Report & Accounts

for the year ended 31 March 2001

Overview

In the year ended 31 March 2001:

- Accumulated surplus after tax decreased from £784 million to £700 million.
- Solvency margin, being accumulated surplus expressed as a percentage of net claims outstanding, decreased from 11.2 per cent to 9.5 per cent.

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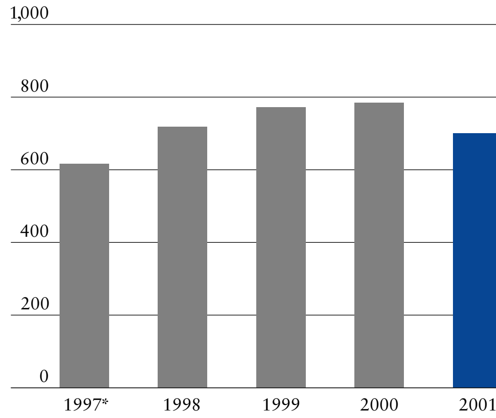
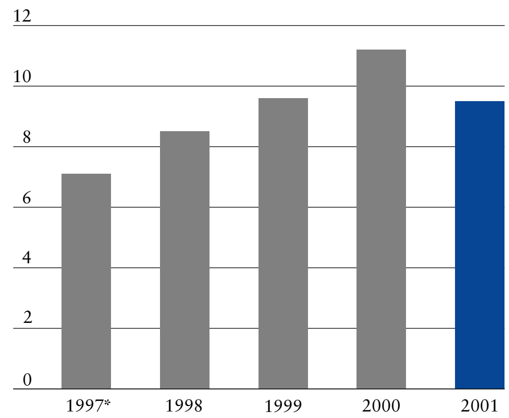
Five year results
as at 31 March

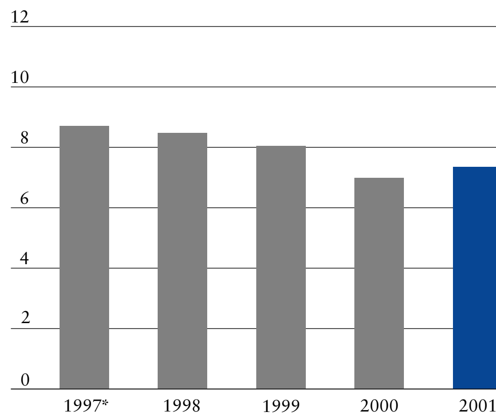
Accumulated surplus (£m)



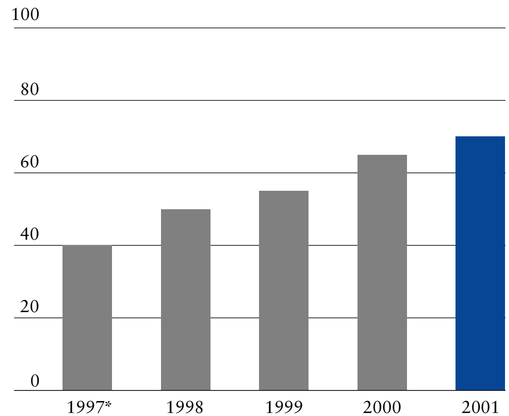
Solvency margin (%)



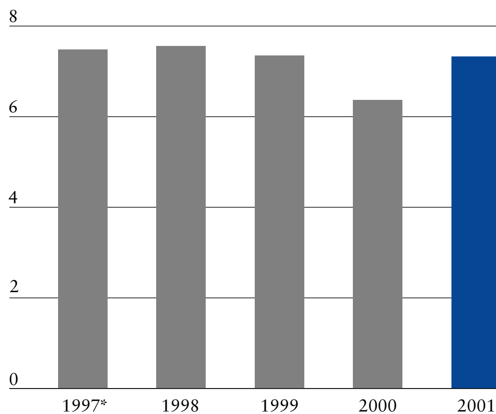
Net claims outstanding (£bn)[1]



APH claims as a percentage of net claims outstanding (%)[1]



Investments (£bn)



* Does not include Lioncover business

[1] Claims figures are shown net of discounting

Chairman’s statement

Hugh Stevenson

In the financial year ended 31 March 2001:

- Accumulated surplus after tax decreased from £784 million to £700 million; and
- The solvency margin, being accumulated surplus expressed as a percentage of net claims outstanding, decreased from 11.2 per cent to 9.5 per cent.

When I wrote to Reinsured Names in November 2000, I stated that it was probable that we would further strengthen asbestos reserves at the end of the year. This has indeed proved to be the case. As a result of the annual comprehensive review of claims liabilities and future reinsurance recoveries, the Group added £1.7 billion on an undiscounted basis, gross of reinsurance, to the provision for asbestos claims. The increase in asbestos reserves has more than offset the entirety of the gains produced in all other areas of the business and has accounted for the decrease in accumulated surplus and solvency margin.

In every area of the business, except for asbestos, the Group made encouraging progress. Claims settlements in the aggregate produced a significant contribution to surplus, as did the collection of reinsurance and the commutation of reinsurance contracts. Investment income again exceeded the unwinding of the discount applied to the claims liabilities, resulting in a balance sheet gain. Operating expenses were less than budgeted, and we exceeded our target of reducing expenses by at least 15 per cent per annum.

Michael Crall describes the performance of our core business activities in his Chief Executive Officer’s Review on pages 5 to 10, while Jane Barker analyses the accounts and the financial contributions made by these activities in her Financial Review on pages 11 to 15.

The need to add to asbestos reserves has not come as a surprise. A year ago we substantially strengthened our reserves and revised our expectations regarding future claims filings in the United States. Many other insurers, as well as leading actuarial and investment advisory firms, followed us in increasing their estimates of future asbestos claims. However, the level of claims filings in the past year was even higher than our revised expectations, making it again necessary

for us to strengthen reserves. Gross undiscounted asbestos reserves now amount to more than £8 billion, representing nearly 60 per cent of gross undiscounted claims reserves.

Asbestos is the biggest single threat to Equitas, and we report in depth on this subject on pages 16 to 27. This special report includes information regarding the nature of asbestos liabilities, explains why claims filings are increasing and provides an estimate of the cost of these claims. The report also details some of the active steps which we are taking to manage asbestos liabilities. We are well aware that Reinsured Names would like to receive as much information as possible regarding asbestos liabilities, and we have gone as far as we can to meet their wishes without disclosing information that could be commercially sensitive.

In the light of the need to strengthen asbestos reserves, it is not surprising that the Auditors continue to qualify their report on the Group's accounts because of the uncertainty inherent in the business which Equitas has reinsured. The terms of this qualification are unchanged from a year ago. Both the audit qualification and the need to strengthen asbestos reserves are a reminder – if one were needed – that Equitas has little or no control over many important external factors which could threaten our stability, such as legal developments, judicial decisions and social trends, or the emergence of new health hazards.

The balance sheet of Equitas is weaker than it was a year ago, and because asbestos now represents such a large proportion of our claims reserves, the uncertainties facing Equitas are greater than ever. As I have stated in the past, success cannot be guaranteed, and we cannot be sure that we will achieve our prime objective of reducing these uncertainties to such an extent that Reinsured Names can disregard the risks which they still face from their underwriting at Lloyd's in respect of 1992 and prior years of account.

In making a judgment about what will happen in the future, however, the Board has also paid particular regard to the following:

- Since Equitas was established in 1996, it has been necessary to strengthen gross discounted claims reserves by an aggregate of more than £1.8 billion. Notwithstanding this increase, accumulated surplus has risen from £588 million to £700 million and the solvency margin has risen from 5.6 per cent to 9.5 per cent through the successful actions taken by the management in settling claims, negotiating commutations and managing our investment portfolio.
- Even though aggregate claims paid have exceeded £11 billion over the life of Equitas up to 31 March 2001, cash and investments at that date amounted to £7.4 billion, which is nearly as great as the highest level in the Group's history.
- Most asbestos claims will not be received – let alone paid – for many years to come. While the provision for future asbestos claims has increased significantly over the past two years, actual cash payments in respect of such claims during the period have been lower than our previous estimates. In the past year, such cash payments represented 5 per cent of our total undiscounted asbestos provision.
- The Equitas team has established an outstanding track record in dealing with long tail liabilities. The special report on pages 16 to 27 describes the steps which are now being taken to manage asbestos liabilities.

We consider that the strategies we have put in place are sound and, as of the date of this report, the Directors believe that the Group's assets should be sufficient to meet all liabilities in full.

As has been previously announced, Paul Jardine, our Commutations Director and Chief Actuary, will be leaving Equitas at the end of September. Paul has made major contributions to Equitas' progress since he joined the company in 1996, not the least of which was to assemble high quality teams to carry out our reserving and commutation functions. Because of this depth of talent, I am confident that excellent results will continue in both of these areas despite Paul's departure.

It is essential that Equitas seeks to attract, motivate and retain the best possible people to manage the Group. The vast majority of our claims originate in the United States, and it is important that our executives should be able to negotiate successfully within the claims environment and judicial system of that country. While our liabilities remain very large, the size of the organisation is relatively small. It follows that the contribution to our results which can be made by senior executives far outweighs the cost of employing them. I have no doubt that the remuneration of our talented and experienced management team has been and continues to be money very well spent.

Equitas' remarkable achievements are largely the result of the leadership exhibited by the Executive Directors and the skill, hard work and dedication of the people who work for Equitas. I offer all of them my sincerest thanks.

Hugh Stevenson
Chairman
17 July 2001

Chief Executive Officer's review

Michael Crall

Because of the need to strengthen reserves for future asbestos claims, Equitas' accumulated surplus decreased during the year ended 31 March 2001 for the first time in the Group's history. The number of asbestos bodily injury claims filed in the United States in the past year has increased substantially, exceeding previous actuarial estimates. There is evidence that suggests that claimants are filing claims against more defendants. This should not mean that the claimants will recover more than the value of their claims; it simply means that claimants have more defendants from which to procure this value. Consequently, increases in claim filings do not necessarily represent equivalent increases in liabilities for defendants and insurers.

Taking a prudent view of this rapidly changing environment, we strengthened our provision for asbestos claims by £1.7 billion on a gross undiscounted basis in the year ended 31 March 2001. This increase follows a £1.5 billion addition to gross undiscounted asbestos reserves during the previous year.

The increase in asbestos claims filings has affected not only Equitas, but also the companies that manufactured or distributed products containing asbestos as well as insurers worldwide. In the past 18 months, eight major US companies have filed for bankruptcy protection because of the growing numbers of asbestos bodily injury claims made against them. It is likely that additional companies will file for bankruptcy because of asbestos claims in the next year. In addition, other insurers have substantially strengthened their reserves for asbestos related claims, while various actuarial and investment advisory firms have significantly increased their estimates of ultimate asbestos claims costs.

A special report on asbestos claims appears on pages 16 to 27. The report not only gives comprehensive information as to why asbestos claims filings have increased at such a rapid rate, but also outlines the strategies we have adopted to manage these claims. These strategies have been formulated as the result of an intensive review of asbestos claims by Equitas and leading London Market insurance companies. While it is extremely difficult to estimate the ultimate size of our asbestos exposure, we are optimistic that these strategies will have a significant positive impact on the cost of asbestos claims to Equitas in future years. As is the case with

other categories of reserves, our asbestos reserves are determined after making judgments and assumptions regarding our success in managing actual cases as well as forecasting the impact of future external developments.

Since the inception of the Group, strengthening reserves for future asbestos claims has represented a major drag on Equitas' financial results. Over that period positive results in other areas of the business have nevertheless more than offset the impact of asbestos. In the past year, the cost of asbestos reserve strengthening was once again substantially blunted by positive operational results, and each of our core business activities – claims management, reinsurance management and investment management – made a significant contribution to surplus:

- Claims management and reinsurance management produced a combined contribution to surplus of £315 million. This contribution arose from the completion of claims and commutations agreements at favourable values compared with those carried on the balance sheet.
- Investment return exceeded the unwinding of the discount applied to claims liabilities by £96 million.
- Our operating expenses for the year of £145 million were £5 million under budget.

We have met or exceeded the operational targets that we established at the beginning of the year, and we believe that the operating strategy outlined a year ago remains appropriate. The key elements of this strategy are to:

- resolve claims at values within our reserves at the earliest appropriate opportunity and to secure, where possible, releases which close off sources of future claims;
- commute syndicate reinsurance programmes whenever we can do so at an appropriate value, thereby converting current and future reinsurance recoverables into cash;
- produce an investment return in excess of the unwinding of the discount;
- keep costs below the levels assumed in our reserves by reducing expenses each year by at least 15 per cent; and
- continue to enhance our core skills – including claims management, deal making and portfolio evaluation – to enable us to deliver the other elements of our strategy.

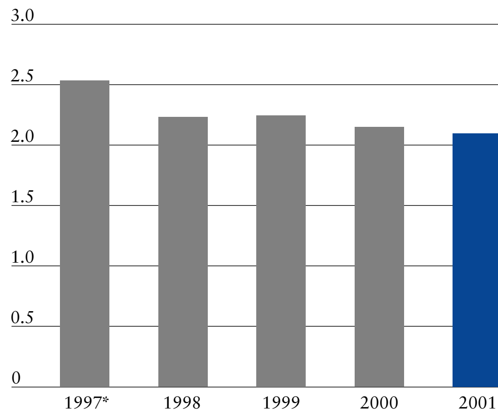
Additionally, as discussed in the special report, our strategy calls for intensive efforts to identify and implement all appropriate actions to meet the challenges presented by the asbestos situation.

Claims management

Gross claims paid, an amount which includes claims resolved through commutation agreements as well as the Group's operating expenses, totalled £2.10 billion in the year ended 31 March 2001, a reduction from the £2.15 billion paid the previous year. Equitas has paid more than £11 billion in gross claims since it was formed nearly five years ago. In the past year alone, we closed nearly 53,000 individual direct and inwards reinsurance claims.

We continued to make progress in key areas of the claims portfolio. We have again achieved

Gross claims paid (£bn)



*Seven month period

good results in settling environmental pollution claims. During the past year we closed 116, or 29 per cent, of the 404 open direct pollution claims pending at 1 April 2000. Furthermore, we settled 44 per cent of the direct pollution claims with reserves in excess of £10 million at 1 April 2000. We continue to receive a broad release from future claims from the policyholder as part of most of these settlements. After taking into account new claims, the number of open pollution claims decreased during the year to 329.

We have also improved our ability to measure and document our claims outcomes. For example, we benchmarked 30 major pollution claims settlements made by Equitas against the settlements made by other insurers in the same cases. In 25 of these cases, our results were better than the other insurers'. The results were the same in one case, while our results were worse than the other companies' in only four cases.

We have not identified any previously unknown health hazard in the past year which we believe could create a material liability for the Group. We continue to track developments regarding previously known health hazards, including tobacco. We do not believe that tobacco claims will create a significant liability for Equitas. Our analysis of several large tobacco liability judgments awarded by US courts in the past year has not altered that assessment.

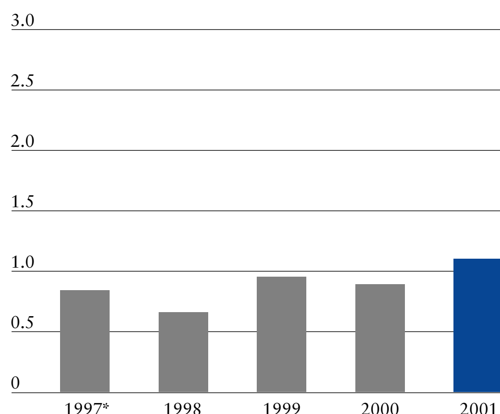
We have also made good progress in settling non-APH (asbestos, pollution and health hazard) claims, also known as 'balance of account' claims. As reflected in the chart on page 1, APH claims now represent 70 per cent of net discounted liabilities, up from 65 per cent on 31 March 2000 and 40 per cent on 4 September 1996 when Equitas began operations. Because APH claims develop more slowly than balance of account claims, APH reserves will inevitably rise as a percentage of overall reserves as time passes.

Reinsurance management

Reinsurers' share of paid claims amounted to £1 billion in the year ended 31 March 2001, compared with £892 million the previous year.

We have continued to pursue the commutation of reinsurance contracts, as well as managing the collection of reinsurance debt by traditional means. Commuting reinsurance contracts as quickly as possible is the preferred strategy for Equitas. While reinsurance is normally purchased as protection against uncertainty, the reinsurance programmes that protected individual Lloyd's syndicates were not designed to protect the aggregate portfolio of liabilities created with the formation of Equitas. These assets do not produce any income for Equitas. Reinsurance collection is a time consuming and costly process, and collection of reinsurance debt is often hampered by market-wide disputes affecting all reinsurers, not only

Reinsurers' share of paid claims (£bn)



*Seven month period

Equitas. As an added benefit, a commutation often extinguishes inwards reinsurance claims liabilities in the process of realising outward reinsurance proceeds.

In the past year, we finalised more than 100 commutation agreements, nearly 30 more than the previous year, including agreements with some of our largest counterparties. Nearly £1 billion in aggregate reinsurance asset – including both amounts owed in respect of past claims payments and amounts to be collected on future claims settlements – was realised through commutations last year. Since the formation of Equitas, we have liquidated more than £5 billion of the reinsurance asset, with more than half of this amount attributable to commutations. Realising reinsurance asset has contributed to the increase in investments from £6.4 billion on 31 March 2000 to £7.3 billion on 31 March 2001, notwithstanding claims paid of £2.1 billion during the year.

We have also continued to refine our traditional reinsurance collection processes. In the past year, we fully implemented a syndicate specific approach to reinsurance collection, under which designated managers determine specific collection strategies and targets for syndicates with material reinsurance assets.

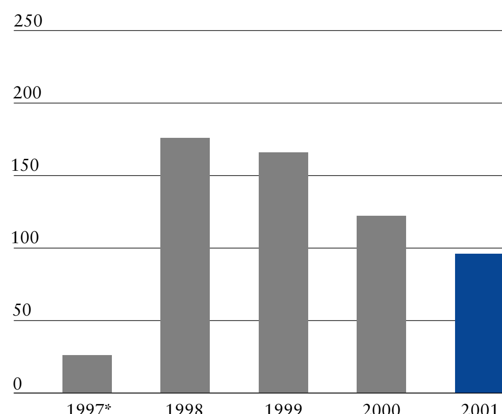
In conjunction with this strategy, earlier this year we consolidated in-house all of our reinsurance processing activities. When Equitas was formed in 1996, we contracted with nearly 70 Lloyd's agencies and specialist companies to provide syndicate reinsurance administration and collection functions. By the end of 1998, we had reduced the number of reinsurance administration contractors to two. In the past year, we concluded that fully consolidating these activities within Equitas would not only reduce costs but would also improve the co-ordination of conventional reinsurance collection efforts with commutations.

In early 2001 we formed an in-house broking department to take over the collection of reinsurance debt in cases where the broker which originally placed the business did not perform to our standards. This new capability significantly expands our ability to collect outstanding reinsurance balances.

Investment management

Investment return amounted to £696 million in the year ended 31 March 2001, compared with £178 million in the previous year. This improvement is primarily attributable to the decline in interest rates in the past year in both the United Kingdom and the United States, which caused the market value of the bonds in our portfolio to rise.

Because Equitas discounts its liabilities to take account of the time value of money, a more



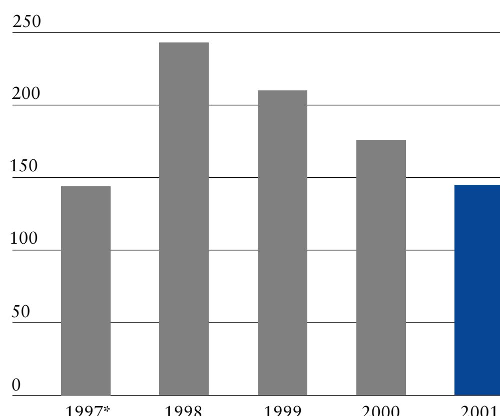
*Seven month period

meaningful indication of investment performance is whether the investment return in a given year is sufficient to match the unwinding of the discount applied to the claims liabilities. In the year ended 31 March 2001, investment return exceeded the unwinding of the discount by £96 million, compared with £122 million the previous year. In the five years since Equitas' formation, investment return has exceeded the unwinding of the discount by nearly £600 million, all of which represents a strengthening of accumulated surplus.

The rate at which we discount our liabilities is based on the prospective yield on our investment portfolio. Taking into account the decline in interest rates in the past year, we lowered the rate at which claims liabilities are discounted from 5.75 per cent per annum at 31 March 2000 to 5 per cent at 31 March 2001. Reducing the discount rate caused the present value of our liabilities to increase by £282 million at 31 March 2001.

The overwhelming proportion of our investment portfolio remains invested in high quality fixed income securities. An amount equal to a portion of the accumulated surplus is invested in equities, and we have increased that position in the past year as market opportunities warranted. While our equity investments incurred a loss during the past year, we have produced a net overall gain of more than £20 million in the equity market since we began investing in equities in 1998. Investment decision making is supported by the Equitas Financial Model, our proprietary asset-liability modelling programme, which enables us to measure the risk/return profile of the investment portfolio.

Expense management



*Seven month period

Operating expenses amounted to £145 million in the year ended 31 March 2001, an 18 per cent reduction from £176 million the previous year. This reduction exceeded the continuing requirement to reduce operating expenses by at least 15 per cent per year to keep these costs in line with the reserve established for operating expenses. Meeting this demanding requirement requires constant attention to productivity and a focus on adding value from our efforts. Our managers are attuned to recognising opportunities to reduce costs without sacrificing operating results.

In the past year, we outsourced our information technology, facilities management and records management functions to specialist service providers. The decision to outsource resulted in reduced costs and provided us with a broadened ability to access skilled technical specialists without having to employ these individuals directly. The outsourcing programmes were completed on schedule with no disruption to our core business.

Employees

Influenced by both the outsourcing referenced above and the consolidation in-house of all reinsurance processing, the monthly average number of employees decreased to 739 during the year ended 31 March 2001 from 872 the previous year. Headcount will continue to reduce gradually over time as the business runs off.

Notwithstanding the fact that many of them are literally working themselves out of their jobs, the commitment of our employees is extraordinary. We have been successful in attracting people to Equitas who have the character to produce an excellent performance as well as the specialised skills required to do their jobs. Our managers have established a culture which is focused on results, which stresses the importance of communication and which encourages teamwork, leading to the achievement of goals on a company-wide as well as on an individual and departmental basis. Our employees have responded superbly to the challenges that confront Equitas, and I take this opportunity to thank them for their outstanding efforts.

To help our employees strengthen their individual capabilities, we continue to offer various programmes to build knowledge and skills. We support a wide variety of in-house employee educational and training courses, and in the past year nearly half of our employees participated in one or more of these programmes. These programmes not only improve employees' individual capabilities, but also reinforce the professional culture that serves as Equitas' foundation.

Conclusion

After nearly five years of operation, Equitas has proved that it can produce superior results in its core areas of claims management, reinsurance management and investment management. We are continuing to build value for Equitas in each of these three areas, notwithstanding the serious threat to Equitas' financial stability posed by increased levels of asbestos claims.

There is little we can do directly to affect the number of asbestos claims that are filed. However, there is much that we can do to influence how the outcomes of those claims affect Equitas. We have developed a variety of approaches to dealing with these claims, and our success in other areas provides encouragement that we will be successful in mitigating asbestos claims costs as well.

Michael Crall
Chief Executive Officer
17 July 2001

Financial review

Jane Barker

For the first time the Group incurred a deficit of £84 million after tax compared with a surplus of £12 million in 2000.

There were, however, many positive features underlying the financial performance of the Group during the year. Cashflow was positive and amounted to £103 million. This reflects successful reinsurance collection activity during the year, principally as a result of commutation agreements with reinsurers. In our core business activities there was a significant contribution to surplus.

These contributions materially offset the substantial strengthening of claims reserves as can be seen in the table below:

	£m
Claims and commutation settlements at favourable values over those in the balance sheet	315
Investment return in excess of unwinding of the discount	96
Operating expenses below budget for the year	5
Total contribution	**416**
Changes in reserving estimates	(499)
Deficit before exchange losses and tax	(83)

Although small in net terms, currency fluctuations made major impacts on both sides of the balance sheet. Broadly, more than £600 million of the increases in both assets and liabilities were due to the strengthening of the US dollar against sterling.

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 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 42.

Investment return

Commentary on investment performance appears on pages 8 and 14.

Claims paid

The amount of gross claims paid of £2,096 million compares with £2,149 million in 2000. The reinsurers' share of the gross claims paid is £1,013 million (2000: £892 million). Payments or proceeds in respect of a commutation are treated as a claim or as part of the reinsurers' share as appropriate.

Operating expenses of £145 million (2000: £176 million) have been included in the amount of gross claims.

Change in the provision for claims

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

Since we expect the liabilities to be settled over a long period of time, they have been discounted to acknowledge the time value of money. The return to be earned in the future on the investments that are held to meet these liabilities is anticipated through this process of discounting.

The calculation of an appropriate discount rate is based on the concept that the prospective return on what is essentially a duration and currency matched fixed income portfolio, if held to maturity, will be approximately equal to its current yield to maturity.

The methodology we have consistently adopted includes the following steps:

- the discounting of all liabilities backed by conventional bonds or financial reinsurances by yields on government fixed interest securities of appropriate currency and duration;
- the discounting of all liabilities backed by index-linked bonds by the real yield on government index-linked securities of appropriate currency and duration plus the price inflation assumption for that currency that has been used for the projection of our liabilities;
- the calculation of a uniform flat rate of discount to give the same total result as in the steps above; and
- the application of an appropriate prudence margin.

The prudence margin takes account of the fact that the liabilities are not perfectly matched, since the investment benchmarks we set for our fund managers do not precisely reflect the liability cash flows and the cash flows themselves cannot be precisely predicted.

The discount 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 reduced the discount rate to 5 per cent per annum from 5.75 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	318
Effect of change in the discount rate from 5.75% to 5% per annum	282
Unwinding of the discount	**600**

The last element in the change in provision for claims arises from our re-evaluation of the effect of the likely timing of future payments and receipts. This resulted in a reduction in claims provisions of £608 million. Claims are expected to be settled later than previously assumed, so that we will be able to earn a higher investment return.

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 provision for claims was largely neutralised by exchange fluctuations in the value of assets. For the most significant foreign currency, the closing exchange rate used for translation of the balance sheet at 31 March 2001 was US$1.42 to £1 sterling compared with US$1.59 at 31 March 2000.

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

Results

The Group's retained surplus after tax decreased to £700 million as at 31 March 2001. The movements were as follows:

	£m	£m
Retained surplus at 1 April 2000		**784**
Investment return in excess of unwinding of the discount	96	
Reassessment of:		
Claims, including expenses (see below)	(1,110)	
Reinsurances (see below)	323	
Timing of net future payments	608	
Deficit before exchange losses and tax		(83)
Exchange losses		(12)
Tax		11
Retained surplus at 31 March 2001		**700**

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 amounts from one year to the next comprise the following:

- payments, receipts and accruals in the year;
- reassessment of liabilities and associated reinsurances;

- changes in discount; and
- movements in exchange rates.

Following the annual comprehensive review, we have strengthened our claims provision, once again primarily in respect of asbestos liabilities. The change in the discount rate and the significant movement in the sterling to US dollar exchange rate have combined to increase the provision for claims outstanding on a like for like basis by approximately £1.2 billion. These adverse effects have been mitigated to some extent by the contributions from our core business activities, by the release of provisions for other classes of business and by increases in the reinsurers' share of outstanding claims.

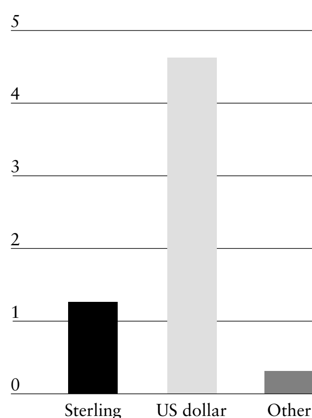
	Claims £m	*Reinsurance £m*	*Net £m*
Provisions at 1 April 2000	**9,030**	**(2,046)**	**6,984**
Payments, receipts and accruals	(2,096)	1,013	(1,083)
Unwinding of the discount	792	(192)	600
Reassessment of:			
Liabilities and reinsurances	1,110	(323)	787
Timing of net future payments	(779)	171	(608)
Exchange and other movements	876	(204)	672
Provisions at 31 March 2001	**8,933**	**(1,581)**	**7,352**

Financial investments

The Group's investment policy is to match its expected liabilities by duration and currency. The aims of the investment strategy are to:

- earn an investment return that matches or exceeds the unwinding of the discount. This return is credited to the technical account; and
- provide adequate funds as investments mature to pay claims.

Financial investments by currency (£bn)



At 31 March 2001 equities represented just over 6 per cent of the market value of our investment portfolio and 54 per cent of our retained surplus. Our intention remains to invest only a portion of our surplus in equities, and the major part of the investment portfolio therefore remains 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 the overall investment strategy.

During the year under review, bond markets rallied significantly as slower economic activity and cuts in short term interest rates led to marked capital gains.

The performance of the key equity markets was characterised by continued volatility, particularly in the US, where anxiety over the outlook for the economy undermined earnings expectations. As a consequence, the return on our equity investment was negative taking into account gains and losses, whether realised or unrealised, and dividends.

With the majority of our assets invested in bonds, we benefited overall from the declining interest rate environment and continued to generate returns in excess of the unwind of the discount.

Bad debts

We have again reassessed our estimates of the amount to be provided for bad or doubtful reinsurance debts. After removing the amounts allocated to reinsurance debts that have since been commuted, the amount that 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 further adjustments have been made.

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 and associated reinsurance recoveries 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.

During the year we again conducted a review of the effectiveness of our systems of internal control. Further details of that review, which was carried out in line with the guidance issued by the Turnbull Committee, appear in the Directors' Report on page 30.

Jane Barker
Finance Director
17 July 2001

Asbestos liabilities: a special report

During the past two years, the number of asbestos bodily injury claims filed in the United States has risen substantially, exceeding previous actuarial estimates. The sharp increase in the number of claims filed has had a major impact on Equitas' balance sheet.

Equitas strengthened its gross undiscounted provisions for future asbestos claims payments – more commonly referred to as gross undiscounted asbestos reserves – by £1.7 billion in the year ended 31 March 2001 (2000: £1.5 billion). Asbestos reserves accounted for 57 per cent of the Group's gross undiscounted claims outstanding as at 31 March 2001 (2000: 46 per cent).

The deteriorating asbestos claims situation has affected not only Equitas but the companies in the US which manufactured, distributed or had some other connection with asbestos products, as well as many insurers worldwide. In the past 18 months, eight major US companies have filed for bankruptcy protection because of the growing numbers of asbestos bodily injury claims they face, and insurers have substantially strengthened their reserves for asbestos related claims.

Equitas has moved decisively to identify and implement new strategies for handling asbestos claims in the light of the increase in claims filings. Equitas, together with leading London Market insurance companies, has conducted an intensive review of its approach to handling asbestos claims. That review is ongoing, but it has already led to new strategies for managing asbestos claims.

The threat that the rise in asbestos claims filings poses to Equitas' financial stability makes it important that Reinsured Names have as much information as possible concerning these claims, consistent with the need to keep commercially sensitive information confidential. We have therefore prepared the following in-depth report on asbestos claims. This report examines in detail asbestos claims filed in the US, since more than 95 per cent of Equitas' asbestos reserves are related to US claims, although we carefully monitor asbestos claims filed in the UK and other countries.

Industrial use of asbestos

The word 'asbestos' is derived from ancient Greek and means 'inextinguishable, unquenchable or inconsumable'. Asbestos is a mineral that can be separated into fibres that will withstand very high temperatures. It is an excellent thermal, electrical and acoustic insulator. Asbestos was used in scores of industries and in hundreds of products, particularly when insulation from high temperatures or electricity was necessary. Asbestos insulation was widely used in the building and construction industry for roofing material, flooring and ceiling tiles. Asbestos was also used in industrial settings to insulate boilers and other high temperature machinery. It was especially used as an insulation material in ships; during World War II, the US government mandated the use of asbestos as a lightweight fire resistant insulator on naval vessels. As a result of its widespread industrial use, millions of American workers were exposed to asbestos in the course of their work. About 500,000 of those workers so far have filed asbestos related bodily injury claims against one or more defendants.

Asbestos fibres

In the early 1970s the US government promulgated wide-scale prohibitions on the use of asbestos in response to growing public awareness of the potential health risks caused by the industrial use of asbestos. Relatively few workers received significant asbestos exposure after that date.

Because an asbestos related disease does not usually develop for 15 to 40 years or more after a person is first exposed to asbestos, some claims were always expected well into this century. However, the current flood of asbestos claims, more than 25 years after most uses of asbestos in the US were rigidly controlled, was not anticipated and consists in large part of claims filed on behalf of people not actually harmed by exposure to asbestos.

Asbestos related medical conditions

Asbestos exposure can cause various forms of cancer and can also scar lung tissue, leading in some cases to significant breathing impairment. The most common asbestos related diseases or conditions, in descending order of severity, are:

- **Mesothelioma**, which is a cancer of the membranes that cover and protect the lungs. It often cannot be diagnosed for 30 to 40 years after exposure. Mesothelioma is invariably fatal, usually within two to three years of its diagnosis. Asbestos exposure is typically identified as the major cause of mesothelioma, although only a very small fraction of the persons exposed to asbestos ever develop this form of cancer.

- **Lung cancer**, which is a cancer of the bronchial covering. Asbestos related lung cancer often appears 20 to 30 years after exposure. Lung cancer can be caused by many factors other than asbestos exposure, including smoking.

- **Other cancers**, which include cancers of the larynx, throat and gastrointestinal tract. There is substantial debate in the medical profession over whether such cancers can be caused by asbestos. However, courts often award damages to claimants with these cancers if exposure to asbestos is proved.

- **Asbestosis**, which is a non-cancerous scarring of the interior lung tissue. Asbestosis can cause breathing impairments which in some cases can be extremely serious. However, most cases of asbestosis involve no significant impairment (such persons are sometimes referred to as unimpaired). Asbestosis usually appears 15 to 30 years after exposure to asbestos.

- **Pleural plaques or thickening**, which are scarring or thickening of the pleural tissue surrounding the lungs. Even though these conditions generally cause no detectable impairment or injury, some US courts allow persons with pleural conditions to recover damages.

History of asbestos litigation

The first claims by US workers with asbestos related diseases were filed against their employers under workers compensation statutes, which regulate and generally limit the damages that can be awarded. Asbestos litigation began in earnest in 1972 when a Texas insulation worker, Clarence Borel, was awarded damages for injuries which he claimed were caused by exposure

to asbestos. This was the first case in which asbestos product manufacturers were held liable for bodily injuries caused by their products. The court decided in the *Borel* case that the manufacturers had a duty to warn users of their products of the dangers posed by such use. Because the manufacturers had not given any such warnings, they were liable for injuries caused by the products without any further evidence that the manufacturers were at fault (commonly referred to as 'strict liability'). Asbestos claims increased rapidly after *Borel* and quickly became the largest area of product liability litigation in the US courts. By 1982, more than 25,000 claims had been filed against some 300 different defendants, costing more than US$1 billion in defence costs and indemnity payments.

As the number of claims and the resulting costs rose, asbestos defendants filed legal actions against their general liability insurers, seeking coverage for the cost of defending these claims and for the cost of indemnifying successful claimants. The courts generally held that bodily injury caused by exposure to asbestos was covered under the product liability sections of general liability insurance policies. The issue before the courts subsequently turned to which policies were 'triggered' by asbestos claims and how the losses should be allocated among different policies. In 1981, the influential US Court of Appeals for the District of Columbia Circuit ruled in *Keene v INA* that all policies in effect from the first time an asbestos claimant was exposed to asbestos until the asbestos disease was diagnosed – including the policies in effect during the period between exposure and diagnosis – were triggered and responsible for some share of the resulting losses. This so-called 'triple trigger' ruling maximised the coverage available to a policyholder. Many other courts later adopted similar 'triple trigger' approaches.

The courts generally held that bodily injury caused by exposure to asbestos was covered under the product liability sections of general liability insurance policies.

In 1982, Johns-Manville, the world's largest supplier of asbestos products, filed for bankruptcy because of what was then thought to be an avalanche of asbestos bodily injury claims. Prior to its bankruptcy, Manville was a successful and profitable business. Its bankruptcy filing was a shock that reverberated throughout the industry. The asbestos litigation problem has, however, proved to be far worse than anyone expected when Manville filed for bankruptcy. Manville's 1988 bankruptcy plan of reorganisation, for example, was based on a projection of 83,000 to 100,000 future claims. At 31 March 2001, the Manville Trust (which assumed Manville's asbestos liabilities) had received more than 512,000 claims, five times the original projection.

The Wellington Agreement

Following the Manville bankruptcy, a number of asbestos defendants and their insurers began negotiations aimed at resolving their differences and establishing a central facility for the unified defence of asbestos claims. These discussions resulted in the 1985 Wellington Agreement.

The Wellington Agreement, named after the former Yale Law School dean who facilitated the discussions, was designed to resolve two sets of problems:

- disputes between asbestos defendants and their insurers over coverage, 'trigger' and allocation issues; and

- the duplication of effort involved in defending claims in which as many as 30 different asbestos defendants were involved.

In response to the first problem, Wellington generally provides that asbestos bodily injury claims against defendants that signed the agreement are covered by the policies which were identified in the agreement. Wellington also sets rules for determining which policies are triggered and how losses will be allocated among the triggered policies. In response to the second problem, the defendants that signed the agreement established a common facility for defending and settling asbestos claims, known as the Asbestos Claims Facility (ACF). The ACF allocated claims payments among its members based on negotiated shares of liability without regard to the circumstances of individual claims. One set of lawyers represented all ACF defendants, eliminating duplicative work by multiple lawyers and disputes over which defendant was liable for each individual asbestos claim. While not all asbestos defendants or insurers signed Wellington, many of the most important participants – including Lloyd's syndicates and certain London Market companies – did so.

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The ACF was disbanded after only three years. Claims filings had increased dramatically and irreconcilable differences arose among the ACF defendants regarding legal defence strategies and the amounts certain defendants contributed to each settlement. Even though the ACF was disbanded, however, the insurance coverage provisions of the Wellington Agreement remained in place.

Approximately 20 of the defendants that signed Wellington formed the Center for Claims Resolution (CCR) as a successor to the ACF. The CCR adopted a strategy of settling almost all cases rather than defending them in court. The CCR continued to settle claims on behalf of many of these defendants until mid-2001.

'Coverage in place' agreements

Some major asbestos defendants declined to sign the Wellington Agreement or join either the ACF or CCR. Many of these defendants negotiated what are known as 'coverage in place' agreements with insurers, including London Market insurers, starting in the mid 1980s. These agreements are similar in many respects to the insurance provisions of the Wellington Agreement. They sometimes define the way in which insurance policies will respond to defendants' asbestos losses, including which policies will be triggered and how losses will be allocated among multiple years of coverage. They also typically require policyholders to handle asbestos claims in good faith and give insurers the right to consent to settlements which exceed a certain amount.

These 'coverage in place' agreements were negotiated following a series of defeats for insurers in coverage litigation with asbestos defendants.

These 'coverage in place' agreements were negotiated following a series of defeats for insurers in coverage litigation with asbestos defendants, and the terms of the agreements relating to trigger and 'allocation' issues therefore tend to favour policyholders. However, at the time these

agreements were negotiated, many US courts had not yet ruled on how asbestos bodily injury claims should be allocated across many years of policies. In later years, some US courts issued rulings on allocation issues that are more favourable to insurers than the early rulings following the *Keene v INA* ruling.

Failed efforts to solve the asbestos problem

Asbestos claims continued to multiply in the late 1980s and early 1990s. By 1991, a special committee of federal judges called the situation "a disaster of major proportions to both the victims and the producers of asbestos products" and, one might have added, to their insurers. The committee added that the burden on the courts "has reached critical dimensions and is getting worse". Some of the increase in the number of claims filed was attributable to the rising numbers of unimpaired claimants. While such claimants have no discernible symptoms of actual impairment, and it is likely they never will, their attorneys have been able to obtain awards for them in some state courts. The potential number of such claims is enormous, since a large proportion of persons exposed to asbestos is believed to exhibit some minimal evidence of these asymptomatic conditions.

The contingency fee system has given claimants' attorneys unprecedented financial resources to use against the existing asbestos defendants.

This worsening situation led to a variety of efforts to solve the problem, including attempted settlements of all future asbestos bodily injury claims against certain defendants, attempts to enact federal legislation, use of 'no settlement' strategies by some defendants and efforts to settle claims in large groups or 'inventories'. None of these efforts has been largely successful to date.

One important reason these efforts have not succeeded is the increasing economic and political power of the claimants' attorneys. These attorneys have, in the aggregate, generated billions of dollars for themselves by handling asbestos claims based on the 'contingency fee' system in the US, whereby attorneys' fees are based on a percentage – sometimes as much as 50 per cent – of a claimant's recovery. The contingency fee system has given claimants' attorneys unprecedented financial resources to use against the existing asbestos defendants and to finance the extension of asbestos litigation to new defendants. It has also permitted some of the leading law firms handling asbestos claims to obtain substantial political influence in the US.

Class actions

In 1993, the CCR member defendants, supported by insurers, reached a settlement of all present and future asbestos bodily injury claims against them with a group of leading claimants' attorneys. The parties sought to make this settlement enforceable against all claimants, including those who had not yet made a claim, through a US procedure called a class action. This settlement, known as *Georgine*, would have paid monetary awards to asbestos claimants based on a compensation schedule, with amounts reflecting the severity of impairment. Significantly, unimpaired claimants would have received little or nothing under the settlement. *Georgine* would have settled the more than 100,000 claims pending against the CCR defendants at the time, as well as providing the basis for settling all future claims against those defendants. The *Georgine* settlement was approved by a trial court judge, but was rejected by

the US Supreme Court in 1997 because the class of claimants was too broad to satisfy US judicial rules. A similar attempt by Fibreboard Corporation to settle all future asbestos claims against it through a class action was also blocked by the Supreme Court in 1999.

These Supreme Court decisions have effectively eliminated class action settlements as a vehicle for solving the asbestos claims problem. Moreover, the collapse of these class action settlements appears to have contributed to a sharp increase in the number of asbestos claims filed against defendants in the latter years of the 1990s, as claims that would have been settled through the class actions were litigated instead.

Federal legislative proposals

In its decisions rejecting the *Georgine* and *Fibreboard* settlements, the Supreme Court urged the US Congress to take action to address the huge volume of asbestos related lawsuits in the courts, estimated at more than 200,000 in 1999, because the courts are simply unable to handle this enormous number of suits. Congress during 2000 considered legislation that would have established an administrative system under which only those who could demonstrate substantial asbestos related impairment could bring claims in court. This legislation would have removed many asbestos claims from the courts and eliminated payments to most unimpaired persons. Proponents argued that the proposal would reduce legal and other transaction costs, provide equitable compensation for asbestos injuries and ensure that adequate funds exist to compensate all asbestos victims, not simply those who file claims early or who have the most creative lawyers. This legislation died in Congress in the face of opposition from claimants' attorneys and labour unions.

This legislation would have removed many asbestos claims from the courts and eliminated payments to most unimpaired persons.

There are a number of legislative initiatives being considered by various groups at present, and at least two pieces of asbestos related legislation are currently before Congress. The prospects for any such legislation must be currently regarded as uncertain, and Equitas does not assume meaningful asbestos reform when making reserving assumptions.

'No settlement' strategies

Several asbestos defendants have, for varying periods of time, adopted a strategy of refusing to settle most cases short of trial. This strategy has failed for most defendants that have tried it, in many cases because these companies had known early on of the dangers of exposure to asbestos. Claimants' attorneys have been able to bring many cases to trial in courts that are very unfavourable to defendants, including courts in certain counties in Texas and Mississippi. Some of these courts have awarded multi-million dollar judgments to individual claimants, including some large punitive damage awards. Mesothelioma claimants have frequently obtained such awards, and even unimpaired claimants have recovered compensatory awards exceeding US$1 million. Very few of these judgments have been appealed to higher courts because the defendants decided to settle the cases after trial to avoid the subsequent assessment of punitive damages or because certain courts required the

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defendants to post exorbitantly large appeal bonds. In 2000, fewer than 1 per cent of asbestos claims went to trial.

Most defendants which adopted a ‘no settlement’ strategy later reversed course and have attempted to settle virtually all claims before trial. Certain asbestos defendants, however, have been successful with ‘no settlement’ strategies. In particular, defendants whose asbestos products were unlikely to emit significant quantities of asbestos fibres into the air, whose products were used by only limited numbers of workers or which did not have early knowledge of the dangers of asbestos have been able to implement a ‘no settlement’ strategy successfully.

There are some recent signs that more defendants may be considering adopting a ‘no settlement’ strategy. One leading defendant in early 2001 announced publicly that it would move to a strategy of refusing to settle claims by unimpaired persons.

Inventory settlements

The failure of ‘no settlement’ strategies has led many defendants to adopt a strategy of settling almost all claims, most frequently through so-called inventory settlements. In many inventory settlements, a defendant agrees to settle all pending claims by claimants represented by a particular law firm for pre-set amounts which vary with the condition alleged by the claimant. The law firm may also agree to recommend settlement at the same amounts for all future claimants that it represents. These inventories can include thousands of current claims, the majority of which are brought by unimpaired persons. The law firms almost invariably insist that the defendants settle all the claims in their inventory, including the unimpaireds’ claims, refusing to settle separately any claims alleging cancer and other serious injuries. Defendants that refuse to enter into such agreements are threatened with being required to risk taking these serious cases to trial, thereby potentially exposing themselves to large monetary judgments, including punitive damages.

Without significant changes in current practices, it is likely that future claimants with serious injuries will not receive adequate compensation.

Inventory settlements are often considered attractive by defendants in comparison to the risks of trial. In an inventory settlement, the payments to unimpaired claimants may appear small, sometimes as little as US$250 per claim.

Nonetheless, inventory settlements have failed to reduce defendants’ asbestos liabilities and now appear to have made the situation worse. Many defendants have reported an increase in the number of pending asbestos claims, even though they have resolved tens of thousands of claims through inventory settlements. Several of the defendants that had most enthusiastically embraced this strategy have filed for bankruptcy protection during the past 18 months.

Inventory settlements have encouraged the filing of new claims because they have made it increasingly easy for claimants’ attorneys to recover money for unimpaired claimants. There are still millions of potential claimants who may be able to demonstrate some exposure to asbestos and find a doctor prepared to testify that asbestos has affected their lungs in some respect. Claimants’ attorneys are increasing their already proven ability to locate such claimants by,

for example, advertising and by paying finder's fees to other attorneys and agents. While individual payments to unimpaired claimants may be modest, their aggregate cost to defendants – and the contingency fees collected by claimants' attorneys – are enormous.

The limited assets available from asbestos defendants and insurers to compensate truly impaired asbestos claimants are being consumed by inventory settlements that channel large amounts of money to the unimpaired and their attorneys. Without significant changes in current practices, it is likely that future claimants with serious injuries will not receive adequate compensation.

The current situation

The number of asbestos claims filed has increased dramatically over the last two years. It is difficult to determine precisely how many new asbestos claims are filed each year because there is no central database of claim filings. The trust established in the Johns-Manville bankruptcy, however, makes available reliable statistics on claim filings that provide some insight into the current situation. The Manville Trust received 58,600 new claims in 2000, an 81 per cent increase over the 32,300 it received in 1999. That rate of increase has continued in 2001. Most other defendants also reported significant increases in the number of claims filed in 2000. The majority of these new claims have been filed on behalf of unimpaired persons.

The increase in claim filings is inconsistent with earlier medical studies and projections of future claims. The leading epidemiological studies suggest that the number of persons contracting asbestos related diseases would decrease by the year 2000.

The unprecedented increase in asbestos claims filings over the past two years has led eight asbestos defendants – Babcock & Wilcox, Armstrong World Industries, Owens Corning, Pittsburgh Corning, Burns & Roe Enterprises, G-I Holdings (formerly GAF Corporation), W R Grace and US Gypsum – to file for bankruptcy protection within the past 18 months. Bankruptcy is the only tool that some defendants believe can provide potential relief from asbestos claims. All claims are automatically stayed by a bankruptcy filing. No money may be paid on such claims until the bankruptcy is resolved, typically by establishing a trust that assumes the asbestos liabilities and receives most or all of the bankrupt company's equity. It can take several years before an asbestos defendant's bankruptcy is resolved and a trust established.

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Bankruptcies often increase the costs incurred by solvent asbestos defendants. In many states these defendants are held to be 'jointly and severally' liable with the bankrupt companies and therefore become financially responsible for the bankrupt companies' shares of the liability. Bankruptcies also prompt claimants' attorneys to seek new companies to sue, and evidence suggests that individual claimants are filing claims against more defendents. Among the companies now facing asbestos personal injury claims are distributors and transporters that handled asbestos products, automobile manufacturers, telephone companies, computer makers, consumer product retailers, life assurance companies and even food product manufacturers. In total, nearly 2,000 US companies have reportedly received asbestos claims. One claimants' attorney was quoted

earlier this year by The Wall Street Journal as saying: "The asbestos companies are going bankrupt faster than you and I can eat…We need to find someone else to pay the victims."

Why are claims filings increasing?

Many explanations have been offered for the sudden surge in new asbestos claims filings. We believe that the increasing use of inventory settlements has made it easy for claimants' attorneys to obtain significant amounts of money for unimpaired claimants with weak evidence of asbestos exposure. A relatively small number of very large court judgments in favour of unimpaired claimants has caused claimants' attorneys to demand more money for these claims and has persuaded defendants to agree to those demands. This, in turn, has caused existing asbestos claimants' attorneys to recruit more unimpaired people from the large number of potential claimants, and it has also encouraged law firms that have not traditionally filed asbestos claims to begin doing so. Law firms now commonly seek out potential asbestos claimants at shipyards and other industrial facilities where asbestos was once used, at union halls and even at churches. Doctors and medical technicians accompany the lawyers and can rapidly screen potential claimants for evidence of asbestos exposure on the spot. These methods can quickly identify thousands of potential new claimants.

Law firms now commonly seek out potential asbestos claimants at shipyards and other industrial facilities where asbestos was once used, at union halls and even at churches.

There are many other explanations offered for the surge in claims filings, including errors in past projections of claims, efforts by claimants' attorneys to file claims before reform legislation is enacted, resolution of some tobacco claims that has freed resources at major law firms representing claimants and so forth. Some or all of these explanations may have contributed to the recent surge in asbestos claims filings.

The cost to insurers

There have been relatively few comprehensive attempts to quantify the cost of asbestos claims to insurers. A M Best, the US insurance rating agency, estimated in 1997 that asbestos claims would ultimately cost the US insurance industry – not including Lloyd's syndicates or other non-US insurers – approximately US$40 billion (£28.4 billion). By May 2001, Best had increased its estimate to US$65 billion (£43.3 billion). Best also estimated that, as at the end of 2000, the US insurance industry had paid US$21.6 billion (£15.3 billion) in asbestos claims, including defence costs, and had asbestos related reserves of approximately US$10 billion (£7.1 billion).

It is impossible to generalise how much coverage was written for individual defendents by Lloyd's syndicates.

The Lloyd's syndicates reinsured by Equitas wrote substantial limits of general liability coverage for US asbestos defendants. Unlike US companies, the Lloyd's syndicates rarely wrote coverage for these defendants on primary layers, which reduces Equitas' ability to influence the defence and settlement of asbestos claims. It is impossible to generalise how much coverage was written for individual defendants by Lloyd's syndicates or at what point the coverage commonly attaches, because programmes varied tremendously among different policyholders and different years. However, when policyholders' total liability insurance limits are examined, it can be

concluded that Lloyd's syndicates wrote only a small percentage of the total liability insurance available to these defendants to pay asbestos claims. While it is more difficult to calculate market share pertaining to inwards reinsurance, it is estimated that Lloyd's syndicates' inwards reinsurance liability is similar to the direct liability.

As claim filings in the US have increased, Equitas has increased its undiscounted gross reserves for asbestos liabilities by £1.7 billion in the year ended 31 March 2001 (2000: £1.5 billion). In the past year, asbestos claims payments and accruals amounted to £406 million (2000: £389 million). At 31 March 2001, gross undiscounted asbestos reserves amounted to £8.1 billion (2000: £6.0 billion), while gross asbestos reserves, discounted to acknowledge the time value of money, amounted to £4.6 billion (2000: £3.6 billion). Approximately half of this provision represents direct claims and half inwards reinsurance and retrocessional claims. It also must be noted that claims payments and accruals are relatively small compared with the size of the overall provision. At any given time no more than 3 per cent of the provision for asbestos claims represents claims actually presented to Equitas for payment. The remainder represents reserves for future claims.

It is extremely difficult to compare accurately the reserve adequacy of individual insurers. One somewhat imprecise tool used to attempt such a comparison is the 'survival ratio', which indicates the number of years a company can continue paying claims at a historic rate before it exhausts its reserves. A higher survival ratio is an indicator of greater financial strength. As at 31 March 2001, Equitas' three year asbestos survival ratio, gross of reinsurance recoveries and excluding commutation payments, was 26.5. This means it would take 26½ years before Equitas would exhaust its asbestos reserves, assuming that asbestos claims continued to be paid at the same rate as over the previous three years. By comparison, we estimate that the average three year gross survival ratio for a representative sample of US insurers was 6.8 as at 31 December 2000.

Actual cash payments made by Equitas in respect of asbestos liabilities over the past several years were below predictions.

The methodology that Equitas uses to establish reserves, which is described below, is not designed to produce an estimate of the global cost of asbestos claims to all defendants and insurers. Nonetheless, a broad comparison is possible and, as best we can judge it, the global figure implied by our reserves would be consistent with the upper end of the range predicted by A M Best and other published analyses.

In estimating asbestos liabilities, Equitas follows a highly developed actuarial framework. Future claims are projected for each major policyholder, based on past levels of claims filings combined with the results of epidemiological and other relevant studies that predict the incidence of asbestos injuries into the future. The average cost of different types of claims is estimated, although this information varies greatly among policyholders. Further assumptions are made regarding the time taken between the filing of a claim and payment. The results of these projections are then applied to the insurance coverage available for major policyholders. This analysis results in an estimation of liabilities for each major policyholder, which is then adjusted to take into account claims to be filed against policyholders not yet identified.

A similar process is used to estimate asbestos liabilities resulting from reinsurance ceded to Lloyd's syndicates reinsured by Equitas.

Despite continuing refinements in this methodology, there are large inherent uncertainties in the estimation of the ultimate cost of future asbestos claims. The fact that the number of asbestos claims filed in the past two years has not followed previous estimates, combined with the large number of claims filed by unimpaired persons, makes it more difficult to use traditional actuarial methodology to estimate the ultimate cost of asbestos claims. The provision for asbestos liabilities relates to claims that have been filed, but not paid, as well as to claims which are yet to be filed. Estimates of both the number of future claims filings and the size of future claims payments include a large degree of judgment since the number of claims filed in the future may be significantly affected by actions taken by individual claimants, their attorneys, asbestos defendants, US courts and the US Congress, among others. It is not possible to construct an actuarial model to predict these actions with any degree of certainty.

It must also be noted that while provisions for future asbestos claims have increased significantly over the past several years, actual cash payments made by Equitas in respect of asbestos liabilities during the same period have fallen below predictions, primarily due to the increased length of time necessary to settle these claims.

While it is possible that further increases in asbestos related reserves will be necessary in the future, the inherent uncertainty and the wide range of potential outcomes means it is also possible that current estimates of future asbestos liabilities could prove to be excessive.

What is Equitas doing about asbestos claims?

Before the new surge in asbestos claims filings was identified in early 2000, Equitas and leading London Market insurance companies had begun an intensive review of asbestos claims and the strategies used to handle them. The review has been conducted by claims representatives from Equitas and the leading London Market companies, working closely with some of the market's long-standing attorneys as well as newly retained experts.

The review began with an intensive, top to bottom analysis of how the London Market has handled asbestos claims and what new strategies could be adopted to manage them. This review is continuing.

The review process has already resulted in a number of significant actions aimed at reducing Equitas' asbestos liabilities, while fulfilling obligations to policyholders of Lloyd's syndicates:

- We have issued documentation requirements to policyholders with asbestos claims so that reimbursement is limited only to claims supported by adequate medical evidence of a claimant's asbestos related disease and the appropriate identification of the product which caused the disease. These requirements are intended to be consistent with what US courts require before a claim can be submitted to a jury for consideration. We believe that policyholders are settling significant numbers of claims that do not meet even these standards.

Before these requirements were adopted in June 2001, they were circulated to more than 100 policyholders for comment. We carefully reviewed those comments and made changes suggested by the comments where warranted.

- We are subjecting proposed inventory settlement agreements to increasingly rigorous review. We believe that many such settlements are unreasonable for a variety of reasons, including the substantial amounts often paid to unimpaired claimants under such settlements. Where appropriate, we will refuse to consent to inventory settlements that we conclude are unreasonable.

- We have terminated one 'coverage in place' agreement and filed a declaratory judgment action in which we asked the court to impose new, more favourable rules for allocating claims among policies and between insurers and the policyholder. We have recently filed another declaratory judgment action because we believe that a 'coverage in place' agreement is no longer enforceable because of the policyholder's bankruptcy and its breaches of the agreement.

- We are actively participating in asbestos defendants' bankruptcy proceedings in an effort to achieve fair and equitable results that do not impose unwarranted liabilities on insurers. Where possible, we are seeking to negotiate final buyouts of policies of bankrupt asbestos defendants. The finality regarding asbestos claims that is available for both policyholders and insurers in the bankruptcy process may make such agreements – which have proven very difficult to obtain outside bankruptcy – more feasible.

- We are attempting to negotiate policy buyouts with a number of other major asbestos policyholders. Policyholders are typically reluctant to enter into such buyouts pertaining to asbestos claims because of the great uncertainties regarding the size of the ultimate liabilities. Where appropriate, we are attempting to overcome this reluctance by exploring the use of innovative financial tools when structuring the buyouts so that they are attractive to policyholders.

Conclusion

The growing number of asbestos claim filings underscores the uncertainties which are fundamental to the long tail book of business which Equitas has reinsured. Asbestos is a problem which has perplexed courts, asbestos defendants and their insurers worldwide for the past 25 years. We are doing what we properly can to contain the ultimate cost of asbestos claims. However, as this report shows, many actions taken by asbestos defendants and insurers in the past have not been successful, and past rulings by US courts limit the actions that we can take to reduce the cost of asbestos claims.

We are optimistic that the actions we are taking will limit the threat which asbestos claims pose to Equitas' financial stability, but we cannot yet be certain that these actions will be successful.

Board of Directors

Hugh Stevenson [‡§]

Chairman; joined the Board in April 1998. He was formerly 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 Merchants Trust PLC and a Director of The Standard Life Assurance Company. Age 58.

Michael Crall [#Δ*]

Chief Executive Officer; joined the Board in December 1995. He was formerly President and Chief Executive Officer of Argonaut Insurance Company in California and a senior executive at CIGNA Corporation. Age 57.

Dick Barfield [†Δ]

Non-Executive Director; joined the Board in April 1997. He is currently a Director of Baillie Gifford Japan Trust plc, Marshalls plc, The Merchants Trust PLC, New Look Group plc and Rio Tinto Pension Investments. He was formerly Chief Investment Manager of The Standard Life Assurance Company. Age 54.

Jane Barker [Δ*]

Finance Director; joined the Board in December 1995. She was formerly 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 the Americas. Age 51.

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. He is also Chairman of the Lloyd's Market Association. Age 47.

Michael Deeny [#‡§]

Trustees-nominated Non-Executive Director; joined the Board in October 1996. He is Chairman of MultiMedia Television plc, Chairman of the Association of Lloyd's Members, Deputy Chairman of The Equitas Trust, a concert promoter and a Chartered Accountant. Age 56.

Paul Jardine [*]

Commutations Director and Chief Actuary; joined the Board in February 1999. He joined Equitas as Chief Actuary in December 1996. He was formerly a Partner in Coopers & Lybrand's Actuarial Insurance Services Group and an Actuary with Prudential Assurance Company Limited. He is a Fellow of the Institute of Actuaries and a Member of the American Academy of Actuaries. Age 40.

James Joll [†§]

Non-Executive Director; joined the Board in June 1996. He is Chairman of AIB Asset Management Holdings and Deputy Chairman of Jarvis Hotels plc. He was formerly Finance Director of Pearson plc. Age 64.

Scott Moser *

Claims Director; joined the Board in May 1997. He was formerly 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 50.

Sir Bryan Nicholson #‡

Non-Executive Director; joined the Board in October 1996. He is Chairman of Cookson Group plc and Chairman of the Council of The Open University. He was formerly President of the Confederation of British Industry; Chairman of the Manpower Services Commission; and Chairman and Chief Executive of the Post Office. Age 69.

Richard Spooner †Δ

Trustees-nominated Non-Executive Director; joined the Board in October 1996. He is Managing Director of Team User Systems Company Limited. He was formerly a member of the Names Committee and the Assistance and Recovery Committee of Lloyd's. Age 54.

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

Directors' report

for the year ended 31 March 2001

The Directors present their report and the audited financial statements for the financial year ended 31 March 2001.

Principal activities

The Equitas Group was formed as part of the 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 under the Insurance Companies Act 1982 by the Financial Services Authority (the body which has day to day responsibility for the regulation of insurance in the United Kingdom) on behalf of HM Treasury. Equitas Reinsurance Limited and Equitas Limited 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 15 report on the progress of the business during the financial year and outline future developments. A detailed commentary regarding the asbestos related liabilities reinsured by the Group, including an outline of measures proposed to address these issues and possible future developments, appears on pages 16 to 27.

Results

The Equitas Group incurred a deficit of £84 million after tax for the year ended 31 March 2001 (2000: £12 million surplus). 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 28.

Mr PA Jardine intends to leave the Board with effect from 30 September 2001.

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

Messrs Stevenson, Deeny and Joll retire by rotation. 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 HA Stevenson was appointed Chairman with effect from 1 November 1998 for an initial three year term, with the expectation that it would be renewed for a further 3 years. The Board has agreed that Mr Stevenson's tenure as Chairman should continue for such further 3 year period commencing 1 November 2001 (subject only to his being re-elected as a director at the forthcoming Annual General Meeting).

Directors' interests

Mr ME McL Deeny has an interest in the business of the Group as an underwriting member of Lloyd's who resumed underwriting in 1999 after having ceased to do so in 1994. Messrs SJO Catlin, 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, 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.

Corporate governance

The Company and its subsidiaries are not listed entities but the Board is committed to high standards of corporate governance; accordingly, it supports the Principles of Good Governance and Code of Best Practice (Combined Code). The Group has in place a framework for sound Corporate Governance which incorporates many of the principles and provisions of the Combined Code. The importance of adhering to the highest ethical standards is reinforced by a formal Code of Ethical Conduct which applies to all employees.

The Board

The Board comprises four Executive Directors and seven Non-Executive Directors, including two Trustees-nominated Directors and one Director appointed by the Corporation of Lloyd's. The Board meets regularly and receives detailed reports from management, including in those months in which no Board meeting is held. 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.

A procedure is in place for Directors to take independent professional advice, if necessary.

Company Secretary

The Board is supported in its work by the Company Secretary who co-ordinates the supply of timely information and provides advice.

Board committees

The Board has established five committees with clearly defined terms of reference. In addition to the Audit and Compliance Committee and the Remuneration Committee, whose roles and responsibilities are outlined on pages 33 and 36, respectively, these committees are as follows:

- **The Claims and Commutations Committee**
  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 three or four times per year.

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

- **The Nominations Committee**
  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

A well developed system of internal control forms an integral part of the Group's management process. The management of risk is a key part of that system. A process for identifying, evaluating and managing significant business, operational, financial, compliance and other risks faced by the Group has been in place throughout the year and up to the date of these reports and accounts. That process is in accordance with the guidance issued by the Turnbull Committee with respect to the principles of the Combined Code relating to internal controls.

The Board has overall responsibility for the system of internal control and for reviewing its effectiveness. Executive management is responsible for the implementation and maintenance of the internal control system. The effectiveness of that system was reviewed during the year, and included a bi-annual systematic self-appraisal carried out across all business areas which considered both risk exposures and the effectiveness of controls. The results of these reviews are reported to executive management, the Audit and Compliance Committee and the Board.

As with any such system, the Group's internal control system is designed to manage rather than eliminate the risk of failure to achieve business objectives, and can only provide reasonable and not absolute assurance against material misstatement or loss. The nature of insurance risk is that events that are unexpected as regards amount or timing will occur.

The Audit and Compliance Committee, which usually meets four times a year, helps to ensure that good practice is maintained throughout the Group with respect to financial and internal control matters and, on behalf of the Board, monitors the Group's system of internal control (including risk management, financial, operational and compliance controls). The committee also independently reviews the Group's accounting policies and the presentation of financial information. The Chief Executive Officer, the Finance Director, the Chief Actuary, the Head of Internal Audit and the external auditors generally attend meetings. The Group maintains an internal audit function that regularly provides reports to the Audit and Compliance Committee. The external auditors also contribute an independent perspective on aspects of financial control and annually report their findings to the Audit and Compliance Committee and the Board.

Directors' responsibilities

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

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 47 set out the issues relevant to the going concern basis for the preparation of the financial statements.

Indemnification of Trustees

The Trust Deed constituting The Equitas Trust provides for 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

The Group is committed to a pro-active programme for involving employees. This includes regular communication through briefings and consultation with staff at all levels. The Group maintains a computer-based internal communications system which provides information to all employees on work related issues and on matters of general interest. Employees are encouraged to provide suggestions for improving efficiency and performance.

The Group recognises its responsibilities towards disabled people, who 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.

As detailed in the Chief Executive Officer's Review, during the year the Group outsourced the information technology, facilities management and records management segments of the business. Employees in the relevant business areas transferred to the employment of the selected outsourced service providers.

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.

Auditors

A resolution to reappoint PricewaterhouseCoopers as auditors to the Company will be put to 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
Stephen Britt
Company Secretary
17 July 2001

Board report on Directors' remuneration

for the year ended 31 March 2001

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 HA Stevenson, ME McL Deeny and JAB Joll, is responsible for setting the remuneration and other terms of service of the Executive Directors within a framework agreed by the Board. It also advises on remuneration policy for senior executives. It consults with the Chief Executive Officer regarding executive remuneration and seeks independent external professional advice, as appropriate, regarding market comparisons and developments in remuneration practice. It meets as necessary.

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 selected executives and managers. This provides for cash payments in recognition of the performance of the Group during a financial year. Payments are deferred for two additional years and are dependent on the continued performance of the Group during this period. The payment of an award is also conditional upon the participant continuing in the employment of the Group throughout the three year period, other than in certain circumstances in which case the entitlement may be pro-rated.

Details of provisional awards made to date under the LTIP in respect of the Executive Directors are shown on page 38.

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 at its discretion the amount which is available to be awarded under the LTIP.

Payments under performance-related incentive arrangements are not pensionable.

Service agreements

Messrs MJ Crall, PA Jardine and SP Moser and Mrs JV Barker have service agreements with Equitas Management Services Limited which are subject to 12 months' notice on a rolling basis. Mr Jardine's service agreement will come to an end when he leaves the Board on 30 September 2001.

Non-Executive Directors' fees

Non-Executive Directors, including the Chairman, do not have service agreements. They do not have bonus or pension arrangements. The Chairman's fee is £125,000 per annum, inclusive of the Director's fee. Non-Executive Directors receive a fee of £30,000 per annum, unchanged from the previous three years. Non-Executive Directors who chair Board committees receive an additional fee of £10,000 per annum for these services, which is also unchanged. Mr HA Stevenson did not receive an additional fee for chairing committees.

Directors' remuneration

Directors' remuneration, excluding LTIP payments, in respect of the financial year ended 31 March 2001 was:

	Salary/ Fees £	*Bonus* £	*Benefits-in-kind* £	*Total emoluments* £	*Pension contribution* £	*Total for year ended 31 March 2001* £	*Total for year ended 31 March 2000* £
Chairman							
HA Stevenson	125,000			125,000		125,000	125,000
Executive Directors							
MJ Crall	368,750	220,000	6,854	595,604	92,188	687,792	635,297
JV Barker	246,250	145,000	1,517	392,767	61,562	454,329	418,762
PA Jardine	245,000	165,000	1,595	411,595	61,250	472,845	432,569
SP Moser	303,750	200,000	3,149	506,899	75,937	582,836	525,996
AC Pollard[1]						–	132,828
Non-Executive Directors							
RA Barfield	40,000			40,000		40,000	40,000
SJO Catlin	30,000			30,000		30,000	30,000
ME McL Deeny	30,000			30,000		30,000	30,000
JAB Joll	40,000			40,000		40,000	40,000
Sir Roger Neville[1]						–	17,500
Sir Bryan Nicholson	40,000			40,000		40,000	40,000
RB Spooner	30,000			30,000		30,000	30,000
Total	1,498,750	730,000	13,115	2,241,865	290,937	2,532,802	2,497,952

[1] Mr AC Pollard and Sir Roger Neville retired from the Board on 17 September 1999.

LTIP awards relating to the year ended 31 March 1998, for which provision was made in the year ended 31 March 1999, were paid in August 2000. These payments, amounting to £464,548, are analysed on page 38 and are included in note 6 on page 50.

Based on the results for the year ended 31 March 2000, a total amount of £660,000 has been provided as follows for awards under the LTIP to the Executive Directors:

	Total provisional awards outstanding at 31 March 2000 £	*Paid during the year* £	*Provisional awards made during the year in respect of year ended 31 March 2000* £	*Total provisional awards outstanding* £
MJ Crall	356,474	147,674	262,500	471,300
JV Barker	230,900	94,000	187,500	324,400
PA Jardine	216,000	94,000	–	122,000
SP Moser	293,274	128,874	210,000	374,400
Total	1,096,648	464,548	660,000	1,292,100

LTIP awards relating to the year ended 31 March 1999, for which provision was made in the year ended 31 March 2000, will be paid in 2001 if confirmed by the Board. LTIP awards relating to the year ended 31 March 2000, for which provision was made in the year ended 31 March 2001, are not payable until 2002. Payments are subject to the Board's determination that all of the conditions governing the plan have been met.

A provisionsal award of £187,500, made to Mr PA Jardine in respect of the year ended 31 March 2000, will not be payable as a consequence of his impending resignation.

No LTIP awards have yet been made in respect of the year ended 31 March 2001.

Messrs ME McL Deeny and RB Spooner also received fees for services as Trustees of The Equitas Trust. Details are shown on page 39.

The Group provides Executive Directors with benefits-in-kind including medical and death-in-service benefits, and contributes towards their 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 and are defined as related party transactions under Financial Reporting Standard 8.

The remuneration and expenses met by the Group in the year ended 31 March 2001 were in respect of the following:

	Year ended 31 March 2001 £	*Year ended 31 March 2000* £
Trustees' fees	200,000	200,000
Trustees' legal, professional and other costs and expenses	653,128	321,150
Total	853,128	521,150

Messrs ME McL Deeny and RB Spooner, who are also Directors of the Company, received Trustees' fees of £33,340 each for the year ended 31 March 2001 (2000: £33,340 each). They received expenses for secretarial, office and other overheads of £19,414 and £14,983, respectively (2000: £16,402 and £15,420, respectively). Included in legal expenses is an amount of £31,020 paid to Viscount Bledisloe QC, a Trustee, in respect of the provision of legal services to The Equitas Trust.

Report of the Auditors

to the Members of Equitas Holdings Limited

1. We have audited the financial statements on pages 42 to 58 which have been prepared in accordance with the accounting policies set out in note 1 on page 47.

Respective responsibilities of directors and auditors

2. The directors are responsible for preparing the Annual Report. As described on page 33, this includes responsibility for preparing the financial statements in accordance with applicable United Kingdom accounting standards. Our responsibilities, as independent auditors, are established in the United Kingdom by statute, the Auditing Practices Board and our profession’s ethical guidance.

3. We report to you our opinion as to whether the financial statements give a true and fair view and are properly prepared in accordance with the United Kingdom Companies Act 1985. We also report to you if, in our opinion, the directors’ report is not consistent with the financial statements, if the Group has not kept proper accounting records, if we have not received all the information and explanations we require for our audit, or if information specified by law regarding directors’ remuneration and transactions is not disclosed.

4. We read the other information contained in the Annual Report and consider the implications of our report if we become aware of any apparent misstatements or material inconsistencies with the financial statements.

Basis of opinion

5. We conducted our audit in accordance with Auditing Standards issued by the Auditing Practices Board. 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.

6. 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 in our audit of claims outstanding, reinsurers’ share of claims outstanding and reinsurance recoveries

Uncertainties

7. In forming our opinion, we have considered the uncertainties, described in notes 1 and 14 to the financial statements, relating to the provision for claims outstanding of £8,933 million, reinsurers’ share of claims outstanding of £1,581 million and reinsurance debtors of £1,164 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 extent to which these and amounts due from reinsurers will be collected.

Consequences of uncertainties

8. The potential adjustments referred to in paragraph 7, if adverse in the aggregate, could be material enough to exceed the amount of the shareholders' funds at 31 March 2001 of £700 million. If at any time the directors determine that there are insufficient assets to meet liabilities in full as they fall due 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 in our audit

9. Except for material adjustments in respect of the matters described in paragraph 7 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 deficit 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 2001 and of the deficit and cashflows of the Group for the year then ended and have been properly prepared in accordance with the United Kingdom Companies Act 1985.

PricewaterhouseCoopers
Chartered Accountants and Registered Auditors
17 July 2001

Group profit and loss account

for the year ended 31 March 2001

Technical account – general business

	Note	£m	2001 £m	£m	2000 £m
Investment return transferred from non-technical account			**696**		178
Claims paid					
Gross amount		**(2,096)**		(2,149)	
Reinsurers' share		**1,013**		892	
Net claims paid		**(1,083)**		(1,257)	
Change in the provision for claims					
Gross amount		**986**		1,438	
Reinsurers' share		**(690)**		(215)	
Unwinding of the discount		**(600)**		(56)	
Timing of net future payments		**608**		(73)	
Change in the net provision for claims	14	**304**		1,094	
Claims incurred, net of reinsurance			**(779)**		(163)
Other technical charges	3		**(12)**		3
Balance on the technical account for general business			**(95)**		18

The accounting policies and notes on pages 47 to 57 form an integral part of these financial statements.

Group profit and loss account

for the year ended 31 March 2001

Non-technical account – general business

	Note	£m	2001 £m	£m	2000 £m
Balance on the technical account for general business			(95)		18
Income from financial investments		**341**		326	
Return on financial reinsurances		**160**		13	
Gains on the realisation of investments		**55**		–	
Unrealised gains on investments		**140**		–	
Losses on the realisation of investments		**–**		(35)	
Unrealised losses on investments		**–**		(126)	
Investment return		**696**		178	
Allocated investment return transferred to general business technical account		**(696)**		(178)	
Investment return retained			**–**		–
(Deficit)/surplus on ordinary activities before tax	4		**(95)**		18
Tax on (deficit)/surplus on ordinary activities	7		**11**		(6)
(Deficit)/retained surplus for the year	13		**(84)**		12

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 47 to 57 form an integral part of these financial statements.

Group balance sheet

as at 31 March 2001

Assets

	Note	2001 £m	2000 £m
Investments			
Financial investments	8	**6,187**	5,342
Financial reinsurances	9	**1,142**	1,027
		7,329	6,369
Reinsurers' share of technical provisions			
Claims outstanding	14	**1,581**	2,046
Debtors			
Debtors arising out of reinsurance operations	11	**1,190**	1,663
Other debtors		**144**	149
		1,334	1,812
Other assets			
Tangible assets		**8**	13
Cash at bank and in hand		**30**	34
		38	47
Prepayments and accrued income			
Accrued interest		**70**	71
Other prepayments and accrued income		**4**	5
		74	76
Total assets		**10,356**	10,350

The accounting policies and notes on pages 47 to 57 form an integral part of these financial statements. The Company's balance sheet is shown on page 58.

Group balance sheet
as at 31 March 2001

Liabilities

	Note	*2001* *£m*	*2000* *£m*
Capital and reserves			
Called up share capital	12	**–**	–
Retained surplus	13	**700**	784
Shareholders' funds – non-equity interests		**700**	784
Technical provisions			
Claims outstanding	14	**8,933**	9,030
Creditors			
Creditors arising out of reinsurance operations	15	**313**	264
Other creditors including taxation and social security	16	**410**	272
		723	536
Total liabilities		**10,356**	10,350

The financial statements on pages 42 to 57 were approved by the Board on 17 July 2001 and were signed on its behalf by:

HA Stevenson
MJ Crall
JV Barker

The accounting policies and notes on pages 47 to 57 form an integral part of these financial statements.

Group cashflow statement

for the year ended 31 March 2001

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

	Note	£m	2001 £m	£m	2000 £m
(Deficit)/surplus on ordinary activities before tax			(95)		18
Depreciation of tangible fixed assets	4	3		5	
Loss on disposal of tangible fixed assets	4	4		–	
Exchange losses/(gains) on retranslation of opening balances*		26		(1)	
Movement on unrealised investment gains and losses		(140)		126	
Return on financial reinsurances		(160)		(13)	
Decrease in provision for claims outstanding		(1,016)		(1,394)	
Decrease in reinsurers' share of technical provisions – claims outstanding		702		287	
Decrease in debtors		615		88	
Increase in creditors		175		10	
			209		(892)
Net cash inflow/(outflow) from operating activities			114		(874)
Taxation paid			(9)		(13)
Capital expenditure			(2)		(4)
Net cash inflow/(outflow) for the year			103		(891)
Cashflows were invested/(realised) as follows:					
(Decrease)/increase in cash holdings	18		(7)		4
Net portfolio investment					
Deposits with credit institutions		33		(205)	
Financial reinsurances		(185)		(248)	
Shares and other variable yield securities and units in unit trusts		130		181	
Debt securities and other fixed interest securities		132		(623)	
	18		110		(895)
Net investment/(realisation) of cashflows	19		103		(891)

*The effect of the retranslation of opening balances has been eliminated from all the relevant cashflow categories and is included within these amounts.

The accounting policies and notes on pages 47 to 57 form an integral part of these financial statements.

Notes to the financial statements

for the year ended 31 March 2001

1 Accounting policies

No changes in respect of accounting policies have been made this year.

Going concern

Significant uncertainties exist as to the accuracy of the provision for 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 14 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 reinsured 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 14 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, the Statement of Recommended Practice on accounting for insurance business issued by the Association of British Insurers in December 1998 and in accordance with Section 255A of, and Schedule 9A to, the Companies Act 1985. The balance sheet of the Parent Company has been prepared in accordance with Section 226 of, and Schedule 4 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 have been prepared in accordance with the historical cost convention modified by the revaluation of certain assets and liabilities. An annual basis of accounting has been adopted.

(a) Basis of consolidation

The consolidated financial statements incorporate the financial statements of the Company and its subsidiaries from 1 April 2000 to 31 March 2001.

(b) 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 and Run-off Contract 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.

(c) 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 14). The Group has structured its asset portfolio to match its expected liability stream. Accordingly the rate of discount applied to those liabilities is calculated having regard to the current prospective yields associated with its asset portfolio.

(d) 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.

(e) 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.

(f) 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. Securities lent are valued on the same basis. In the Company's accounts, investments in Group undertakings are stated at cost.

(g) 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 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.

(h) Investment return

The return from investments, which is reported on an accruals basis and includes net income from securities lent, is transferred together with the related foreign withholding taxes to the technical account.

(i) Foreign exchange

Assets and liabilities are translated into 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 differences taken to the profit and loss account.

(j) 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.

(k) Leases

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

2 Segmental information

The Group transacts only one class of business, being 100% proportional reinsurance written in the United Kingdom.

3 Other technical charges

Other technical charges relate to foreign exchange differences.

4 (Deficit)/surplus on ordinary activities before tax

The (deficit)/surplus is stated after charging:

	Group 2001 £m	*Group 2000 £m*
Auditors' remuneration – audit fees	**1.8**	2.4
– non-audit fees	**0.6**	0.5
	2.4	2.9
Depreciation – tangible owned fixed assets	**3.0**	4.9
Loss on disposal of tangible fixed assets	**4.4**	0.1
Operating lease rentals incurred – property	**3.0**	3.1
– other	**0.3**	0.3

The loss on disposal of tangible fixed assets was incurred largely in respect of computer equipment that was transferred under the contract to outsource information technology services.

The audit fees for the Company of £2,000 (2000: £2,000) were borne by a subsidiary company.

Details of related party transactions, as defined by Financial Reporting Standard 8, are given on page 39.

5 Employees

The monthly average number of persons employed by the Group, including Directors, was 739 for the year ended 31 March 2001 (2000: 872), all of whom were engaged in run-off and related activities.

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

	Group 2001 £m	*Group 2000 £m*
Wages and salaries	**36**	39
Social security costs	**4**	4
Pension contributions	**4**	4
	44	47

6 Directors' emoluments

The aggregate remuneration of the Directors was as follows:

	Group 2001 £000	*Group 2000 £000*
Executive Directors – remuneration	**1,907**	1,859
– LTIP awards paid	**464**	–
– pension contributions	**291**	286
Non-Executive Directors – fees	**335**	353
	2,997	2,498

In addition to the above amounts, provisional awards under the long term incentive plan were made to the Executive Directors as detailed on page 38. Full details of the remuneration of, and transactions with, Directors are given in the Board Report on Directors' Remuneration on page 36.

7 Tax on (deficit)/surplus on ordinary activities

	Group 2001 £m	*Group 2000 £m*
United Kingdom corporation tax at 30% (2000: 30%)		
Current tax (credit)/charge	**(11)**	9
Overprovision in respect of prior years	**–**	(3)
	(11)	6

8 Investments: financial investments

	£m	Group 2001 £m	£m	Group 2000 £m
Listed				
Shares and other variable yield securities and units in unit trusts	**378**		280	
Debt securities and other fixed interest securities	**5,154**		4,477	
		5,532		4,757
Unlisted				
Deposits with credit institutions		**655**		585
Market value		**6,187**		5,342
Cost		**6,096**		5,386

These investments include sterling denominated assets of US$410 million (2000: US$410 million) equivalent which are charged in favour of the New York Insurance Department.

Included in the above table are lent securities with a market value of £121.4 million (2000: £54.7 million), which were fully collateralised.

A charge in favour of Citibank NA over sterling denominated assets of A$217 million equivalent as at 31 March 2000 was released on 4 July 2000, following the establishment of the Equitas Australian Trust Fund (see note 10).

Certain investments are held in trust funds as described in note 10.

9 Investments: financial reinsurances

The average prospective rate of return on financial reinsurances is 5 per cent (2000: 7 per cent) per annum. The mean term is four (2000: five) years. The value of the expected receipts from financial reinsurances, before discounting at market yields to recognise the period until receipt, is £1,366 million (2000: £1,375 million).

10 Trust funds

Financial investments amounting to £3,561 million (2000: £2,847 million) and cash amounting to £2.8 million (2000: £0.4 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.

The Equitas Australian Trust Fund was established under a trust deed dated 7 June 2000, to support obligations undertaken in Australia. It is financed by a letter of credit of A$180 million, which is supported by a charge over a proportion of Australian dollar financial investments.

11 Debtors arising out of reinsurance operations

	Group 2001 £m	*Group 2000 £m*
Unpaid premium	**4**	30
Reinsurance recoveries	**1,164**	1,596
Other	**22**	37
	1,190	1,663

The unpaid premium of £4.0 million (2000: £6.6 million) is receivable through a structured payment plan secured upon bank guarantees and is being collected by the Corporation of Lloyd's on the Group's behalf.

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

12 Called up share capital

	Company 2001 £	*Company 2000 £*
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 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.

13 Retained surplus

	Company £	*Group £m*
At 1 April 2000	–	784
Deficit for the year	–	(84)
At 31 March 2001	–	700

The retained surplus is not distributable.

14 Provision for claims outstanding

	Claims £m	Reinsurance £m	Group 2001 Net £m	Claims £m	Reinsurance £m	Group 2000 Net £m
Provision before discounting	**14,085**	**2,545**	**11,540**	13,212	2,910	10,302
Discount	**(5,152)**	**(964)**	**(4,188)**	(4,182)	(864)	(3,318)
	8,933	**1,581**	**7,352**	9,030	2,046	6,984

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

Claims are stated after elimination of inter-syndicate transactions.

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 70 per cent (2000: 65 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 analysis of the liabilities under the relevant Lloyd's policies. 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.

The provision for future claims represents the Group's assessment of those claims it believes to be valid. Where a claim is disputed, the validity of the claim is ultimately an issue that can only be finally determined by the courts. In many cases the outcome is difficult to predict with certainty. The provision for a disputed claim is based on the Group's view as to the expected outcomes of such court decisions.

Non-APH liabilities comprised approximately 30 per cent (2000: 35 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. 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 3,000 reinsurers and 2,000 reinsurance 'pools', 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 in full when due. No single reinsurer accounts for more than 6 per cent (2000: 7 per cent) of the total expected 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 per cent (2000: 5.75 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 modelled using the estimated 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 2001, 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 ten (2000: eight) years.

At each balance sheet date a portion of the increase in the liability for claims outstanding compared to those outstanding at 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.

15 Creditors arising out of reinsurance operations

Creditors arising out of reinsurance operations are due in less than one year.

16 Other creditors including taxation and social security

These balances include corporation tax payable of £3 million (2000: £23 million). This is composed of £12 million receivable (2000: £5 million payable) within one year and £15 million (2000: £18 million) payable in more than one year.

17 Reconciliation of movements in shareholders' funds

	Group 2001 £m	*Group 2000 £m*
Opening shareholders' funds	784	772
(Deficit)/surplus for the year (see note 13)	(84)	12
Closing shareholders' funds	**700**	**784**

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.

18 Movement in portfolio investments net of financing

	Group 2001 £m	*Group 2000 £m*
Net cash (outflow)/inflow for the year (see note 19)	(7)	4
Movement arising from cashflows of portfolio investments	**110**	(895)
Changes to market values and discount (see note 19)	**300**	(113)
Other changes, including exchange rate effects (see note 19)	**552**	26
Total movement in portfolio investments net of financing	**955**	(978)
Opening portfolio investments net of financing (see note 19)	**6,398**	7,376
Closing portfolio investments net of financing (see note 19)	**7,353**	6,398

19 Movement in cash, portfolio investments and financing

	At 31 March 2000 £m	*Cashflow £m*	*Changes to market values and discount £m*	*Other changes, including exchange rate effects £m*	*At 31 March 2001 £m*
Cash at bank and in hand	29	(7)	–	2	**24**
Deposits with credit institutions	585	33	–	37	**655**
Financial reinsurances	1,027	(185)	160	140	**1,142**
Shares and other variable yield securities and units in unit trusts	280	130	(39)	7	**378**
Debt securities and other fixed interest securities	4,477	132	179	366	**5,154**
	6,398	103	300	552	**7,353**

During the year shares and other variable yield securities and units in unit trusts of £380 million (2000: £248 million) were purchased and £250 million (2000: £67 million) were sold. For the same period debt securities and other fixed interest securities of £6,543 million (2000: £5,107 million) were purchased and £6,411 million (2000: £5,730 million) were sold. Cash at bank and in hand as at 31 March 2001 shown above is stated net of £6 million (2000: £5 million) of overdrafts.

20 Contingent liabilities

The Group has granted certain indemnities to Trustees, Directors, Employees and the Auditors.

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

21 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. Such a payment would require the consent of the Financial Services Authority on behalf of HM Treasury.

22 Financial commitments

	Group 2001 £m	*Group 2000 £m*
Expiring within one year	–	1
Expiring between two and five years inclusive	–	–
Expiring in over five years	4	3
	4	4

Company balance sheet
as at 31 March 2001

	Note	*2001* *£*	*2000* *£*
Fixed assets			
Investments – investments in Group undertakings	21	**300**	300
Current assets			
Amounts due from a Group undertaking		**1**	1
Net current assets		**1**	1
Total assets less current liabilities		**301**	301
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	12	**101**	101
Profit and loss account	13	**–**	–
Shareholders' funds – non-equity interests		**101**	101

The financial statements on pages 47 to 58 were approved by the Board on 17 July 2001 and were signed on its behalf by:

HA Stevenson
MJ Crall
JV Barker

The accounting policies and notes on pages 47 to 57 form an integral part of these financial statements.

Open Meeting of Reinsured Names

The annual Open Meeting of Reinsured Names will be held at 10.30am on Friday 7 September 2001 at the Queen Elizabeth II Conference Centre, Broad Sanctuary, Westminster, London SW1. All Reinsured Names are invited to attend. A card with complete details of the meeting accompanies this report. Reinsured Names who wish to attend the meeting are asked to return the reply-paid section of the card by 28 August 2001.

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.

Designed and produced by Fishburn Hedges

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