion, the PFFS for the financial year ended 31 December 2008 have been properly prepared in accordance with the basis of preparation set out in note 2.

**Ernst & Young LLP, London**

23 March 2009

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## MARKET RESULTS

### PRO FORMA PROFIT AND LOSS ACCOUNT

for the year ended 31 December 2008

	Note	£m	2008 £m	£m	2007 £m
<b>Technical account</b>					
Gross written premiums – continuing operations			<b>17,945</b>		16,349
– discontinued operations	5		<b>40</b>		17
	9		<b>17,985</b>		16,366
Outward reinsurance premiums			<b>(3,768)</b>		(3,110)
Premiums written, net of reinsurance			<b>14,217</b>		13,256
Change in the gross provision for unearned premiums		<b>(558)</b>		(237)	
Change in provision for unearned premiums, reinsurers' share		<b>137</b>		78	
			<b>(421)</b>		(159)
<b>Earned premiums, net of reinsurance</b>			<b>13,796</b>		13,097
<b>Allocated investment return transferred from the non-technical account</b>			<b>543</b>		1,223
			<b>14,339</b>		14,320
<b>Claims paid</b>					
Gross amount		<b>9,736</b>		8,741	
Reinsurers' share		<b>(2,158)</b>		(2,515)	
			<b>7,578</b>		6,226
<b>Change in provision for claims</b>					
Gross amount		<b>1,777</b>		(1,278)	
Reinsurers' share		<b>(891)</b>		1,599	
			<b>886</b>		321
Claims incurred, net of reinsurance			<b>8,464</b>		6,547
Net operating expenses	11		<b>4,134</b>		4,451
<b>Balance on the technical account for general business</b>			<b>1,741</b>		3,322
Attributable to: – continuing operations					
– discontinued operations	5		<b>117</b>		32
<b>Total</b>			<b>1,741</b>		3,322
<b>Non-technical account</b>					
<b>Balance on the technical account for general business</b>			<b>1,741</b>		3,322
Syndicate investment return	12	<b>521</b>		1,226	
Notional investment return on funds at Lloyd's	6	<b>271</b>		653	
Investment return on Society assets		<b>165</b>		128	
			<b>957</b>	2,007	
Allocated investment return transferred to the technical account		<b>(543)</b>		(1,223)	
			<b>414</b>		784
Other income			<b>75</b>		89
Contribution to Equitas-Berkshire Hathaway transaction			<b>–</b>		(90)
Other expenses			<b>(331)</b>		(259)
<b>Profit for the financial year before tax</b>	8		<b>1,899</b>		3,846
<b>Statement of total recognised gains and losses</b>					
Profit for the financial year			<b>1,899</b>		3,846
Other recognised gains and losses			<b>619</b>		106
<b>Total recognised gains and losses</b>	8		<b>2,518</b>		3,952

# PRO FORMA BALANCE SHEET

as at 31 December 2008

	Note	£m	2008 £m	£m	2007 £m
<b>Investments</b>					
Financial investments	13		34,942		29,484
<b>Deposits with ceding undertakings</b>					
<b>Reinsurers' share of technical provisions</b>					
Claims outstanding		10,504		7,449	
Unearned premiums		1,167		841	
			<b>11,671</b>		<b>8,290</b>
<b>Debtors</b>					
Debtors arising out of direct operations		4,663		3,428	
Debtors arising out of reinsurance operations		3,763		2,918	
Other debtors		419		318	
			<b>8,845</b>		<b>6,664</b>
<b>Other assets</b>					
Tangible assets		30		26	
Cash at bank and in hand	14	9,428		7,497	
Other		8		28	
			<b>9,466</b>		<b>7,551</b>
<b>Prepayments and accrued income</b>					
Accrued interest and rent		125		144	
Deferred acquisition costs		2,064		1,656	
Other prepayments and accrued income		209		155	
			<b>2,398</b>		<b>1,955</b>
<b>Total assets</b>			<b>67,332</b>		<b>53,953</b>
<b>Capital and reserves</b>					
Members' funds at Lloyd's	6	10,630		9,858	
Members' balances	15	2,562		2,652	
Members' assets (held severally)		13,192		12,510	
Central reserves (mutual assets)		990		939	
			<b>14,182</b>		<b>13,449</b>
Subordinated debt	8		586		516
Subordinated perpetual capital securities			496		496
<b>Capital, reserves and subordinated debt and securities</b>			<b>15,264</b>		<b>14,461</b>
<b>Technical provisions</b>					
Provision for unearned premiums		9,043		7,282	
Claims outstanding		38,420		28,971	
			<b>47,463</b>		<b>36,253</b>
<b>Deposits received from reinsurers</b>			<b>161</b>		<b>42</b>
<b>Creditors</b>					
Creditors arising out of direct insurance operations		770		697	
Creditors arising out of reinsurance operations		2,517		1,534	
Other creditors including taxation		883		774	
			<b>4,170</b>		<b>3,005</b>
<b>Accruals and deferred income</b>			<b>274</b>		<b>192</b>
<b>Total liabilities</b>			<b>67,332</b>		<b>53,953</b>

Approved and authorised for issue by the Council of Lloyd's on 23 March 2009 and signed on their behalf by

Lord Levene of Portsoken, Chairman

Richard Ward, Chief Executive Officer

## MARKET RESULTS

### PRO FORMA CASH FLOW STATEMENT

for the year ended 31 December 2008

	2008 £m	2007 £m
Profit on ordinary activities before tax	1,899	3,846
Depreciation	3	3
Realised and unrealised (gains)/losses and foreign exchange	(4,643)	(157)
Net purchase of investments	(44)	(1,576)
Notional return on funds at Lloyd's	(271)	(653)
Increase/(decrease) in technical provisions	7,800	585
(Increase)/decrease in debtors	(2,656)	243
Increase/(decrease) in creditors	1,293	(15)
<b>Cash generated from operations</b>	<b>3,381</b>	<b>2,276</b>
Tax paid	(54)	(20)
<b>Net cash from operating activities</b>	<b>3,327</b>	<b>2,256</b>
<b>Cash flows from financing activities</b>		
Net profits paid to members	(2,201)	(1,537)
Net movement in funds at Lloyd's	772	(1,424)
Capital transferred into syndicate premium trust funds	107	322
Interest paid	(74)	(46)
<b>Net increase/(decrease) in cash holdings</b>	<b>1,931</b>	<b>(429)</b>
Cash holdings at 1 January	7,497	7,926
<b>Cash holdings at 31 December</b>	<b>9,428</b>	<b>7,497</b>

# NOTES TO THE PRO FORMA FINANCIAL STATEMENTS

as at 31 December 2008

## 1. INTRODUCTION

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

## 2. BASIS OF PREPARATION

### GENERAL

The PFFS include the aggregate of syndicate annual accounts (Aggregate Accounts), members' funds at Lloyd's (FAL) and the financial statements of the Society of Lloyd's pages 83 to 137.

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

The aggregate of syndicate annual accounts report the audited results for calendar year 2008 and the financial position at 31 December 2008 for all syndicates which transacted business during the year. They include the syndicate level assets, which represent the first link in the chain of security (see pages 80 to 82). The Aggregate Accounts are reported as a separate document and can be viewed at [www.lloyds.com/financialreports](http://www.lloyds.com/financialreports). During 2008, certain syndicates changed their accounting policies in relation to foreign exchange resulting in a restatement of the comparative figures for 2008 within their annual accounts and the Aggregate Accounts have been restated accordingly. The restatements are not material and, therefore, the comparative figures within the PFFS have not been restated.

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

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

The profit and loss account in the PFFS aggregates the syndicate results, the notional investment return on members' capital and the results of the Society of Lloyd's. The balance sheet in the PFFS aggregates the assets held at syndicate level, members' assets held as FAL and the central resources of the Society. Overall, the PFFS aggregate the results and resources of the Society and its members and reflect all the links in Lloyd's chain of security as described in detail in the 'Security underlying policies issued at Lloyd's' section on pages 80 to 82. The PFFS may, therefore, be used as a reasonable presentation of the results and state of affairs of the Lloyd's market on a basis that is broadly comparable with general insurance companies.

## TAXATION

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

## FUNDS AT LLOYD'S

FAL comprise the capital provided by members to support their underwriting, and are the equivalent of capital shown in insurance companies' accounts. The valuation of FAL has, therefore, been included in the pro forma balance sheet.

FAL are available to meet cash calls made on the member in respect of a syndicate. The assets in FAL must be readily realisable, may include letters of credit and bank and other guarantees, and must be at least equivalent to the aggregate of the member's net economic capital assessment (ECA) requirement and certain liabilities in respect of its underwriting business. Each member's ECA to support its underwriting at Lloyd's is determined using Lloyd's Individual Capital Assessment (ICA) capital setting methodology.

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

## SOCIETY OF LLOYD'S FINANCIAL STATEMENTS

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

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### 2. BASIS OF PREPARATION CONTINUED

#### TRANSACTIONS BETWEEN SYNDICATES AND THE SOCIETY

- (1) Central Fund contributions, members' subscriptions and other market charges levied by the Society are reported as net operating expenses in the syndicate annual accounts and as income in the Society financial statements.
- (2) Central Fund claims and provisions to discharge the liability of members where they have unpaid cash calls and do not have the resources to meet those cash calls are reported as a profit and loss charge and balance sheet liability in the Society financial statements. The Central Fund other income includes recoveries from insolvent members. The syndicate annual accounts for calendar year 2008 and earlier years include those members' results and at the balance sheet date will report the outstanding liability within members' balances.
- (3) Loans funding statutory overseas deposits are reported as assets within the syndicate annual accounts and as liabilities in the Society financial statements.

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

#### INTER-SYNDICATE LOANS

The syndicate annual accounts report debtor and creditor balances for inter-syndicate loans totalling £50m (2007: £101m). These amounts have been eliminated from the amounts reported in the balance sheet to provide a more meaningful presentation of the balance sheet for users of the PFFS.

#### THE SUBORDINATED DEBT AND SECURITIES

In accordance with the terms of the subordinated debt and securities, the capital raised is available for payment to policyholders in advance of repayment to the note holders and is included in 'capital, reserves and subordinated debt and securities' in the pro forma balance sheet. The Society financial statements on pages 105 to 137 provide additional information.

### 3. ACCOUNTING POLICIES NOTES

#### A. AGGREGATE ACCOUNTS

##### General

Under the Insurance Accounts Directive (Lloyd's Syndicates and Aggregate Accounts) Regulations 2004, managing agents must prepare the syndicate annual accounts under UK GAAP. However, where UK GAAP permits different accounting treatments, each managing agent is able to adopt the accounting policies it considers most appropriate to its syndicate. In particular, in certain circumstances, UK GAAP permits various accounting treatments for the movement in foreign exchange. The following accounting policies are, therefore, generic in nature.

##### Premiums written

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

##### Unearned premiums

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

##### Outwards reinsurance premiums

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

##### Claims provisions and related recoveries

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

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

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

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

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

### 3. ACCOUNTING POLICIES NOTES CONTINUED

#### Unexpired risks provision

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

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

#### Acquisition costs

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

#### Foreign currencies

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

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

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

#### Investments

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

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

#### Syndicate investment return

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

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

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

#### Taxation

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

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

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

#### Operating expenses

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

#### Profit commission

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

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

#### B. FUNDS AT LLOYD'S

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

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

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

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

#### C. SOCIETY OF LLOYD'S

The accounting policies adopted in the Society of Lloyd's financial statements are as set out on pages 108 to 112.

#### 4. VARIABILITY

Calendar year movements in reserves are based upon best estimates as at 31 December 2008 taking into account all available information as at the balance sheet date. These estimates are subject to variability until the date at which the underlying claims are settled. Such changes in best estimate are reflected in the technical account of the year in which they occur.

## MARKET RESULTS

### NOTES TO THE PRO FORMA FINANCIAL STATEMENTS CONTINUED

as at 31 December 2008

#### 5. DISCONTINUED OPERATIONS

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

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

Where business has been reported as discontinued in 2008, the results for that business have also been reported as discontinued in the 2007 comparative figures.

#### 6. MEMBERS' FUNDS AT LLOYD'S

The valuation of members' FAL in the balance sheet totals £10,630m (2007: £9,858m).

The notional investment return on FAL included in the non-technical profit and loss account totals £271m (2007: £653m).

#### 7. SOCIETY OF LLOYD'S

The results of the group financial statements of the Society included in the profit and loss account are a profit of £198m (2007: £296m) in the technical account and a loss of £93m (2007: £132m) in the non-technical account.

#### 8. AGGREGATION OF RESULTS AND NET ASSETS

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

	2008 £m	2007 £m
<b>Profit and loss account</b>		
Result per syndicate annual accounts	1,523	3,029
Result of the Society	102	164
Central Fund claims and provisions (credit)/charge in Society financial statements	(6)	(18)
Central Fund recoveries from insolvent members	(21)	(48)
Taxation charge in Society financial statements	40	66
Notional investment return on members' funds at Lloyd's	271	653
Society income not accrued in syndicate annual accounts	(10)	–
<b>Result on ordinary activities before tax</b>	<b>1,899</b>	<b>3,846</b>

	2008 £m	2007 £m
<b>Statement of total recognised gains and losses</b>		
Result for the financial year	1,899	3,846
Foreign currency movements in the syndicate annual accounts	659	73
Other recognised gains and losses per syndicate annual accounts	11	(4)
Other recognised gains and losses of the Society	(51)	37
<b>Total recognised gains and losses</b>	<b>2,518</b>	<b>3,952</b>

	2008 £m	2007 £m
<b>Capital and reserves</b>		
Net assets per syndicate annual accounts	2,502	2,523
Net assets of the Society	990	939
Central Fund claims and provisions	102	129
Members' funds at Lloyd's	10,630	9,858
Unpaid cash calls reanalysed from debtors to members balances	(32)	–
Society income receivable not accrued in syndicate annual accounts	(10)	–
<b>Total capital and reserves</b>	<b>14,182</b>	<b>13,449</b>

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

## 9. SEGMENTAL ANALYSIS

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

	Gross written premiums £m	Net earned premium £m	Result £m
<b>2008</b>			
Reinsurance	6,298	4,522	734
Property	3,971	3,125	103
Casualty	3,762	3,005	148
Marine	1,334	1,041	160
Energy	1,150	814	(194)
Motor	939	897	3
Aviation	481	363	48
Life	49	28	(2)
<b>Total from syndicate operations</b>	<b>17,984</b>	<b>13,795</b>	<b>1,000</b>
Transactions between syndicates and the Society (notes 2 and 8) and insurance operations of the Society	1	1	198
<b>Total per PFFS</b>	<b>17,985</b>	<b>13,796</b>	<b>1,198</b>

	Gross written premiums £m	Net earned premium £m	Result £m
<b>2007</b>			
Reinsurance	5,453	4,312	790
Property	3,809	2,975	408
Casualty	3,364	2,805	205
Marine	1,226	1,010	127
Energy	1,019	774	206
Motor	983	866	14
Aviation	464	323	50
Life	46	30	3
<b>Total from syndicate operations</b>	<b>16,364</b>	<b>13,095</b>	<b>1,803</b>
Transactions between syndicates and the Society (notes 2 and 8) and insurance operations of the Society	2	2	296
<b>Total per PFFS</b>	<b>16,366</b>	<b>13,097</b>	<b>2,099</b>

## 10. LIFE BUSINESS

The PFFS include the results of all life and non-life syndicates transacting business during 2008. The results and net assets for life syndicates are not material and have not been separately disclosed in the profit and loss account and balance sheet. The results for life business are reported in the segmental analysis (note 9).

## 11. NET OPERATING EXPENSES

	2008 £m	2007 £m
Acquisition costs	3,897	3,519
Change in deferred acquisition costs	(177)	(70)
Administrative expenses	1,267	1,117
	4,987	4,566
(Profit)/loss on exchange	(853)	(115)
	4,134	4,451

## MARKET RESULTS

### NOTES TO THE PRO FORMA FINANCIAL STATEMENTS CONTINUED

as at 31 December 2008

#### 12. SYNDICATE INVESTMENT RETURN

	2008 £m	2007 £m
Income from investments	1,064	1,029
Net realised (losses) / gains on investments	(60)	57
Net unrealised (losses) / gains on investments	(452)	165
Investment management expenses, including interest	(31)	(25)
	521	1,226

The breakdown of the society investment return is provided in the Society's financial statements on page 117. This analysis is not appropriate for the notional investment return on funds at Lloyd's.

#### 13. FINANCIAL INVESTMENTS

	2008 £m	2007 £m
Shares and other variable yield securities and units in unit trusts	3,278	3,075
Debt securities and other fixed income securities	25,176	20,811
Participation in investment pools	1,254	1,180
Loans and deposits with credit institutions	5,216	4,414
Other	18	4
	34,942	29,484

#### 14. CASH AT BANK AND IN HAND

Cash at bank and in hand includes letters of credit and bank guarantees held in trust within members' FAL to meet policyholder claims as required, totalling £6,140m (2007: £5,399m).

#### 15. MEMBERS' BALANCES

	2008 £m	2007 £m
Balance at 1 January	2,652	597
Result for the year per syndicate annual accounts	1,523	3,029
Distribution on close of 2005 (2004) year of account	(687)	(1,204)
Advance distributions from open years of account	(1,626)	(414)
Movement in cash calls	50	79
Capital transferred into syndicate premium trust funds	107	322
Repayment of syndicate loans from the Central Fund	-	214
Foreign currency movements	570	(14)
Other movements	(27)	43
Balance at 31 December	2,562	2,652

Members participate on syndicates by reference to years of account. Members' ultimate results, assets and liabilities are assessed by year of account with reference to policies incepting in that year of account. Members' balances represent the net profit/(loss) to be distributed/(collected) by syndicates to/(from) the members. Where there are profits and funds at Lloyd's held in excess of members' capital requirements, they will be distributed in the second quarter of 2008.

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

**16. TECHNICAL PROVISIONS**

	2008 £m	2007 £m
<b>Gross</b>		
Claims reported and loss adjustment expenses	22,307	16,343
Claims incurred but not reported	16,113	12,628
Unearned premiums	9,043	7,282
<b>Total technical provisions, gross</b>	<b>47,463</b>	<b>36,253</b>
<b>Recoverable from reinsurers</b>		
Claims reported and loss adjustment expenses	7,172	5,037
Claims incurred but not reported	3,332	2,412
Unearned premiums	1,167	841
<b>Total reinsurers' share of technical provisions</b>	<b>11,671</b>	<b>8,290</b>
<b>Net</b>		
Claims reported and loss adjustment expenses	15,135	11,306
Claims incurred but not reported	12,781	10,216
Unearned premiums	7,876	6,441
<b>Total net technical provisions</b>	<b>35,792</b>	<b>27,963</b>

**17. FIVE YEAR SUMMARY**

	2008 £m	2007 £m	2006 £m	2005 £m	2004 £m
<b>Results</b>					
Gross written premiums	17,985	16,366	16,414	14,982	14,614
Net written premiums	14,217	13,256	13,201	11,770	11,734
Net earned premiums	13,796	13,097	12,688	11,785	11,797
Result attributable to underwriting	1,198	2,099	2,142	(1,388)	396
Result for the year before tax	1,899	3,846	3,662	(103)	1,367
<b>Assets employed</b>					
Cash and investments	44,370	36,981	35,091	35,012	31,412
Net technical provisions	35,792	27,963	27,371	29,402	25,079
Other net assets	5,604	4,431	5,116	4,881	5,330
<b>Capital and reserves</b>	<b>14,182</b>	<b>13,449</b>	<b>12,836</b>	<b>10,491</b>	<b>11,663</b>
<b>Statistics</b>					
Combined ratio (%)	91.3	84.0	83.1	111.8	96.6
Return on capital (%)	13.7	29.3	31.4	(0.9)	12.5

## MARKET RESULTS

# SECURITY UNDERLYING POLICIES ISSUED AT LLOYD'S

as at 31 December 2008

### SUMMARY

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

There were 80 syndicates, (including syndicates set up to accept RITC of orphan syndicates and Special Purpose Syndicates) as at 31 December 2008, registered to conduct business at Lloyd's. Each syndicate is managed by a managing agent. Managing agents write insurance business on behalf of the member(s) of the syndicate, which receive profits or bear losses in proportion to their share in the syndicate for each underwriting year of account. The adoption of annual accounting and presentation of the syndicate annual accounts do not change the allocation of profits and losses to members.

### THE LLOYD'S CHAIN OF SECURITY

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

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

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

#### First link – syndicate level assets

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

#### Second link – members' funds at Lloyd's (FAL)

The capital provided by every member is assessed according to the Lloyd's Individual Capital Assessment (ICA) capital setting framework. When agreed, each ICA is then 'uplifted' (by 35% for 2008) to provide an extra buffer to support Lloyd's rating and financial strength. This uplifted ICA, which is the Economic Capital Assessment (ECA) is used to determine members' capital requirements subject to prescribed minimum levels.

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

#### Third link – central assets

At the discretion of the Council, the Central Fund is available to meet any portion of any member's insurance liabilities that the member is unable to meet in full.

### THE FIRST LINK

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

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

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

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

Premiums trust funds are used to fund 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 surplus lines, US situs reinsurance and Kentucky business respectively.

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

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

The total value of all the above funds was £38,306m at 31 December 2008.

## THE SECOND LINK

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

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

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

As at 31 December 2008, the total value of capital supporting underwriting held in trust by members amounted to £10,630m.

## THE THIRD LINK

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

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

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

The net assets of the Central Fund as at 31 December 2008 were £852m.

In 2004 and 2007, Lloyd's issued subordinated loan notes and perpetual capital securities respectively which, as at 31 December 2008, are included as a liability of £1,082m within the Society's financial statements. As set out in note 17 to the Society's financial statements, payments on the notes are subordinated to certain payments which may be made out of central assets, including payments made to discharge the liabilities of an insolvent member to any person (including any policyholders) arising out of or in connection with insurance business carried on at Lloyd's by that insolvent member.

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

In addition, the other assets of the Society, totalling £138m at 31 December 2008, are available to meet underwriting liabilities in the last resort.

In aggregate, the value of the central resources of the Society (excluding the subordinated debt liability and the callable layer), amounted to £2,072m at 31 December 2008.

## AGGREGATE RESOURCES

The total of syndicate assets, members' capital to support underwriting (ie funds at Lloyd's and capital held in syndicate premiums trust funds) and central resources of the Society as at 31 December 2008 was £51,008m. The total of net syndicate technical provisions at the end of 2008 was £35,744m. The total net resources of the Society and its members were therefore £15,264m (excluding the subordinated debt liability) as shown in the PFFS on page 71.

The aggregated resources are based on the total of the assets and liabilities of all members and those of the Society. The aggregate declared resources of the Society do not represent a consolidated statement of the financial position of Lloyd's business taken as a single entity and, as indicated above, the first two links of the chain of security operate on a several, not mutual, basis.

## SOLVENCY CONTROLS

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

The annual solvency process requires the managing agent of each syndicate to estimate and provide for all current and future liabilities for each year of account. These liabilities 'technical provisions for solvency' are subject to a statement of actuarial opinion. The requirement for an opinion and its required wording that the net technical provisions for solvency are *not less than* the current and future liabilities is a higher test than required in the UK company market. In the event that it is not possible for the managing agent to secure an unqualified actuarial opinion for any reason, the technical provisions for solvency would be determined by the Lloyd's Actuary, who would provide a report to the FSA. In addition, any syndicate which is not able to secure an unqualified actuarial opinion will normally be subject to a monitoring review by Lloyd's. There were no qualified actuarial opinions as at 31 December 2008.

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

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

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

## MARKET RESULTS

### SECURITY UNDERLYING POLICIES ISSUED AT LLOYD'S CONTINUED

as at 31 December 2008

#### RECAPITALISATION AT MEMBER LEVEL

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

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

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

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

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

#### THE LLOYD'S RETURN

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

	2008 £m	2007 £m
<b>I Syndicate level assets (several basis)</b>	<b>38,306</b>	30,601
<b>II Members' funds at Lloyd's (several basis)</b>	<b>10,630</b>	9,858
<b>III Central assets (mutual basis)</b>		
Net Central Fund assets	852	767
Subordinated loan notes	586	516
Subordinated Perpetual Capital Securities	496	496
Other net assets of the Society	138	172
	<b>2,072</b>	1,951
<b>Total resources of the Society of Lloyd's and its members</b>	<b>51,008</b>	42,410
<b>Net syndicate technical provisions</b>	<b>(35,744)</b>	(27,949)
<b>Total net resources of the Society of Lloyd's and its members</b>	<b>15,264</b>	14,461

- Notes
1. This financial summary 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.
  2. The 'total net resources of the Society of Lloyd's and its members' represents the capital, reserves and subordinated notes and securities shown in the PFFS as set out on page 71.
  3. Syndicate level assets includes capital to support underwriting held by aligned corporate members in the syndicate premiums trust fund.