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Lloyd's 2004 Annual Report
Corporation of Lloyd's

Lloyd's Central Fund

OPERATING AND FINANCIAL REVIEW

This review considers the activities of the Corporation of Lloyd's and the Lloyd's Central Fund.

The results of the Lloyd's market are considered in the Market Commentary on pages 8 to 23.

Operating Review

The progress achieved during 2004 towards meeting Lloyd's key strategic objectives is set out in the Chief Executive Officer's Report on pages 4 to 7. This review is directed towards the activities of the operations function whose objective is to provide value for money services to the Lloyd's market, including information technology, facilities and administration and other services to members and policyholders. It also drives the achievement of high operational standards throughout the Corporation.

Strong focus is placed on the maintenance of an effective commercial relationship with suppliers following the successful implementation over the last five years of Lloyd's outsourcing strategy. A supplier management framework was successfully implemented as planned in 2004. This not only ensures that all of parts of the business improve their management of suppliers, but also enables Lloyd's to demonstrate to regulators its ability to control supplier related risk. An organisation-wide supplier management solution will be implemented in 2005 to support the framework.

The relationship with Xchanging continues to develop, with strong emphasis on the enhancement of operational processes and service quality. Contractually, the signing of the Settlement Trust Fund Operation Agreement was a key achievement which formally marks the completion of the outsourcing of LPSO and gives clarity to the overall outsourcing arrangement.

The foundations for effective Business Continuity Planning have been strengthened by completing a Business Impact Analysis for the Corporation. Testing included technical recovery and emergency communications and work commenced on a broader range of disaster scenarios against which to test plans. Working with the LMA and the LMBC, a Market Working Group was formed to develop further contingency plans for the Underwriting Room and share best practice to identify practical solutions to market-wide business continuity issues.

Property Services

Close liaison with the City of London Police and Security Services has continued throughout 2004 with the 1986 building security remaining a priority. A new building access card and security barrier system has been installed and progress is being made with the local authorities to improve the security arrangements for the surrounding area.

Lloyd's Property Services has continued to provide the management of the buildings and facilities services throughout 2004 with improved customer service delivery and reduced financial costs from the outsourced suppliers.

The 1958 building sale agreement was successfully concluded with British Land, a further profit of £23.6m being recognised during 2004.

Information technology

The Lloyd's IT Group, which provides infrastructure and applications services internally and to many market customers, further reduced its operational costs during 2004 through the outsourcing of infrastructure services and an associated 40% reduction in staff. It is now well positioned to capitalise on recent changes to deliver enhanced service quality to all of its customers.

An information management programme successfully delivered a new central data warehouse in 2004. This programme will improve the collection, storage and distribution of data used by Lloyd's. In 2005 the data warehouse will be populated with further market data to enhance significantly the timely provision of key financial and performance information helping to rationalise the reporting requirements of the market.

Members' Services

2004 has been another year of significant change. Preparatory work has been completed for the implementation of major systems changes in 2005. Staff numbers have reduced to less than 100 but service standards have been maintained across the 400 different processes undertaken for members and their agents.

OPERATING AND FINANCIAL REVIEW continued

Complaints
The Complaints Department handled over 3,000 complaints on behalf of the market in accordance with FSA requirements during 2004. The level of complaints was higher in the fourth quarter than predicted following the Florida hurricanes. However, quality standards were maintained in terms of both timeliness and support from the Financial Ombudsman Service for decisions made.

Financial Review
This review should be read in conjunction with the financial statements of the Corporation of Lloyd's (see pages 82 to 105) and the Lloyd's Central Fund (see pages 108 to 120).

Introduction
For the year ended 31 December 2004 this review consists of two parts: the first reports on the consolidated results of the Corporation of Lloyd's; the second includes a review of the Lloyd's Central Fund. The objectives of the two sets of financial statements are different: the financial statements of the Corporation of Lloyd's show the income and expenditure, financial position and cash flows directly as a result of managing and supervising the activities of the Society; the Central Fund is held separately and administered by the Council of Lloyd's primarily as a fund available for the protection of policyholders. In future years, with effect from 2005, following changes to financial reporting standards, financial statements will be prepared for the Society of Lloyd's that consolidate the Corporation of Lloyd's, its subsidiaries and the Lloyd's Central Fund.

International accounting standards
It is proposed to adopt International Financial Reporting Standards (IFRS) for the preparation of financial statements for the Society (comprising the Corporation of Lloyd's and all of its subsidiaries and the Lloyd's Central Fund). The first reporting periods will be for the six months ending 30 June 2005 and the full year ending 31 December 2005.

The adoption of IFRS will result in significant changes in the accounting, presentation and disclosure of certain items in the financial statements. We believe we are well placed to comply with the Reporting Standards.

Financial review of the Corporation of Lloyd's in 2004
Basis of preparation and consolidation
The consolidated financial statements are prepared in accordance with generally accepted accounting principles in the UK. There are two particular matters that are relevant to an understanding of the basis of preparation and consolidation:

- Consistent with prior years, two insurance company subsidiaries whose activities relate to the underwriting affairs of certain syndicates and Names have not been consolidated. The Society of Lloyd's does not itself underwrite and the Council of Lloyd's has taken advantage of the exemption permitted by FRS 2 'Accounting for subsidiary undertakings' not to consolidate these subsidiaries on the grounds that their activities are so dissimilar that to consolidate their results would not achieve the objective of these financial statements – to show the financial effect of managing and supervising the activities of the Society. The two subsidiaries are Lioncover Insurance Company Limited and Centrewrite Limited. All of Lioncover's insurance liabilities, and the 1992 and prior liabilities of Centrewrite have been reinsured into Equitas. Details of the financial position of these companies have been included in note 14b (on page 91). As noted above, with effect from 1 January 2005 the exemption allowing non-consolidation of these subsidiaries has been removed and, in future, they will be consolidated together with the Lloyd's Central Fund.

- The subordinated loan notes issued by the Society on 17 November 2004 have been accounted for within the financial statements of the Central Fund, the proceeds of the issue being an addition to Central Fund assets.

Accounting policies and financial reporting standards
The accounting policies adopted in 2004 are consistent with the prior year and are disclosed in note 2 (on page 85). The following points in respect of 2004 should be noted:

- FRS 13 'Derivatives and other financial instruments – disclosures' has been fully adopted in 2004 following the issue of subordinated loan notes by the Society, notwithstanding the fact that they are not accounted for in the Corporation's financial statements. There has been no impact on the primary financial statements as a result of providing the additional disclosures.

- The effective date for the full adoption of FRS 17 'Retirement benefits' is 1 January 2005. The Corporation has not adopted the standard early but has made the transitional disclosures required in note 18 to the financial statements (on page 94). These show the effect on the financial statements had FRS 17 been adopted. The changes introduced by FRS 17 principally impact the accounting treatment of defined benefit schemes. At each year end, the pension scheme assets should be measured at market value while pension scheme liabilities should be measured at a present value using a specified actuarial valuation method and discounted at a high quality corporate bond rate. The resulting pension scheme surplus or deficit would be included on the balance sheet in place of the pension prepayment currently included under SSAP24 rules.

Basis of presentation of financial statements

The format of the financial statements is unchanged from 2004 with two exceptions.

Firstly, in previous years market settlement recoveries, which represent debt recoveries arising from the 1996 *Reconstruction and Renewal* settlement, have been separately disclosed in the revenue account below the surplus/(deficit) on ordinary activities. For 2004, these recoveries, which total £8.9m, have been included as part of operating income and the comparatives restated (£7.9m) in the revenue account and five year summary.

Secondly, any surplus/(deficit) on the sale and revaluation of statutory insurance deposits has been separately disclosed in the revenue account within the heading entitled 'Finance'.

Overall result

The overall surplus for the year after taxation is £48.6m and includes a group operating surplus of £19.7m and further proceeds from the sale of the Lloyd's 1958 building of £23.6m. An increase in the valuation of Lloyd's collection of paintings, antiques and artefacts of £2.8m is reflected as a movement in the revaluation reserve. At 31 December 2004, the Corporation's net assets are £121.9m, an increase of £51.5m during the year.

	2004 £000	2003 £000	2002 £000
Net assets at 1 January	**70,365**	87,151	90,714
Surplus/(deficit) for year	**48,611**	(17,286)	(4,117)
Movement in revaluation reserve	**2,797**	–	–
Other recognised gains	**109**	500	554
Net assets at 31 December	**121,882**	70,365	87,151

Group operating surplus/(deficit)

	2004 £000	2003 £000	2002 £000
Operating income	**180,453**	141,420	134,896
Operating expenses	**(160,742)**	(160,267)	(159,154)
Group operating surplus/(deficit)	**19,711**	(18,847)	(24,258)

In recent years, prior to 2004, the Corporation had absorbed substantial operating deficits which reflect litigation defence costs incurred, principally in 2001 and earlier years, and, since 2001, the investment in Kinnect.

Kinnect is a market infrastructure project, funded by the Corporation, to support the transfer of risk data between brokers and underwriters within a defined business process and using structured electronic messages. It is a critical component of Lloyd's business process reform initiatives. The development costs of Kinnect have been expensed to the revenue account as part of operating expenses and have not been capitalised.

In setting operating budgets for 2004 it was recognised that the Corporation could not continue to absorb such operating deficits which would further reduce working capital. As a result, the annual members' subscription, which is based on members' allocated premium limits, was increased to 0.50% having been held at 0.25% since 2000. This was intended to ensure that a group operating surplus was achieved in 2004, whilst containing operating costs, and to provide greater financial flexibility. Increased operating income in 2004, as a result of the increase in members' subscriptions, has improved the group operating result producing a surplus of £19.7m for the year compared to a deficit of £18.8m in 2003.

OPERATING AND FINANCIAL REVIEW continued

Operating income

The following table shows the main sources of operating income:

	2004 £000	2004 %	2003 £000	2003 %	2002 £000	2002 %
Market charges	**78,908**	**44%**	77,458	55%	75,833	56%
Members' subscriptions	**74,935**	**42%**	36,142	26%	31,600	23%
Other	**26,610**	**14%**	27,820	19%	27,463	21%
	180,453	**100%**	141,420	100%	134,896	100%

Operating income has increased in 2004 by £39.1m to £180.5m from £141.4m in 2003. This shows the effect of increasing the rate of members' subscriptions, which increased by £38.8m to £74.9m.

Total direct market charges, including the recovery of overseas operating expenses, members' services unit charges to members and managing agents and the Franchise Performance and Risk Management charge, have increased by £1.4m in 2004 to £78.9m.

Other income includes market settlement recoveries representing continuing debt recoveries for the 1996 *Reconstruction and Renewal* settlement, rent and building service charges, charges to associates and the Lloyd's Central Fund. In total, other income reduced by £1.2m to £26.6m. This includes a reduction of £1.9m relating to charges to associated undertakings, Xchanging Ins-sure and Xchanging Claims Services as they reduced their reliance on the Corporation for the provision of IT and property services.

Operating expenses and cost control

The increase in overall operating expenses in 2004 from £160.3m to £160.7m has been limited to £0.4m due to careful control of the Corporation's operating activities. Total operating expenses include the development costs of Kinnect of £15.1m in 2004 (2003: £17.9m).

The main operating costs can be summarised as follows:

	2004 £000	2004 %	2003 £000	2003 %	2002 £000	2002 %
Employment	**60,107**	**37%**	53,483	33%	47,242	30%
Premises	**30,339**	**19%**	30,127	19%	30,244	19%
Overseas operations	**20,592**	**13%**	21,524	13%	21,497	14%
Other	**49,704**	**31%**	55,133	35%	60,171	37%
	160,742	**100%**	160,267	100%	159,154	100%

The Executive Committee has contained increases in its cost base over recent years whilst making significant investment in initiatives such as the establishment of the Franchise Performance Directorate in 2003 and, since 2001, Kinnect. By the end of 2004 the Corporation had provided total funding of £55m for the development of the Kinnect infrastructure.

In 2004, employment costs have increased by £6.6m to £60.1m. This includes a substantial increase in pension costs from £0.5m in 2003 to £8.5m in 2004. The reasons for this increase are detailed below.

Pension costs

Pension costs of £8.5m in 2004 include the regular costs of providing pensions under SSAP24 of £4.0m and the award for 2005 of a discretionary increase to pre 6 April 1997 pensions when in payment, the latter required a contribution of £3.1m to be paid by the Corporation in 2004. The triennial valuation of the Lloyd's Pension Scheme for determining the funding position of the scheme and future contribution rates disclosed a past service deficit of £9m as at 30 June 2004. The Corporation has made two special contributions to eliminate the deficit, £4.2m being paid in December 2004 and a further £4.8m in February 2005. Normal employer contributions to the scheme recommenced with effect from January 2004 at a rate of 17% of pensionable salaries totalling £4.3m. Following the triennial valuation, with effect July 2004, the contribution rate has been increased to 21.2% and the Corporation has paid the additional contributions due from that date in 2005.

As noted above, the Corporation did not adopt FRS 17 in 2004 and continued to apply SSAP24. Under the valuation bases required by FRS 17 the Lloyd's Pension Scheme reports a net deficit of £37m, after allowance for deferred taxation, as at 31 December 2004. This compares with a net deficit of £38m as at 31 December 2003. The valuation results exclude liabilities for discretionary increases to pensions. Such increases have always been payable at the discretion of Lloyd's and will continue to be considered on the basis of affordability. As noted above, a discretionary award for 2005 was made in November 2004.

The valuation for SSAP24 purposes uses a best estimate of investment returns rather than the more prudent assumptions used for funding and FRS 17 purposes. On this basis there is a surplus which enables the pre-existing pension scheme prepayment included in the balance sheet to be retained. Indeed, because of the special contribution of £4.2m paid in 2004 to eliminate part of the past service deficit disclosed by the triennial review for funding purposes, the prepayment increases to £28.8m as at 31 December 2004.

Had FRS 17 been applied as at 31 December 2004 the reported net assets of the Corporation would have fallen from £122m to £56m reflecting the elimination of the SSAP24 prepayment and recognition of the deficit calculated using the FRS 17 valuation bases.

Share of operating profit of associated undertakings
The Corporation's share of operating profits from its interests in Xchanging Ins-sure and Xchanging Claims Services, before interest, taxation and amortisation of goodwill, is £2.7m (2003: £3.4m). This enabled the Corporation to rebate £2.1m to the Lloyd's market during 2004. Future rebates will be made directly by Xchanging Ins-sure and Xchanging Claims Services.

Finance
Included under finance are dividends receivable. Centrewrite, which is not consolidated, has declared a dividend of £7.49m for 2004 (2003: £7.49m). The dividend reflects the company's ability to release reserves as open years of account close.

Cash flows and liquidity
Net funds increased during 2004 from £55.9m to £118.2m. This reflects both the operating surplus for the year and the receipt of further proceeds from the disposal of the Lloyd's 1958 building which was sold in 2001. The Corporation has no bank borrowings, the £500m loan notes issued by the Society in November 2004 have been accounted for in the Central Fund financial statements (see page 117). The following table sets out net funds available resulting from cash flows:

	2004 £000	2003 £000	2002 £000
Increase/(decrease) in net funds in the year resulting from cash flows	**62,264**	13,254	(23,770)
Net funds at 1 January	**55,891**	42,637	66,407
Net funds at 31 December	**118,155**	55,891	42,637

Treasury management and policies
The Corporation's objectives and policies for holding financial instruments and similar contracts, and the strategies for achieving those objectives, are described in note 23 to the financial statements (on page 100).

Payment policies
It is Corporation policy to ensure that suppliers are paid within agreed terms. At the year end, the Corporation's trade creditors represented the equivalent of 27 days' credit.

Related party transactions
Except for disclosures made in note 26 (on page 104), no other related party has had material transactions with the Corporation of Lloyd's in 2004.

Outlook for 2005
Members' subscriptions were held at 0.50% of members' premium limits for 2005. As market capacity has reduced to £13.7bn for 2005, income from this source will reduce to £68.5m from £74.9m in 2004. Nevertheless, an operating surplus for 2005 is budgeted. There will be further investment in Kinnect during 2005.

Financial Review of the Lloyd's Central Fund in 2004
Basis of preparation
The Central Fund, which is held at the discretion of the Council of Lloyd's, has not been consolidated within the financial statements of the Corporation of Lloyd's as it is primarily a Fund available for the protection of policyholders and hence relates to the insurance related activities of the members of Lloyd's.

The liabilities of the Fund include those amounts contractually committed by the Fund and exclude provision for future discretionary payments. The financial statements therefore do not take account of claims approved after the balance sheet date or future payments that may be made to cover underwriting losses of members except to the extent that the Central Fund is contractually committed to make such payments under hardship and other agreements.

OPERATING AND FINANCIAL REVIEW continued

Accounting policies and financial reporting standards

The accounting policies adopted in 2004 are consistent with the prior period, except as noted below, and are disclosed in note 2 (on page 111):

- FRS 13 'Derivatives and other financial instruments – disclosures' has been fully adopted in 2004. In prior years FRS 13 did not apply to the Central Fund. There has been no impact on the primary financial statements as a result of providing the additional disclosures.

- The accounting policy in respect of claims and recoveries from members has been amended to account for recoveries when contractually agreed rather than when received. In 2004, the effect of this change has been to account for recoveries receivable of £7.4m as at 31 December 2004. This is a change in accounting policy as recoveries were previously accounted for on a received basis. No amounts were receivable at 31 December 2003 and therefore no prior year adjustment is required.

- Following the issue of subordinated loan notes in November 2004, the accounting policy adopted for recognising the loan notes at amortised cost, taking account of issue costs and issue discount has been set out at note 2G on page 112. Issue costs are amortised on a straight line basis over the period to the earliest option date. The principal disclosures relating to the loan notes are set out in note 14 (on page 117).

Basis of presentation of financial statements

The format of the General Fund Account (the revenue statement) has been changed for 2004 to reflect a clearer presentation. In particular, all investment returns (dividends and interest, the surplus on sale and revaluation of investments) have been grouped together under a 'Finance' heading and the distinction between realised and unrealised gains and losses on investments has been eliminated. In addition, income and expenditure is now described as 'operating income' and 'operating expenditure'.

Fund balance

At 31 December 2004, the combined assets of the Lloyd's Central Fund total £555.8m, a decrease of £155.3m since last year. This decrease reflects the net effect of the settlement of the dispute with insurers of the New Central Fund (the details of the dispute were noted in the 2003 financial statements) amounting to £323.8m before tax and £227m after tax following the write off of insurance claims previously considered to be receivable. The settlement of the dispute with insurers of the New Central Fund is described in note 9 (on page 114).

The movement in the Fund balance is summarised below:

	2004 £000	2003 £000	2002 £000
Operating income	**215,588**	444,881	390,106
Operating expenditure – before settlement of the arbitration dispute	**(148,943)**	(143,772)	(154,932)
Settlement of the arbitration dispute	**(323,755)**	–	–
(Deficit)/surplus on ordinary activities before finance	**(257,110)**	301,109	235,174
Finance	**29,167**	29,449	(26,500)
(Deficit)/surplus before tax	**(227,943)**	330,558	208,674
Taxation credit/(charge)	**72,688**	(95,750)	(59,266)
(Decrease)/increase in year	**(155,255)**	234,808	149,408
Total Fund balance at 1 January	**711,045**	476,237	326,829
Total Fund balance at 31 December	**555,790**	711,045	476,237

Regulatory solvency and the role of the Central Fund

Although provision is made in the Central Fund financial statements for amounts that may be payable under undertakings once they have been given, members' solvency deficiencies in the solvency test that the FSA required the Society to undertake are not reflected in the financial statements of the Central Fund. The security underlying policies issued at Lloyd's is described on pages 55 to 59.

Operating income

Contributions from members to the Lloyd's New Central Fund amounted to £190.7m in 2004. There were no contributions from the Corporation of Lloyd's during the year (2003: £279.5m representing the transfer of premium levy collections which ceased at the end of 2003).

New Central Fund contributions are based on a percentage of members' overall premium limits. The rate for 2004 was 1.25% for all members (2003: 1%). New corporate members underwriting on new syndicates in 2004 will be required to contribute at double the annual rate for their first three years of operations at Lloyd's.

The following table shows the sources of operating income:

	2004 £000	2003 £000	2002 £000
Contribution from members of Lloyd's	**190,657**	159,923	134,467
Contribution from Corporation of Lloyd's	**–**	279,493	246,809
Recoveries	**24,678**	5,465	8,830
Gain on exchange	**253**	–	–
	215,588	444,881	390,106

Operating expenditure

Overall operating expenses in 2004, before the effect of the settlement of the arbitration dispute with the insurers of the New Central Fund, have increased by £5.1m from £143.8m to £148.9m reflecting the continuing provisions for undertakings given to insolvent members. The settlement with the New Central Fund insurers, whereby they agreed to pay total claims under the policy of £152m, including amounts previously paid under the policy terms, has resulted in a write off of £323.8m before taking account of tax.

In 2004, the final refund of £2.6m in respect of members' special contributions arising from the 1996 *Reconstruction and Renewal* settlement was made.

Legal and professional fees include Lloyd's costs in connection with the arbitration dispute. There is no change for insurance premiums and brokerage fees in 2004 following the expiry of the insurance policy on 31 December 2003.

Lloyd's was brought within the scope of the Financial Services Compensation Scheme (FSCS) with effect from 1 January 2004, but was not required to contribute to levies raised by the FSCS in respect of 2004.

The operating costs can be summarised as follows:

	2004 £000	2003 £000	2002 £000
Refunds of members' special contributions	**(2,608)**	(39,988)	(46,591)
Income Support Schemes	**(2,193)**	(1,622)	(1,713)
Other claims and provisions	**(135,493)**	(79,669)	(87,726)
Run-off management costs (incl. provisional liquidators' fees)	**(2,273)**	(3,421)	(1,343)
Insurance premiums and brokerage fees	**–**	(16,706)	(16,706)
Legal and professional fees	**(5,580)**	(1,282)	(25)
Administrative expenses	**(796)**	(817)	(828)
Loss on exchange	**–**	(267)	–
	(148,943)	(143,772)	(154,932)
Settlement of Central Fund arbitration dispute	**(323,755)**	–	–
	(472,698)	(143,772)	(154,932)

OPERATING AND FINANCIAL REVIEW continued

Finance

As set out in the table below, net finance has decreased by £0.2m in 2004 to £29.2m. Dividends and interest have increased by £6.0m to £21.5m set against an interest charge of £4.0m in respect of the subordinated loan notes and an unrealised exchange loss on translation of subordinated loan notes of £2.6m.

	2004 £000	2003 £000	2002 £000
Dividends and interest receivable	**21,506**	15,477	14,409
Surplus on sale and revaluation of investments	**14,337**	13,972	(40,909)
Interest payable and similar charges	**(6,676)**	–	–
	29,167	29,449	(26,500)

Taxation credit

A tax credit of £72.7m on the deficit before taxation of £227.9m has been recognised for the year ended 31 December 2004 compared to a tax charge of £95.8m in 2003.

Cash flows and liquidity

The following table sets out the total investments and cash available resulting from cash flows including the issue of subordinated loan notes:

	2004 £000	2003 £000	2002 £000
Increase/(decrease) in net funds in the year resulting from cash flows	**40,106**	150,111	(20,545)
Net funds at 1 January	**491,037**	340,926	361,471
Net funds at 31 December	**531,143**	491,037	340,926
Subordinated loan notes	**506,439**	–	–
Total investments and cash	**1,037,582**	491,037	340,926

Net cash flows include the claims paid from the New Central Fund in respect of corporate and individual members as follows:

	2004 £000	2003 £000	2002 £000
Claims paid in respect of corporate members	**(137,411)**	(191,137)	(465,533)
Claims paid in respect of individual members	**(2,677)**	(4,447)	(2,231)
	(140,088)	(195,584)	(467,764)

Outlook for 2005

The basis for members contributing to the New Central Fund has changed for 2005. Members will continue to contribute based on a percentage of their allocated overall premium limit. However, from 2005 this will be partly by way of interest bearing loans from syndicate premiums trust funds. The annual contribution rate for existing members has fallen to 0.50% from 1.25% in 2004, while the rate for syndicate loans is 0.75%. New corporate members underwriting on new syndicates are required to contribute at an increased rate for their first three years of operations at Lloyd's. The rate for such new members in 2005 is 2.5%. Syndicate loans will ordinarily be repaid on the closure of the year of account after three years. Contributions for 2005 were collected on 1 April 2005 and total £69.7m in annual contributions and £103.2m by way of syndicate loans.

On 6 April 2005, the Council of Lloyd's gave further undertakings to certain corporate members to use the New Central Fund to discharge the liability of those members where they have unpaid cash calls and do not have the resources to meet those cash calls. After taking account of the expiry of unutilised undertakings, the net increase in undertakings, which will be reflected as a liability of the New Central Fund is £216.5m.

Going Concern

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

Corporate governance

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

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

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

The operation of effective risk management is the responsibility of all managers. This is kept under review by the Executive Committee which is responsible for ensuring that the Corporation maintains effective and efficient internal control, and compliance with Financial Services Authority (FSA) and related requirements. The Corporation has a Head of Internal Audit who is supported by KPMG LLP who provide resources to complete the audit plan. The Corporation is committed to the highest standards of business conduct and has a clearly defined organisational structure.

Employment policy

Communications and employee involvement

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

Equal opportunities

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

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

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

Training and development

Training and development are conducted in order to achieve business objectives, meet FSA requirements and improve individual and business performance. The Corporation actively encourages employees to obtain relevant qualifications and to develop their full potential. Training and development is available to all staff. A system of internal job advertising is in place and internal transfer and promotion fill many vacancies.

REPORT OF THE NOMINATIONS, APPOINTMENTS AND COMPENSATION COMMITTEE

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

Composition of the NACC

The Nominations, Appointments and Compensation Committee (NACC) currently comprises two nominated, two external and three working members of the Council. The NACC members for 2004 are indicated within the remuneration table on pages 74 and 75.

The Committee met six times during the year. The attendance at meetings by members of the Committee is set out in the Corporate Governance report, page 34. The Committee's terms of reference are available on request from the Secretary to the Council.

Nominations and appointments

The NACC is responsible for making recommendations to Council on the appointment of the Chairman, Chief Executive Officer (CEO), nominated Council members, Franchise Board members and members of a number of Council and Franchise Board committees. Other than the annual exercise of making recommendations with respect to the composition of Council and Franchise Board committees, the NACC made recommendations to Council during 2004 with respect to one new nominated member of Council and the Director, Finance and Risk Management (the latter is also a member of the Franchise Board). The nominations were accepted by Council.

To assist it with its work in this area, the NACC employs external search consultants from time to time as well as making use of its own resources and expertise.

The NACC also recommended to Council that the Chairman should be offered a second three-year term of office to run from the expiry of his current term in November 2005. As before, the Chairman's employment is subject to 12 months' notice of termination by either party. The Chairman accepted the invitation and the Council agreed the recommendation. The appointment is subject to the Chairman being re-elected to Council in November 2005. In addition, under Lloyd's Act 1982, the Council of Lloyd's is required to elect annually a Chairman.

Remuneration and compensation

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

In determining their recommendations for the year, the NACC consulted with the Chairman and the CEO about its proposals as well as engaging the assistance of remuneration advisers, Deloitte & Touche LLP. During the year, Deloitte & Touche LLP also provided other services to the Corporation including work on the capitalisation review and benchmark return on capital projects.

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

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

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

Our total remuneration approach is supported by the following practices:

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

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

- emanates from business strategies and goals;
- is based on business success (ability to pay);

- provides a flexible mix of rewards which will attract, retain and motivate the high calibre people we need with the varied range of experience and skills the business requires;

- is externally competitive and regularly monitored by means of remuneration surveys;

- rewards for performance not cost of living;

- ensures employees understand the criteria by which rewards are determined and reviewed;

- gives managers as much freedom as possible in deciding the rewards of their teams; and

- is in line with our equal opportunities and diversity policy.'

Remuneration

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

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

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

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

Long Term Incentive Plan

A long term incentive plan ('the 2004 LTIP') for the CEO and other senior executives of the Corporation was established with the approval of the NACC and Council in March 2004. This replaced the previous LTIP with effect from 1 January 2004, although transitional measures described below apply.

Objectives

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

- is directly linked to the profitability of the Lloyd's market and will therefore align the interests of participants with the capital providers within the market; and

- will provide competitive incentives and therefore enable Lloyd's to recruit and retain the talented executives required to support the future strategy for the market.

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

Operation of the 2004 LTIP

Three-year pooling principle

Payments made under the 2004 LTIP are determined by reference to the profitability of the Lloyd's market over three years, so that both profits and losses over a three-year period are taken into account in determining an LTIP award. The principle of pooling means that any losses made over the three-year period will offset profits when determining payments, thus encouraging prudential behaviour. Pooling also means that awards may be made in loss making years. This would be the case if the aggregate profits outweighed the aggregate losses over the relevant three-year period.

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

Profit/loss

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

REPORT OF THE NOMINATIONS, APPOINTMENTS AND COMPENSATION COMMITTEE continued

Eligibility
Selected senior permanent employees of the Corporation are eligible for the scheme which include the CEO, Directors and existing staff in role level 1 as at 1 January 2004. The NACC retains absolute and sole discretion as to who participates in the LTIP in any particular year.

Limits
There is an overall limit such that the total 2004 LTIP awards for all participants in any year will not exceed 0.075% of the aggregate profits and losses for the relevant three-year period.

Joining employment
Subject to NACC's discretion, executives who are newly recruited or promoted may be made a 2004 LTIP award on a pro-rated basis. When this occurs, awards will normally be pro-rated in relation to the number of full months of employment during the 36-month period to which the three-year pool relates.

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

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

Transitional measures
In 2004 only, transitional measures apply in order to assist the transition from the previous LTIP, so that an LTIP award under the 2004 LTIP will not be lower than the award that would have been made under the previous LTIP. This test is applied as at the first payment date in 2005. It will be applied only once and there will be no subsequent re-test. Vested awards under the previous LTIP continue to be paid as they fall due, subject to rules of that plan. The transitional arrangements do not apply to any participant who joined on or after 1 January 2004.

Calculation of award and timing of payments
Under the 2004 LTIP, the value of an award is calculated as a percentage of the profits for the relevant three-year period for each £1m of aggregate LTIP participant salary. For the CEO and other Directors, this percentage is 0.008%. For other participants, the percentage used is lower, 0.004%. The percentages have been set by reference to external market data on remuneration levels as measured against other organisations of similar complexity and size.

For the financial year 2004, therefore, the award made under the LTIP, subject to adjustment for discretionary awards, is the greater of:

- the award calculated under the 2004 LTIP – i.e. the aggregate profits of the Lloyd's market for the financial years 2002-2004 of £2,988m x relevant % x salary of LTIP participant/£1m; and

- the award calculated under the previous LTIP – i.e. the aggregate projected pure year pre-tax profits (on a three-year accounting basis) of Lloyd's members after deducting personal expenses for the 2004 year of account provided by the Lloyd's market of £1,074m x 0.05% x salary of LTIP participant/£1m.

The discretionary element of the award is calculated in accordance with the rules of the relevant plan under which payment is being made as follows:

- the discretionary award calculated under the 2004 LTIP: the payment of each award is made in three tranches, subject to continued employment with the Corporation, in April following the end of the financial year and in April of the following two years. For participants other than the CEO, the Director, Finance and Risk Management, and the Franchise Performance Director, a discretionary adjustment may be made to the first payment of an LTIP award to increase or decrease it by a maximum of 100%, to reflect the individual's performance over the year. However, in no circumstances can an adjustment be made to increase the size of the total discretionary LTIP pool. The further two payments (of equal amounts) will be paid in the following two years, subject to the individual remaining in employment with the Corporation.

- the discretionary award calculated under the previous LTIP: one-third of the bonus is paid on a discretionary basis (the discretionary performance bonus) to reflect individual performance over the period, while two-thirds (the long term bonus) is based on a percentage of the participant's eligible salary as set out within the terms of the plan. The discretionary performance bonus is payable in March following the end of the underwriting year. The long term bonus is payable in three instalments commencing in October following the underwriting year and annually thereafter.

For those participants where the transitional arrangements apply, the higher award is that calculated under the previous LTIP and the amount and timing of payments of the 2004 award will therefore be based on the previous LTIP rules.

Details of the awards to the CEO, the Director, Finance and Risk Management and the Franchise Performance Director are shown on page 76.

Pension arrangements

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

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

A pension contribution of £40,500 was payable in respect of the Chairman for 2004.

Contracts of employment

The Chairman has a three-year term of office, which may be extended by mutual agreement and is subject to a 12 months' notice of termination by either party (see paragraph above entitled 'Nominations and Appointments' for details of the offer and acceptance by the Chairman of a second three-year term of office, expiring in November 2008).

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

Details of the contracts of the Chairman and directors are summarised in the table below:

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

	Contract Date	Unexpired Term as at 31 Dec 2004	Notice Period(i)
Lord Levene of Portsoken	01/11/02	46 months	12 months
Nick Prettejohn(ii)	27/03/95	rolling 1 year	12 months
Luke Savage(iii)	20/09/04	rolling 1 year	12 months
Rolf Tolle(iv)	03/03/03	rolling 1 year	12 months

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

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

(iii) Luke Savage was appointed to the Franchise Board on 30/09/04

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

REPORT OF THE NOMINATIONS, APPOINTMENTS AND COMPENSATION COMMITTEE continued

Remuneration and contracts of service for members of the Council of Lloyd's and Franchise Board who are not employees of the Corporation

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

In 2004, fees for members of Council and Franchise Board were £25,000 and £37,500 per annum, respectively. Members of both Council and the Franchise Board receive fees of £50,000. Fees are also payable in respect of membership of a number of Council and the Franchise Board committees. Non-employee members of the Council and Franchise Board are not eligible to join the Lloyd's Pension Scheme.

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

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

Information subject to audit

Basis of preparation

The following section provides details of the remuneration of all members of the Council of Lloyd's and Franchise Board for the year ended 31 December 2004. This section contains the following information in the form specified in Schedule 7A Part 3 of the Companies Act 1985:

- amount of each member's emoluments and compensation in the current financial year;
- details of each member's accrued benefits in the Lloyd's Pension Scheme and transfer values of those accrued benefits; and
- details of each member's interests under the Long Term Incentive Plan.

Remuneration of members of the Council of Lloyd's and Franchise Board

Individual remuneration, excluding LTIP awards, for the year to 31 December is shown in the table below. LTIP awards are shown on page 76.

	Salary/Fees		Taxable Benefits(i)		Annual Bonus		Other(xi)		Total	
	2004 £000	2003 £000	**2004 £000**	2003 £000	**2004 £000**	2003 £000	**2004 £000**	2003 £000	**2004 £000**	2003 £000
Chairman of Council of Lloyd's										
Lord Levene of Portsoken(ii) (viii)	**408**	400	**28**	–	**150**	150	**41**	38	**627**	588
Executive Directors										
Nick Prettejohn, CEO(ii) (viii)	**457**	440	**17**	14	**250**	205	**156**	152	**880**	811
Andrew Moss(ii) (ix) (xvi)	**125**	338	**4**	11	**–**	150	**37**	70	**166**	569
Luke Savage(ii) (ix) (xxi)	**93**	–	**3**	–	**54**	–	**–**	–	**150**	–
Rolf Tolle(ii) (ix) (xvii) (xviii)	**453**	372	**41**	25	**250**	250	**102**	334	**846**	981
Non-Executive Council Members										
Working members										
Stephen Catlin(viii) (x)	**55**	52	**–**	–	**–**	–	**–**	–	**55**	52
John Coldman, Deputy Chairman(x)	**36**	29	**–**	–	**–**	–	**–**	–	**36**	29
Christine Dandridge	**30**	–	**–**	–	**–**	–	**–**	–	**30**	–
Bronek Masojada, Deputy Chairman(x)	**41**	35	**–**	–	**–**	–	**–**	–	**41**	35
David Shipley	**31**	21	**–**	–	**–**	–	**–**	–	**31**	21
External members										
Julian Avery(iii) (x)	**30**	24	**–**	–	**–**	–	**–**	–	**30**	24
Steven Burns(vi) (viii) (xii)	**56**	27	**–**	–	**–**	–	**–**	–	**56**	27
Sean Dalton(vii) (xxii)	**31**	21	**–**	–	**–**	–	**–**	–	**31**	21
Quentin Davies	**30**	–	**–**	–	**–**	–	**–**	–	**30**	–
Peter Morgan(v) (x)	**35**	32	**–**	–	**–**	–	**–**	–	**35**	32
Charles Philipps(iv)	**30**	27	**–**	–	**–**	–	**–**	–	**30**	27

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

	Salary/Fees		Taxable Benefits[i]		Annual Bonus		Other[xi]		Total	
	2004 £000	2003 £000	**2004 £000**	2003 £000	**2004 £000**	2003 £000	**2004 £000**	2003 £000	**2004 £000**	2003 £000
Nominated members										
Judith Hanratty[viii] [x] [xx]	**67**	64	**–**	–	**–**	–	**–**	–	**67**	64
Bill Knight, Deputy Chairman of the Council of Lloyd's[x]	**53**	41	**–**	–	**–**	–	**–**	–	**53**	41
Philip Lader[xxiii]	**25**	–	**–**	–	**–**	–	**–**	–	**25**	–
Brian Pomeroy[xix]	**44**	42	**–**	–	**–**	–	**–**	–	**44**	42
Andreas Prindl[xiii]	**37**	2	**–**	–	**–**	–	**–**	–	**37**	2
Non-Executive Franchise Board Members										
Roy Brown	**38**	38	**–**	–	**–**	–	**–**	–	**38**	38
Edward Creasy	**38**	38	**–**	–	**–**	–	**–**	–	**38**	38
Stephen Hodge	**38**	41	**–**	–	**–**	–	**–**	–	**38**	41
Jim Stretton	**48**	48	**–**	–	**–**	–	**–**	–	**48**	48
Former Members										
Alastair Ross Goobey[xiv]	**–**	37	**–**	–	**–**	–	**–**	–	**–**	37
Andrew Kendrick[xv]	**–**	28	**–**	–	**–**	–	**–**	–	**–**	28
Paul Kelly[xxiv]	**–**	32	**–**	–	**–**	–	**–**	–	**–**	32
David Robson[xxiv]	**–**	29	**–**	–	**–**	–	**–**	–	**–**	29

(i) Taxable benefits include items such as company car or car allowance, medical and life insurance
(ii) Employee of the Corporation of Lloyd's
(iii) Representative of Wellington (Five) Limited
(iv) Representative of Amlin Corporate Member Limited
(v) Representative of AJSLP 9
(vi) Representative of Limit (No 2) Limited
(vii) Representative of Liberty Corporate Capital Limited
(viii) Member of both Council and the Franchise Board
(ix) Member of the Franchise Board only
(x) Member of the Nominations, Appointments & Compensations Committee (NACC) for 2004
(xi) Other includes payments into a Funded Unapproved Retirement Benefit Scheme (FURBS) of 20% of Executive Directors' total salary. This is grossed up for tax in respect of Nick Prettejohn only. In 2003, Rolf Tolle received a payment of £220,000 in respect of accepting office as an Executive Director. The amount stated in respect of the Chairman represents pension contributions to a personal pension scheme
(xii) Steven Burns was appointed a member of the Franchise Board on 3 December 2003
(xiii) Andreas Prindl was appointed a member of Council on 21 November 2003
(xiv) Alastair Ross Goobey's term of office as a Council member expired on 25 November 2003, until that date he was also a member of NACC
(xv) Andrew Kendrick resigned as a member of the Franchise Board on 25 September 2003
(xvi) Andrew Moss became a member of the Franchise Board on 1 January 2003 and left the Corporation of Lloyd's on 8 May 2004
(xvii) Rolf Tolle became a member of the Franchise Board on 3 March 2003
(xviii) In 2003, Lloyd's paid £83,000 to Rolf Tolle's previous employer in respect of the assignment of a property lease to Lloyd's. The lease expired in August 2004 and £101,000 was paid to the landlord on renewal of the lease for a further two years. The property is occupied by Rolf Tolle. These amounts are not included in the table above
(xix) Brian Pomeroy's term of office as a Council member expired on 31 December 2004
(xx) Judith Hanratty retired from the Franchise Board on 31 December 2004
(xxi) Luke Savage joined the Corporation of Lloyd's on 20 September 2004 and was appointed to the Franchise Board on 30 September 2004
(xxii) Representative of SUMAC Underwriting (UK) Limited
(xxiii) Philip Lader was appointed a member of Council on 2 March 2004
(xxiv) Paul Kelly and David Robson's terms of office as Council members expired on 31 January 2004

REPORT OF THE NOMINATIONS, APPOINTMENTS AND COMPENSATION COMMITTEE continued

Lloyd's Pension Scheme provisions

	Contributions in year to 31 Dec 2004[i] £000	Age at 31 Dec 2004	Increase in pension in year to 31 Dec 2004 – actual £000	Increase in pension in year to 31 Dec 2004 – net of price inflation £000	Total accrued annual pension in year to 31 Dec 2004 £000 pa	Retirement age
Nick Prettejohn	**n/a**	**44**	**2**	**1**	**24**	**60**
Andrew Moss	**n/a**	**46**	**2**	**2**	**9**	**60**
Luke Savage	**n/a**	**43**	**1**	**1**	**1**	**60**
Rolf Tolle	**n/a**	**57**	**3**	**3**	**6**	**60**

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

Transfer values of accrued pension benefits

	Transfer value of accrued pension as at 31 Dec 2003 £000	Transfer value of accrued pension as at 31 Dec 2004 £000	Increase in transfer value over the year less director's own contributions £000
Nick Prettejohn	194	**245**	**51**
Andrew Moss	71	**96**	**25**
Luke Savage	n/a	**6**	**6**
Rolf Tolle	39	**98**	**59**

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

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

			Estimated Long Term Bonus						
	Award year	Discretionary Performance Bonus £000	As at 31 Dec 2003 £000	Change in year £000	As at 31 Dec 2004 £000	Total £000	Amount paid during the year ended 31 Dec 2003 £000	Amount paid during the year ended 31 Dec 2004 £000	Total award outstanding as at 31 Dec 2004 £000
Nick Prettejohn	**2002**	**110**	**228**	**(65)**	**163**	**273**	**178**	**85**	**10**
	2003	**135**	**267**	**48**	**315**	**450**	**–**	**224**	**226**
	2004	**80**	**–**	**165**	**165**	**245**	**–**	**–**	**245**
Luke Savage	**2004**	**6**	**–**	**13**	**13**	**19**	**–**	**–**	**19**
Rolf Tolle	**2003**	**126**	**249**	**45**	**294**	**420**	**–**	**209**	**211**
	2004	**89**	**–**	**182**	**182**	**271**	**–**	**–**	**271**

Bill Knight, Chairman

Nominations, Appointments and Compensation Committee

REPORT OF THE AUDIT COMMITTEE

This report sets out the role, remit and activities of the Audit Committee during 2004.

Composition of the Audit Committee
In 2004 the Audit Committee comprised two nominated, two external and one working member of the Council and a non-executive member of the Franchise Board. The Committee met four times during the year. The members of the Committee in 2004 and their attendance at meetings are indicated in the Corporate Governance report on page 34.

On 31 December 2004, Brian Pomeroy's term of office as a member of Council and Chairman of the Committee ceased. Stephen Hodge was appointed Chairman of the Committee by the Council on 2 February 2005.

For the purposes of the Combined Code, Stephen Hodge is considered by the Council to have recent and relevant financial experience.

Terms of reference
The Council has delegated to the Committee, responsibility for overseeing the financial reporting and internal controls of the Corporation of Lloyd's and its subsidiaries and the Central Fund. The principal responsibilities of the Committee include:

- ensuring that the financial activities of Lloyd's are subject to independent review and audit. The Committee reviews Lloyd's published annual financial statements including the Pro Forma Annual Accounting Statement, the global results, the financial statements of the Corporation of Lloyd's and the Central Fund and principal regulatory filings;
- reviewing and monitoring the arrangements for ensuring the objectivity and effectiveness of the external and internal audit functions;
- considering, on behalf of the Council, the appointment or removal of the external auditors;
- reviewing and monitoring the effectiveness of the systems of internal control of the Corporation of Lloyd's; and
- ensuring that appropriate arrangements are in place for ensuring compliance with relevant laws and regulations.

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

Report on the Committee's activities in 2004
The principal issues addressed during 2004 were:

- the annual financial statements for 2003 including financial disclosures and various accounting matters raised by management and auditors;
- the 2003 FSA return;
- the FSA risk assessment of Lloyd's and management's response;
- the external auditors' status reports and management letters;
- the independence and objectivity of the external auditors, including a review of non-audit fees;
- the external and internal audit plans;
- the reports of the Head of Internal Audit, including follow-up of findings; and
- assessment of the effectiveness of internal controls.

The Committee also received reports from the Compliance Officer, reviewed management accounts and carried out an effectiveness review of internal and external auditors. It also reviewed its own performance.

The Chief Executive Officer, the Director, Finance and Risk Management, the Financial Controller, Head of Internal Audit, Head of Market Reporting and the external and internal auditors attended meetings as appropriate. During the year the Committee met separately with the external and internal auditors without executive management present.

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

Stephen Hodge, Chairman
Audit Committee

RISK AND RESPONSIBILITY

The Lloyd's market may be synonymous with risk, but the Corporation takes its wider responsibilities seriously. As franchisor, we recognise that our responsibilities to franchisees, suppliers, employees and neighbouring communities are wide-ranging. This is reflected in our Corporate Responsibility policy and action plan, which was developed in 2004.

Our Corporate Responsibility policy: an overview
Our commitments fall under four main headings:

- **Marketplace:** The insurance services provided by Lloyd's are important to a thriving UK and global economy. As well as its own responsibility to conduct business in full compliance with laws and regulations, including those relating to whistleblowing, financial crime, money laundering, conflicts of interest and client confidentiality, the Corporation recognises its role in helping and supporting franchisees in their efforts to conduct their business in compliance with such regulations.

- **Workplace:** All businesses depend on their people, Lloyd's is no exception. We fully recognise our responsibility for ensuring that all employees are treated with fairness, integrity and respect. To this end, we have developed a set of policies that cover every aspect of an individual's working life at the Corporation, from recruitment and remuneration, to flexible working and work/life balance. In 2004, a particular focus of activity has been to focus on the benefits of diversity.

- **Environment:** We operate a wide-ranging environment policy covering everything from energy efficiency to waste reduction and vehicle emissions. We are also developing work with our suppliers, tenants, staff and users of the Underwriting Room to ensure support for environmental initiatives; for example, encouraging suppliers to minimise packaging or use recyclable materials.

- **Community:** Lloyd's success is impacted by the health and prosperity of the communities of which it is a part – locally, nationally and internationally. Lloyd's has a long-standing tradition of charitable giving and involvement in the local community. Please turn to page 26 for more on the Lloyd's Charities Trust and page 28 for details of how employees from both the Corporation and firms across the market are supported and encouraged to give part of their time and skills to the local community.

Two successful initiatives drawn from our action plan for Corporate Responsibility are detailed below.

Diversity: realising the benefits
Lloyd's believes that diversity is good for business; a workforce that embraces individuals from a wide range of backgrounds is likely to perform better.

The Corporation has established a Diversity Steering Group to promote equality and diversity within the organisation. It meets monthly with members drawn from business units across the Corporation. The group exists to promote equality and diversity within Lloyd's by:

- Acting as a centre of excellence and knowledge for diversity issues;

- Recommending practical measures for meeting statutory and commercial requirements in relation to diversity; and

- Developing proposals that will help individuals and departments to take greater responsibility for diversity.

The Diversity Steering Group has the full support of the Executive Committee.

Recycling: finding a good home for unwanted furniture
In partnership with Green-Works, a social business in East London, Lloyd's has been able to pass on or recycle over 60 tonnes of old office furniture to local charities, schools, health centres and community groups. Some has even been used to create innovative artworks.

Corporate responsibility: aiming higher
Running a successful business in a socially responsible manner is always work in progress. As one goal is partially achieved, another presents itself. To ensure we continue to improve, in 2005 we aim to benchmark our Corporate Responsibility policy against other organisations throughout the UK. The results will help to further define the policy and identify new initiatives for the action plan.

LLOYD'S MEMBERS' OMBUDSMAN'S REPORT

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

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 2004, I received 16 new complaints; five more than the previous year.

In eight cases I decided, after conducting the necessary investigations, to take no further action, as I was satisfied that considerations of maladministration did not arise. In these cases I explained to the complainant why this was so with a detailed letter of response. In one case I found that Lloyd's was guilty of maladministration; however, I was satisfied that the complainant had not suffered an injustice as a consequence of the maladministration and took no action against Lloyd's.

On four occasions I referred the complaint to the Lloyd's department concerned and in three of these cases Lloyd's was able to take action sufficient to resolve the complaint. In the remaining case Lloyd's wrote a letter of explanation which prompted the complainant to withdraw his complaint; however, he indicated that he might resurrect the complaint at a later date.

Two cases fell outside my jurisdiction and there is one complaint still under investigation.

The expenses incurred by my office during 2004 amounted to £37,835.

STATEMENT OF LLOYD'S RESPONSIBILITIES IN RESPECT OF THE FINANCIAL STATEMENTS

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

- Select suitable accounting policies and then apply them consistently;
- Make judgements and estimates that are reasonable and prudent;
- State whether applicable accounting standards have been followed, subject to any material departures disclosed and explained in the financial statements; and
- Prepare the financial statements on the going concern basis unless it is inappropriate to presume that the Corporation will continue in business.

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

INDEPENDENT AUDITOR'S REPORT TO THE MEMBERS OF LLOYD'S

We have audited the financial statements for the year ended 31 December 2004 which comprise the consolidated revenue account, consolidated balance sheet, consolidated cash flow statement, consolidated statement of total recognised gains and losses and the related notes 1 to 27. These financial statements have been prepared on the basis of the accounting policies set out therein. We have also audited the information in the Report of the Nominations, Appointments and Compensation Committee that is described as audited.

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

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

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

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

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

Opinion
In our opinion:

- the financial statements give a true and fair view of the state of affairs of the Corporation as at 31 December 2004 and of its surplus for the year then ended; and
- the section of the Report of the Nominations, Appointments and Compensation Committee to be audited has been properly prepared in accordance with the basis of preparation described therein.

Ernst & Young LLP

Ernst & Young LLP, Registered Auditor, London
6 April 2005

CONSOLIDATED REVENUE ACCOUNT

for the year ended 31 December 2004

	Note	2004 £000	2004 £000	2003 £000	2003 £000
Operating income	3		**180,453**		141,420
Operating expenses	4		**(160,742)**		(160,267)
Group operating surplus/(deficit)			**19,711**		(18,847)
Share of operating profits of associates	14	**2,736**		3,440	
Amortisation of goodwill of associates	14	**(118)**		(118)	
Total share of associates' results			**2,618**		3,322
Total operating surplus/(deficit)			**22,329**		(15,525)
Profit on sale of the Lloyd's 1958 building	12		**23,638**		–
Profit on disposal of discontinued operations			**–**		1,702
Surplus/(deficit) on ordinary activities before finance			**45,967**		(13,823)
Finance					
Dividends receivable from non-consolidated subsidiaries	14		**7,490**		7,490
Dividends and interest receivable:	7				
Group		**7,166**		5,986	
Associates		**103**		99	
Deficit on sale and revaluation of investments	15	**(2,812)**		(4,465)	
Interest payable and similar charges	7	**(501)**		(589)	
			3,956		1,031
Surplus/(deficit) on ordinary activities after finance			**57,413**		(5,302)
Premium levy income	8	**–**		260,858	
Transfers to Lloyd's New Central Fund	9	**–**		(279,493)	
			–		(18,635)
Surplus/(deficit) before taxation			**57,413**		(23,937)
Taxation (charge)/credit	10		**(8,802)**		6,651
Surplus/(deficit) for the year			**48,611**		(17,286)

CONSOLIDATED STATEMENT OF TOTAL RECOGNISED GAINS AND LOSSES

for the year ended 31 December 2004

	Note	2004 £000	2003 £000
Surplus/(deficit) for the year:			
Group		**46,750**	(19,673)
Associates		**1,861**	2,387
Total surplus/(deficit) for the year		**48,611**	(17,286)
Unrealised gain on disposal of subsidiaries	21	**109**	500
Unrealised gain on revaluation of other investments	14	**2,797**	–
Total recognised gains/(losses) relating to the year	24	**51,517**	(16,786)

CONSOLIDATED BALANCE SHEET

as at 31 December 2004

	Note	2004 £000	2003 £000
Fixed assets			
Tangible assets	11	**14,551**	15,023
Investments			
Investments in associates	14	**4,459**	6,332
Subsidiary companies not consolidated	14	**90**	155
Other	14	**9,710**	6,913
		28,810	28,423
Statutory insurance deposits	15	**112,641**	111,594
Funding provided by syndicates	15	**(106,831)**	(107,871)
		5,810	3,723
Total non-current assets		**34,620**	32,146
Current assets			
Stocks	16	**461**	467
Debtors and prepayments			
– amounts due: within one year	17	**51,756**	70,915
: after more than one year – pension scheme prepayment	18	**28,806**	24,318
Investments	19	**46,442**	5,134
Cash		**65,903**	47,034
Total current assets		**193,368**	147,868
Creditors – due within one year	20	**(99,453)**	(102,253)
Net current assets		**93,915**	45,615
Total assets less current liabilities		**128,535**	77,761
Provisions for liabilities and charges	21	**(6,653)**	(7,396)
Net assets		**121,882**	70,365
Revaluation reserve	24	**9,710**	6,913
Accumulated reserve	24	**112,172**	63,452
Total reserves	24	**121,882**	70,365

Signed on behalf of the Council of Lloyd's on 6 April 2005

Lord Levene of Portsoken, Chairman

Nick Prettejohn, Chief Executive Officer

CONSOLIDATED CASH FLOW STATEMENT

for the year ended 31 December 2004

	Note	2004 £000	2003 £000
Cash flow from operating activities	22	**32,113**	(1,158)
Dividends received from associates		**3,734**	2,086
Returns on investments and servicing of finance	22	**14,163**	8,014
Taxation		**(13)**	1,161
Capital expenditure and financial investment	22	**21,643**	(1,211)
Acquisitions and disposals	22	**–**	1,702
Cash inflow before use of liquid resources and financing		**71,640**	10,594
Management of liquid resources	22	**(45,167)**	(48,567)
Financing	22	**(7,604)**	53,410
Increase in cash in the year		**18,869**	15,437
Reconciliation of net cash flow to movement in net funds (note 22)			
Increase in cash in the year		**18,869**	15,437
Cash outflow/(inflow) from movement in financing		**7,604**	(53,410)
Cash outflow from movement in liquid resources		**45,167**	48,567
Change in net funds resulting from cash flows		**71,640**	10,594
Other movements	22	**(9,376)**	2,660
Movement in net funds in the year		**62,264**	13,254
Net funds at 1 January		**55,891**	42,637
Net funds at 31 December	22	**118,155**	55,891

NOTES TO THE FINANCIAL STATEMENTS

as at 31 December 2004

1. Basis of preparation and consolidation

In 1871, pursuant to Lloyd's Act 1871, the then existing association of underwriters was incorporated as the Society and Corporation of Lloyd's (Lloyd's or the Society or the Corporation of Lloyd's). The activities of the Society are accordingly governed by statute and, since 1982, have been managed by the Council of Lloyd's (the Council) pursuant to Lloyd's Act 1982. The Society's main corporate purposes are to facilitate the carrying on of insurance business by members of Lloyd's and the advancement and protection of their interests in this context.

The purpose of the financial statements is to demonstrate the income and expenditure, financial position and cash flows of the Corporation of Lloyd's to members in their capacity as members. The financial statements exclude all insurance-related activities arising from members' underwriting at Lloyd's. In meeting this objective, certain operating subsidiaries are consolidated whilst others, principally Lioncover Insurance Company Limited and Centrewrite Limited, are excluded since their activities relate to running off the underwriting affairs of certain syndicates and Names. The Corporation of Lloyd's does not itself underwrite and the Council has taken advantage of the exemption permitted by FRS 2 'Accounting for subsidiary undertakings' not to consolidate these subsidiaries because their activities are so dissimilar that to consolidate their results would not achieve the objective of the financial statements. For the same reasons the Central Fund, which is held at the Council's direction, has not been consolidated, as it is primarily a fund available for the protection of policyholders. However, the Central Fund financial statements describe how its assets may be used to cover members' solvency shortfalls. In the last resort, the Corporation of Lloyd's assets may also be used for this purpose at the discretion of Council.

The subordinated loan notes issued by the Society on 17 November 2004 have been accounted for within the financial statements of the Central Fund, the proceeds of the issue being an addition to Central Fund assets, thereby strengthening the capital base of the Society and the Lloyd's market.

The financial statements have been prepared under the historical cost convention as modified by the revaluation of investments and in accordance with applicable accounting standards. There were no discontinued activities during 2004.

FRS 13 'Derivatives and other financial instruments – disclosures' has been fully adopted in these financial statements. In prior years FRS 13 did not apply to the Corporation of Lloyd's, however, certain voluntary disclosures were given. The additional information is also included in the 2003 comparatives in note 23. There has been no impact on the primary financial statements as a result of providing the additional disclosures.

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

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

2. Principal accounting policies

A Tangible fixed assets and depreciation

Fixed assets are included at cost.

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

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

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

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

NOTES TO THE FINANCIAL STATEMENTS continued

as at 31 December 2004

2. Principal accounting policies continued

B Investments

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

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

Other investments represent Lloyd's collection of various paintings, antiques and artefacts and are included at market valuation. The collection is revalued at least every three years and any revaluation surplus or deficit is taken to the revaluation reserve.

C Acquisitions and disposals

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

D Stocks

Stocks are stated at the lower of cost and net realisable value.

E Income

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

Income, which is stated net of value added tax, represents amounts invoiced for goods and services provided, including members' subscriptions and is recognised in the period for which it is received.

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

F Pension costs

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

G Taxation

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

H Foreign currency and derivative instruments

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

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

Where contracts are entered into to cover foreign exchange exposure, contracted rates are used for balance sheet valuation purposes.

2. Principal accounting policies continued

H Foreign currency and derivative instruments

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

The principal year end exchange rates were:

	2004	2003
US$	**1.92**	1.79
Can$	**2.30**	2.31
Euro	**1.41**	1.42

3. Operating income	**2004 £000**	2003 £000
Market charges		
Managing agents and syndicates	**52,152**	53,624
Members and members' agents	**14,463**	14,913
Franchise Performance and Risk Management charge (2003: Regulatory levy)	**12,293**	8,921
Total market charges	**78,908**	77,458
Members' subscriptions	**74,935**	36,142
Other income		
Market settlement recoveries	**8,864**	7,919
Rent and building service charges	**6,852**	6,707
Charges to associates	**5,043**	6,891
Charges to Lloyd's Central Fund	**2,599**	3,465
Income from other services	**3,252**	2,838
Total other income	**26,610**	27,820
Total operating income	**180,453**	141,420

Market settlement recoveries represent continuing debt recoveries from the 1996 *Reconstruction and Renewal* settlement.

4. Operating expenses	**2004 Corporation £000**	**2004 Kinnect Limited £000**	**2004 Total £000**	2003 Corporation £000	2003 Kinnect Limited £000	2003 Total £000
Operating expenses include:						
Employment costs (note 5)	**53,152**	**6,955**	**60,107**	45,902	7,581	53,483
Overseas operating expenses (note 6)	**20,592**	**–**	**20,592**	21,524	–	21,524
Professional fees, including legal fees and related costs	**10,208**	**412**	**10,620**	15,073	716	15,789
Operating lease rentals – land and buildings	**16,767**	**–**	**16,767**	16,767	–	16,767
Audit services	**187**	**17**	**204**	109	14	123
Further assurance services payable to Ernst & Young LLP	**410**	**–**	**410**	670	10	680
Tax services payable to Ernst & Young LLP	**74**	**17**	**91**	31	–	31
Other services payable to Ernst & Young LLP	**311**	**–**	**311**	430	23	453
Depreciation (note 11)	**2,541**	**37**	**2,578**	2,590	30	2,620
Charitable donations	**216**	**1**	**217**	199	–	199

The costs of Kinnect Limited to 31 December 2004 total £15.1m (2003: £17.9m) and include, in addition to the costs itemised above, systems and communications costs of £6.0m (2003: £7.9m).

NOTES TO THE FINANCIAL STATEMENTS continued

as at 31 December 2004

5. Employment	2004 £000	2003 £000
Salaries and wages (including performance-related bonus)	**33,393**	29,557
Long term incentive plan (excluding social security costs – note 21)	**2,823**	4,643
Pension costs (note 18)	**8,538**	536
Social security costs	**4,274**	3,986
Severance costs	**2,049**	1,818
Contract and agency staff	**4,087**	8,442
Other employment costs	**4,943**	4,501
	60,107	53,483

	2004 Number	2003 Number
Average numbers of employees during the year	**587**	582

The emoluments of the Chairman, Chief Executive Officer, members of Council and Franchise Board are included in the report of the Nominations, Appointments and Compensation Committee on page 70.

6. Overseas operating expenses	2004 £000	2003 £000
Expenses in connection with underwriting activities in the following areas:		
USA	**6,962**	8,146
Canada	**4,058**	4,433
Asia	**3,558**	3,692
Europe	**4,100**	3,560
Africa, Australasia, Central and South America	**1,914**	1,693
	20,592	21,524
Operating expenses include:		
Employment	**5,848**	5,258
Legal and professional	**4,672**	5,822
Systems and communications	**3,121**	3,099
Premises	**1,392**	1,471
Other expenses	**5,559**	5,874
	20,592	21,524

7. Interest	Other interest £000	Statutory insurance deposits £000	2004 Total £000	2003 Total £000
Dividends and interest receivable:				
Group Dividends and interest	**3,482**	**3,103**	**6,585**	4,573
Other movements	**–**	**581**	**581**	1,413
Total group	**3,482**	**3,684**	**7,166**	5,986
Associates	**103**	**–**	**103**	99
Total interest receivable	**3,585**	**3,684**	**7,269**	6,085
Interest payable and similar charges:				
Bank loans/overdrafts	**–**	**–**	**–**	(59)
Funding provided by syndicates	**–**	**(501)**	**(501)**	(511)
Foreign exchange movement	**–**	**–**	**–**	(19)
Total interest payable	**–**	**(501)**	**(501)**	(589)

Other movements include realised and unrealised exchange differences arising on the revaluation of foreign currency operating cash flows and funding provided by syndicates.

8. Premium levy income	2004 £000	2003 £000
Premium levy income:		
Receivable at 1 January	**(19,641)**	(18,635)
Levy collections	**19,641**	264,374
Receivable at 31 December	**–**	19,641
Refundable in respect of return premiums at 31 December	**–**	(4,522)
	–	260,858

The premium levy was originally required to repay a syndicated bank loan. The Council of Lloyd's agreed to continue to collect the premium levy after the syndicated bank loan was fully repaid in September 2001. For 2002 and 2003 the premium levy was increased to 2% of premiums received for most classes of business (1% for UK motor and life business). The premium levy ceased at the end of 2003 having achieved its objective of increasing central assets.

9. Transfers to Lloyd's New Central Fund

There were no contributions to the Lloyd's New Central Fund during the year (2003: £279.5m in respect of the premium levy which ceased at the end of 2003).

10. Taxation	2004 £000	2003 £000
(a) Analysis of charge in the year		
Current tax:		
UK corporation tax based on profits for the year at 30% (2003: 30%)	**–**	–
Current year group tax relief	**(7,925)**	3,660
Adjustments in respect of previous years	**(92)**	2,065
Foreign tax suffered	**(13)**	(26)
Share of associate undertakings' current tax	**(860)**	(1,034)
Total current tax (note 10(b))	**(8,890)**	4,665
Deferred tax:		
Origination and reversal of timing differences	**88**	1,986
Taxation (charge)/credit	**(8,802)**	6,651

(b) Factors affecting current tax charge	2004 £000	2003 £000
The tax assessed for the year is lower than the standard rate of corporation tax in the UK of 30%		
The differences are explained below:		
Surplus/(deficit) on ordinary activities before tax	**57,413**	(23,937)
Surplus/(deficit) on ordinary activities multiplied by standard rate of corporation tax in the UK of 30%	**(17,224)**	7,181
Expenses not deductible for tax purposes	**(1,732)**	(4,526)
Non-taxable income	**9,537**	2,247
Other timing differences	**(610)**	30
Capital allowances for the year in excess of depreciation	**1,324**	999
Utilisation of tax credits/(losses)	**15**	(3,305)
Overseas tax	**(13)**	(26)
Adjustments in respect of previous years	**(92)**	2,065
Other	**(95)**	–
Current tax (charge)/credit (note 10(a))	**(8,890)**	4,665

(c) Deferred tax	2004 £000	2003 £000
A deferred tax asset has been recognised in respect of the following timing differences:		
Accelerated capital allowances	**1,159**	594
Other	**1,597**	2,074
Deferred tax asset at 31 December	**2,756**	2,668
At 1 January	**2,668**	682
Deferred tax credit in consolidated revenue account (note 10(a))	**88**	1,986
At 31 December (note 17)	**2,756**	2,668

NOTES TO THE FINANCIAL STATEMENTS continued

as at 31 December 2004

11. Fixed assets	Freehold land and buildings £000	Plant and other fixed assets £000	Total £000
Cost:			
At 1 January 2004	**10,413**	**44,908**	**55,321**
Additions	**–**	**2,120**	**2,120**
Disposals	**–**	**(1,014)**	**(1,014)**
At 31 December 2004	**10,413**	**46,014**	**56,427**
Depreciation:			
At 1 January 2004	**3,426**	**36,872**	**40,298**
Charge for the year	**125**	**2,453**	**2,578**
Disposals	**–**	**(1,000)**	**(1,000)**
At 31 December 2004	**3,551**	**38,325**	**41,876**
Net book value:			
At 31 December 2004	**6,862**	**7,689**	**14,551**
At 31 December 2003	6,987	8,036	15,023

Included in freehold land and buildings is land valued at £2.5m (2003: £2.5m) which has not been depreciated in the year.

12. Profit on sale of the Lloyd's 1958 building

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

The sale agreement provided for Lloyd's to benefit from any enhanced value as a result of the site being redeveloped. On 1 June 2004, additional proceeds of £24.3m were received and there were directly attributable costs of £0.7m, resulting in the recognition of a further profit of £23.6m.

13. Principal investments in subsidiary companies and associates

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

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

13. Principal investments in subsidiary companies and associates continued

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

The issued share capital of Ins-sure Holdings Limited is £4,000. There are three separate classes of shares. The Corporation holds 1,000,000 B shares of 0.1p each that have the right to participate in 25% of any profits available for distribution.

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

a) The C shares carry a right to a fixed cumulative preference dividend of 5% calculated on the nominal capital and a variable participating dividend calculated by reference to trading profits.

b) The A shares participate in 50% of any profits available for distribution after taking account of the dividend rights outlined above.

14. Investments

a) Investments in associates	Goodwill £000	Share of other net assets £000	2004 £000	2003 £000
At 1 January	861	5,471	6,332	6,031
Share of operating profits	–	2,736	2,736	3,440
Dividends received	–	(3,734)	(3,734)	(2,086)
Amortisation of goodwill	(118)	–	(118)	(118)
Share of interest income	–	103	103	99
Share of tax on profit on ordinary activities	–	(860)	(860)	(1,034)
At 31 December	743	3,716	4,459	6,332

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

b) Subsidiary companies not consolidated	2004 £000	2003 £000
Shares of non-consolidated subsidiary companies at cost	44	44
Current accounts	46	111
	90	155

Non-consolidated insurance related subsidiaries 2004 balance sheet summary	Centrewrite £000	Lioncover £000	Total £000
Investments	40,316	–	40,316
Current assets	13,199	3	13,202
Current liabilities	(11,380)	(80)	(11,460)
	42,135	(77)	42,058
Insurance fund – assets	686	599,362	600,048
– liabilities	(15,649)	(599,362)	(615,011)
Shareholders' funds at 31 December 2004	27,172	(77)	27,095
Shareholders' funds at 31 December 2003	28,751	(61)	28,690
Profit/(loss) before dividends	5,911	(16)	5,895
Proposed dividends	(7,490)	–	(7,490)
Retained loss for the year	(1,579)	(16)	(1,595)

Dividends amounting to £7.49m have been proposed by Centrewrite in respect of the year ended 31 December 2004 (2003: £7.49m).

NOTES TO THE FINANCIAL STATEMENTS continued

as at 31 December 2004

14. Investments continued

Centrewrite Limited

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

Lioncover Insurance Company Limited

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

As these financial statements are not yet available, the above figures have been produced from the management accounts as at 31 December 2004.

c) Other investments

Other investments represent Lloyd's collection of various paintings, antiques and artefacts. They have been included in the consolidated balance sheet at 31 December 2004 at an open market valuation of £9.7m (2003: £6.9m). The collection was valued in September 2004 on the basis of open market auction value assuming all items are not sold at the same time taking into account the nature, age, condition and quality of each chattel, by Gurr Johns Limited, valuers and fine art consultants.

15. Statutory insurance deposits	**2004 £000**	2003 £000
Held by subsidiary companies:		
Statutory insurance deposits	**112,641**	111,594
Funding provided by syndicates	**(106,831)**	(107,871)
	5,810	3,723

Statutory insurance deposits	**Securities £000**	**Cash deposits £000**	**2004 Total £000**	2003 Total £000
Market value at 1 January	**45,669**	**65,925**	**111,594**	67,016
Additions at cost	**29,701**	**352,102**	**381,803**	279,929
Disposal proceeds	**(36,725)**	**(341,219)**	**(377,944)**	(230,886)
Deficit on the sale and revaluation of investments	**(799)**	**(2,013)**	**(2,812)**	(4,465)
Market value at 31 December	**37,846**	**74,795**	**112,641**	111,594

Analysis of securities at year end – statutory insurance deposits	**2004 Cost £000**	**2004 Valuation £000**	2003 Cost £000	2003 Valuation £000
Listed on:				
Overseas stock exchanges	**32,551**	**32,818**	40,093	40,268
	32,551	**32,818**	40,093	40,268
Unlisted:				
Fixed interest	**4,964**	**5,028**	5,609	5,401
	37,515	**37,846**	45,702	45,669

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

Unlisted fixed interest securities are valued as follows:

15. Statutory insurance deposits continued

	2004 £000	2003 £000
Foreign treasury bills – at market value	**4,520**	4,634
Foreign government debentures – at par and market value	**508**	767
	5,028	5,401

Funding provided by syndicates

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

	2004 £000	2003 £000
Lloyd's market – deposits	**(106,831)**	(107,871)
Allocated:		
Financing of underwriting deposits	**(101,629)**	(102,669)
Working capital	**(5,202)**	(5,202)
	(106,831)	(107,871)

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

The terms and conditions of these advances are governed by the Overseas Underwriting Byelaw (No 2 of 2004) which enables the Council of Lloyd's to vary the amount, term and rate of interest of these loans, as appropriate. The provision of funds by members under this Byelaw is in respect of the establishment and maintenance of overseas deposits and is a condition of permission to underwrite insurance business at Lloyd's.

16. Stocks	2004 £000	2003 £000
Consumables	**461**	467

17. Debtors and prepayments	2004 £000	2003 £000
Due within one year:		
Trade and other debtors	**24,425**	34,280
Dividends receivable from subsidiary companies not consolidated	**7,490**	7,490
Forward foreign exchange asset	**2,256**	3,233
Amounts due from group undertakings	**4,028**	4,028
Group tax relief receivable	**–**	3,664
Corporation tax receivable	**–**	9
Prepayments and accrued income	**10,801**	15,543
Deferred taxation (note 10)	**2,756**	2,668
	51,756	70,915
Due after more than one year:		
Pension scheme prepayment (note 18)	**28,806**	24,318

NOTES TO THE FINANCIAL STATEMENTS continued
as at 31 December 2004

18. Pension scheme
The Corporation of Lloyd's operates a defined benefit pension scheme with assets held in a separately administered fund. For the purposes of determining the funding position of the scheme and future contributions, a formal actuarial valuation of the scheme was carried out by Watson Wyatt LLP, actuaries and consultants, as at 30 June 2004 using the projected unit method. The principal actuarial assumptions adopted in the valuation were that (in real terms relative to retail price inflation), present and future pensions in payment relating to benefits accruing on or after 6 April 1997 would remain constant whilst total pensionable remuneration would increase by 1.8% per annum. The real rate of return on investments held at the valuation date was assumed to be approximately 3.9% whilst the real rate of return on future contributions receivable after the valuation date was assumed to be 4.2%. The total market value of the scheme's assets at the date of valuation was £245m, which equates to 96% of the value placed on the benefits that had accrued to members of £254m, after allowing for assumed future increases in pensionable remuneration. These figures exclude both liabilities and the related assets in respect of money purchase AVCs and in respect of the accrued benefits of scheme members employed by LPSO Limited, LCO Marine Limited and LCO Non-Marine and Aviation Limited. Whilst these companies are participating employers of the scheme, they ceased to be subsidiaries during 2001.

No allowance has been made for discretionary increases to pre 6 April 1997 benefits when in payment. In 2003 the Corporation of Lloyd's instructed Watson Wyatt LLP not to allow for such increases in calculating the scheme's liabilities when carrying out a 2003 interim review and for future actuarial valuations. Such increases have always been payable at the discretion of Lloyd's and will continue to be considered on the basis of affordability, but are no longer taken into account by the actuary in determining the funding level. In November 2003, a discretionary increase of 2.8% for 2004 was awarded, which was funded out of the scheme surplus revealed by an interim actuarial review as at 30 June 2003. In November 2004, a discretionary increase of 3.1% was awarded for 2005. Because the results of the actuarial valuation for funding purposes disclosed a deficit as at 30 June 2004, a contribution of £3.1m was paid by the Corporation of Lloyd's in 2004. This has been charged to the 2004 consolidated revenue account in accordance with the requirements of SSAP24.

The Corporation of Lloyd's has made two special contributions to the Lloyd's Pension Scheme to eliminate the past service deficit of £9m revealed by the actuarial valuation as at 30 June 2004. The first payment of £4.2m was made in December 2004 and a further payment of £4.8m was made in February 2005. The past service deficit having been eliminated, the actuary has determined the contribution rate for the Corporation of Lloyd's in respect of future service from 1 July 2004 should be 21.2% of pensionable pay for existing members. During 2004, and up to February 2005, the Corporation of Lloyd's made contributions to Lloyd's Pension Scheme at a rate of 17% of pensionable salaries. In March 2005 a further contribution of £0.7m was made to reflect the increased contribution rate from 1 July 2004.

Disclosures under SSAP24
For the purposes of SSAP24, the market value of the scheme's assets equated to 112% of the benefits accrued to members, after allowing for assumed future increases in pensionable remuneration but excluding discretionary increases to pensions in payment as referred to above.

The liabilities of the scheme were valued using a discount rate which reflected best estimates of investment returns as at 30 June 2004 of 4.9% (in real terms relative to retail price inflation) rather than the more prudent assumptions adopted for the actuarial valuation carried out for funding purposes. Other assumptions remain unchanged from those noted above.

18. Pension scheme continued

The pension costs charged to the consolidated revenue account are as follows:

	2004 £000	2003 £000
Regular costs	**4,007**	–
Discretionary pension increase	**3,100**	–
Pension augmentation	**680**	–
Other pension costs	**751**	536
	8,538	536

The movement in the pension scheme prepayment included in the consolidated balance sheet is as follows:

	2004 £000	2003 £000
Balance at 1 January	**24,318**	24,318
Regular costs	**(4,007)**	–
Normal contributions	**4,295**	–
Special contributions	**4,200**	–
Balance at 31 December	**28,806**	24,318

The disclosures required in relation to the transitional arrangements within FRS 17 'Retirement benefits' have been based on the most recent formal actuarial review at 30 June 2004 updated to 31 December 2004. The major financial assumptions used by the actuary as at 30 June 2004 for the purposes of FRS 17 were as follows:

	2004 % per annum	2003 % per annum	2002 % per annum
General salary and wage inflation	**4.60%**	4.50%	4.10%
Rate of increase in pensions in payment			
– pre 6 April 1997 (in excess of GMPs)	**–**	–	2.30%
– post 5 April 1997	**2.80%**	2.70%	2.30%
Increases to deferred pensions	**2.80%**	2.70%	2.30%
Discount rate	**5.40%**	5.50%	5.75%
Price inflation	**2.80%**	2.70%	2.30%

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

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

NOTES TO THE FINANCIAL STATEMENTS continued

as at 31 December 2004

18. Pension scheme continued

Asset analysis of the scheme and expected returns	2004 Expected rate of return % per annum	2004 Fair value £m	2003 Expected rate of return % per annum	2003 Fair value £m	2002 Expected rate of return % per annum	2002 Fair value £m
Bonds	**5.0%**	**105**	5.1%	101	5.0%	59
Equities	**8.2%**	**163**	8.3%	140	8.3%	160
Cash and net current assets	**3.6%**	**1**	3.7%	1	3.8%	1
Total market value of assets		**269**		242		220
Actuarial value of liability		**(322)**		(296)		(287)
Deficit in the scheme		**(53)**		(54)		(67)
Related deferred tax asset		**16**		16		20
Net pension liability		**(37)**		(38)		(47)

The table below shows the total reserves of the Corporation as disclosed in the consolidated balance sheet adjusted for the requirements of FRS 17 as at 31 December 2004:

	2004 £m	2003 £m
Total reserves	**122**	70
Exclude SSAP24 pension scheme prepayment	**(29)**	(24)
Net pension liability under FRS 17	**(37)**	(38)
Total reserves including pension liability	**56**	8

Movement in deficit during the year	2004 £m	2003 £m
Deficit in scheme at beginning of the year	**(54)**	(67)
Movement in the year:		
Contributions paid	**13**	–
Current service cost	**(7)**	(5)
Past service cost	**(4)**	(4)
Actuarial (loss)/gain recognised in statement of recognised gains and losses (STRGL)	**(1)**	22
Deficit in scheme before tax	**(53)**	(54)
Deferred tax	**16**	16
Deficit in scheme at end of the year after tax	**(37)**	(38)

18. Pension scheme continued

Analysis of the amount that FRS 17 would require to be recognised in the statement of total recognised gains and losses (STRGL)	2004 £m	2003 £m
Actual return less expected return on pension scheme assets	**11**	19
Experience losses arising on the scheme liabilities	**–**	(3)
Changes in the assumptions underlying the present value of the scheme liabilities	**(12)**	6
Actuarial (loss)/gain	**(1)**	22
Deferred tax movement during the year	**–**	(4)
Actuarial (loss)/gain net of deferred tax recognised in the STRGL	**(1)**	18

The measurement bases set by FRS 17 are likely to give rise to significant fluctuations to the scheme's assets and liabilities. However, this may not necessarily require changes to the contribution rate, as recommended by the independent actuary, which is based on expected long term rates of return.

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

Analysis of the amount charged to operating profit	2004 £m	2003 £m
Current service cost	**7**	5
Past service cost	**4**	4
Total operating charge	**11**	9

Analysis of the amount credited to other finance income	2004 £m	2003 £m
Expected return on pension scheme assets	**16**	16
Interest on pension scheme liabilites	**(16)**	(16)
Net return	**–**	–

History of experience gains and losses	2004	2003	2002
Actual return less expected return on pension scheme assets:			
amount (£m)	**11**	19	(60)
percentage of scheme assets	**3.9%**	7.9%	(27.0%)
Experience gains and losses on scheme liabilities:			
amount (£m)	**–**	(3)	(9)
percentage of the present value of the scheme liabilities	**–**	(1.0%)	(3.2%)
Total amount recognised in the STRGL:			
amount (£m)	**(1)**	22	(57)
percentage of the present value of the scheme liabilities	**(0.3%)**	7.5%	(19.9%)

19. Current asset investments	2004 £000	2003 £000
Short term deposits and certificates of deposit	**46,442**	5,134

20. Creditors – due within one year	2004 £000	2003 £000
Accruals and deferred income	**31,403**	46,698
Forward foreign exchange liability	**1,899**	3,127
Trade and other creditors	**54,686**	44,966
Group tax relief payable	**4,353**	–
Taxation and social security	**4,248**	6,292
Arbitration awards	**2,864**	1,170
	99,453	102,253

NOTES TO THE FINANCIAL STATEMENTS continued

as at 31 December 2004

21. Provisions for liabilities and charges	Long term incentive plan £000	Travel insurance dispute £000	Other provisions £000	2004 Total £000	2003 Total £000
Balance at 1 January	**6,915**	**222**	**259**	**7,396**	4,263
Charged/(credited) to consolidated revenue account	**3,176**	**(156)**	**–**	**3,020**	5,278
Unrealised gain on disposal of subsidiaries	**–**	**–**	**(109)**	**(109)**	–
Utilised in the year	**(3,618)**	**(36)**	**–**	**(3,654)**	(2,145)
Balance at 31 December	**6,473**	**30**	**150**	**6,653**	7,396

Long term incentive plan

The Corporation of Lloyd's operates a long term incentive plan for executive directors and senior employees that is related to the results of the Lloyd's market. This helps to ensure that the objectives of directors and employees are aligned with those of the Lloyd's market. Details of the plan, and changes introduced for 2004, are outlined in the report of the Nominations, Appointments and Compensation Committee on pages 71 to 73. The provision, including employers' National Insurance, for estimated contribution amounts due in respect of the plan is as follows:

	Balance at 1 January £000	Paid in the year £000	Charged/ (released) in the year £000	Balance at 31 December £000
2002 Long term incentive plan	**1,621**	**(859)**	**(651)**	**111**
2003 Long term incentive plan	**5,294**	**(2,759)**	**360**	**2,895**
2004 Long term incentive plan	**–**	**–**	**3,467**	**3,467**
Total provisions	**6,915**	**(3,618)**	**3,176**	**6,473**

Included within the charge for the year are National Insurance contributions of £0.4m (2003: £0.6m).

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

Travel insurance dispute

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

Other provisions

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

22. Notes to the cash flow statement

A Reconciliation of surplus/(deficit) on ordinary activities before finance to operating cash flows	2004 £000	2003 £000
Operating surplus/(deficit)	**19,711**	(18,847)
Depreciation charges	**2,578**	2,620
Profit on sale of fixed assets	**(55)**	(39)
Decrease in stocks	**6**	–
(Increase)/decrease in debtors	**(8,511)**	8,385
Increase/(decrease) in creditors	**13,948**	(384)
(Decrease)/increase in provisions	**(634)**	3,133
	27,043	(5,132)
Premium levy collection	**19,641**	264,374
Transfers to Lloyd's New Central Fund	**(14,571)**	(260,400)
Net cash inflow/(outflow) from operating activities	**32,113**	(1,158)

B Analysis of cash flows for headings netted in the cash flow statement	2004 £000	2003 £000
Returns on investments and servicing of finance:		
Dividends received	**7,490**	2,750
Interest received	**7,196**	5,979
Interest paid	**(523)**	(715)
	14,163	8,014
Capital expenditure and financial investment:		
Purchase of tangible fixed assets	**(2,120)**	(1,801)
Sale of tangible fixed assets	**125**	590
Additional proceeds on sale of the Lloyd's 1958 building	**23,638**	–
	21,643	(1,211)
Acquisitions and disposals of business operations:		
Additional proceeds on sale of businesses	**–**	1,702
Management of liquid resources:		
Purchase of cash deposits	**(352,102)**	(244,891)
Purchase of securities	**(29,701)**	(35,038)
Sale of cash deposits	**299,911**	202,670
Sale of securities	**36,725**	28,692
	(45,167)	(48,567)
Financing:		
Increase in borrowings for insurance deposits	**(7,604)**	53,410
	(7,604)	53,410

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

NOTES TO THE FINANCIAL STATEMENTS continued

as at 31 December 2004

22. Notes to the cash flow statement continued

C Analysis of net funds	At 01.01.04 £000	Cash flow £000	Other movements £000	At 31.12.04 £000
Cash in hand, at bank	47,034	18,869	–	65,903
Overnight deposit (see below, b)	4,605	(2,882)	–	1,723
	51,639	15,987	–	67,626
Current asset investments (see below, a)	5,134	41,308	–	46,442
Other deposits (see below, b)	106,989	6,741	(2,812)	110,918
Debt due within one year:				
Funding provided by syndicates	(107,871)	7,604	(6,564)	(106,831)
	55,891	71,640	(9,376)	118,155

a) Current asset investments comprise short term deposits and certificates of deposit that are not repayable on demand without penalty.

b) Overnight deposits and other deposits relating to the funding of Additional Securities Limited are included in the consolidated balance sheet under statutory insurance deposits.

23. Financial assets and liabilities

Financial instrument risk management

The Corporation's principle financial instruments comprise cash and liquid resources, investments, borrowings, provisions and items that arise directly from operations such as trade debtors and creditors.

Forward foreign exchange contracts are entered into to manage currency and interest rate risks of the Corporation and the Lloyd's group companies, as well as facilitating certain transactions in connection with the Lloyd's market. The Corporation separately provides a Currency Conversion Service (CCS) to participating Lloyd's syndicates.

The Corporation's treasury operations are managed within the formally defined policies which are reviewed regularly by the Lloyd's Investment Committee. Policies for managing these risks are summarised below.

Interest rate risk

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

Liquidity risk

The value and term of short term assets are carefully monitored against those of the Corporation's liabilities. The Corporation aims to maintain sufficient liquid assets to meet liabilities as they fall due. However, a total of £40m of standby committed borrowing facilities, negotiated with leading international banks, was also available to the Corporation as at 31 December 2004 (2003: £40m). There are no plans to utilise these facilities, which are available to meet unforeseen short term requirements and are renewed annually.

23. Financial assets and liabilities continued

Foreign currency risk

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

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

Credit risk

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

Financial assets and liabilities held

Other than short term debtors and creditors, the following material financial assets and liabilities were held at 31 December 2004:

	2004 Book value £000	**2004 Fair value £000**	2003 Book value £000	2003 Fair value £000
Primary financial instruments held or issued to finance operations				
Unhedged statutory insurance deposits	**112,641**	**112,641**	111,594	111,594
Investments	**46,442**	**46,442**	5,134	5,134
Cash and deposits	**65,903**	**65,903**	47,034	47,034
	224,986	**224,986**	163,762	163,762
Other financial assets				
Subsidiary companies not consolidated	**90**	**90**	155	155
Other investments	**9,710**	**9,710**	6,913	6,913
Financial assets	**234,786**	**234,786**	170,830	170,830
Funding provided by syndicates	**(106,831)**	**(106,831)**	(107,871)	(107,871)
Provisions for liabilities and charges	**(6,653)**	**(6,653)**	(7,396)	(7,396)
Financial liabilities	**(113,484)**	**(113,484)**	(115,267)	(115,267)
Net	**121,302**	**121,302**	55,563	55,563
Derivative financial instruments				
Outstanding forward foreign exchange gains	**2,256**	**2,256**	3,233	3,233
Outstanding forward foreign exchange losses	**(1,899)**	**(1,899)**	(3,127)	(3,127)

Outstanding forward foreign exchange contracts are marked-to-market at the year end closing rates to determine the fair value.

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as at 31 December 2004

23. Financial assets and liabilities continued

Funding provided by syndicates consist of annual multicurrency floating rate interest loans and earn interest at various interest rates linked to currency borrowing rates. The currency profile is shown in the currency and interest rate profile table below.

The provisions for liabilities and charges are interest free and denominated in sterling.

The currency and interest rate profiles of the financial assets and liabilities were as follows:

	Financial assets				Financial liabilities				
	2004 Fixed rate £000	2004 Floating rate £000	2004 Interest free £000	2004 Total £000	2004 Fixed rate £000	2004 Floating rate £000	2004 Interest free £000	2004 Total £000	Net £000
Sterling	–	65,185	9,800	74,985	–	–	(6,653)	(6,653)	68,332
United States dollar	–	184	–	184	–	–	–	–	184
Canadian dollar	–	2,688	–	2,688	–	–	–	–	2,688
Japanese yen	–	12,017	–	12,017	–	–	–	–	12,017
Australian dollar	894	26	–	920	–	(941)	–	(941)	(21)
Swiss franc	31,731	17,550	–	49,281	–	(48,908)	–	(48,908)	373
Singapore dollar	–	30,405	–	30,405	–	(29,651)	–	(29,651)	754
Hong Kong dollar	–	22,934	–	22,934	–	(22,482)	–	(22,482)	452
South African rand	–	5,414	–	5,414	–	–	–	–	5,414
Others	5,221	30,737	–	35,958	–	(4,849)	–	(4,849)	31,109
	37,846	187,140	9,800	234,786	–	(106,831)	(6,653)	(113,484)	121,302

	2003 £000	2003 £000	2003 £000	2003 £000	2003 £000	2003 £000	2003 £000	2003 £000	Net £000
Sterling	–	13,263	7,068	20,331	–	–	(7,396)	(7,396)	12,935
United States dollar	–	8,221	–	8,221	–	(2,898)	–	(2,898)	5,323
Canadian dollar	–	3,195	–	3,195	–	–	–	–	3,195
Japanese yen	–	13,471	–	13,471	–	(1,042)	–	(1,042)	12,429
Australian dollar	862	70	–	932	–	(915)	–	(915)	17
Swiss franc	39,211	14,628	–	53,839	–	(54,132)	–	(54,132)	(293)
Singapore dollar	–	19,496	–	19,496	–	(19,569)	–	(19,569)	(73)
Hong Kong dollar	–	18,301	–	18,301	–	(12,885)	–	(12,885)	5,416
South African rand	–	1,446	–	1,446	–	–	–	–	1,446
Cyprus pound	249	2,806	–	3,055	–	(10,353)	–	(10,353)	(7,298)
Others	5,347	23,196	–	28,543	–	(6,077)	–	(6,077)	22,466
	45,669	118,093	7,068	170,830	–	(107,871)	(7,396)	(115,267)	55,563

The average interest rate of the Australian dollar fixed interest security is 7.50% (2003: 9.00%) and the period for which the interest rate is fixed is 4.7 years (2003: 0.7 years). The average interest rate of the Switzerland franc fixed interest securities is 3.67% (2003: 3.83%) and the weighted average period for which the interest rate is fixed is 2.0 years (2003: 1.2 years).

Interest free financial assets represent other investments and investment in subsidiaries not consolidated (see note 14). Interest free financial liabilities represent provisions for liabilities and charges (see note 21).

23. Financial assets and liabilities continued

Borrowing facilities

The maturity profile of the undrawn committed facility is shown below:

	2004 £000	2003 £000
Expiring in one year or less	**40,000**	40,000

Derivative instruments	2004 £000	2003 £000
Cumulative gains unrecognised at 31 December	**2**	9
Gains expected to be recognised in the consolidated revenue account in the following year	**2**	9
Gains recognised in the consolidated revenue account in the current year arising in previous years	**9**	–

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

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

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

24. Reserves	Revaluation reserve £000	Accumulated reserve £000	Total reserves £000	Total 2003 £000
Balance at 1 January	**6,913**	**63,452**	**70,365**	87,151
Total recognised gains/(losses) for the year	**2,797**	**48,720**	**51,517**	(16,786)
Balance at 31 December	**9,710**	**112,172**	**121,882**	70,365

Accumulated reserves attributable to:	2004 £000	2003 £000
Corporation of Lloyd's	**148,025**	89,754
Consolidated subsidiaries	**(41,804)**	(30,392)
Associates	**5,951**	4,090
	112,172	63,452

25. Commitments

a) Capital expenditure commitments

No contractual commitments exist at 31 December 2004 other than those included within the financial statements. The same applied at 31 December 2003.

	2004 Land and buildings £000	2003 Land and buildings £000
b) Operating lease commitments		
The annual commitments under non-cancellable operating leases are as follows:		
Leases expiring:		
Over five years	**16,767**	16,767

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

NOTES TO THE FINANCIAL STATEMENTS continued

as at 31 December 2004

26. Disclosure of related party transactions

In accordance with the exemption allowed by FRS 8 'related party disclosures', transactions with consolidated entities within the group have not been disclosed.

Services provided to Ins-sure Holdings Limited group in the year ended 31 December 2004 included operating systems support and development, premises and other administrative services. The total value of the services provided was £2,716,000 (2003: £4,738,000). In addition, Ins-sure Holdings Limited group have charged the Corporation £1,093,000 for services provided in the same year (2003: £1,077,000).

At 31 December 2004, there was a balance of £332,000 (2003: £921,000) owing from Ins-sure Holdings Limited group to the Corporation. The Corporation owed £15,000 to Ins-sure Holdings Limited at the same date (2003: £8,000).

Services provided to Xchanging Claims Services Limited group in the year ended 31 December 2004 included premises and other administrative services. The total value of the services provided was £2,327,000 (2003: £2,153,000). In addition, Xchanging Claims Services Limited group have charged the Corporation £131,000 for services provided in the same year (2003: £177,000).

At 31 December 2004, there was a balance of £340,000 (2003: £225,000) owing from Xchanging Claims Services Limited group to the Corporation. The Corporation owed £4,000 to Xchanging Claims Services Limited as the same date (2003: £5,000).

Services provided to Centrewrite Limited in the year ended 31 December 2004 included premises and other administrative services. The total value of the services provided was £549,000 (2003: £488,000). Centrewrite Limited did not charge the Corporation for any services in the same year. The same applied for 2003.

At 31 December 2004, there was a balance of £46,000 (2003: £111,000) owing from Centrewrite Limited to the Corporation.

Services provided to Lioncover Insurance Company Limited in the year ended 31 December 2004 included accounting and audit services. The total value of the services provided was £15,000 (2003: £13,000). Lioncover Insurance Company Limited did not charge the Corporation for any services in the same year. The same applied for 2003.

At 31 December 2004, there were no amounts due from Lioncover Insurance Company Limited to the Corporation. The same applied for 2003. The Corporation owed £nil (2003: £15,000) to Lioncover Insurance Company Limited at the same date.

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

There were no other related party transactions in 2004.

27. Contingent liabilities

A) General average guarantees have been given on behalf of, and secured by, Lloyd's underwriters. It is estimated that the aggregate of the liabilities attaching to these guarantees at 31 December 2004 amounted to £9.3m (2003: £6.4m).

B) The Corporation of Lloyd's has given indemnities to Lioncover Insurance Company Limited, Centrewrite Limited and to certain Names under hardship and other agreements in respect of their underwriting losses. The Council has determined that any losses resulting from such indemnities will be met by the Central Fund. The financial statements of the Central Fund on pages 107 to 120 give further details of the indemnities and the exposures arising.

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

			2004 £000	2003 £000
Guarantees provided by the Corporation of Lloyd's:				
USA	US$1,500,000	(2003: US$1,500,000)	**781**	838
Guarantees provided by the Corporation of Lloyd's and Additional Securities Limited:				
Cayman Islands:				
Letter of credit	US$1,000,000	(2003: US$1,000,000)	**521**	559

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

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

F) Three Names have commenced proceedings claiming misfeasance in public office against Lloyd's in respect of an alleged failure to regulate leading to the Names incurring underwriting losses as members of the 1993 accounts of syndicates 103 and 178, the business of which it is claimed was unauthorised and conducted fraudulently by their managing agents. Lloyd's does not accept any liability in respect of this action.

G) In the United States, the reparations action commenced against Lloyd's and others on behalf of descendents of slaves in respect of the insurance of slaves as cargo was dismissed by the US District Court for Northern District Court of Illinois on 26 January 2004. The Plaintiffs subsequently amended their complaint which Lloyd's (and other defendants) have applied to dismiss. The decision of the US District Court is awaited. Lloyd's does not accept any liability in respect of this action.

H) In Quebec, proceedings have been issued by Agence Nationale D'Encadrement Du Secteur Financier as the regulator of the Quebec policyholder protection fund against Lloyd's and other parties arising out of the issue by a coverholder of purported 'policies of insurance' without the authority of the involved Lloyd's syndicate. Lloyd's does not accept any liability in respect of this action.

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

FIVE YEAR SUMMARY

	2000 £000	2001 £000	2002 £000	2003 £000	**2004 £000**
Consolidated revenue account					
Operating income	180,625	161,165	134,896	141,420	**180,453**
Operating expenses:					
Employment	(53,195)	(44,793)	(47,242)	(53,483)	**(60,107)**
Premises	(27,874)	(37,853)	(30,244)	(30,127)	**(30,339)**
Overseas operating expenses	(18,136)	(22,112)	(21,497)	(21,524)	**(20,592)**
Other expenses	(71,961)	(72,586)	(60,171)	(55,133)	**(49,704)**
Operating expenses	(171,166)	(177,344)	(159,154)	(160,267)	**(160,742)**
Operating surplus/(deficit)	9,459	(16,179)	(24,258)	(18,847)	**19,711**
Share of operating profits of associates before exceptional items	–	216	2,873	3,440	**2,736**
Share of exceptional items of associates	–	(495)	–	–	**–**
Amortisation of goodwill of associates	–	(78)	(118)	(118)	**(118)**
Total operating surplus/(deficit)	9,459	(16,536)	(21,503)	(15,525)	**22,329**
Profit on sale of the Lloyd's 1958 building	–	25,069	1,926	–	**23,638**
Profit on disposal of businesses	319	–	–	1,702	**–**
Dividends receivable	–	7,300	2,750	7,490	**7,490**
Finance	(7,064)	2,505	1,874	1,031	**3,956**
Premium levy income	–	–	256,147	260,858	**–**
Transfers to Lloyd's New Central Fund	–	(80,000)	(246,809)	(279,493)	**–**
Market settlement net	97,704	119,997	–	–	**–**
Taxation (charge)/credit	18,198	(491)	1,498	6,651	**(8,802)**
Surplus/(deficit) for the year	118,616	57,844	(4,117)	(17,286)	**48,611**

	Number	Number	Number	Number	**Number**
Average numbers of employees during the year	1,176	825	589	582	**587**

LLOYD'S CENTRAL FUND

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

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

The New Central Fund was established with a transfer of £110m from the 'Old' Central Fund following authorisation by the Council on 4 June 1997. Members contribute to the New Central Fund each year based on a percentage of their allocated overall premium limit, partly by way of annual contribution and, from 2005, partly by way of loan from syndicate premiums trust funds. The annual contribution rate for 2004 was 1.25% (2003: 1%). New corporate members in 2004 underwriting on new syndicates are required to contribute at double the annual rate for their first three years of operations at Lloyd's. The New Central Fund syndicate loans rate is 0.75% of syndicate allocated capacity for the 2005 year of account. It is intended that syndicate loans will ordinarily be repaid on the closure of the year of account after three years.

As part of Lloyd's solvency procedures, assets of the Fund may be used to cover underwriting deficiencies of members at the preceding 31 December to enable them to pass the solvency test and meet the requirements of the Financial Services Authority. Assets may be made available to discharge the underwriting liabilities of members in the event of actual or potential default.

LLOYD'S CENTRAL FUND – INDEPENDENT AUDITOR'S REPORT TO THE COUNCIL OF LLOYD'S

We have audited the financial statements for the year ended 31 December 2004 which comprise the balance sheet, general fund account, cash flow statement and the related notes 1 to 21. These financial statements have been prepared on the basis of the accounting policies set out therein.

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

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

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

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

Opinion
In our opinion the financial statements give a true and fair view of the financial transactions of the Fund for the year ended 31 December 2004 and of the disposition at that date of its assets and liabilities.

Ernst & Young LLP

Ernst & Young LLP, Registered Auditor, London
6 April 2005

LLOYD'S CENTRAL FUND BALANCE SHEET

as at 31 December 2004

	Note	2004 £000	2003 £000
New Central Fund		**515,905**	674,889
'Old' Central Fund		**39,885**	36,156
Total Fund balance	15	**555,790**	711,045
Represented by:			
Investments			
Listed:			
United Kingdom		**517,383**	162,205
Overseas		**428,558**	163,797
Short term deposits		**91,625**	164,987
	6	**1,037,566**	490,989
Current assets			
Debtors	7	**136,112**	358,353
Cash		**16**	48
		136,128	358,401
Total assets		**1,173,694**	849,390
Current liabilities			
Creditors	12	**(19,561)**	(58,516)
Total assets less current liabilities		**1,154,133**	790,874
Creditors – amounts due after more than one year			
Subordinated loan notes	14	**(506,439)**	–
Provisions for liabilities and charges			
Undertakings given to insolvent members	13	**(91,904)**	(79,829)
Net assets		**555,790**	711,045

Signed on behalf of the Council of Lloyd's on 6 April 2005

Lord Levene of Portsoken, Chairman

Nick Prettejohn, Chief Executive Officer

LLOYD'S CENTRAL FUND GENERAL FUND ACCOUNT

for the year ended 31 December 2004

	Note	**New Central Fund 2004 £000**	**'Old' Central Fund 2004 £000**	**Total 2004 £000**	Total 2003 £000
Operating income					
Contribution from members of Lloyd's	5	**190,657**	**–**	**190,657**	159,923
Contribution from Corporation of Lloyd's	5	**–**	**–**	**–**	279,493
Recoveries		**20,114**	**4,564**	**24,678**	5,465
Gain on exchange		**253**	**–**	**253**	–
		211,024	**4,564**	**215,588**	444,881
Operating expenditure					
Refunds of members' special contributions		**(2,608)**	**–**	**(2,608)**	(39,988)
Income Support Schemes		**–**	**(2,193)**	**(2,193)**	(1,622)
Other claims and provisions	8	**(135,493)**	**–**	**(135,493)**	(79,669)
Run-off project costs (incl. provisional liquidators' fees)		**(2,273)**	**–**	**(2,273)**	(3,421)
Insurance premiums and brokerage fees		**–**	**–**	**–**	(16,706)
Legal and professional fees		**(5,570)**	**(10)**	**(5,580)**	(1,282)
Administrative expenses		**(399)**	**(397)**	**(796)**	(817)
Loss on exchange		**–**	**–**	**–**	(267)
		(146,343)	**(2,600)**	**(148,943)**	(143,772)
Settlement of Central Fund arbitration dispute	9	**(323,755)**	**–**	**(323,755)**	–
		(470,098)	**(2,600)**	**(472,698)**	(143,772)
(Deficit)/surplus on ordinary activities before finance		**(259,074)**	**1,964**	**(257,110)**	301,109
Finance					
Dividends and interest receivable		**18,965**	**2,541**	**21,506**	15,477
Surplus on sale and revaluation of investments	6	**13,787**	**550**	**14,337**	13,972
Interest payable and similar charges	10	**(6,676)**	**–**	**(6,676)**	–
		26,076	**3,091**	**29,167**	29,449
(Deficit)/surplus before taxation		**(232,998)**	**5,055**	**(227,943)**	330,558
Taxation credit/(charge)	11	**74,014**	**(1,326)**	**72,688**	(95,750)
Net (decrease)/increase in general fund for the year		**(158,984)**	**3,729**	**(155,255)**	234,808

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

LLOYD'S CENTRAL FUND CASH FLOW STATEMENT

for the year ended 31 December 2004

	Note	2004 £000	2003 £000
Cash inflow from operating activities before claims paid and insurance recoveries	16	**214,028**	380,966
Returns on investments and servicing of finance	17	**9,788**	15,262
Claims paid in respect of corporate members	13	**(137,411)**	(191,137)
Claims paid in respect of individual members	8	**(2,677)**	(4,447)
Cash inflow from operating activities		**83,728**	200,644
Taxation paid		**(56,236)**	(64,238)
Cash inflow before use of liquid resources and financing		**27,492**	136,406
Management of liquid resources	17	**(532,240)**	(136,119)
Financing	17	**504,463**	–
(Decrease)/increase in cash in the year		**(285)**	287
Reconciliation of net cash flow to movement in net funds			
(Decrease)/increase in cash in the year		**(285)**	287
Cash inflow from movement in financing	17	**(504,463)**	–
Cash outflow from movement in liquid resources	17	**532,240**	136,119
Change in net funds resulting from cash flows		**27,492**	136,406
Gain/(loss) on exchange of cash balances		**253**	(267)
Movement in valuation of investments	6	**14,337**	13,972
Movement in valuation of borrowings		**(1,976)**	–
Movement in net funds in the year		**40,106**	150,111
Net funds at 1 January		**491,037**	340,926
Net funds at 31 December	18	**531,143**	491,037

LLOYD'S CENTRAL FUND NOTES TO THE FINANCIAL STATEMENTS

as at 31 December 2004

1. Basis of preparation

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

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

These financial statements summarise the income, expenditure, assets and liabilities of the Fund at 31 December 2004. The liabilities of the Fund include those amounts contractually committed by the Fund and exclude provision for future discretionary payments. The financial statements therefore do not take account of claims approved after the balance sheet date or future payments that may be made to cover underwriting losses of individual Names except to the extent that the Central Fund is contractually committed to make such payments under hardship and other agreements. No value has been assumed for the assets pledged by hardship Names under the terms of their hardship agreements.

FRS 13 'Derivatives and other financial instruments – disclosures' has been fully adopted in these financial statements including prior year comparatives (see note 19). In prior years, FRS 13 did not apply to the Central Fund. There has been no impact on the primary financial statements as a result of providing the additional disclosures.

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

2. Principal accounting policies

A Investments

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

B Dividends and interest

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

C Claims and recoveries

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

Insurance recoveries arise from the operation of the New Central Fund insurance contract, which is described in note 9. The contract provided that where the New Central Fund has been applied to meet members' cash calls in respect of any one year, the New Central Fund is entitled to a matching recovery of the claim paid (a 'qualifying debt'), subject to the policy terms. Consequently, insurance recoveries are accounted for when a qualifying debt has been paid or is expected to be paid when undertakings (see note 3) have been given, in accordance with the principles of the Statement of Recommended Practice on Accounting for Insurance Business. The New Central Fund insurance contract commenced in 1999 and expired on 31 December 2003. However, insurers disputed their liability to meet the claims made under the policy and Lloyd's commenced arbitration proceedings in April 2003. A settlement was reached with all of the insurers on 14 March 2005 and the financial effect has been fully reflected in these financial statements.

Recoveries, other than insurance recoveries, in respect of claims approved are credited to the general fund account when contractually committed to be received. This is a change in accounting policy as recoveries were previously accounted for on a received basis. No amounts were receivable at 31 December 2003 and therefore no prior year adjustment is required.

D Loans and provisions

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

E Foreign currency

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

LLOYD'S CENTRAL FUND NOTES TO THE FINANCIAL STATEMENTS continued

as at 31 December 2004

2. Principal accounting policies continued

F Taxation

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

G Subordinated loan notes

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

After initial recognition, the loan notes are subsequently recorded at amortised cost on a straight-line basis over the period to the earliest option date. Amortised cost is calculated by taking into account issue costs and issue discount.

3. Solvency shortfalls

As part of Lloyd's solvency procedures, wherever there is a shortfall in comparing a member's Lloyd's assets with liabilities at the preceding year end, sufficient central and other assets are identified to enable the member to pass the solvency test and meet the requirements of the Financial Services Authority. The results of the 2004 solvency test will not be determined until June 2005.

The Council of Lloyd's has given undertakings with financial limits to certain corporate members to use the New Central Fund to discharge the liability of those members where they have unpaid cash calls and do not have the resources to meet those cash calls. The purpose of these undertakings is primarily to allow valid claims made on policies underwritten by insolvent members to continue to be paid in full as and when the claims fall due. Provision has been made for these undertakings on the basis that they represent contractual commitments (see note 13). Unutilised undertakings as at 31 December 2004 were £91.9m. By 31 March 2005 this balance had been reduced to £5.0m by the payment of claims of £26.4m and the expiry of undertakings totalling £60.5m, which had been given in 2004. Those undertakings which expired have been replaced and further undertakings have been given on 6 April 2005 that total £277.0m, a net increase of £216.5m. No provision has been included in these financial statements in respect of these further undertakings.

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

4. Contingent liabilities

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

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

5. Contributions to New Central Fund

New Central Fund contributions from members amounted to £190.7m in 2004 (2003: £159.9m). There were no contributions from the Corporation of Lloyd's during the year (2003: £279.5m in respect of a premium levy which ceased at the end of 2003).

Contributions from members	2004 £000	2003 £000
Individual members	**23,363**	18,374
Corporate members	**167,294**	141,549
	190,657	159,923

6. Investments	2004 £000	2003 £000
Movement in the year:		
Market value at 1 January	**490,989**	340,898
Additions at cost	**834,420**	117,270
(Decrease)/increase in short term deposits	**(70,636)**	66,984
Proceeds from disposals	**(231,544)**	(48,135)
Surplus on sale and revaluation of investments	**14,337**	13,972
Market value at 31 December	**1,037,566**	490,989
Analysis of securities at year end:		
Listed on London Stock Exchange:		
Fixed interest	**380,566**	60,513
Equities	**136,817**	101,692
	517,383	162,205
Listed on overseas stock exchanges:		
Fixed interest	**307,651**	72,763
Equities	**120,907**	91,034
	428,558	163,797
Short term deposits	**91,625**	164,987
	1,037,566	490,989

7. Debtors	2004 £000	2003 £000
Corporation tax	**84,654**	–
Group tax relief receivable	**7,366**	–
Interest and dividends receivable	**14,768**	3,050
Insurance policy claim receivable (notes 9 and 13)	**18,643**	326,538
Deferred taxation (note 11)	**2,915**	6,840
Other debtors and prepayments	**7,766**	21,925
	136,112	358,353

8. Other claims and provisions	2004 £000	2003 £000
Provision for amounts paid and payable under undertakings given to insolvent members (note 13)	**132,816**	75,541
Claims paid in respect of individual members	**2,677**	4,447
Release of provision against loans to syndicates	**–**	(319)
	135,493	79,669

LLOYD'S CENTRAL FUND NOTES TO THE FINANCIAL STATEMENTS continued

as at 31 December 2004

9. Settlement of Central Fund arbitration dispute	2004 £000	2003 £000
Insurance policy claim receivable written off (note 13)	324,582	–
Cancellation of premiums payable	(827)	–
	323,755	–

In 2002, insurers of the New Central Fund disputed their liability to meet the claims made under the policy. Lloyd's commenced arbitration proceedings on 2 April 2003 under the terms of the policy for recovery of the sums claimed from the insurers. As at 31 December 2004 Lloyd's considered it was entitled to claim £477m under the policy in respect of cash calls made in 2002 and 2003. The insurers had paid £134m during 2002, subject to a reservation of their rights made by certain insurers in respect of these claims.

On 14 March 2005, Lloyd's reached a settlement with all of the insurers involved. The settlement provides that the insurers agree to pay total claims under the policy of £152m which includes amounts previously paid under the policy terms.

The net effect of the settlement of the dispute on the financial statements as at 31 December 2004 has been to decrease the net assets of the Central Fund by £323.8m offset by a related tax credit of £97.1m.

10. Interest payable and similar charges	2004 £000	2003 £000
Interest payable on subordinated loan notes wholly repayable after more than five years	3,981	–
Amortisation of issue costs and unwinding of discount on issue of subordinated loan notes	65	–
	4,046	–
Unrealised exchange loss on retranslation of subordinated loan notes	2,630	–
	6,676	–

11. Taxation	New Central Fund 2004 £000	'Old' Central Fund 2004 £000	Total 2004 £000	Total 2003 £000
(a) Analysis of charge in year				
Current tax:				
UK corporation tax based on (deficit)/surplus for the year at 30% (2003: 30%)	**62,009**	**–**	**62,009**	(84,683)
Current year group relief	**12,601**	**(1,326)**	**11,275**	(3,659)
Adjustments in respect of previous years	**3,329**	**–**	**3,329**	(533)
Total current tax (note 11(b))	**77,939**	**(1,326)**	**76,613**	(88,875)
Deferred tax:				
Origination and reversal of timing differences	**(3,925)**	**–**	**(3,925)**	(6,875)
Taxation credit/(charge)	**74,014**	**(1,326)**	**72,688**	(95,750)
(b) Factors affecting tax charge for year				
The tax assessed for the year is lower than the standard rate of corporation tax in the UK of 30% The differences are explained below:				
(Deficit)/surplus before taxation	**(232,998)**	**5,055**	**(227,943)**	330,558
(Deficit)/surplus before taxation multiplied by standard rate of corporation tax in the UK of 30% (2003: 30%)	**69,899**	**(1,517)**	**68,382**	(99,167)
Non-taxable income	**4,711**	**191**	**4,902**	7,506
Utilisation of tax losses	**–**	**–**	**–**	3,319
Adjustments in respect of previous years	**3,329**	**–**	**3,329**	(533)
Current tax credit/(charge) for year (note 11(a))	**77,939**	**(1,326)**	**76,613**	(88,875)
(c) Provision for deferred tax				
Revaluation of investments	**2,915**	**–**	**2,915**	6,840
Deferred tax asset at 31 December	**2,915**	**–**	**2,915**	6,840
At 1 January	**6,840**	**–**	**6,840**	13,715
Deferred tax charge on revaluation of investments (note 11(a))	**(3,925)**	**–**	**(3,925)**	(6,875)
At 31 December (note 7)	**2,915**	**–**	**2,915**	6,840

12. Creditors	2004 £000	2003 £000
Corporation tax	**–**	37,170
Group tax relief payable	**–**	3,659
Amounts due to group undertakings	**4,007**	4,007
Other creditors and accruals	**9,871**	11,945
Income Support Schemes	**1,702**	1,735
Interest payable on subordinated loan notes	**3,981**	–
	19,561	58,516

Under the terms of the Income Support Scheme and the Hardship Income Top-Up Scheme, the Central Fund has a commitment in respect of Support Scheme payments approved by the Council of Lloyd's for 2005. These amounts are provided for at 31 December 2004.

LLOYD'S CENTRAL FUND NOTES TO THE FINANCIAL STATEMENTS continued

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13. Provision for undertakings given to insolvent members

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

The aggregate amount of all undertakings (excluding the supporting commitment) given by the Council at 31 December 2004 was £925m of which £833m had been paid by that date.

Undertakings	2004 £000	2004 £000	2003 £000	2003 £000
Provisions for amounts payable at 1 January		**79,829**		85,110
Undertakings given in the year		**149,486**		185,856
Analysis of paid undertakings by member:				
Blodget and Hazard Limited	**(3,698)**		(3,160)	
Cotesworth Capital Limited (in provisional liquidation)	**(12,827)**		(50,920)	
Crowe Corporate Capital Limited	**(1,208)**		(2,284)	
Crowe Dedicated Limited	**(8,568)**		(29,462)	
Dreason Underwriting Limited	**(699)**		–	
Duncanson & Holt Underwriters Limited	**(23,193)**		(51,921)	
Grenville Underwriting I/II/III Limited	**(23,512)**		–	
Jago Capital Limited	**(3,608)**		–	
Margent Capital Management Limited (in provisional liquidation)	**(539)**		(500)	
Newmarket Corporate Member Limited (in provisional liquidation)	**–**		(19,580)	
North American London Underwriters Limited	**(1,304)**		(6,443)	
Riverside Corporate Underwriters Limited (in provisional liquidation)	**(858)**		(1,007)	
Shrewsbury Underwriting Capital (Bermuda) Limited and Shrewsbury Underwriting Capital Limited	**(50,000)**		(15,903)	
Standfast Corporate Underwriters Limited*	**(5,405)**		(7,757)	
Winford Company Limited	**(602)**		–	
Other corporate members	**(1,390)**		(2,200)	
Paid during the year		**(137,411)**		(191,137)
Provision for amounts payable at 31 December		**91,904**		79,829

Paid undertakings are disclosed by corporate member where the amounts in any one year exceed £500,000. If below this amount members are grouped together.

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

13. Provision for undertakings given to insolvent members continued	2004 £000	2004 £000	2003 £000	2003 £000
Insurance policy claim receivable				
At 1 January		**326,538**		216,223
Undertakings given in the year	**149,486**		185,856	
Less: drawdowns made against undertakings during the year under the 2003 policy excess where not previously provided	**–**		(14,890)	
Less: drawdowns made against undertakings during year in excess of 2002 policy limits	**–**		(4,085)	
Less: drawdowns made against undertakings during year not subject to the insurance policy	**(50,403)**		–	
Less: balance of undertakings falling due after 31 December either not subject to the insurance policy or up to the amount of the insurance policy excess	**(89,483)**		(56,566)	
Recoveries made or receivable under the insurance policy	**7,087**		–	
		16,687		110,315
		343,225		326,538
Insurance policy claim receivable written off (note 9)		**(324,582)**		–
Insurance policy claim receivable at 31 December (note 7)		**18,643**		326,538
Charge to general fund account				
Drawdowns made against undertakings during the year under the 2003 policy excess where not previously provided		**–**		14,890
Drawdowns made against undertakings during the year in excess of 2002 policy limits		**–**		4,085
Drawdowns made against undertakings during year not subject to the insurance policy		**50,403**		–
Balance of undertakings falling due after 31 December either not subject to the insurance policy or under the Central Fund insurance policy excess		**89,483**		56,566
Less: recoveries made or receivable under the insurance policy		**(7,087)**		–
Drawdowns made that are not covered by undertakings		**17**		–
		132,816		75,541

14. Subordinated loan notes	2004 £000	2003 £000
Details of loans payable wholly or partly after more than five years:		
6.875% subordinated notes of £300m maturing 17 November 2025	**300,000**	–
5.625% subordinated notes of €300m maturing 17 November 2024	**212,389**	–
	512,389	–
Less: issue costs to be charged in future years (note 2G)	**(3,722)**	–
Less: discount on issue to be unwound in future years (note 2G)	**(2,228)**	–
	506,439	–

On 17 November 2004, the Society of Lloyd's issued two tranches of subordinated debt, a £300m tranche which carries a coupon of 6.875% (the 'Sterling Notes') and a €300m tranche which carries a coupon of 5.625% (the 'Euro notes' and together with the Sterling Notes, the 'Notes').

The Sterling Notes mature on 17 November 2025, however, the Society of Lloyd's may redeem them at 17 November 2015 and 17 November 2020. In the event that the Society does not redeem the Sterling Notes on 17 November 2015, the rate of interest payable will be the rate per annum which is the aggregate of the Gross Redemption Yield on the relevant Benchmark Gilt (a United Kingdom government security having a maturity date on or nearest to the next reset date) plus a margin of 3.07%.

The Euro Notes mature on 17 November 2024, however, the Society of Lloyd's may redeem them at 17 November 2014 or on any interest payment date thereafter. In the event that the Society does not redeem the Euro notes on 17 November 2014, the rate of interest payable will be three-month Euribor plus a margin of 2.72%.

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14. Subordinated loan notes continued

The Notes are subordinated obligations of the Society. Each tranche of the Notes will rank *pari passu* with the other in a winding-up of the Society of Lloyd's. Upon the occurrence of any winding-up proceedings of the Society, payments on the Notes will be subordinated in right of payment to the prior payment in full of all other liabilities of the Society, except for liabilities which rank equally with or junior to the Notes. Payments on the Notes will also be subordinated to certain payments which may be made out of central assets including payments made to discharge the liabilities of an insolvent member to any person (including any policyholders) arising out of or in connection with insurance business carried on at Lloyd's by that insolvent member and payments made in respect of the costs required by or under any insolvency procedure to which the Society or the Lloyd's market may be subject.

However, in the event of a winding-up of the Society, the claims of the holders of the Notes rank senior to the Society's obligations to members under the New Central Fund Syndicate Loans (which commenced on 1 April 2005) and also in priority to the distribution of any central assets to members of Lloyd's generally (other than payments made to members in their capacity as senior creditors of the Society).

15. Total Fund balance	New Central Fund £000	'Old' Central Fund £000	Total £000
Balance at 1 January 2004	674,889	36,156	711,045
(Decrease)/increase in general fund for the year	(158,984)	3,729	(155,255)
Balance at 31 December 2004	515,905	39,885	555,790

16. Reconciliation of (deficit)/surplus on ordinary activities before finance to operating cash flows before claims paid and insurance recoveries	2004 £000	2003 £000
Operating (deficit)/surplus	(257,110)	301,109
Undertakings given to insolvent members (note 13)	149,486	185,856
Decrease/(increase) in insurance claim receivable	307,895	(110,315)
Claims paid in respect of individual members	2,677	4,447
Decrease/(increase) in other debtors	14,159	(9,401)
(Gain)/loss on exchange	(253)	267
(Decrease)/increase in creditors	(2,826)	9,003
Net cash inflow from operating activities before claims paid and insurance recoveries	214,028	380,966

17. Analysis of cash flows for headings netted in the cash flow statement	2004 £000	2003 £000
Returns on investments and servicing of finance:		
Dividends and interest received	9,788	15,262
Net cash outflow from returns on investments and servicing of finance	9,788	15,262
Management of liquid resources:		
Purchase of fixed interest securities and short term deposits	(782,561)	(128,371)
Purchase of equities	(51,859)	(55,883)
Sale of fixed interest securities and short term deposits	302,180	48,135
Net cash outflow from management of liquid resources	(532,240)	(136,119)
Financing:		
Issue of 6.875% subordinated note of £300m maturing 17 November 2025, net of issue costs	296,904	–
Issue of 5.625% subordinated notes of €300m maturing 17 November 2024, net of issue costs	207,559	–
Net cash inflow from financing	504,463	–

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

18. Analysis of net funds	At 01.01.04 £000	Cash flow £000	Loan note issue and discount costs £000	Other movements £000	At 31.12.04 £000
Cash at bank	48	(285)	–	253	16
Debt due after one year	–	(504,463)	654	(2,630)	(506,439)
Current investments	490,989	532,240	–	14,337	1,037,566
	491,037	27,492	654	11,960	531,143

Other movements include realised and unrealised exchange differences arising on the revaluation of foreign currency operating cash flows, investments and borrowings.

19. Financial assets and liabilities

Financial instrument risk management

The Central Fund's principal financial instruments comprise cash and liquid resources, investments, provisions, subordinated loan notes and items that arise directly from operations such as trade debtors and creditors.

The Corporation's treasury operations are managed within the formally defined policies which are reviewed regularly by the Lloyd's Investment Committee. Policies for managing these risks of the Central Fund are summarised below.

Interest rate risk

During the year, the Society issued capital market debt of £300m and €300m at fixed rates of interest. The subordinated loan notes have call options attached at different reset dates. Depending on whether the Society calls the notes on the first reset date will determine the rates of interest payable (see note 14). Interest rate risk in respect of this exposure is managed by investing assets within Lloyd's Central Fund to immunise the liability represented by the debt instrument.

Liquidity risk

The value and term of assets are carefully monitored against those of the Central Fund's liabilities. The Central Fund aims to maintain sufficient liquid assets to meet liabilities as they fall due. However, the Central Fund assets may be supplemented by an extra 3% of members' current overall premium limits callable from members' premiums trust funds (2003: 3%). This facility is available to meet unforeseen short term requirements and is renewed annually.

Foreign currency risk

The Central Fund enters into foreign exchange transactions in response to the foreign currency requirements.

Credit risk

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

Financial assets and liabilities held

Other than short term debtors and creditors, the following material financial assets and liabilities were held at 31 December 2004:

	2004 Book value £000	2004 Fair value £000	2003 Book value £000	2003 Fair value £000
Primary financial instruments held or issued to finance operations				
Investments	1,037,566	1,037,566	490,989	490,989
Cash and deposits	16	16	48	48
Financial assets	1,037,582	1,037,582	491,037	491,037
Subordinated loan notes	(506,439)	(506,439)	–	–
Undertakings given to insolvent members	(91,904)	(91,904)	(79,829)	(79,829)
Financial liabilities	(598,343)	(598,343)	(79,829)	(79,829)
Net	439,239	439,239	411,208	411,208

The terms of the subordinated loan notes are set out in note 14.

The provisions for liabilities and charges are interest free and denominated in sterling.

LLOYD'S CENTRAL FUND NOTES TO THE FINANCIAL STATEMENTS continued

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19. Financial assets and liabilities continued

The currency and interest rate profiles of the financial assets and liabilities were as follows:

	Financial assets				Financial liabilities				
	2004 Fixed rate £000	2004 Floating rate £000	2004 Interest free £000	2004 Total £000	2004 Fixed rate £000	2004 Floating rate £000	2004 Interest free £000	2004 Total £000	Net £000
Sterling	**380,566**	**309,677**	**–**	**690,243**	**(296,581)**	**–**	**(91,904)**	**(388,485)**	**301,758**
United States dollar	**79,507**	**34,848**	**–**	**114,355**	**–**	**–**	**–**	**–**	**114,355**
Euro	**228,144**	**4,840**	**–**	**232,984**	**(209,858)**	**–**	**–**	**(209,858)**	**23,126**
	688,217	**349,365**	**–**	**1,037,582**	**(506,439)**	**–**	**(91,904)**	**(598,343)**	**439,239**
	2003 £000	2003 £000	2003 £000	2003 £000	2003 £000	2003 £000	2003 £000	2003 £000	Net £000
Sterling	60,512	352,925	–	413,437	–	–	(79,829)	(79,829)	333,608
United States dollar	51,846	3,757	–	55,603	–	–	–	–	55,603
Euro	20,917	1,080	–	21,997	–	–	–	–	21,997
	133,275	357,762	–	491,037	–	–	(79,829)	(79,829)	411,208

The average interest rate of the sterling fixed interest securities is 5.43% (2003: 6.18%) and the weighted average period for which the interest rate is fixed is 9.3 years (2003: 5.6 years). The average interest rate of the United States dollar fixed interest securities is 4.87% (2003: 6.06%) and the weighted average period for which the interest rate is fixed is 6.0 years (2003: 5.7 years). The average rate of the Euro fixed interest securities is 4.39% (2003: 4.87%) and the weighted average period for which the interest rate is fixed is 9.1 years (2003: 5.0 years).

Interest free financial liabilities represent undertakings given to insolvent members (see note 13).

Borrowing facilities

There are no undrawn committed borrowing facilities as at 31 December 2004. The same applied as at 31 December 2003.

20. Tutelle Limited

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

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

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

Tutelle's position is under biennial review and, having been reviewed in June 2004, will be reviewed again in June 2006. The security may continue for a period of up to 80 years. Any of the funds remaining after this period will be repaid to the 'Old' Central Fund.

21. Lioncover Insurance Company Limited

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

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