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SECURITY UNDERLYING POLICIES ISSUED AT LLOYD'S

as at 31 December 2004

Summary

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

There are 62 syndicates registered to conduct business at Lloyd's in 2005. Each syndicate is managed by a managing agent. Managing agents write insurance business on behalf of the member(s) of the syndicate, who receive profits or bear losses in proportion to their share in the syndicate.

Every member underwriting at Lloyd's in 2005 is subject to an annual risk assessment, based on Lloyd's risk-based capital methodology. This determines a member's capital requirement subject to prescribed minimum levels.

The Lloyd's chain of security

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

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

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

First link

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

Premiums Trust Funds and overseas regulatory deposits*: £21,873m

Second link

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

Capital held at Lloyd's*: £9,622m

Third link

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

Individual members' other declared assets*: £219m

Fourth link

The Central Fund is available to meet any portion of any member's liabilities that the member is unable to meet in full. The Council is also able to call from members' premiums trust funds (first link) an amount up to 3% of members' premium limits in aggregate, in any one year (the callable layer). In addition, the other assets of the Corporation, totalling £122m, are available to meet underwriting liabilities in the last resort.

Lloyd's central assets excluding the subordinated debt liability and the callable layer*: £1,184m

* as at 31 December 2004

The first link

The first link in the chain of security is the members' premiums trust funds, and other assets held in trust at syndicate level. To protect the interests of policyholders, all premiums and other monies received or receivable in connection with the members' underwriting business are initially paid into the premiums trust funds, managed by the managing agent of the syndicate concerned. Payments from these funds may only be made to meet permitted trust outgoings: claims, reinsurance premiums, underwriting expenses and the like, including funding overseas regulatory deposits. Profit is not distributed until provision has been made for all outstanding liabilities. Continuous solvency transfers (CSTs) on open years of account, to the extent permitted by reference to the cumulative annual accounting result up to 31 December 2004, may be applied to meet cash calls and loss payments. Any CSTs not used will be held in the members' personal reserve funds and will be available for release to members subject to the Release Test calculations to be conducted later in 2005.

SECURITY UNDERLYING POLICIES ISSUED AT LLOYD'S continued

as at 31 December 2004

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

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

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

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

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

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

The total value of all the above funds was £21,873m in aggregate, at 31 December 2004.

The second link

The second link is members' funds at Lloyd's. Funds at Lloyd's comprise the three trust funds in which members' assets may be held: the Lloyd's deposit, the special reserve fund and the personal reserve fund held under the terms of the premiums trust

deed. These are each available to meet cash calls made on the member in respect of a syndicate. The assets in funds at Lloyd's must be readily realisable, may include letters of credit and bank and other guarantees, and must be at least equivalent to the aggregate of the member's net funds at Lloyd's requirement and certain liabilities in respect of his underwriting business. Each member's net funds at Lloyd's requirement to support his underwriting at Lloyd's is determined using Lloyd's risk-based capital methodology. As at 31 December 2004, the total value of funds at Lloyd's held in trust by members amounted to £9,622m.

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

The third link

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

Individual members who show a minimum level of personal wealth (i.e. funds at Lloyd's and other personal wealth) of £350,000 may reduce their net funds at Lloyd's requirement by the amount of declared other personal wealth. This credit is limited to 10% of the member's net funds at Lloyd's requirement and must not reduce the net funds at Lloyd's below 35% of premium limit. The aggregate value of personal wealth declared to Lloyd's by individual members, not counting their funds at Lloyd's, was £219m at 31 December 2004. In addition, individual members of Lloyd's have other assets, not declared to Lloyd's, which are available to meet claims.

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

The fourth link

The fourth link includes the Central Fund assets resulting from annual contributions made by all members. The New Central Fund has been established to be available, at the discretion of the Council of Lloyd's, to ensure that policyholders' claims are met in the event of members being unable to meet their underwriting liabilities relating to 1993 and post non-life business and all life business. In practice this entails the payment of syndicate cash calls where a member is unable to do so from his funds at Lloyd's or his own resources. The net assets of the Central Fund as at 31 December 2004 were £556m.

In late 2004, Lloyd's placed subordinated loan notes amounting to £506m in value, which are reflected as an asset and a liability within the Central Fund financial statements. As set out in note 14 to the Central Fund financial statements, payments on the notes are subordinated to certain payments which may be made out of central assets including payments made to discharge the liabilities of an insolvent member to any person (including any

policyholders) arising out of or in connection with insurance business carried on at Lloyd's by that insolvent member.

Central Fund assets may be supplemented by an amount not exceeding 3% of members' overall premium limits callable in any one calendar year from members' premiums trust funds (described and included in the first link). Additional information regarding the Central Fund is contained on pages 107 to 120.

In addition, the other assets of the Corporation, totalling £122m at 31 December 2004, are available to meet underwriting liabilities in the last resort.

In aggregate, the value of Lloyd's central assets (excluding the subordinated debt liability and the callable layer) amounted to £1,184m at 31 December 2004.

Aggregate resources

Taken together with the total declared members' qualifying assets, the aggregate resources of all members of Lloyd's and those of the Society declared as at 31 December 2004 were £32.9bn. The total amount of estimated current and future liabilities at the end of 2004, was £19.3bn. The aggregate declared resources of the Society and its members were equivalent to 171% of the provision for current and future liabilities.

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

Solvency controls

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

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

The annual solvency process requires the managing agent of each syndicate to estimate and provide for all current and future liabilities for each year of account. These liabilities (i.e. solvency reserves) are subject to a statement of actuarial opinion. In the event that it is not possible for the managing agent to secure an unqualified actuarial opinion for any reason, the solvency reserves would be determined by the Lloyd's Actuary, who would provide a report to the Financial Services Authority (FSA). In addition, any syndicate which is not able to secure an unqualified actuarial opinion will normally be subject to a

monitoring review by Lloyd's. There were no qualified actuarial opinions at 31 December 2004.

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

First, each member's solvency position is calculated. Each member must have sufficient assets – those held in the premiums trust funds, overseas regulatory deposits and his funds at Lloyd's – to cover his underwriting liabilities and on top of this an additional solvency margin. The solvency margin is calculated separately for each member, determined essentially as the greater of 16% of total annual premium income or 23% of average claims incurred over a three-year period. With effect from 1 January 2004, premiums and claims in respect of certain types of liability business have their value increased by 50%, for the purpose of this calculation. Where a member's assets are not sufficient to cover the aggregate of his underwriting liabilities and his solvency margin, the member has a solvency shortfall.

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

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

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

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

SECURITY UNDERLYING POLICIES ISSUED AT LLOYD'S: FINANCIAL DATA

as at 31 December 2004

	2004 £m	2003 £m
I Calendar year premium income		
Before ceded reinsurance		
a) before brokerage and commission (note 2)	14,573	15,193
b) after brokerage and commission (note 3)	11,622	12,132
After ceded reinsurance		
a) before brokerage and commission	12,040	11,743
b) after brokerage and commission	9,089	8,682
II Balances on open underwriting and run-off years (note 4)	21,873	18,995
III Members' qualifying assets		
Funds at Lloyd's:		
Deposits	8,976	9,102
Personal reserves	636	541
Special reserves	10	16
	9,622	9,659
Analysed by:		
Individual members	1,426	1,598
Corporate members	8,196	8,061
	9,622	9,659
Members' other qualifying assets	219	278
Total members' qualifying assets	9,841	9,937
IV Total net resources of the Society of Lloyd's and its members		
Balances on open underwriting and run-off years	21,873	18,995
Total members' qualifying assets	9,841	9,937
Total resources of members	31,714	28,932
Net Central Fund assets (note 5)	556	711
Subordinated debt (note 6)	506	–
Net assets of the Corporation of Lloyd's	122	70
Total resources of the Society of Lloyd's and its members	32,898	29,713
Provision for current and future liabilities (note 7)	(19,277)	(18,120)
Total net resources of the Society of Lloyd's and its members	13,621	11,593
V Ratios		
Total net resources as a percentage of premium income (before brokerage and after ceded reinsurance)	113%	99%
Total resources as a percentage of provision for liabilities	171%	164%

NOTES

Note 1

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

Note 2

Calendar year premium income is arrived at after deducting inter-syndicate reinsurances of £466m (2003: £644m). The inter-syndicate claims paid were £306m (2003: £388m).

Note 3

The average deduction for brokerage and commission across all markets has been estimated at 20.3% (2003: 20.2%).

Note 4

Balance on open underwriting and run-off years.

	2004 £m	2003 £m
Balance on open underwriting accounts	17,380	16,244
Reserves retained in respect of run-off years of account	4,594	4,822
Result for 2002 and prior years of account	1,193	(2,378)
Cash calls made in advance	23	989
Continuous solvency transfer	(816)	(392)
Net uncalled deficiency on run-off years	(501)	(290)
	21,873	18,995

The balances on open underwriting years consist of the underwriting balances in respect of the two open years of account, including the premiums received for the reinsurance to close earlier years of account and are stated after deduction of personal expenses relating to these years.

Note 5

The net Central Fund assets at 31 December 2004 of £556m (2003: £711m) are as shown in the Central Fund financial statements (see page 108).

Note 6

Further information on the subordinated debt is set out at note 14 on page 117 of the Central Fund financial statements. Repayments to note holders are subordinated to payments which may be required to meet liabilities of insolvent members, i.e. to meet policyholder claims.

Note 7

The provision for current and future liabilities includes a provision for amounts which have been called by 31 December 2004 but remain outstanding of £101m (2003: £101m).