Report & Accounts

for the year ended 31 March 1998

Financial progress

The Equitas Group was formed to reinsure and run off the 1992 and prior years' non-life liabilities of Lloyd's syndicates. This report documents the progress which Equitas has achieved during the financial year ended 31 March 1998:

- Paid claims, including operating costs, amounted to £2.2 billion.
- Reinsurance recoveries amounted to £660 million.
- Investment return totalled £932 million.
- Surplus increased by £101 million to £718 million.
- The Group's solvency margin (the ratio of surplus to net outstanding liabilities) increased to 8.5 per cent from 7.1 per cent at 31 March 1997.

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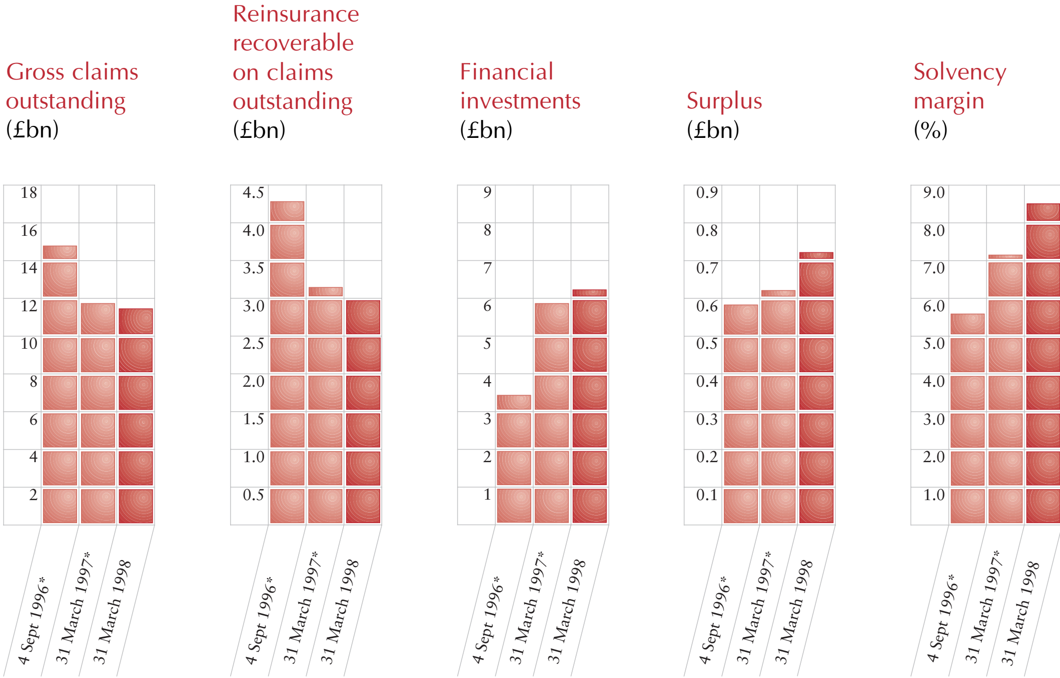
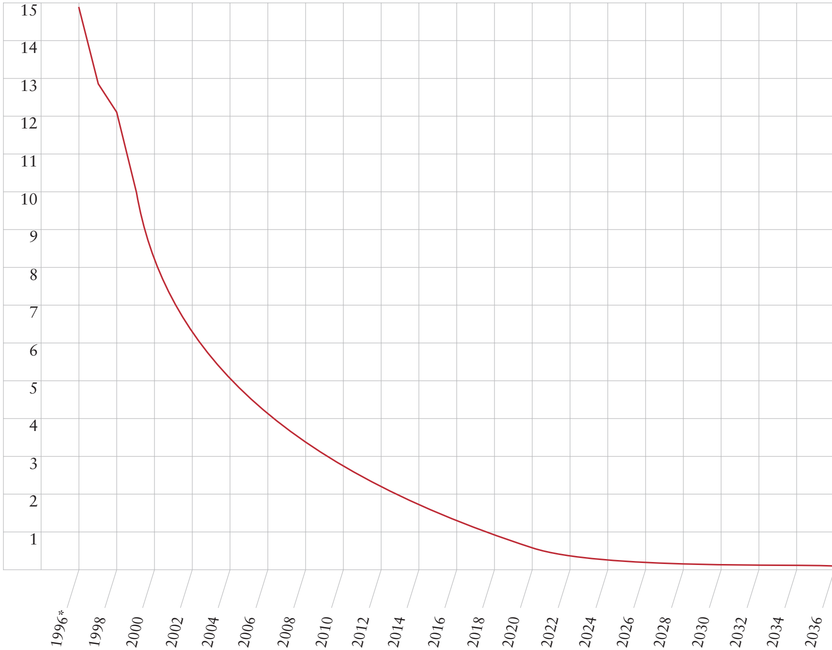
Financial overview





*Does not include Lioncover business

Chairman's statement

From left:
David Newbigging,
Chairman;
Hugh Stevenson,
Chairman-Designate;
Michael Crall,
Chief Executive Officer

I am pleased to report that Equitas has made good progress during the financial year ended 31 March 1998, the period covered by these financial statements.

The Group's financial results have consistently exceeded the original projections since 3 September 1996, the date on which Equitas Reinsurance Limited and Equitas Limited accepted the reinsurance and retrocession obligations and began running off the 1992 and prior years' liabilities of Lloyd's non-life syndicates (other than the liabilities of Lioncover Insurance Company Limited). Furthermore, in the two years since we 'went live', Equitas has developed into a professional, cost-efficient organisation which is proving capable of successfully running off the liabilities it has reinsured. Whilst it will take many years to determine whether Equitas can be declared an unqualified success, we are encouraged by the progress to 31 March this year and in the five subsequent months to the date of this report.

In conjunction with these financial statements we have carried out a comprehensive review of our outstanding liabilities, taking independent professional advice where appropriate, which built on the information we took over from the Lloyd's Reserving Project two years ago. Based on our experience generally and on claims payments and reinsurance recoveries in particular, the review concluded that some reserves from some classes of business were conservative whilst others needed strengthening. However, the review confirmed that overall no material changes were necessary.

At 31 March 1998, the surplus reflected in our balance sheet had increased by £101 million to £718 million from £617 million at 31 March 1997. This surplus arose despite an exchange loss of £15 million, whilst tax on surplus amounted to £63 million. The surplus at 31 March 1998 represents a 22 per cent increase on our opening surplus of £588 million at 4 September 1996.

Perhaps more significantly the Group's solvency margin, defined as the ratio of surplus to net outstanding liabilities (as shown in note 15 to the financial statements), increased to 8.5 per cent at 31 March 1998 from 7.1 per cent at 31 March 1997 and 5.6 per cent at 4 September 1996. The latest figure includes the reinsurance of the Lioncover liabilities, on which I report later.

Encouraging results were achieved in each of our three major operating activities. Paid claims, including operating costs, amounted to £2.23 billion in the financial year ended 31 March 1998, bringing total paid claims since operations began in September 1996 to £4.76 billion, which is significantly less than had been originally projected. Reinsurance recoveries of £660 million during the financial year met expectations in light of the lower than projected claims payments. Investment return during the financial year of £932 million was better than expected, largely due to the strength in the capital values of the fixed-income investments in our portfolio. The concurrent fall in bond yields in turn has caused us to revise the rate at which the Group's claims liabilities are discounted to 5.25 per cent from 6 per cent per annum.

In the two years since we 'went live', Equitas has developed into a professional, cost-efficient organisation which is proving capable of successfully running off the liabilities it has reinsured.

Further progress has been made through the first five months of our current financial year, and we have continued to improve upon the original cashflow projections. Also, we can again confirm that we have not encountered any major surprises nor have we identified any external event, trend or emerging issue that we believe would endanger the financial stability of Equitas.

We have also made good progress in the operational management of the Group. It is worth remembering that Equitas began operations in September 1996 with very little time to develop an infrastructure to manage what was widely considered to be the most complex book of business in the history of the insurance industry. In just two years since then, the Group has developed the skills, expertise, resources and systems necessary to produce the encouraging results contained in this report. We are now a vigorous company with a strong and professional management team and staff in place.

However, our progress must be viewed in the context of the uncertainties inherent in the book of business Equitas has reinsured, particularly in respect of the asbestos, pollution and health hazard (APH) liabilities which represent some 50 per cent of our claims portfolio. It is not surprising, therefore, that our auditors have again qualified our financial statements. The establishment of loss reserves is an inherently uncertain process, and in Equitas' case this is exacerbated by the much greater uncertainty associated with the long-tail nature of APH liabilities. Accordingly, we expect that these fundamental uncertainties are likely to exist for some time to come.

> The Group has developed the skills, expertise, resources and systems necessary to produce the encouraging results contained in this report. We are now a vigorous company with a strong and professional management team and staff in place.

We have continued to experience difficulty with the data Equitas inherited from individual syndicate records and from the Lloyd's Reserving Project. Whilst we have begun the long process to verify and supplement this data, the complexity and quantity of the data means that this process will take some time to complete. However, we hope that a considerable improvement in the quality of our data will be achieved in the current financial year. Meanwhile, our auditors have again qualified our accounts in this respect since they have difficulty with the data.

Since our last Report and Accounts, a number of important events have occurred. Some of these were referred to in my letter of 21 January this year to Reinsured Names whilst others have occurred since then. These events include:

- The collection in late 1997 of the final balance of the original premium for the reinsurance owed to Equitas, except for less than £100 million which is subject to deferred payment arrangements. Over £11 billion in premiums were received from a variety of sources in just over one year, a complicated task completed with efficiency and perseverance by all concerned.

- The agreement in December 1997 to reinsure the Lioncover business for a premium of £622 million (after adjustments). We believe that the price and terms for this reinsurance were in the best interests of Equitas and Reinsured Names. An immediate benefit of the transaction was a strengthening of our surplus by £70 million and the addition of over £500 million to our investment portfolio. The integration of Lioncover with the rest of our business has proceeded smoothly over the past eight months.

- The dispatch in December 1997 of Statements of Reinsurance to Reinsured Names. These statements, produced by Lloyd's, included schedules showing in detail how each Reinsured Name's Equitas reinsurance premium was calculated by syndicate year of account.

- The commitment by Equitas to quote for the reinsurance of the 1993, 1994 and 1995 Orphan Syndicates after 60 months, where required, as set out in the Settlement Offer Document sent out by Lloyd's. The vast majority of the 1993 Orphan Syndicates has received and accepted quotes from the ongoing market, which eliminates the need for an Equitas quote, but we have issued indicative quotes for two Orphan Syndicates which are still under consideration.

- A recent financial settlement with Lloyd's. As part of the original Equitas Premium, Lloyd's agreed to provide an additional amount up to a maximum of £100 million in February 2002 to protect Equitas from adverse movements in interest rates and a possible shortfall in certain deferred payments. In August 1998, we reached agreement for Lloyd's to pay Equitas £66 million in early settlement of this undertaking. These funds have been received and are earning income. The transaction further strengthened the Group's balance sheet and removes some future uncertainty, and it will be reflected in the financial statements for the current year ending 31 March 1999.

We continue to strive to be an open and responsive organisation. We welcome questions and comments from Reinsured Names, and we were delighted that more than 400 Reinsured Names attended the first Open Meeting in London on 14 November 1997. A notice outlining the arrangements for this year's meeting accompanies this report. We anticipate following a similar format to last year: a review by management of the Group's performance followed by as much time as possible devoted to questions and answers.

The subject of corporate governance continues to receive considerable attention from boards, regulators and the media. Our position is that we are committed to high standards of corporate governance, and we support the Combined Code issued recently by the committee chaired by Sir Ronald Hampel which combined the recommendations of the Cadbury and Greenbury Committees with its own. The Board has put in place a framework for sound corporate governance which incorporates as far as practicable the principles and provisions of the Combined Code, and this is kept under regular review.

We continue to strive to be an open and responsive organisation. We welcome questions and comments from Reinsured Names, and we were delighted that more than 400 Reinsured Names attended the first Open Meeting.

A year ago I announced my intention to step down as Chairman and a Director of Equitas in the second half of 1998 and that a Committee of the Board had been formed to seek my successor. As a result of this process Hugh Stevenson was appointed to the Board on 1 April this year, and it is the Board's intention that he should be appointed Chairman on 1 November 1998 following my retirement from the Board on 31 October.

We are fortunate that Hugh has agreed to take on this task. He has excellent credentials having recently retired as Chairman of Mercury Asset Management following its acquisition by Merrill Lynch. He began his career with Linklaters & Paines in London and subsequently served as a Managing Director of S G Warburg's investment banking business before joining Mercury Asset Management as Chairman in 1992. I have no doubt that Hugh will steer Equitas through its next stage of development with great skill. I have enjoyed working closely with him for the past six months, and I am confident that there will be a smooth and orderly succession.

When I was appointed nearly four years ago, we defined two overriding objectives which have governed our philosophy and business strategy: to endeavour to secure true finality for Reinsured Names and, in time, to create sufficient surplus to enable a return of premium to be made to Reinsured Names. These two objectives remain as valid today, and encouraging progress has been made towards achieving them with an increase in the surplus on the face of our balance sheet, a further improvement in our solvency margin and some prudent reserve strengthening as outlined earlier in my Statement. Having said this, however, our surplus and solvency margin are still low, and it will be some years – if ever – before a return premium could be considered. Reinsured Names must be realistic about this.

> I believe we have a good mixture of intellectual rigour and hard-nosed business ability, and I am confident that the progress achieved so far will continue under the able leadership of Hugh Stevenson and Mike Crall.

Whilst our financial statements support the view that Equitas has made good progress in the two years since we became operational, the success of any business depends on the quality, skill and dedication of the people who work for it. In Equitas we have an excellent Board, management and staff who have developed into a cohesive, professional and vigorous team and in which Reinsured Names can have confidence. From the outset we have endeavoured to establish a culture of integrity, hard work and teamwork which is essential to the ultimate success of this very complex business. I believe we also have a good mixture of intellectual rigour and hard-nosed business ability, and I am confident that the progress achieved so far will continue under the able leadership of Hugh Stevenson and Mike Crall.

Finally, I must thank our Board and management for their support and co-operation during my tenure as Chairman. None of them had to join Equitas. They all took a step into the unknown in doing so with – unusually in this day and age – little discussion and no demands over such matters as their personal terms of service. It was a leap of faith and it has been a pleasure to work with them. I would particularly like to thank Mike Crall and Jane Barker, the first two senior executives to join Equitas, for their professionalism, commitment and the high standards they set for themselves which have been transmitted successfully throughout the Group.

David Newbigging
Chairman
15 September 1998

Chief Executive Officer's review

Equitas has completed a productive and successful year. In our initial two years in operation, we have laid a solid foundation on which to base the attainment of our objectives in the future.

Our overall strategy is working well, combining a flexible, fast and responsive approach to immediate problems with the development of more comprehensive solutions to the longer-term challenges we face. The creation of a company that was immediately capable of running off the 1992 and prior years' non-life liabilities of Lloyd's syndicates – probably the most complex portfolio of insurance risks ever assembled – represented an enormous and extremely demanding undertaking. With the start-up behind us, and as our organisation and strategy have been tested in operation, we have increasing confidence in our ability to carry out our mission in the years ahead.

Equitas mission statement
To achieve long-term security for all stakeholders by demonstrating world class capability for innovation and effective management of claims, recoveries, investment assets and operating processes.

Looking at the financial year ended 31 March 1998, which is covered in this report, we have made encouraging progress in each of our three core activities: claims management, reinsurance recovery and investment management. We have controlled our expenses effectively, and we have strengthened and deepened the organisation and the systems and information which support it.

Claims management

Gross claims paid, including operating costs, totalled £2.23 billion in the financial year ended 31 March 1998. As with the previous financial period, this was lower than expected and less than the £2.53 billion in claims paid during the Group's first seven months of operations (from 4 September 1996 to 31 March 1997). The graph on the bottom of page 1 of this report depicts how undiscounted liabilities (net of reinsurance recoveries) have been projected to run off over time.

One of our key priorities is to reduce as quickly as possible the level of uncertainty inherent in our book of business, especially in relation to asbestos, pollution and health hazard (APH) claims. By taking proactive measures to reduce the size and volatility of our liabilities, our objective is, first, to move more rapidly towards achieving finality for Reinsured Names and, in time, creating surplus to permit a return premium.

Our overall strategy is working well, combining a flexible, fast and responsive approach to immediate problems with the development of more comprehensive solutions to the longer-term challenges we face.

The Group's 'fair but firm' claims management policy remains unchanged. Equitas will pay valid claims promptly, both to fulfil policy obligations and to reduce unnecessary costs. Invalid claims are resisted by all means at our disposal. In many cases, especially those involving APH claims, neither coverage nor cost issues are clear-cut. Our strategy here is to resolve these claims at the earliest appropriate opportunity, providing that the settlement cost is appropriate to the claim. We place

great emphasis on negotiation, rather than litigation, and we attempt to discuss issues directly with policyholders whenever feasible. When dealing with APH matters we generally seek to commute all coverage with a given policyholder in order to deal definitively with all current and potential exposures.

Our approach has been broadly successful. More than 95 per cent of the claims paid by Equitas have been settled through negotiation rather than court judgments. On the other hand, we will vigorously litigate when necessary to defend our position, either with reference to a specific claim or to establish a more general point of law.

The Group has set ambitious targets for settling major claims in the current financial year. While Equitas deals with hundreds of thousands of potential claims, in many classes of business a relatively modest number of claims – generally 50 to 100 – represent up to 90 per cent of the estimated losses in that class. By focusing talent and resources on these most material claims, we believe we can significantly influence outcomes and overall results.

The financial impact of the claims strategy summarised above should be to generate positive results against reserves on an undiscounted basis. However, earlier settlements will marginally reduce the funds available for investment and, therefore, the interest income earned. These results have been factored into our reserving assumptions.

In the past year the Group has completed a large-scale review of hundreds of law firms and other claims service providers used in the past by various syndicates. The review has identified the most professional cost-effective providers, with whom we are concentrating future assignments. In addition, new task-based billing procedures have been implemented to control legal and associated costs more rigorously.

For commercial reasons it is inappropriate to comment on individual claims developments. In a loss portfolio of our size and diversity, it is inevitable that in any given year various reserve classes are adjusted upwards and downwards. However, in the aggregate external developments have not required us to modify significantly the underlying assumptions on which the estimates of the Group's liabilities are based. We are closely tracking developments involving tobacco-related personal injury lawsuits and potential claims associated with Year 2000 computer problems, but we do not believe that Equitas will have significant exposure with regard to these two issues. We can also confirm that there have been no material adverse claims developments since the balance sheet date.

In many classes of business a relatively modest number of claims – generally 50 to 100 – represent up to 90 per cent of the estimated losses. By focusing talent and resources on these most material claims, we believe we can significantly influence outcomes and overall results.

Reinsurance recoveries

In the financial year ended 31 March 1998, the Group recovered £660 million in reinsurance on paid claims, compared with £840 million in the first seven months of operations. This is in line with expectations, particularly considering that claims payments in both periods were lower than expected.

The realisation of the reinsurance asset is crucial to Equitas' success. We are

generally encouraged by the positive reaction which Equitas has received from most reinsurers. On the other hand, the absence of an ongoing revenue-producing relationship often means that we must expend considerable effort to ensure that our reinsurance claims receive the right level of attention from brokers and reinsurers. More generally, some litigation on reinsurance issues is inevitable. In parallel with our claims philosophy, we prefer negotiation to litigation when disputes arise, but we will take whatever action is appropriate, including litigation, to protect our recovery rights and to expedite recovery.

The Group has negotiated a substantial number of commutations of syndicates' obligations to, and recoverables from, individual reinsurers. Based on the Group's experience to date, we intend to increase our commutation activities in the current financial year. As a result of these efforts we expect to reduce reinsurance administration costs, to reduce the uncertainty inherent in the reinsurance collection process and to improve cashflow.

Since it is a time-consuming and expensive activity, reinsurance collection is the focus of many of the Group's process re-engineering efforts. In March this year, we announced two major changes to our reinsurance collection processes which, taken together, will reduce operating costs by more than £30 million annually.

First, we have changed the criteria for issuing reinsurance collection notes. Standard market practice has been to issue a collection note to a broker whenever a claim attaches to a reinsurance programme. As a result, a great number of collection notes represent claims of low value. Under our revised approach we aggregate reinsured claims until they have reached a threshold of US$25,000 per reinsurer before a collection note is issued. We estimate this change will reduce the number of collection notes issued by nearly 60 per cent, while deferring collection activity on less than 10 per cent of the total value to be collected. The cost savings will significantly exceed the cashflow impact of deferring low value collection efforts.

> Reinsurance collection is the focus of many of the Group's process re-engineering efforts. In March this year, we announced two major changes to our reinsurance collection processes which, taken together, will reduce operating costs by more than £30 million annually.

A disproportionate share of the Group's reinsurance administration costs has been associated with syndicates whose reinsurance programmes have relatively low values. We therefore have ceased processing reinsurance transactions on a daily basis for 150 syndicates (out of a total of 390) whose reinsurance programmes have an ultimate value of less than £10 million, but whose costs are disproportionately high. Instead, we now process losses attaching to these syndicates' reinsurance programmes less frequently, for example biannually or annually, depending on the size of the syndicate and the type of reinsurance programme. We estimate that cost reductions will be two to three times greater than the loss of income on deferred collections.

In conjunction with other process changes supporting our reinsurance collections, we expect both to reduce costs and to increase the attention paid to high value reinsurance matters. Similar to the situation with claims, relatively small segments of our business constitute a disproportionate share of the value. Reinsurance collection notes representing just 4 per cent of our transactions account for over 95 per cent of

the total value of reinsurance to be recovered. Dealing effectively with these high value items will obviously receive our attention.

Contracting arrangements

One of the necessary elements of Equitas' initial business strategy was the delegation of reinsurance administration and collection functions to Lloyd's managing agencies and other specialist companies. This was necessary to allow us to 'go live' without disrupting the orderly flow of regular business transactions. When Equitas began operations it had contracts with 69 service suppliers to perform these run-off management functions. That number had been reduced to 35 as of 31 December 1997 through a process by which these functions had been 'migrated' from the initial contractors either to Equitas or to 'strategic business partners' – specialist companies committed to working to Equitas' service quality and cost standards.

This financial year the performance of our investment portfolio, which consists of high-quality fixed-income instruments, benefited from very favourable conditions in bond markets. The market value of long-dated instruments rose throughout the year amid a climate of falling bond yields.

At the beginning of this calendar year, the migration process was significantly accelerated by the introduction of the simplified reinsurance collection processes described above, which created additional capacity within Equitas and its strategic partners. By the end of 1998, all reinsurance administration and collection processes will be managed either directly by Equitas or by one of two specialist companies. In addition, our reinsurance ledgers are now managed by Equitas and just one outside contractor. These changes will lead to a significant reduction in the amount Equitas pays to contractors, with no corresponding increase in internal costs, but with significantly improved levels of control.

Equitas also contracts with Lloyd's managing agencies and other companies for claims adjusting services. A migration process is under way with regard to these contractors, with the number reduced to 30 as of 1 September 1998, compared with 57 claims adjusting contractors when operations began in September 1996.

Investment management

Investment return totalled £932 million during the year ended 31 March 1998, which represents a 13.6 per cent total return on our investment portfolio. This return also represented a 112 per cent increase on an annualised basis over the £256 million in investment return produced during the Group's first seven months of operations, during which the short-dated portfolios which Equitas inherited were largely transformed into longer-term investments that reflect the projected maturity of the Group's claims portfolio.

This financial year the performance of our investment portfolio, which consists of high-quality fixed-income instruments, benefited from very favourable conditions in bond markets. The market value of long-dated instruments rose throughout the year amid a climate of falling bond yields. In addition to market factors, the performance

of a majority of our portfolio managers exceeded the benchmarks established at the beginning of the year. Thus our overall investment performance was outstanding although, it must be added, to a degree unlikely to be sustainable in the future.

Somewhat offsetting these results, the general decline in bond yields caused the Group to revise the rate at which claims liabilities are discounted to 5.25 per cent from 6 per cent per annum. As a result the present value of our liabilities increased by £311 million.

While we have remained invested in fixed-income instruments, the Group continuously reassesses various investment options, including the purchase of equities. This process is aided by development of the Equitas Financial Model, a sophisticated computer modelling system that allows us to evaluate and manage the risks pertaining to both investments and liabilities, and to understand the probable effects of alternative portfolio strategies.

During the past year we have established a European currency portfolio which seeks to match our projected liabilities in major European currencies. This portfolio anticipates the introduction of a single European currency. The Group continued to maintain investment portfolios in four other currencies: Sterling, US dollars, Canadian dollars and Australian dollars.

Day-to-day investment management is sub-contracted to independent fund managers under the overall supervision of the Board's Investment Committee supported by a small in-house team of investment management professionals. In the past year, the Group has contracted with additional fund managers with respect to the US dollar, Australian dollar and European currency portfolios.

Data/systems

One of the Group's greatest challenges is to ensure that our management has the timely and accurate data necessary to carry out our core activities. The data in the Group's possession was obtained from a variety of sources, including approximately 90 independent syndicate managers, Lloyd's bureaux and the Lloyd's Reserving Project, which estimated the initial syndicate liabilities reinsured by Equitas. It was inevitable that significant variations existed in the quality and consistency of this data.

Looking to the immediate future, the Group's expense budget for the 1998-99 financial year is 11 per cent lower than in the prior year. We are constantly exploring ways to operate more economically, and cost-efficiency is an important criterion in every decision that we make.

Data quality improvement is a central issue for us, and progress in this area has been slower than we would have liked owing to the scale and complexity of the task. The implementation in the past year of the Equitas Information Platform (EQUIP) serves as the cornerstone of our data improvement efforts. EQUIP is an information warehouse which serves as the central depository for the management and insurance-related information needed across the Group. While EQUIP is a powerful resource which will help enable us to verify, standardise and, where necessary, supplement critical data, this task is not yet complete and improvement of data quality to 'fit for purpose' standards will occupy significant resources during the current year.

We have made excellent progress in collecting and securing crucial policy and reinsurance documentation from storage locations spread across the UK. These paper documents, which now total more than 500 million pages, are being indexed and centrally stored where they can be quickly retrieved when necessary. The most crucial documents are electronically imaged and stored so that they can be accessed immediately by Equitas employees via desktop personal computers. This project is proceeding ahead of schedule.

Like other organisations, the Group is currently engaged in another important data-related project: ensuring that our systems are Year 2000 compliant and monitoring the compliance efforts of our contractors and suppliers. This task is considerably simplified because of our aggressive migration strategy. Many of our systems are new and thus are already Year 2000 compliant, while we are now updating any non-compliant systems. This activity is on schedule, and we expect it to be completed well in time to avoid any serious problems.

Equitas has accomplished a great deal in a relatively short period of time. We believe we have the management, staff, systems and strategies in place to continue to achieve positive results, and we believe we are well positioned to meet our obligations to all stakeholders, including Reinsured Names.

Expense management

The Group's operating expenditure of £243 million in the financial year ended 31 March 1998 was on target. However, this is an area where constant diligence is required, and we must reduce costs systematically each and every year if the Group is to fulfil its mission. Looking to the immediate future, the Group's expense budget for the 1998-99 financial year is 11 per cent lower than in the prior year. We are constantly exploring ways to operate more economically, and cost-efficiency is an important criterion in every decision that we make.

Employees

Equitas' success depends upon the talents of its people. We have assembled a workforce of more than 700 employees, supplemented by staff working on fixed-length contracts where appropriate. Our employees represent a good balance of Lloyd's and London insurance market experience with expertise from outside the insurance industry. What unites us is a common appetite for seeking creative and innovative solutions to major challenges. Equitas' achievements to date are the result of the hard work, dedication and ingenuity of our people, and I thank them for their outstanding efforts.

The challenges facing Equitas require a high level of teamwork. The solution to most of Equitas' problems can only be found through a broad, corporate-wide perspective. The great majority of our accomplishments, especially in the area of process refinement and improvement, has been the result of the work of teams of employees from different departments and disciplines. In our relatively brief existence we have rapidly developed our ability to work on a cross functional basis, and I believe this augurs well for Equitas' future.

The Group has implemented compensation and incentive structures to reward

positive performance and results. Our policy is to pay salaries at or near the median for the types of skills we require, supplemented by performance-related pay. Bonuses are paid if individual, departmental and Group objectives are met or exceeded. We believe this compensation policy will encourage excellent performance and, at the same time, ensure that the financial interests of our employees are aligned with those of Reinsured Names.

Conclusion

Equitas has accomplished a great deal in a relatively short period of time. We believe we have the management, staff, systems and strategies in place to continue to achieve positive results, and we believe we are well positioned to meet our obligations to all stakeholders, including Reinsured Names. As we have developed a deeper understanding of the challenges we face, our confidence in our ability to meet these challenges has grown.

As a final note, I would like to thank David Newbigging for his dedicated and tireless effort as Chairman of Equitas and to congratulate him for a job well done. David's leadership through these exciting and often difficult days has been consistently of the highest order. It has been my great pleasure and privilege to work closely with David these past two and a half years, and I wish him the best of fortune in his future endeavours.

Michael Crall
Chief Executive Officer
15 September 1998

Financial review

This financial review covers the Group's operations in the year ended 31 March 1998 whereas the comparative figures cover the seven month period from commencement of operations in September 1996 to 31 March 1997.

Technical account

The Companies Act requires that we split the profit and loss account into the technical account and the non-technical account. Details of our insurance business transactions are provided in the technical account; non-insurance transactions are detailed in the non-technical account.

Set out below is a description of some of the key items included in the technical account on page 34.

Gross written and earned premium

The gross written and earned premium of £622 million represents the premium collected by Equitas Reinsurance Limited for the reinsurance of the liabilities of Lioncover Insurance Company Limited on 18 December 1997. This premium was determined following a review of the premium calculated by the Lloyd's Reserving Project in the light of developments since September 1996, the date at which the Lioncover reinsurance was originally intended to take place. The premium, calculated as at 1 January 1997, amounted to £601 million. It was subject to an adjustment to the completion date of 18 December 1997 to take into account movements in actual and accrued claims and expense payments, reinsurance recoveries, investment return and exchange fluctuations. As with the initial Equitas Premium, a surplus resulted from discounting the net liabilities of Lioncover at a higher rate of interest than that used to set the premium. The net discounted liabilities using this approach amounted to £552 million thereby producing a surplus of £70 million.

Investment return

Our investments produced a return of £932 million during the year. Management commentary on investment performance appears on page 10.

Other technical income

The other technical income of £122 million includes the release of £103 million from a prudent provision against the reinsurance premium in the Group's opening accounts at 4 September 1996. The remainder represents a recovery in respect of assets which have been realised at values in excess of the amounts at which they were carried in the Group's books.

Claims paid

Gross claims paid of £2,232 million include £243 million of operating costs. The comparable gross claims paid for the previous seven month period were higher principally because of non-recurring items arising in connection with the opening transaction. The reinsurers' share of the gross claims paid is £660 million.

Change in the provision for claims

The change in the provision for claims results from the reinsurance of the Lioncover liabilities and from our re-assessment of future insurance claims and reinsurance recoveries by major category and currency, including an adjustment for payments, receipts and accruals during the year.

Since the liabilities are expected to be settled over a period of time, they have been discounted to acknowledge the time value of money. The return to be earned in future on the investments which are held to meet these liabilities is anticipated through this process of discounting. As stated in the Group's accounting policies, the discount rate applied to the liabilities is determined having regard to current prospective yields on the asset portfolio. This rate is reviewed each year to ensure that it remains a prudent estimate of the average annual return expected to be achieved for the period for which these assets are likely to be held. For the year under review, we have revised the discount rate to 5.25 per cent per annum to reflect current market yields.

Two elements make up the discount adjustment, which is referred to as the 'unwinding' of the discount.

	£m
Reduction of one year in period over which net liabilities are discounted	445
Effect of change in the discount rate from 6% to 5.25%	311
Unwinding of the discount	**756**

The last element in the change in provision for claims arises from our re-evaluation of the discounting effect of the likely timing of future payments and receipts.

Other technical charges

The other technical charges are made up of foreign exchange gains and losses. Liabilities are denominated in a number of currencies, and the Group's policy is to match our assets to the currencies of our liabilities as closely as possible. Thus the effect of exchange fluctuations on the provisions for claims was largely neutralised by exchange fluctuations in the value of assets, but left a small exchange loss of £15 million primarily arising from some overseas regulatory requirements to hold foreign currency assets in excess of the corresponding liabilities. For the most significant foreign currency, the closing exchange rate used for translation of the balance sheet at 31 March 1998 was US$1.67 to £1 Sterling compared with US$1.64 at 31 March 1997.

The balance on the technical account is then carried forward to the non-technical account.

Taxation

The taxation charge of £63 million is made up of two items: UK corporation tax of £29 million arising on the current year surplus and £34 million not previously provided in respect of prior periods. Tax has been provided following negotiations with the Inland Revenue which centred on the valuation of some assets received as consideration for the Equitas Premium. Of the total tax charge, £48 million is either paid or due to be paid in the next 12 months; the balance of £15 million is our best

estimate of the potential amounts which may become payable as a result of the agreement with the Inland Revenue.

Surplus

The Group's surplus increased to £718 million as at 31 March 1998. The movements were as follows:

	£m	*£m*
Retained surplus at 1 April 1997		**617**
Lioncover surplus		70
Recovery of premium debt (other technical income)		122
Investment return in excess of unwinding of the discount		176
Reassessment of:		
Claims, including expenses (see below)	9	
Reinsurances (see below)	14	
Timing of net future payments	(212)	
		(189)
Exchange losses		(15)
Taxation		(63)
Retained surplus at 31 March 1998		**718**

Provision for claims outstanding

The provision for claims outstanding remains the most significant item on the Group's balance sheet. It should be considered together with the reinsurers' share of claims outstanding. Movements in these provisions from one year to the next have the following components:

- Payments, receipts and accruals in the year;
- Adjustments in estimates of liabilities and associated reinsurances;
- Changes in discount; and
- Movements in exchange rates.

	Claims £m	Reinsurance £m	Net £m
Provisions at 1 April 1997	**11,830**	**(3,128)**	**8,702**
Lioncover business	682	(130)	552
Payments, receipts and accruals	(2,232)	660	(1,572)
Unwinding of the discount	1,064	(308)	756
Reassessment of:			
Liabilities and reinsurances	(9)	(14)	(23)
Timing of net future payments	394	(182)	212
Exchange and other movements	(208)	56	(152)
Provisions at 31 March 1998	**11,521**	**(3,046)**	**8,475**

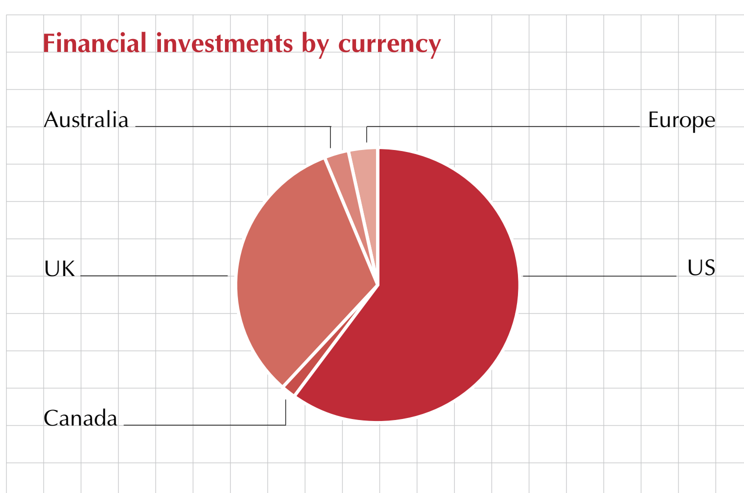
Financial investments

The Group's asset portfolio is designed to match the liabilities by duration and currency. The aim of the investment strategy is to:

- Earn an investment return which matches the unwinding of the discount. This return is credited to the technical account; and
- Provide adequate funds as investments mature to pay claims.

During the year a European currency portfolio was added to the existing investments in Sterling, US dollars, Canadian dollars and Australian dollars.

The investment portfolio remained largely invested in high-quality fixed-interest instruments. The Group continually assesses the performance of its fund managers against pre-determined benchmarks which are established in the light of its overall investment strategy.



During the year under review, the overall rate of return exceeded expectations as the bond markets in which the funds were invested benefited from a marked improvement in long term inflation expectations. The combination of an exceptionally strong performance from global bonds and a higher-than-expected fund size contributed to a satisfactory investment result. This is indicated by the fact that the investment return of £932 million exceeded the unwinding of the discount of £756 million. The Lioncover transaction increased Equitas' investment portfolio by £525 million. These funds were invested on a matched currency basis.

As at the date of this report, the Group retained the following professional fund managers:

United States

BlackRock Financial Management Inc
Dodge & Cox
Scudder Kemper Investments Inc
Wellington Management Company LLP

United Kingdom

Barclays Global Investors Limited
HSBC Asset Management Europe Limited
Mercury Asset Management Limited
Phillips & Drew Fund Management Limited
Prudential Portfolio Managers Limited
Rothschild Asset Management Limited

Australia

UBS Brinson Limited

Canada

RT Capital Management Inc

Bad debts

Considerable work has been carried out to establish the amount to be provided in the year end accounts in respect of bad or doubtful reinsurance debts. This has confirmed that, based on current data, the amount which was deducted from the reinsurance asset in the Group's opening accounts remains the best estimate of a prudent bad debt provision and accordingly no adjustments have been made.

The euro

The Group has formed a task force which is studying the implications of the introduction of the euro. Since non-Sterling European currencies represent a small percentage of the Group's overall liabilities, no significant financial or other business impact is expected as a result of this development.

Accounting systems and data quality

As a result of the implementation of the Equitas Information Platform (EQUIP) and the syndicate migration strategy, progress is being made in centralising and validating data. This process has largely confirmed initial concerns over the quality of the data received in respect of the reinsured business. The aim remains to improve quality levels to facilitate the efficient management of our business.

Financial risk management

The principal risk to the Group remains that it may not be able to settle its liabilities in full.

We have in place a system of controls over insurance transactions such as claims, reinsurance and commutations, investment transactions and operational transactions. These are reviewed and changed where necessary in the light of any new circumstances.

Insurance claims, associated reinsurance recoveries and commutations are periodically assessed by major category and currency against provisions held. New types of claims and any changes in settlement trends are examined carefully and their impact on provisions evaluated.

Other financial risks include counterparty risks such as amounts due from reinsurers, balances at banks and custodians, and obligations of specific insurers. These risks are managed by regular review and assessment of relevant balances against established criteria.

Jane Barker
Finance Director
15 September 1998

Board of Directors

David Newbigging [§Δ]
Chairman; appointed Chairman-Designate in May 1995 and joined the Board as Chairman in December 1995. He is also Chairman of Friends' Provident Life Office and Deputy Chairman of Benchmark Group PLC. He is a Director of Merrill Lynch & Co Inc, Ocean Energy Inc and Wah Kwong Shipping Holdings Limited. He was formerly Chairman and Chief Executive of Jardine Matheson & Co Limited and Chairman of Rentokil Group PLC. Age 64.

Hugh Stevenson [§Δ]
Chairman-Designate; joined the Board in April 1998. He was previously Chairman of Mercury Asset Management Group plc; a Managing Director of S G Warburg Group plc's investment banking business; and with Linklaters & Paines. He is Chairman of the Institutional Fund Managers' Association, and a Director of the Investment Management Regulatory Organisation. Age 56.

Michael Crall [‡#*]
Chief Executive Officer; joined the Board in December 1995. He was previously President and Chief Executive Officer of Argonaut Insurance Company in California and a senior executive at CIGNA Corporation. Age 54.

Dick Barfield [†#]
Non-executive Director; joined the Board in April 1997. He was formerly Chief Investment Manager of Standard Life Assurance Company. He is currently a Director of New Look PLC, Quintain Estates & Development PLC and Rio Tinto Pension Investments Ltd. He also holds various advisory posts. Age 51.

Jane Barker [#*]
Finance Director; joined the Board in December 1995. She was previously Chief Financial Officer and Chief Operating Officer of the London Stock Exchange and Chief Financial Officer of the insurance broking operations of Marsh & McLennan Inc outside of the Americas. Age 48.

Stephen Catlin [‡§]
Lloyd's Appointed Non-executive Director; joined the Board in October 1996. He is Chairman of Catlin Underwriting Agencies Limited and Catlin Holdings Limited and Underwriter of Lloyd's Syndicates 1003 and 2003. Age 44.

Michael Deeny [‡§Δ]
Trustees-nominated Non-executive Director; joined the Board in October 1996. He is Chairman of the Association of Lloyd's Members, the Litigating Names Committee and the Gooda Walker Action Group. He is also Deputy Chairman of The Equitas Trust. Age 53.

James Joll [†‡]
Non-executive Director; joined the Board in June 1996. He is an advisor to Donaldson, Lufkin & Jenrette; Chairman of AIB Asset Management Holdings; Deputy Chairman of Jarvis Hotels plc; and a Director of The Economist Newspaper Limited. He was formerly Finance Director of Pearson plc. Age 61.

Scott Moser [*]
Claims Director; joined the Board in May 1997. He was previously President of Envision Claims Management Corporation; Vice President of Environmental/Excess Claims at Aetna Casualty & Surety Company; and a Partner with the law firm Day, Berry & Howard. Age 47.

Sir Roger Neville [#Δ]
Non-executive Director; joined the Board in April 1996. He was formerly Group Chief Executive of Sun Alliance Group plc; Deputy Chairman of the Association of British Insurers; Chairman of the Policyholders Protection Board; and Chairman of Pool Reinsurance Company Ltd and Pool Nuclear Limited. Age 66.

Sir Bryan Nicholson [‡§]
Non-executive Director; joined the Board in October 1996. He is Chairman of the British United Provident Association (BUPA) and a Director of GKN, NewsQuest plc, Cookson Group plc and LucasVarity plc. He was formerly President of the Confederation of British Industry; Chairman of the Manpower Services Commission; and Chairman and Chief Executive Officer of the Post Office. Age 66.

Alan Pollard [*]
Run-off Operations Director; joined the Board in June 1996. He was previously Managing Director of Syndicate Underwriting Management Limited. Age 64.

Richard Spooner [†#]
Trustees-nominated Non-executive Director; joined the Board in October 1996. He is Managing Director of Team User Systems Co Limited and a Member of the Committee of the Association of Lloyd's Members. He was previously a Member of the Names Committee and the Assistance and Recovery Committee of Lloyd's. Age 52.

[†] Member of Audit and Compliance Committee
[‡] Member of Claims and Commutations Committee
[#] Member of Investment Committee
[§] Member of Nominations Committee
[Δ] Member of Remuneration Committee
[*] Executive office held with Equitas Limited

Directors' report for the year ended 31 March 1998

The Directors present their report for the financial year ended 31 March 1998.

Principal activities

The Equitas Group was formed as part of Lloyd's Reconstruction and Renewal Plan to reinsure the liabilities of Lloyd's of London syndicates allocated to the 1992 and prior years of account, other than life syndicates, and to perform the run-off of these liabilities. Equitas Reinsurance Limited completed the reinsurance of the 1992 and prior years' business, except business previously reinsured by Lioncover Insurance Company Limited ('Lioncover business'), with effect from 3 September 1996 and reinsured the Lioncover business with effect from 18 December 1997. It retroceded these businesses to Equitas Limited, which is the main operating company of the Group. Equitas Reinsurance Limited and Equitas Limited are regulated by HM Treasury (formerly by the Department of Trade and Industry) and are only authorised to effect these reinsurances and related activities and to perform the run-off of the reinsured liabilities.

Business review and future developments

The Chairman's Statement, the Chief Executive Officer's Review and the Financial Review on pages 2 to 19 report on the progress of the business during the financial year and outline future developments.

Results

The Equitas Group made a surplus after tax of £101 million for the year ended 31 March 1998 (1997: £29 million) which is being retained in the business. The Company's Articles of Association do not permit the payment of a dividend.

Share capital

The share capital of the Company comprises two ordinary shares of £50 each, which were issued at par on incorporation and which are fully paid, and one deferred share of £1, which was allotted on 2 September 1996 and which is fully paid. The ordinary shares carry voting rights, but no dividends may be paid on these shares. The deferred share carries neither voting nor dividend rights.

Substantial shareholding

Ownership of the entire issued ordinary share capital of the Company was transferred on 3 September 1996 from the Corporation of Lloyd's to the seven Trustees of The Equitas Trust who hold these shares jointly.

The Corporation of Lloyd's owns the one deferred share in the capital of the Company, which carries the right to appoint one Director.

Directors

The names of the Directors at the date of this report, together with brief biographical details, are listed on page 20.

Messrs ME McL Deeny and RB Spooner are the Trustees-nominated Directors. Mr SJO Catlin is the Lloyd's appointed Director.

Messrs RA Barfield and SP Moser were appointed Directors on 1 April 1997 and 1 May 1997 respectively. Mr HA Stevenson joined the Board on 1 April 1998. Mr J Teff resigned as a Director with effect from 31 May 1997.

Messrs ME McL Deeny, JAB Joll and AC Pollard retire by rotation and Mr HA Stevenson, having been appointed a Director during the year, retires pursuant to Article 72 of the Articles of Association. They offer themselves for re-appointment at the forthcoming Annual General Meeting.

All Directors of the Company also hold office as directors of Equitas Reinsurance Limited and Equitas Limited.

Chairman

Mr DK Newbigging has indicated his intention to retire from the Board on 31 October 1998, following the 1998 Open Meeting of Reinsured Names. The Board intends to appoint Mr HA Stevenson as Chairman with effect from 1 November 1998, following Mr Newbigging's retirement.

Directors' interests

Mr DK Newbigging has an interest in the business of the Group as an underwriting member of Lloyd's since 1985. Messrs SJO Catlin, ME McL Deeny, JAB Joll and RB Spooner also have an interest in the business of the Group as former underwriting members of Lloyd's who ceased underwriting in 1997, 1994, 1991 and 1993, respectively. Mr Catlin has a continuing interest in Syndicate 2003 through his shareholding in Catlin Westgen Limited, the sole member of Syndicate 2003.

Directors appointed prior to September 1997 were provided with indemnities by the Company, Equitas Reinsurance Limited, Equitas Limited and the Corporation of Lloyd's in respect of liabilities arising out of or connected with the Lloyd's Reconstruction and Renewal Plan.

None of the Directors has an interest in shares in any Group company other than Messrs ME McL Deeny and RB Spooner who, since 3 September 1996, have held the two ordinary shares in the Company jointly with the other Trustees of The Equitas Trust. Mr J Teff had an interest in one ordinary share of £50 as a subscriber to the Company's Memorandum of Association.

Corporate governance

The Board supports the Combined Code recently issued by the Committee on Corporate Governance chaired by Sir Ronald Hampel. The Group has in place a framework for sound corporate governance which incorporates as far as practicable the principles and provisions of the Code.

The Board

The Board comprises four Executive Directors and nine Non-executive Directors, including two Trustees-nominated Directors and one Director appointed by the Corporation of Lloyd's. The Board meets approximately 10 times a year and the roles of Chairman and Chief Executive Officer are split.

The Board is responsible for policy and strategy and for monitoring the performance of executive management. Certain matters are reserved to the Board for collective decision. In addition, there are matters which require the consent of the holders of the ordinary shares pursuant to the Company's Articles of Association. Day-to-day management is delegated to the Chief Executive Officer.

Non-executive Directors are appointed for an initial three year term, which may be renewed, and all Directors, except the Lloyd's appointed Director, are subject to the re-election provisions of the Company's Articles of Association.

The Board is supported in its work by the Company Secretary who co-ordinates the supply of timely information and provides advice. A procedure is in place for Directors to take independent professional advice, if necessary.

Board committees

The Board has established five committees with clearly defined terms of reference:

1 The Audit and Compliance Committee

JAB Joll (Chairman)
RA Barfield
RB Spooner

The committee meets at least three times a year and reviews the annual financial statements, the interim financial information and the system of internal controls. The Chief Executive Officer, the Finance Director, the external auditors and the Head of Internal Audit attend meetings as appropriate.

2 The Investment Committee

RA Barfield (Chairman)
JV Barker
MJ Crall
Sir Roger Neville
RB Spooner

The committee formulates and decides the strategy for management of the Equitas Group's investment assets within a broad framework agreed by the Board, develops policies for the management of investment risks, and monitors the performance of external fund managers and custodians. It meets at approximately quarterly intervals.

3 The Claims and Commutations Committee

Sir Bryan Nicholson (Chairman)
SJO Catlin
MJ Crall
ME McL Deeny
JAB Joll

The committee has certain decision making authorities delegated to it by the Board in respect of the adjustment and settlement of major claims, commutations, and the initiation of significant litigation or arbitration. It meets at approximately quarterly intervals.

4 The Remuneration Committee

DK Newbigging (Chairman)
ME McL Deeny
Sir Roger Neville
HA Stevenson

The committee decides on the remuneration and other terms of service of the Executive Directors within a framework agreed by the Board and operates the performance-related incentive arrangements. It also advises on remuneration policy for senior executives. It meets as necessary.

5 The Nominations Committee

DK Newbigging (Chairman)
SJO Catlin
ME McL Deeny
Sir Bryan Nicholson
HA Stevenson

The committee is responsible for making recommendations to the Board on the appointment of new Board members other than Directors nominated by the Trustees or appointed by the Corporation of Lloyd's. It meets as necessary.

Internal controls

The Group has in place a system of internal controls which, *inter alia*, defines accountability and authority levels. Compliance is monitored on a regular basis by the Audit and Compliance Committee.

Directors' responsibilities

The Directors are required by the Companies Act 1985 to prepare financial statements which give a true and fair view of the state of affairs of the Group at the end of the financial year and of the profit and loss for the financial year.

In preparing the financial statements, the Directors are required to:

- Select suitable accounting policies and then apply them consistently;

- Make judgments 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 a going concern basis unless it is inappropriate to do so.

The Directors are responsible for keeping proper accounting records which disclose with reasonable accuracy at any time the financial position of the Group and enable them to ensure that the financial statements comply with the Companies Act 1985. They are also responsible for safeguarding the assets of the Group and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities. The Directors' responsibility for the accounting records in relation to the reinsured liabilities commenced on 3 September 1996 on execution of the Reinsurance and Run-off Contract. The accounting policies on page 39 set out the issues relevant to the going concern basis for preparation of the financial statements.

Reinsurance Contract

The Reinsurance and Run-off Contract dated 3 September 1996 ('Reinsurance Contract') pursuant to which Equitas Reinsurance Limited provided the reinsurance of the 1992 and prior years' non-life business, was amended and corrected by an agreement dated 17 December 1997. The main changes concerned certain aspects of return premium rights. The date for calculation of Reinsured Names' shares of return premium was changed from 4 September 1996 to 31 December 1995 as the quality of information available at that date allowed a more accurate assessment of each Reinsured Name's share. In addition, the Reinsurance Contract was amended by incorporation of the provision contained in the Lloyd's Settlement Offer Document dated July 1996 that return premium rights cannot be assigned or transferred except as part of a Reinsured Name's estate.

Reinsured Names were advised of these changes in a letter dated 27 December 1997 which accompanied their Statements of Reinsurance.

Indemnification of Trustees

The Trust Deed constituting The Equitas Trust provides for the indemnification of the Trustees against liabilities arising from or connected with the proper performance of their duties as Trustees. The Trustees have been granted a charge over a £10 million bank deposit as security for this indemnity.

Employees

At the date of this report, the Group had approximately 740 permanent employees. The Group is committed to a pro-active programme for involving employees. This includes regular communication through newsletters and briefings and consultation with staff at all levels. Suggestion schemes are in operation, providing a regular flow of ideas for improving efficiency and performance.

The Group recognises its responsibilities towards disabled people and they receive full and fair consideration for job vacancies for which they are suitable applicants. Employees who become disabled during their working life will be retained in employment and given help with any necessary rehabilitation retraining.

Suppliers

It is the policy of the Group to establish terms of payment with suppliers when agreeing the terms of business transactions. The aim is to effect payment in accordance with agreed terms.

Charitable and political donations policy

The Group has not made any charitable or political donations in the year and will not make any political donations. The Directors do not intend to make any charitable donations, but will keep this under review.

Registered office

The address of the Company's registered office was changed to 33 St Mary Axe, London EC3A 8LL with effect from June 1997.

Year 2000

The Group has in place a dedicated project team of IT specialists which is responsible for ensuring that the systems on which the Group is reliant are Year 2000 compliant. The focus is on updating the Group's core systems and on monitoring compliance of external service providers.

As Equitas became operational only approximately two years ago, a number of its systems are of recent design and are Year 2000 compliant. Work is ongoing to ensure that the millennium change will not result in any material disruption to the Group's systems and facilities.

A review was carried out during the financial year to identify the external service providers whose systems are critical to the Group's operations. The programmes for achieving compliance put in place by these providers are being actively monitored. Acceleration of the Group's timetable for migrating syndicate reinsurance

administration through transfer in-house or to two key service providers will significantly reduce the extent of this monitoring work.

The estimated cost of ensuring that all systems on which Equitas is dependent will be Year 2000 compliant is approximately £4 million. All costs in connection with compliance work will be written off to the profit and loss account as incurred.

Auditors

Following the merger of Coopers & Lybrand with Price Waterhouse with effect from 1 July 1998, Coopers & Lybrand resigned as Auditors to the Company. The Board appointed the merged partnership, PricewaterhouseCoopers, as Auditors to fill a casual vacancy. PricewaterhouseCoopers are willing to continue in office and offer themselves for re-appointment at the forthcoming Annual General Meeting.

As permitted by the Company's Articles of Association, indemnities have been given to PricewaterhouseCoopers against costs and liabilities incurred or arising out of their work as auditors in circumstances where a court finds in their favour.

By Order of the Board
Gisela Gledhill
Company Secretary
15 September 1998

Board report on Directors' remuneration

for the financial year ended 31 March 1998

Policy on Executive Directors' remuneration

The Equitas Group operates in an international environment. In framing its policy on remuneration, the Group aims to:

- Set reward structures which enable the Group to attract, retain and motivate executives with the appropriate skills, background and experience to operate effectively in a run-off environment;
- Pay basic salaries approximately at the median of market rates for companies in the same industry and of similar size; and
- Provide a significant bonus opportunity based on the achievement of measurable goals and an executive's personal contribution to the Group's overall performance.

The Remuneration Committee, which comprises Messrs DK Newbigging, ME McL Deeny, HA Stevenson and Sir Roger Neville, is responsible for setting the remuneration and other terms of service of the Executive Directors. It consults with the Chief Executive Officer on executive remuneration and seeks independent external professional advice, as appropriate, on market comparisons and developments in remuneration practice.

Performance-related incentive arrangements

The Group has an annual cash bonus plan in which all permanent employees participate. Awards are subject to achievement of financial goals and personal performance criteria.

In addition, the Group operates a long-term incentive plan (LTIP) for senior executives. This provides for cash payments based on a strengthening of surplus over a 12 month period with payout deferred for a further 24 months and subject to an enhancement in surplus being maintained. The first payments relating to the year ended 31 March 1998 are expected to be made in 2000.

The Remuneration Committee administers the annual cash bonus plan and the LTIP under its delegated powers and decides on participation and the amounts of incentive payments. The Board determines the increase in surplus which counts for awards under the LTIP.

Payments under performance-related incentive arrangements are not pensionable.

Service agreements

Messrs MJ Crall, SP Moser and AC Pollard and Mrs JV Barker have service agreements with Equitas Management Services Limited which are subject to 12 months' notice on a rolling basis. Mr DK Newbigging is party to, and has an interest in, an agreement for the provision of his services between Kennedy Financial Services Limited and Equitas Management Services Limited which can be terminated on six months' notice. This agreement will terminate when Mr Newbigging steps down as Chairman and a Director on 31 October 1998.

Non-executive Directors' fees

Payment for the services of the Chairman are made to Kennedy Financial Services Limited. This comprises a Chairman's fee of £150,000 per annum (inclusive of the Director's fee) and a fee of £50,000 per annum for the provision by Kennedy Financial Services Limited of office, secretarial, benefits and other overheads for Mr DK Newbigging in support of his duties as Chairman.

Non-executive Directors other than the Chairman do not have service agreements. They do not have bonus or pension arrangements. The Board agreed to raise the Director's fee from £25,000 per annum to £30,000 per annum with effect from 1 January 1998. Non-executive Directors who chair Board committees receive an additional fee of £10,000 per annum for these services. Mr Newbigging does not receive an additional fee for chairing a Board committee.

Directors' remuneration

Total Directors' remuneration in respect of the financial year ended 31 March 1998 was £2.1 million.

	Salary/ Fees £	*Bonus £*	*Benefits-in-kind £*	*Total emoluments £*	*Pension contribution £*	*Total for year ended 31 Mar 1998 £*	*Total for seven month period ended 31 Mar 1997 £*
Chairman							
DK Newbigging	200,000			200,000		200,000	110,382
Executive Directors							
MJ Crall	297,500	122,000	2,041	421,541	74,375	495,916	257,977
JV Barker	193,750	75,000	459	269,209	48,437	317,646	149,491
SP Moser	222,769	125,000	160,789	508,558	55,692	564,250	–
AC Pollard	172,500	60,000	344	232,844	44,095	276,939	132,416
J Teff	29,129		157	29,286	5,826	35,112	149,122
Non-executive Directors							
RA Barfield	35,160			35,160		35,160	–
SJO Catlin	26,250			26,250		26,250	12,466
ME McL Deeny	26,250			26,250		26,250	12,466
JAB Joll	36,250			36,250		36,250	19,945
Sir Roger Neville	27,391			27,391		27,391	19,945
Sir Bryan Nicholson	36,250			36,250		36,250	17,452
RB Spooner	26,250			26,250		26,250	12,466
JD Webster						–	17,500
Total	1,329,449	382,000	163,790	1,875,239	228,425	2,103,664	911,628

The benefits-in-kind paid to Mr SP Moser were principally in respect of the costs incurred in his relocation from the United States. As part of his terms of appointment, Mr Moser was entitled to a minimum bonus of £100,000, and this is included in his bonus as stated above.

Messrs ME McL Deeny and RB Spooner also received fees for services as Trustees of The Equitas Trust. Details are shown below.

Under a programme for interest-free season ticket loans available to all employees, a subsidiary company made season ticket loans to Mr AC Pollard. The maximum amount of the liability during the year was £2,988 and the amount outstanding at the end of the year was £2,447 (31 March 1997: £2,246).

No Director waived any emoluments during the periods ended 31 March 1998 and 31 March 1997.

The Group provides benefits-in-kind including medical and death-in-service benefits, and contributes towards the Executive Directors' pension arrangements which are based on defined contributions. A percentage of basic salary is paid into the Group's pension scheme or at the direction of the Executive Director concerned.

The Equitas Trustees

The Trust Deed constituting The Equitas Trust contains provisions entitling the Trustees to remuneration and the discharge of expenses properly incurred by them in acting as Trustees. These are met by the Group.

The remuneration and expenses met by the Group in the year ended 31 March 1998 amounted to £851,982 (period ended 31 March 1997: £157,817). This included an amount of £219,727 which related to costs incurred by the seven Trustees in the previous period. The total amounts expended were in respect of the following:

	Year ended 31 Mar 1998 £	*Period ended 31 Mar 1997 charged in year ended 31 Mar 1998 £*	*Total year ended 31 Mar 1998 £*	*Total seven month period ended 31 Mar 1997 £*
Trustees' fees	171,666	109,583	281,249	67,083
Trustees' legal, professional and other costs and expenses	460,589	110,144	570,733	90,734
Total	632,255	219,727	851,982	157,817

Messrs ME McL Deeny and RB Spooner, who are also Directors of the Company, received fees of £27,228 each for the year ended 31 March 1998 (1997: £8,750 each). They also received fees of £22,090 each paid in the year ended 31 March 1998 for the period ended 31 March 1997. They received expenses for secretarial, office and other overheads of £13,037 and £13,917, respectively (1997: £1,601 and £1,390, respectively). They also received expenses of £8,000 and £8,840, respectively, paid in the year ended 31 March 1998 for the period ended 31 March 1997.

Report of the auditors

to the Members of Equitas Holdings Limited

1. We have audited the financial statements on pages 34 to 51 which have been prepared under the historical cost convention as modified by the revaluation of certain assets and liabilities, and the accounting policies set out in note 1, on page 39.

Respective responsibilities of directors and auditors

2. As described on page 25 the Company's directors are responsible for the preparation of financial statements. It is our responsibility to form an independent opinion, based on our audit, on those statements and to report our opinion to you.

Basis of opinion

3. We conducted our audit in accordance with Auditing Standards issued by the Auditing Practices Board, except that the scope of our work was limited as explained below. Furthermore in the light of the exceptional circumstances of the Group, our opinion is qualified in respect of the uncertainties described below. 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 judgments made by the directors in the preparation of the financial statements, and of whether the accounting policies are appropriate to the circumstances of the Group, consistently applied and adequately disclosed.

4. We planned 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.

Uncertainties and limitations in our audit of claims outstanding, reinsurers' share of claims outstanding and reinsurance recoveries

Uncertainties

5. In forming our opinion, we have considered the uncertainties, described in notes 1 and 15 to the financial statements, relating to the provision for claims outstanding of £11,521 million, reinsurers' share of claims outstanding of £3,046 million and reinsurance debtors of £1,509 million. Future experience may show material adjustments are required to these amounts particularly in respect of:
   (a) assumptions made in estimating provisions and the reliability of the underlying data upon which estimates are based;
   (b) the potential for unforeseen change in the legal, judicial, technological or social environment and the potential for new sources or types of claim to emerge;

(c) assumptions in relation to expected interest yields and the timing of settlement of claims and reinsurance recoveries which influence the discount calculation; and

(d) assumptions in relation to estimating the reinsurers' share of claims outstanding and the appropriate provision in respect of these and amounts due from reinsurers.

Limitations

6. Underlying data, some of which was inherited from the Reserving Project, established by Lloyd's in connection with the Reconstruction and Renewal Plan, is not complete and accurate in all respects.

7. As a consequence, the evidence we considered necessary for our audit is not wholly available in respect of the following:
   (a) the provision for claims outstanding in respect of non-APH liabilities;
   (b) reinsurers' share of claims outstanding; and
   (c) exposure to individual reinsurers and consequently the appropriate level of bad debt provisions.

8. Had we been able to obtain all the evidence necessary to satisfy ourselves in respect of these matters we might have concluded that material increases or decreases are required to the relevant amounts included in the balance sheet.

Consequences of uncertainties and limitations

9. The potential adjustments referred to in paragraphs 5 and 8, if adverse in the aggregate, could be material enough to exceed the amount of the shareholders' funds at 31 March 1998 of £718 million. If at any time the directors determine that there are insufficient assets to meet liabilities in full then, under the contract by which the Group reinsured the 1992 and prior years' liabilities, the directors may implement a proportionate cover plan under which the Group will then be entitled to pay claims at a reduced rate, and liabilities under the Reinsurance Contract will be restricted in aggregate to assets available such that shareholders' funds would not become negative though they may be reduced to nil.

Qualified opinion arising from uncertainties and limitations in our audit

10. In respect alone of the limitations on our work described in paragraphs 6 and 7 above:
    (a) we have not obtained all the information and explanations that we considered necessary for the purpose of our audit; and
    (b) we were therefore unable to determine whether proper accounting records had been maintained.

11. Except for material adjustments in respect of the matters described in paragraphs 5 to 8 above, which may ultimately be required to the provision for claims outstanding, reinsurers' share of claims outstanding, reinsurance recoveries and consequent adjustments to shareholders' funds and the surplus for the year, in our opinion the financial statements give a true and fair view of the state of affairs of the Company and the Group as at 31 March 1998 and of the surplus and cashflows of the Group for the year then ended and have been properly prepared in accordance with the Companies Act 1985.

PricewaterhouseCoopers
Chartered Accountants and Registered Auditors
London
15 September 1998

Group profit and loss account

for the year ended 31 March 1998

Technical account – general business

	Note	Year ended 31 Mar 1998 £m	Year ended 31 Mar 1998 £m	5 Sept 1996 to 31 Mar 1997 £m	5 Sept 1996 to 31 Mar 1997 £m
Gross written and earned premiums	2		**622**		–
Outward reinsurance premiums			**–**		(4)
Net premiums written and earned			**622**		(4)
Investment return transferred from non-technical account			**932**		256
Other technical income	3		**122**		–
Claims paid					
Gross amount		**(2,232)**		(2,534)	
Reinsurers' share		**660**		840	
Net claims paid		**(1,572)**		(1,694)	
Change in the provision for claims					
Claims accepted for premiums written and earned during the year					
Gross amount		**(682)**		–	
Reinsurers' share		**130**		–	
Other changes in the provision					
Gross amount		**2,241**		2,508	
Reinsurers' share		**(646)**		(945)	
Unwinding of the discount		**(756)**		(230)	
Timing of net future payments		**(212)**		95	
Change in the net provision for claims	15	**75**		1,428	
Claims incurred, net of reinsurance			**(1,497)**		(266)
Other technical charges	4		**(15)**		43
Balance on the technical account for general business			**164**		29

No gains and losses have been recognised other than through the profit and loss account and the Group has no discontinued activities.

The accounting policies and notes on pages 39 to 50 form an integral part of these financial statements.

Group profit and loss account

for the year ended 31 March 1998

Non-technical account – general business

	Note	Year ended 31 Mar 1998 £m	£m	5 Sept 1996 to 31 Mar 1997 £m	£m
Balance on the technical account for general business			**164**		29
Income from financial investments		**370**		200	
Gains on realisation of investments		**114**		54	
Movement on unrealised investment gains and losses		**305**		(65)	
Return on financial reinsurances		**143**		67	
Investment return		**932**		256	
Allocated investment return transferred to general business technical account		**(932)**		(256)	
Investment return retained			**–**		–
Surplus on ordinary activities before tax	5		**164**		29
Tax on surplus on ordinary activities	8		**(63)**		–
Retained surplus for the year	14		**101**		29

No gains and losses have been recognised other than through the profit and loss account and the Group has no discontinued activities.

The accounting policies and notes on pages 39 to 50 form an integral part of these financial statements.

Group balance sheet

as at 31 March 1998

Assets

	Note	31 Mar 1998 £m	31 Mar 1997 £m
Investments			
Financial investments	9	**6,187**	5,995
Financial reinsurances	10	**1,367**	1,481
Deposits with ceding undertakings		**–**	1
		7,554	7,477
Reinsurers' share of technical provisions			
– claims outstanding	15	**3,046**	3,128
Debtors			
Debtors arising out of reinsurance operations	12	**1,673**	1,801
Other debtors		**258**	176
		1,931	1,977
Other assets			
Tangible assets		**12**	4
Cash at bank and in hand		**65**	70
		77	74
Prepayments and accrued income			
Accrued interest		**89**	74
Other prepayments and accrued income		**3**	6
		92	80
		12,700	12,736

The accounting policies and notes on pages 39 to 50 form an integral part of these financial statements. The Company's balance sheet is shown on page 51.

Group balance sheet

as at 31 March 1998

Liabilities

	Note	*31 Mar 1998 £m*	*31 Mar 1997 £m*
Capital and reserves			
Called up share capital	13	–	–
Retained surplus	14	**718**	617
Shareholders' funds – non equity interests		**718**	617
Technical provisions			
Gross claims outstanding	15	**11,521**	11,830
Deposits received from reinsurers		**15**	15
Creditors			
Creditors arising out of reinsurance operations	16	**152**	143
Other creditors including taxation and social security	17	**294**	124
		446	267
Accruals and deferred income		**–**	7
		12,700	12,736

The financial statements on pages 34 to 50 were approved by the Board on 15 September 1998 and were signed on its behalf by:

DK Newbigging
MJ Crall
JV Barker

The accounting policies and notes on pages 39 to 50 form an integral part of these financial statements.

Group cashflow statement

for the year ended 31 March 1998

Reconciliation of surplus on ordinary activities before tax to net cash (outflow)/inflow from operating activities

	Note	Year ended 31 Mar 1998 £m	Year ended 31 Mar 1998 £m	5 Sept 1996 to 31 Mar 1997 £m	5 Sept 1996 to 31 Mar 1997 £m
Surplus on ordinary activities before tax			**164**		29
Depreciation of tangible fixed assets	5	**2**		–	
Exchange gains on retranslation of opening balances		**(2)**		(28)	
Movement on unrealised investment gains and losses		**(305)**		65	
Return on financial reinsurances		**(143)**		(67)	
Decrease in provision for gross claims outstanding		**(143)**		(2,420)	
Decrease in reinsurers' share of technical provisions – claims outstanding		**35**		992	
Decrease in debtors		**10**		3,520	
Increase/(decrease) in creditors		**132**		(401)	
			(414)		1,661
Net cash (outflow)/inflow from operating activities			**(250)**		1,690
Taxation paid			**(31)**		–
Capital expenditure			**(10)**		(3)
Net cash (outflow)/inflow for the year			**(291)**		1,687
Cashflows were invested as follows:					
Decrease in cash holdings	19		**(6)**		(992)
Net portfolio investment					
Deposits with credit institutions		**156**		(237)	
Financial reinsurances		**(241)**		(89)	
Shares and other variable yield securities and units in unit trusts		**(4)**		–	
Debt securities and other fixed-interest securities		**(196)**		3,005	
	19		**(285)**		2,679
Net investment of cashflows	20		**(291)**		1,687

The accounting policies and notes on pages 39 to 50 form an integral part of these financial statements.

Notes to the financial statements

for the year ended 31 March 1998

1 Accounting policies

Going concern

Significant uncertainties exist as to the accuracy of the provision for gross claims outstanding established by Equitas Limited and recoveries due from reinsurers shown in the balance sheet, further details of which are set out in note 15 to the financial statements. The ultimate cost of claims and the amounts ultimately recovered from reinsurers could vary materially from the amounts established and could, therefore, have a materially adverse effect on the ability of Equitas Limited to meet the reinsurance liabilities in full.

In addition, there is uncertainty as to whether actual investment yields and the actual timing of claims settlements and reinsurance recoveries will match those assumed in discounting the provision for claims outstanding and reinsurance recoveries. Further details of these uncertainties are set out in note 15 to the financial statements.

If at any time, the Directors of Equitas Reinsurance Limited believe that the reinsured liabilities cannot be met in full, they may consider implementing a proportionate cover plan. At the date of this report, the Directors believe that the assets should be sufficient to meet all liabilities in full.

Basis of accounting

The financial statements of the Group have been prepared in accordance with applicable accounting standards in the United Kingdom, current guidance on accounting for insurance business issued by the Association of British Insurers and in accordance with Section 255A of, and Schedule 9A to, the Companies Act 1985. A summary of the more important accounting policies, which have been applied consistently, is set out below.

The financial statements are prepared in accordance with the historical cost convention modified by the revaluation of certain assets and liabilities.

(a) Basis of consolidation

The consolidated financial statements incorporate the financial statements of the Company and its subsidiaries from 1 April 1997 to 31 March 1998.

(b) Premiums

Gross premiums receivable are earned when reinsurance business is written and are credited in full to the profit and loss account. Outward reinsurance premiums payable are charged in full to the profit and loss account when incurred.

(c) Claims and related reinsurance recoveries

The provision for claims outstanding in the consolidated balance sheet is based upon the estimated ultimate cost of all claims incurred but not settled at the balance sheet date, whether reported or not, together with related claims handling expenses. Provisions for claims outstanding are stated gross of recoveries to be made on reinsurance contracts purchased by the reinsured syndicates in recognition of the fact that they are separate liabilities and assets of the Group.

Claims incurred include all operational expenses relating to the run-off of the reinsured liabilities. Deductions are made for salvage and other recoveries. Additional premiums receivable and payable by syndicates in respect of risks accepted under the reinsurance are included within the movement of claims incurred.

The adequacy of the provision for claims outstanding is assessed by reference to actuarial and other studies of the ultimate cost of liabilities, which use exposure based and statistical techniques. Significant delays occur in the notification and settlement of certain claims, and a substantial measure of experience and judgment is involved in assessing outstanding liabilities, the ultimate cost of which cannot be known with certainty at the balance sheet date. The gross provision for claims outstanding and the related reinsurance recoveries are determined on the basis of information currently available; however, it is inherent in the nature of the business written that the estimates of the ultimate liabilities will vary as a result of subsequent developments.

(d) Discounting

As the reinsured liabilities will not be fully settled for many years, the provisions for claims outstanding and related reinsurance recoveries have been discounted (see note 15). The Group has structured its asset portfolio to match its expected liability stream. Accordingly the rate of discount applied to its liabilities is calculated having regard to the current prospective yields associated with its asset portfolio.

(e) Tangible assets

Tangible assets are stated at cost less accumulated depreciation. The cost of tangible assets is their purchase cost together with any incidental costs of acquisition. Depreciation is calculated so as to write off the cost of tangible assets, less their estimated residual values, on a straight line basis over the expected useful economic lives of the assets concerned.

(f) Deferred taxation

Provision is made for deferred taxation, using the liability method, on all material timing differences to the extent that it is probable that a liability or asset will crystallise in the foreseeable future.

(g) Investments

Listed investments are stated at mid-market value based on prices quoted by the relevant exchanges. Other investments are stated at prices quoted by various recognised sources. In the Company's accounts, investments in Group undertakings are stated at cost.

(h) Financial reinsurances

In accordance with Financial Reporting Standard 5 – Reporting the Substance of Transactions, financial reinsurance policies are accounted for as investment assets. They are stated at the value of the expected receipts discounted at their market yields to recognise the period until receipt. The change in the amount by which these assets are discounted from one period end to the next is recognised as investment return.

(i) Investment return

The return from investments, which is on an accruals basis, is transferred together with the related tax credit to the technical account.

(j) Foreign exchange

Assets and liabilities are translated to Sterling at the rates of exchange ruling at the balance sheet date and the exchange differences taken to the profit and loss account. Transactions during the period are translated into Sterling using the rate of exchange prevailing at the time of the transaction with the exchange gains and losses included within other charges in either the technical account or the non-technical account according to the transaction type.

(k) Pension costs

The Group operates a defined contribution pension scheme. Contributions payable to the scheme are charged in the period in which they are incurred.

The Group provides no other post-retirement benefits to its employees.

(l) Leases

Operating lease costs are charged in the period in which they are incurred.

2 Segmental and premium information

The Group transacts only one class of business, being 100 per cent proportional reinsurance written in the United Kingdom. The premium for the reinsurance of the business previously reinsured by Lioncover Insurance Company Limited, pursuant to the Lioncover Reinsurance Contract dated 18 December 1997, has been credited in full to the profit and loss account for the year ended 31 March 1998 since it was earned when written.

3 Other technical income

Other technical income includes the release of £103 million from a prudent provision against the reinsurance premium in the Group's opening accounts as at 4 September 1996. The balance represents recoveries on assets in excess of their book values.

4 Other technical charges

Other charges in the technical account relate to foreign exchange differences.

5 Surplus on ordinary activities before tax

The surplus is stated after charging:

	Group year ended 31 Mar 1998 £m	*Group period ended 31 Mar 1997 £m*
Auditors' remuneration – audit fees	**3.5**	3.3
– non-audit fees	**1.5**	0.5
Remuneration to other firms for audit of syndicate returns	**–**	1.0
	5.0	4.8
Depreciation – tangible owned fixed assets	**2.2**	0.3
Operating lease rentals incurred – property	**2.9**	0.2
– other	**0.9**	0.5

The audit fees for the Company were borne by a subsidiary company.

Details of related party transactions, as defined by Financial Reporting Standard 8, are given on page 30.

6 Employees

The monthly average number of persons employed by the Group, including Executive Directors, was 723 for the year ended 31 March 1998 (522 during the period 5 September 1996 to 31 March 1997), all of whom were engaged in run-off and related activities.

Total staff costs, including those for Executive Directors, comprised the following:

	Group year ended 31 Mar 1998 £m	*Group period ended 31 Mar 1997 £m*
Wages and salaries	**26**	15
Social security costs	**2**	1
Pension contributions	**3**	1
	31	17

7 Directors' emoluments

The aggregate remuneration of the Directors was as follows:

	Group year ended 31 Mar 1998 £000	*Group period ended 31 Mar 1997 £000*
Chairman	**200**	110
Executive Directors – remuneration	**1,462**	594
– pension contributions	**228**	96
Non-executive Directors – fees	**214**	112
	2,104	912

The emoluments of the Chairman were £200,000 (1997: £110,382). No pension contributions were paid on his behalf. Full details of the remuneration of, and transactions with, Directors, including the remuneration of the highest paid Director, are given on page 28.

8 Tax on surplus on ordinary activities

	Group year ended 31 Mar 1998 £m	*Group period ended 31 Mar 1997 £m*
United Kingdom corporation tax at 31% (1997:33%)		
Current	**29**	–
Underprovision in respect of prior years	**34**	–
	63	–

Tax relief in respect of asset valuation deficits netted in the original Equitas Premium has been disallowed. The taxation charge in respect of the current and prior year arises as a result of negotiations with the Inland Revenue in respect of this disallowance.

9 Investments: financial investments

	Group as at 31 Mar 1998 £m	*Group as at 31 Mar 1997 £m*
Shares and other variable yield securities and units in unit trusts	**–**	4
Debt securities and other fixed-interest securities	**5,691**	5,648
Deposits with credit institutions	**496**	343
	6,187	5,995

At 31 March 1998 the cost of the above investments, which are stated at their market value, was £5,950 million (31 March 1997: £6,060 million).

Included above are investments listed on a recognised stock exchange in Great Britain with a market value of £1,451 million (31 March 1997: £1,507 million).

Certain investments are held in trust funds as described in note 11.

10 Investments: financial reinsurances

The average prospective rate of return on financial reinsurances is 6.3 per cent (as at 31 March 1997: 7.2 per cent) per annum. The mean term is five (as at 31 March 1997: six) years. The value of the expected receipts from financial reinsurances, before discounting at their market yields to recognise the period until receipt, is £1,808 million (31 March 1997: £2,083 million).

11 Trust funds

Financial investments amounting to £3,158 million (31 March 1997: £3,606 million) and cash amounting to £3 million (31 March 1997: £2 million) were held in trust funds in the United States and Canada. In addition, all proceeds of financial reinsurances are assigned to a trust fund in the United States. These trust funds were established under the laws of those countries for the settlement of claims relating to those jurisdictions. The amounts held in these trust funds cannot be used for any other purpose and can only be released with the appropriate regulatory consent if there is a surplus of assets over the liabilities they support.

12 Debtors arising out of reinsurance operations

	Group as at 31 Mar 1998 £m	*Group as at 31 Mar 1997 £m*
Unpaid premium	**97**	244
Reinsurance recoveries	**1,509**	1,481
Other	**67**	76
	1,673	1,801

The unpaid premium is being collected by the Corporation of Lloyd's on the Group's behalf and includes £14.5 million (31 March 1997: £14.7 million) receivable through a structured payment plan secured upon bank guarantees. The remaining amount mainly consists of brokers' contributions under deferred payment arrangements.

Reinsurance recoveries are stated after elimination of inter-syndicate transactions.

13 Called up share capital

	Company as at 31 Mar 1998 £	*Company as at 31 Mar 1997 £*
Authorised, allotted and called up		
1 deferred share of £1	**1**	1
2 ordinary shares of £50 each	**100**	100
	101	101

All of these shares were issued at par and are fully paid.

The deferred share carries the right to appoint and remove one Director of Equitas Holdings Limited (who will also serve as a Director of Equitas Reinsurance Limited and Equitas Limited) and is held by the Corporation of Lloyd's. On winding up, the deferred share carries no rights to any portion of surplus assets of the Company other than a return of the par value; it is accordingly a non-equity share.

The ordinary shares bear the right to appoint and remove the remaining Directors of the Company and to decide on all matters reserved for decision by shareholders. The Articles of Association do not permit the payment of a dividend on the ordinary shares. Accordingly, these are non-equity shares.

14 Retained surplus

	Company £	*Group £m*
At 1 April 1997	–	617
Retained surplus for the year	–	101
At 31 March 1998	–	718

The retained surplus is not distributable.

15 Provision for claims outstanding

	Group as at 31 Mar 1998			*Group as at 31 Mar 1997*		
	Claims £m	*Reinsurance £m*	*Net £m*	*Claims £m*	*Reinsurance £m*	*Net £m*
Provisions before discounting	**16,296**	**4,245**	**12,051**	17,674	4,745	12,929
Discount	**(4,775)**	**(1,199)**	**(3,576)**	(5,844)	(1,617)	(4,227)
	11,521	**3,046**	**8,475**	11,830	3,128	8,702

Provision has been made for the estimated cost of all future claims liabilities including those incurred but not reported ('IBNR') at the balance sheet date and for the operational cost of handling and settling these liabilities. The provision for claims outstanding is based on actuarial and other assessments of ultimate claims costs including exposure based and statistical methods. While the Group has taken into account all available information within its assessment of future claims liabilities, there is nevertheless significant inherent uncertainty. The ultimate liability may vary as a result of subsequent

information and events which may result in significant adjustments being made to the amounts provided.

(a) Claims

The provision for claims outstanding includes significant amounts in respect of notified and potential IBNR claims relating to long-tail liabilities. These claims are not expected to be settled for many years, and there is considerable uncertainty as to the amounts at which they will be settled. The principal components of long-tail liabilities are asbestos, pollution and health hazard (APH) liabilities, which comprised approximately 50 per cent (31 March 1997: 40 per cent) of the net discounted provision for claims outstanding.

Potential APH liabilities have been estimated by means of exposure based analyses of the global losses and potential insurance claims arising from these causes and the Lloyd's market share of these claims. These analyses involved the use of many critical assumptions which have a significant effect on the quantification of claims liabilities. These assumptions included those in respect of numbers of and average costs per claim, the basis of liability and insurance coverage issues. Uncertainty is further increased because of the potential for unforeseen changes in the legal, judicial, technological or social environment, which may increase or decrease the cost, frequency or reporting of claims, and because of the potential for new sources or types of claim to emerge.

Non-APH liabilities comprised approximately 50 per cent (31 March 1997: 60 per cent) of the net discounted provision for claims outstanding. The estimation of the majority of these liabilities involved the analysis of separate homogeneous sub-divisions of the underlying syndicate historical claims experience by underwriting year and currency. This assessment also included the review of the results of independent actuarial studies undertaken for a number of syndicates and the establishment of market benchmarks against which to compare the estimates of liabilities. Notwithstanding the analytical nature of the methodologies adopted, significant judgment was required to determine the necessary level of provision for claims outstanding.

The provision for the cost of handling and settling the claims to extinction was based on an analysis of the expected costs to be incurred in run-off activities and adjusted to reflect savings expected to arise as a result of centralisation and reduction of transaction volumes over time. There are inherent uncertainties in projecting future costs which will be incurred over an extended period of time.

(b) Reinsurance recoveries

Reinsurance recoveries are stated after elimination of inter-syndicate transactions.

In determining the expected reinsurance recoveries on claims outstanding, assumptions have been made about the distribution of these claims based on a combination of historical claims experience and the reinsurance programmes of the Lloyd's syndicates which were reinsured. The reinsurance policies were purchased from approximately 2,900 reinsurers, some of which are no longer paying claims or are subject to insolvency procedures. Provision has been made where companies are currently, or are considered to be at risk of being in the future, unable or unwilling

to settle their liabilities when due. No single reinsurer accounts for more than 4 per cent (31 March 1997: 4 per cent) of the total recoveries before discounting.

If the actual experience differs from these assumptions, material adjustments may be required to the amount of reinsurance recoveries, including those amounts within debtors arising out of reinsurance operations.

(c) Discounting

The provision for claims outstanding and the cost of undertaking the run-off has been discounted at a rate of 5.25 per cent (31 March 1997: 6 per cent) per annum compound to reflect the time value of money. An adjustment for non-interest bearing assets has been made. The period of time which will elapse before the liabilities are settled has been estimated by modelling the settlement patterns of the underlying claims and associated reinsurance recoveries separately. The long-tail liabilities are expected to be paid out over a period in excess of 40 years with the majority of the remaining liabilities expected to be settled in the next several years. As at 31 March 1998, the mean term of the liabilities, that is the weighted average period to settlement where the weights are the undiscounted expected cashflows in each future period, was approximately eight (31 March 1997: eight) years.

At each balance sheet date a portion of the increase in the liability for claims outstanding compared to the previous reporting date will relate to discounted claims not yet settled being one period closer to settlement. In effect, one year's interest at the previously assumed discount rate has to be credited to discounted claims which are still outstanding in order to revalue them to the balance sheet date. In addition, any change to the discount rate employed compared to the previous balance sheet date will, other things being equal, result in an increase or decrease to the discounted liability. The combination of these two features is referred to as the 'unwinding' of the discount.

The ability to settle the liabilities in full is also dependent upon the generation of sufficient investment income to match the increase in insurance liabilities that will result each year from the unwinding of the discount. There are uncertainties in forecasting the generation of such investment income, which may vary due to changes in interest rates, exchange rates, the ultimate cost of claims, and the timing of liability settlements and reinsurance recoveries. If there is insufficient investment income to offset the increase in the discounted liabilities arising from the unwinding of the discount, the resulting shortfall will be accounted for through the profit and loss account.

16 Creditors arising out of reinsurance operations

	Group as at 31 Mar 1998 £m	*Group as at 31 Mar 1997 £m*
Amounts due in less than one year	**142**	139
Amounts due in more than one year but less than five years	**2**	2
Amounts due in more than five years	**8**	2
	152	143

17 Other creditors including taxation and social security

These balances are all payable in less than one year.

18 Reconciliation of movements in shareholders' funds

	Group as at 31 Mar 1998 £m	*Group as at 31 Mar 1997 £m*
Opening shareholders' funds	**617**	588
Surplus for the year (see note 14)	**101**	29
Closing shareholders' funds	**718**	617

The Company made neither a profit nor a loss for the year. As permitted by Section 230 of the Companies Act 1985, the Company does not present its own profit and loss account.

19 Movement in opening and closing portfolio investments net of financing

	Group as at 31 Mar 1998 £m	*Group as at 31 Mar 1997 £m*
Net cash outflow for the year (see note 20)	(6)	(992)
Movement arising from cashflows of portfolio investments	**(285)**	2,679
Changes in market values and discount (see note 20)	**448**	2
Other changes, including exchange rate effects (see note 20)	**(85)**	(205)
Total movement in portfolio investments net of financing	**72**	1,484
Opening portfolio investments net of financing (see note 20)	**7,531**	6,047
Closing portfolio investments net of financing (see note 20)	**7,603**	7,531

20 Movement in cash, portfolio investments and financing

	At 31 Mar 1997 £m	Cashflow £m	Changes to market values and discount £m	Other changes, including exchange rate effects £m	At 31 Mar 1998 £m
Cash at bank and in hand	55	(6)	–	–	**49**
Deposits with credit institutions	343	156	–	(3)	**496**
Financial reinsurances	1,481	(241)	143	(16)	**1,367**
Shares and other variable yield securities and units in unit trusts	4	(4)	–	–	**–**
Debt securities and other fixed-interest securities	5,648	(196)	305	(66)	**5,691**
	7,531	(291)	448	(85)	**7,603**

During the year debt securities and other fixed-interest securities of £9,842 million (1997: £15,549 million) were purchased and £10,038 million (1997: £12,544 million) were sold. Cash at bank and in hand as at 31 March 1998 is stated net of £16 million (1997: £15 million) of overdrafts.

21 Contingent liabilities

The Group has granted certain indemnities to Trustees, Directors, employees and the auditors.

Apart from these indemnities, the Group has no contingent liabilities outside the normal course of business at the balance sheet date.

22 Investments in Group undertakings

Company Name	*Class and proportion of shares held*	*Country of incorporation*	*Business activities*
Equitas Reinsurance Limited	Ordinary 100%	England	Reinsurance
Equitas Limited*	Ordinary 100%	England	Reinsurance Run-off
Equitas Management Services Limited	Ordinary 100%	England	Provision of administrative services
Equitas Policyholders Trustee Limited	Ordinary 100%	England	Trustee

**Held via a subsidiary.*

No dividends may be paid or capital distributions made by Equitas Reinsurance Limited or Equitas Limited. Any surplus assets would be applied by Equitas Reinsurance Limited towards the payment of a return premium to Reinsured Names.

23 Financial commitments

	Group as at 31 Mar 1998 £m	Group as at 31 Mar 1997 £m
Expiring within one year	**1**	1
Expiring between two and five years inclusive	**1**	1
Expiring in over five years	**2**	2
	4	4

24 Post balance sheet event

As part of the Reconstruction and Renewal Completion Agreement, Lloyd's had an obligation to make a payment to Equitas Limited of up to £100 million in February 2002 to protect Equitas from adverse movements in interest rates and the possible shortfall in some deferred payments. In August 1998 an agreement was reached with Lloyd's to pay Equitas Limited £66 million in early settlement of this obligation. This amount was paid by Lloyd's to Equitas Limited on 13 August 1998. No adjustment has been made in the financial statements for the year ended 31 March 1998 in respect of this receipt.

Company balance sheet

as at 31 March 1998

	Note	31 Mar 1998 £	31 Mar 1997 £
Fixed assets			
Investments – investments in Group undertakings	22	**300**	300
Current assets			
Amounts due from a Group undertaking		**1**	1
Net current assets		**1**	1
Creditors – amounts falling due after more than one year			
Amounts owed to Group undertakings		**200**	200
Net assets		**101**	101
Capital and reserves			
Called up share capital	13	**101**	101
Profit and loss account	14	**–**	–
Shareholders' funds – non equity interests		**101**	101

The financial statements on pages 39 to 51 were approved by the Board on 15 September 1998 and were signed on its behalf by:

DK Newbigging
MJ Crall
JV Barker

The accounting policies and notes on pages 39 to 50 form an integral part of these financial statements.

Equitas Group

Chairman
David Newbigging

Chairman-Designate
Hugh Stevenson

Executive Directors
Michael Crall, *Chief Executive Officer*
Jane Barker, *Finance Director*
Scott Moser, *Claims Director*
Alan Pollard, *Run-off Operations Director*

Non-executive Directors
Dick Barfield
Stephen Catlin
Michael Deeny
James Joll
Sir Roger Neville
Sir Bryan Nicholson
Richard Spooner

Company Secretary and Corporate Counsel
Gisela Gledhill

Registered Office and Operating Head Office
33 St Mary Axe
London EC3A 8LL
Telephone: 0171 342 2000
Facsimile: 0171 342 2001

Bankers
Midland Bank plc
Barclays Bank plc
Citibank, NA
Royal Trust Corporation of Canada
Bankers Trust Company

Auditors
PricewaterhouseCoopers

Legal Advisors
Freshfields

Designed and produced by Fishburn Hedges

Notice to Reinsured Names

Reinsured Names should note that the Reinsurance and Run-off Contract dated 3 September 1996 requires them to notify Equitas Reinsurance Limited of a change of address or, if so required, to provide written confirmation of their addresses. Equitas Reinsurance Limited does not require written confirmation of a Reinsured Name's address at this time, but changes in address in the past 12 months (unless previously notified) should be sent to the Company Secretary, Equitas Reinsurance Limited, 33 St Mary Axe, London EC3A 8LL within 21 days from receipt of this report.

Equitas Holdings Limited
33 St Mary Axe
London EC3A 8LL