Report & Accounts

for the year ended 31 March 2003

EQUITAS

Overview

In the year ended 31 March 2003:

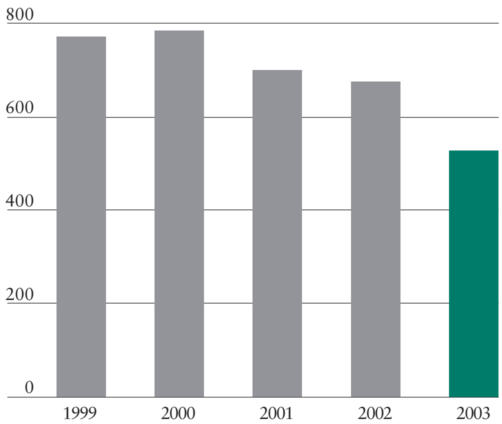
- Accumulated surplus after tax decreased by £152 million from £679 million to £527 million.
- Solvency margin, being accumulated surplus expressed as a percentage of net claims outstanding, decreased from 10.3 per cent to 8.7 per cent.

Contents

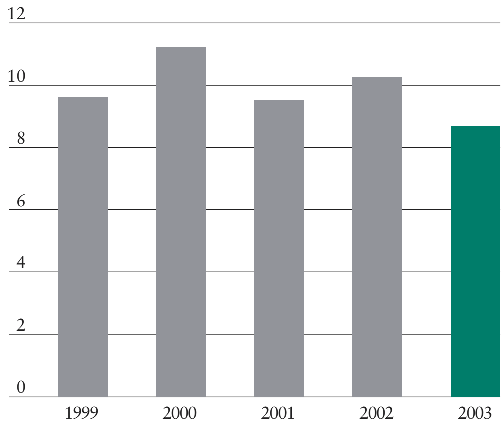
Five year results

as at 31 March

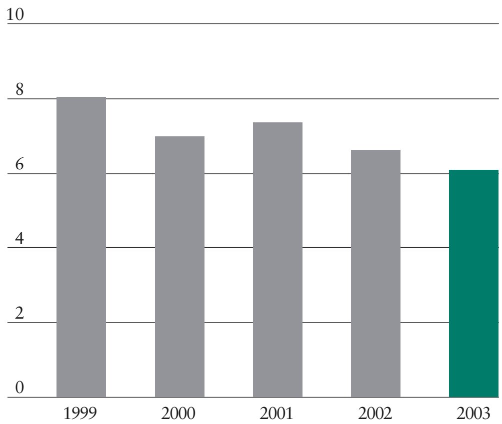
Accumulated surplus (£m)



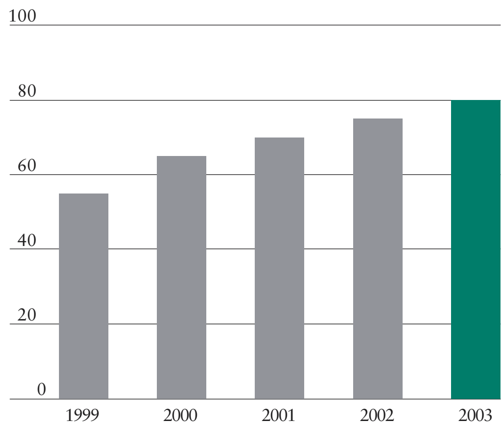
Solvency margin (%)



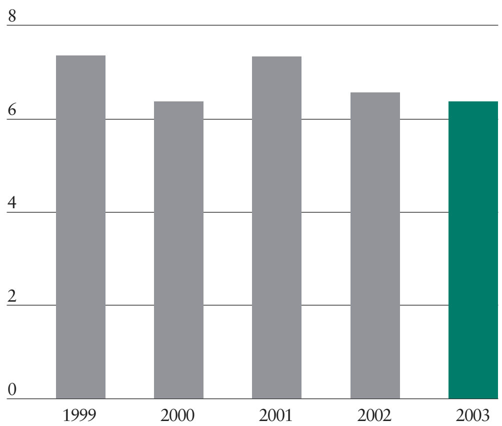
Net discounted provision for claims outstanding (£bn)



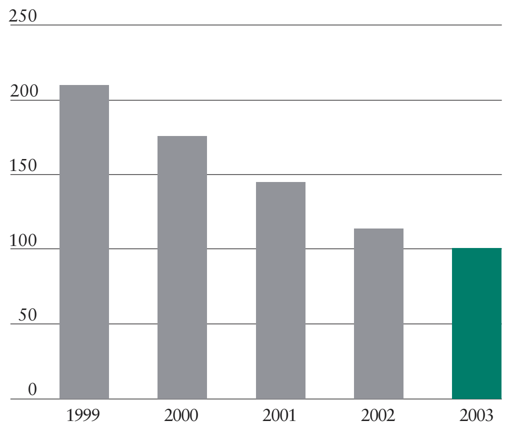
APH claims as a percentage of net discounted provision for claims outstanding



Investments (£bn)



Operating expenses (£m)



Chairman's statement

Hugh Stevenson

In the financial year to 31 March 2003:

- Accumulated surplus after tax decreased by £152 million from £679 million to £527 million;
- Solvency margin fell from 10.3 per cent to 8.7 per cent.

When I wrote to Reinsured Names last December, I stated that it was possible that we would have to strengthen our asbestos reserves at the end of the year. I also referred to the falls in the UK and US equity markets and to the impact of exchange losses on the portion of our surplus held in US dollars. These three factors have combined to produce the decrease in both our accumulated surplus and our solvency margin.

Asbestos remains the greatest single threat to Equitas. We have once again had to strengthen our asbestos reserves, adding £399 million on a gross discounted basis. Gross undiscounted asbestos liabilities now amount to £5.3 billion, equivalent to more than 54 per cent of the Group's total gross undiscounted claims reserves.

There are however some encouraging signs. Our experience during the past year confirms our belief that our strategies for managing asbestos claims will assist us in restricting the financial impact of such claims on Equitas. Secondly, several policy buyouts have provided an important additional validation of our reserving process. Thirdly, there is now a general consensus in the US that the asbestos litigation crisis must be addressed by legislative action, although we cannot forecast the outcome of the discussions currently in progress in Washington or the impact on Equitas of any legislation which may be passed. Asbestos matters are discussed in more detail within both Michael Crall's and Scott Moser's reports.

While we match our claims liabilities with holdings of high quality bonds, we have for some years invested a portion of our surplus in equities as well as in bonds. During the year our bond portfolio – representing over 95 per cent of our financial investments – performed strongly. By contrast, consistent with the sharp declines in equity markets worldwide, the value of our equity portfolio fell by £114 million. As a result, our overall investment return fell £72 million short of matching the unwinding of the discount.

Since a large part of our business is conducted in US dollars, a portion of our surplus is held in both bonds and equities denominated in that currency. While this makes sense in economic terms, it inevitably opens the Group to an accounting exposure because it accounts in sterling. The weakening of the dollar against sterling this year has created an unrealised exchange loss, which is included in our overall exchange loss of £26 million. We do not speculate through currency trading and our exposure to exchange losses is limited by our policy of matching the currency of our assets and liabilities.

The Group has made good progress in other areas of the business. Claims settlements, collection of reinsurance and the commutation of reinsurance contracts produced significant contributions. Operating expenses were in line with our target.

Michael Crall reviews the performance of our core business activities and comments on decisions regarding claims reserves in his Chief Executive Officer's review on pages 5 to 10. Scott Moser reports on developments regarding asbestos claims and our strategy to manage them on pages 11 to 15. Jane Barker analyses the accounts and other financial information in her financial review on pages 16 to 19.

The balance sheet of Equitas is weaker than it was a year ago, and we still face significant uncertainties arising from matters over which we have little or no control. In the light of these uncertainties the Auditors have once again qualified the Group's accounts. As I have often stated in the past, success cannot be guaranteed. However, as in previous years the Board has taken into account the following points when making judgments about the future:

- Our solvency margin remains stronger than when Equitas commenced. This has been achieved despite the fact that during the last seven years we have strengthened gross discounted reserves by £1.3 billion.

- Since the inception of Equitas, aggregate paid claims have exceeded £13.7 billion. Despite this, cash and investments amounted to £6.4 billion at 31 March 2003.

- The majority of asbestos claims will not be received or paid for many years to come. Asbestos payments in the last year, excluding policy buyouts and commutations, represented just over 3 per cent of gross undiscounted asbestos reserves.

- Equitas has an excellent and now proven track record of dealing with long tail claims. The terms on which we have bought out a number of major asbestos policies have served to validate our methodology and processes for assessing the value of our asbestos liabilities.

In December we announced that Michael Crall intended to retire as an executive director on reaching age 60. Reinsured Names owe a great deal to Michael. He was appointed to the Board in December 1995 and he has been instrumental in transforming the fragmented businesses we inherited into a fully integrated organisation of the highest standards. By communicating his professionalism and fairness throughout the Group he has set the example for others to follow. I am very pleased that we will have the benefit of his continued advice as a non-executive director. Scott Moser, who has been Claims Director at Equitas since April 1997, will succeed Michael as Chief Executive Officer in November. As already announced we have made three new appointments to the Board: Glenn Brace, previously head of Asbestos Pollution and Health Hazard Claims, who becomes Claims Director; Jon Collins, our Chief Actuary, and Jeremy Heap, who becomes Reinsurance Recoveries Director. Each of them has been with Equitas for over five years. They have all played a central role in the Group's progress, and I am delighted that the importance which we attach to succession planning has been vindicated in this way.

In this context I should say something about senior executive pay. The success or failure of Equitas, to the extent that we can control it, is in the hands of its executive team and it is of the first importance that we should be able to attract, retain and promote the best possible people. The contribution which they are able to make is out of all proportion to the cost of employing them. I can assure Reinsured Names that the payments which we make to our senior executives are appropriate, particularly as we have never been able to provide for them any of the equity related incentive schemes which have been offered to others in the financial sector.

The continued uncertainties relating to asbestos claims, the turbulence in world stock markets and the weakness of the US dollar have all served to make the past year particularly challenging for everyone who works at Equitas. They have responded to these challenges with skill, professionalism and commitment. I am sincerely grateful to all of them.

Hugh Stevenson
Chairman
5 June 2003

Chief Executive Officer's review

Michael Crall

Results for the year ended 31 March 2003 were adversely affected to an unprecedented degree by swings in the financial markets. Positive contributions from claims settlements and reinsurance commutations were more than offset by increases in selected categories of claims reserves. In the aggregate, Group surplus deteriorated by £152 million.

Investment management

Investment return amounted to £693 million for the year ended 31 March 2003 (2002: £277 million). The increase in investment return was due to the general fall in interest rates over the course of the year, resulting in an increase in bond values. Excellent fixed interest results were, however, counter-weighted by the poor performance of equities.

Because Equitas discounts its liabilities to take account of the time value of money, the investment performance measure most important to the financial health of the Group is the amount by which investment return varies from the unwinding of the discount applied to claims liabilities. Since the first full year that we reported results this measure had never been less than £95 million positive, and in the first six years of Equitas' existence, up until 31 March 2002, investment return exceeded the unwinding of the discount by a total of some £680 million. In the year just ended, however, and notwithstanding positive bond portfolio performance, investment return fell £72 million short of the unwinding of the discount. This shortfall was wholly due to the fall in the value of our equity holdings.

Our investment portfolio remains overwhelmingly invested in high quality fixed interest securities, with only a portion of our surplus invested in equity markets. The composition of the fixed interest portfolio is adjusted regularly to comply with our long term policy of matching expected liabilities by currency and duration. The portion of our surplus invested in non-sterling assets is exposed to exchange rate effects, which last year were negative.

Investment return in excess of unwinding of discount (£m)

Notwithstanding the adverse results of the past year, we continue to believe that our investment policies, including the decisions to invest in equities and to invest a portion of the surplus in US dollars (in order to support US dollar liabilities), are appropriate. Our perspective needs to remain geared to the long term. The liabilities we are charged with running off will persist for decades, and we do not believe our investment strategy should be unduly swayed by short term swings, be they positive or negative.

The rate at which we discount our liabilities is based on the prospective yield on our bond portfolio. As a direct result of the changes in the yield curve we reduced the rate at which claims liabilities are discounted from 5.25 per cent per annum at 31 March 2002 to 3.90 per cent per annum at 31 March 2003. Reducing the discount rate had the effect of increasing the present value of liabilities by £501 million at 31 March 2003.

Asbestos liabilities

The year ended 31 March 2003 was very eventful in the evolution of asbestos related claims. There was a significant increase in the level of awareness of the problem in both the US and the UK and a great deal of activity on a variety of fronts. In particular, both courts and legislative bodies in the US have paid increasing attention to the issues raised by claims made on behalf of individuals who are not ill, a problem we highlighted in our special report on asbestos in the Report & Accounts of 31 March 2001. In the Claims Management report on pages 11 to 15, Scott Moser reviews asbestos related developments over the past year.

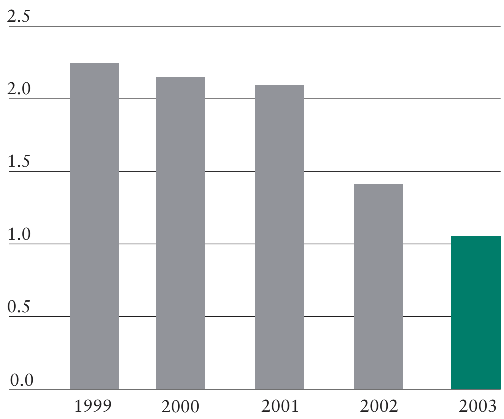
As we do every year, we have undertaken a comprehensive review of our asbestos liabilities as part of our year end accounting exercise. We have determined that the core assumptions (for example, the probable incidence of various types of asbestos related disease) used for the past several years to estimate the costs of future asbestos claims remain broadly appropriate and so do not require any material adjustment. Nonetheless, asbestos reserves in respect of both US and non-US liabilities have been increased, owing to the more comprehensive analysis of specific asbestos assureds and cedants. A wide ranging review of potential asbestos defendants has resulted in the identification of a number of exposed policies not previously recognised as possible targets of asbestos claims. Additionally, analysis of individual assureds and cedants has led to the revision – both upward and downward – in reserves. We have not taken any account within our reserves of possible legislative reform, currently under discussion in the US Congress.

At 31 March 2003 gross undiscounted asbestos reserves amounted to £5.3 billion compared with £6.4 billion at 31 March 2002. Over half of the apparent year to year reduction is due to translating US dollar exposures at different exchange rates. Gross asbestos reserves, discounted to take account of the time value of money, amounted to £3.7 billion (2002: £3.6 billion). The combined effect of strengthening our overall asbestos reserves at the undiscounted level and bringing forward the expected timing of claims payments has required an increase in our gross discounted asbestos reserve of £399 million. Asbestos claims payments and the value of liabilities extinguished through policy buyouts and commutations during the past year amounted to £610 million. Excluding liabilities extinguished through policy buyouts and commutations, asbestos claims payments last year were £170 million.

Last year we negotiated policy buyouts with nine policyholders with significant asbestos liabilities, including two of our ten largest insured exposures. Additionally, as part of our strategy to commute the reinsurance asset, we routinely commute inwards liability as well, thus closing out additional asbestos exposure.

Over the past year a number of major US and international insurance companies have announced well publicised increases in their asbestos reserves. A detailed analysis of these

Gross claims paid (£bn)



reserve adjustments supports the view that these companies are, in effect, acknowledging the asbestos situation which Equitas recognised in its accounts two and three years ago, when we increased our gross asbestos reserves by a total of £3.2 billion. Moreover, with reference to the US insurance companies which ceded reinsurance to the reinsured syndicates, our confidence in our reserving methodology is reinforced by the fact that, after increasing reserves, the reinsurance asset disclosed by these companies as being payable by Equitas is consistent with amounts already identified by the Equitas reserving process.

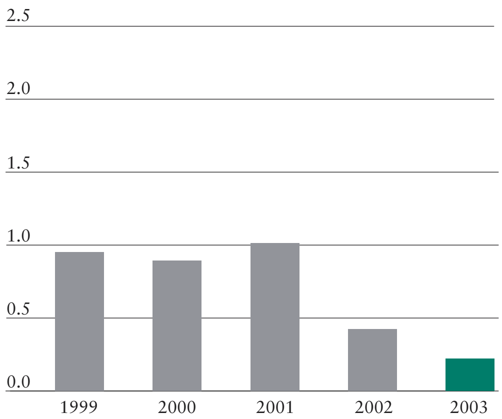
Observers often attempt to compare the adequacy of individual insurers' asbestos reserves. An imprecise tool used by insurance industry analysts to compare reserve adequacy is the 'survival ratio'. This ratio indicates the number of years a company can continue paying claims at a historical rate before it exhausts its reserves. As at 31 March 2003, Equitas' three year asbestos survival ratio, gross of reinsurance recoveries and excluding payments in respect of commutations and policy buyouts, was 24.6 (2002: 23.6). This means it would take 24 years before Equitas would exhaust its undiscounted asbestos reserves, assuming that asbestos claims continue to be paid at the same underlying rate as during the previous three years. By comparison, we estimate that the average three year asbestos survival ratio for a representative sample of US insurers (that are not allowed to discount claims reserves), gross of reinsurance recoveries but including payments in respect of commutations and policy buyouts, if any, was 11.0 at 31 December 2002 (2001: 6.1).

Claims management

Gross claims paid for all types of coverage, an amount which includes claims resolved through commutation agreements as well as the Group's operating costs, amounted to £1.1 billion in the year ended 31 March 2003 (2002: £1.4 billion). In addition to the gradual reduction of claims activity over time, the decrease in claims paid reflects the fact that we have by now closed out many of our largest claims, either through policy buyouts or commutations.

We continued to make good progress in nearly all areas of the claims portfolio. We maintained our excellent record in settling environmental pollution claims. During the past year we closed 57, or 18 per cent, of the 312 open direct pollution claims pending at 1 April 2002. Equitas has by now resolved 45 of the 50 largest pollution claims that were pending at its inception. As part of most of these settlements we received a broad release from future claims from the policyholders. When Equitas was created we faced over 600 open direct pollution claims. Today, after taking into account new claims, the number of open direct pollution claims stands at 299.

Reinsurers' share of claims paid (£bn)



We also continue to make encouraging progress in settling non-APH (asbestos, pollution and health hazard) claims, also known as 'balance of account' claims. Non-APH claims represent 20 per cent of net discounted liabilities, down from 25 per cent at 31 March 2002 and compared to 60 per cent when Equitas began operations. Balance of account claims can be expected to continue to run off more rapidly than APH claims. Thus APH claims will inevitably rise as a percentage of overall reserves.

As part of our annual reserve review we thoroughly examine developments regarding previously identified health hazards. This review has resulted in some revisions of ultimate claims estimates in a few reserve categories. In the aggregate these revisions are not material. With regard to tobacco related exposures, we continue to believe that tobacco claims will not create a significant liability for Equitas. Additionally, we have not identified any previously unknown health hazard in the past year which we believe is likely to create a material liability for the Group.

Reinsurance Recoveries management

Reinsurers' share of claims paid amounted to £222 million in the year ended 31 March 2003 (2002: £424 million). Reinsurance recoverable on claims paid will normally reduce in line with claims payments and as outwards reinsurance contracts are commuted. During the past year, we completed the negotiation of 83 commutation agreements, down slightly from the previous year.

We are working to commute reinsurance contracts wherever we can do so on appropriate terms. Terminating complex reinsurance arrangements in exchange for a cash settlement has many advantages:

- Reinsurance asset does not produce investment income until it is collected. By converting reinsurance asset to cash through commutations, we will increase future investment income. Realising reinsurance asset through commutations has helped keep the value of the investment portfolio at a steady level, even though we have paid more than £13.7 billion in claims since Equitas began operations.

- Reinsurance recovery is an expensive and time consuming process. Commuting reinsurance arrangements will reduce future processing and collection expenses.

- Collection of reinsurance debt is hampered by individual and market-wide disputes which affect all reinsurers, not only Equitas. These disputes can often be settled more easily through a commutation than through litigation or arbitration.

- Commutations eliminate the risk of non-payment due to reinsurer insolvency.

When possible, Equitas prefers to negotiate 'global' commutations, which not only collect outwards reinsurance proceeds, but also extinguish liabilities for inwards reinsurance. Commutations, therefore, are a means by which we can reduce our claims outstanding, including in many cases asbestos liabilities.

Some reinsurers are unwilling to enter into commutation agreements, and we will collect the reinsurance proceeds owed by these companies through either traditional means or, where appropriate, by resorting to litigation.

With effect from 1 April 2003 we have combined in a single department all our reinsurance recovery activities, including both commutations and loss-by-loss collections. We expect this consolidation to lead to both better results and lower costs.

Expense management

Operating expenses amounted to £101 million in the year ended 31 March 2003 (2002: £114 million). This level of operating expenses met our targets and represented an 11% year to year reduction. This was achieved in spite of higher insurance costs and increased rent, stemming from contractual rent review clauses, and only slightly reduced investment management fees. These fees track with the size of the portfolio, which has remained relatively unchanged for the past several years.

Employment costs represent roughly half of our total expenses. The average number of employees decreased to 596 in the year ended 31 March 2003 as compared with 660 in the prior year. Notwithstanding the constant requirement to reduce costs and employee numbers, our employees continue to perform at a high level. One of the prevailing characteristics of Equitas over the years has been the willingness of our people to work diligently on the completion of tasks, even where finishing a job is likely to result in a reduction in staffing levels.

Conclusion

Since the inception of Equitas in 1996 I have had the privilege, as the Group's Chief Executive, of leading an extraordinary group of people dedicated to achieving a uniquely challenging mission. I am extremely proud of the accomplishments of the organisation. While rationalising a wide variety of systems and processes and aggressively reducing costs, we have applied highly innovative solutions to apparently intractable claims and reinsurance recovery problems. That being said, I would have hoped by now to be further advanced in eliminating the uncertainty which Reinsured Names face. The re-emergence of asbestos as a serious threat to solvency has largely offset the very substantial progress we have made in every other area of the business.

As I look forward to the end of my executive association with the Group later this year, I am encouraged by the quality and breadth of leadership which follows me. This is a highly professional team fully qualified to meet our objectives and unconditionally committed to the successful completion of our central tasks.

Finally, I want to thank Reinsured Names for the support they have provided over the past seven years. Equitas was formed under crisis circumstances which gave those involved every right to be sceptical of purported solutions. In spite of this Reinsured Names from around the world have consistently gone out of their way to express good wishes and goodwill. I have endeavoured to represent their interests effectively, and I have every confidence my successors will do likewise.

Michael Crall
Chief Executive Officer
5 June 2003

Claims Management report

Scott Moser

In last year's Annual Report, we discussed Equitas' efforts to manage asbestos claims as well as the changes in the environment in which those claims were handled. Over the past year the speed and scope of those changes have continued at a remarkable pace.

Changes in the asbestos claims environment

Before London Market insurers including Equitas will reimburse an asbestos bodily injury claim presented by a policyholder, the policyholder must, as with all claims, prove that the claim is covered. That means that the policyholder must produce sufficient evidence of an asbestos related injury that was caused by the policyholder's product or premises to satisfy the requirements of the policies. In mid-2001, this principle was incorporated into a set of guidelines for policyholders known as the London Documentation Requirements (DRs). In late 2001, the DRs were expanded by issuing Reinsurance Documentation Requirements (RDRs) for asbestos claims presented by cedants which purchased reinsurance coverage from Lloyd's syndicates and other London Market insurers. When the DRs became effective in June 2001, there was no significant discussion, outside certain industry and academic circles, regarding the problems created by payments to people who are not ill. Since that time the problem of unimpaired claimants, and the need for meaningful medical standards, have become widely acknowledged. The past two years have seen a flood of media comment. The Chicago Tribune summed up the comments of many when it said: "Today's dysfunctional system benefits primarily trial lawyers and healthy plaintiffs – and that drains resources from those who are sick and dying because of asbestos. That's a national shame."

Similar coverage has appeared in numerous US newspapers, magazines and insurance industry periodicals. New articles appear each week on asbestos claims abuses. The broadcast media have also dealt with the issue on prime time television in the US. In virtually every case, the media has identified claims by unimpaired individuals as a societal problem and corroborated the need for responsive changes.

Influential scholars and national leaders in the US have also joined the cry for reform. Professor Lester Brickman has written frequently about the abuses in the asbestos litigation system. He asserts that asbestos litigation will join the "pantheon of . . . . great American swindles." Economist and Nobel laureate Joseph Stiglitz published a report assessing some of the harmful economic consequences of asbestos claims abuses. Griffin Bell, a jurist and former Attorney General of the United States, has published and spoken repeatedly about the need for asbestos reform. He has been quoted with approval by courts and commentators. The Rand Institute, a prestigious US think tank, has issued a frequently cited report that identifies the problem of unimpaired claimants. In short, the principles that underlie the London Documentation Requirements have gathered distinguished, vocal and widespread support since the DRs became effective in June 2001.

Importantly, courts in the US have also begun to address the problem of unimpaired claims by either refusing to hear such claims or dismissing them. The judge responsible for New York City's asbestos cases has ruled that claims not meeting specified medical criteria must be placed on a list of inactive cases. Judges in other states have employed similar strategies and still more have such strategies under consideration. The federal judge responsible for all federal asbestos cases has effectively stayed cases resulting from mass screenings lacking in valid medical support. A federal judge responsible for multiple asbestos bankruptcies has imposed some medical standards and is requiring the disclosure of other sources of asbestos recoveries.

The most high-profile changes have happened in Washington D.C. The US Congress has considered asbestos reform legislation in the past but without success. This year members of Congress, like the general public, have been inundated with reports of asbestos abuses – reports that emphasise the negative effects of such practices on the economy, the reputation of the judicial system and the rights of present and future asbestos victims.

As a result, the activity on Capitol Hill during the past year has been intensive and unprecedented. There are several major asbestos reform proposals before Congress, all of which advocate or contemplate the imposition of medical standards. These proposals are being sponsored or advanced by respected senior members of Congress. This activity is important to Equitas, not only because it may result in national legislation, but also because each of these legislative proposals demonstrates the reasonableness of DR-like standards. Even if these proposed statutes fail to be enacted, they will stand as testimony that the steps we have been taking to manage asbestos claims are entirely reasonable and appropriate.

Legislative activity is occurring at the state level as well. Two of the most unattractive jurisdictions for asbestos defendants have this year passed reform legislation that significantly alters the asbestos landscape. West Virginia has passed a bill that restricts access to its courts by out-of-state residents (known as 'forum shopping'), thus altering its status as a magnet for asbestos claims. Mississippi, perhaps the jurisdiction most highly favoured by asbestos plaintiffs, has passed a tort reform law limiting forum shopping, excessive punitive damages and joint and several liability.

Those fighting against unimpaired claims have found an important ally in the American Bar Association ('ABA'), the largest and most widely recognised association of American legal professionals. Earlier this year, the ABA Board of delegates condemned the current asbestos claims environment and called for federal legislation imposing medical standards. This action will be influential and the president elect of the ABA has already testified on this subject before the US Congress.

We continue to see changes in the atmosphere surrounding asbestos claims that seemed unlikely 18 months ago. Tolerance of misconduct by those involved in the asbestos claim industry is low. Federal prosecutors in Mississippi have investigated asbestos lawyers and judges for alleged corruption, and numerous criminal indictments are expected. In Texas, a court has levied sanctions against a prominent asbestos plaintiff's firm for forum shopping.

In Pennsylvania, a state court judge has pleaded guilty to charges that he accepted money from asbestos lawyers with cases before him.

Equitas has helped to effect change

Equitas has played its role in creating change in the asbestos 'atmosphere.' We have always recognised that one of the strategies in combating asbestos abuses would be to expose those abuses. It was recognised when the DRs, and later the RDRs, were issued, that there was risk that the opponents of reform would, at the least, criticise these actions. Yet, by taking that risk, we were able to help make asbestos claims abuses a subject of public scrutiny. For example, one study of selected media showed that in the year after the DRs were issued there was a ninefold increase in media reports about the problems of unimpaired asbestos claims.

We have accepted numerous invitations to speak or write on the need for changes in the way asbestos claims are handled. We thought it necessary to demonstrate that the prevailing asbestos claims practices are destructive to the judicial system, violate fundamental tort law principles and are harmful to the future victims of asbestos related disease. As we have seen, judges, journalists, legislators, scholars and citizens have all come to view the current system as dysfunctional.

But there are other, more important battles ahead. Merely perceiving the need for change is not enough. There must also be the will to enact those changes. We cannot control the courts or the legislature. We can, however, continue to deter attempts to use insurance policies improperly to fund asbestos claims that are not covered.

The impact on Equitas

If these favourable trends continue to favourable conclusions, the impact on Equitas and Reinsured Names will be significant. A number of states have passed asbestos reform measures and other states have reforms on the legislative agenda. Federal legislative reform would further relieve the pressure caused by the continued payment of unimpaired claims. Changes in judge-made law, including the use of inactive case lists, would also offer relief.

Although it is too early to say whether all of these proposed reforms will become a reality, within Equitas we are beginning to see tangible effects of the changing atmosphere surrounding asbestos claims. We have noticed a distinct drop in the number of inventory deals submitted to London for approval (i.e. mass settlements including both obviously injured and unimpaired claimants). This change could be due to a number of factors, including the application of the DRs. Whatever the causes, some practices which previously characterised the asbestos claim industry also seem to be changing.

Before 2001, policy buyout deals with asbestos assureds were rare. Since 2001, we have concluded 14 buyout deals with policyholders that have claimed major asbestos exposures. These deals involved several of our largest assureds and realised an extensive release of asbestos and other coverage. It is difficult to assign precise causes to this increased asbestos settlement activity. It is indisputable, however, that opposition to unimpaired claims, growing support for DR-like standards, alterations in public awareness of the asbestos situation and a rapidly changing legal and legislative landscape have all become relevant topics for discussion at the negotiating table.

Challenges to the DRs and RDRs

Despite encouraging developments, the fight against asbestos abuses, including the payment of unimpaired claims, is far from over. There are a number of outstanding challenges to the DRs and RDRs. We continue to believe firmly in the DRs and RDRs and remain confident that our efforts to prevent payment of unimpaired claims that are not covered by insurance will be sustained.

Only one court has thus far issued a ruling on the DRs. In that case, the court rejected a policyholder's motion to declare the DRs invalid as a matter of law.

The DRs have also been the subject of two arbitration decisions. Both involved arbitrations under the Wellington Agreement. Consequently, neither has precedential value in courts or non-Wellington arbitrations and both are governed by confidentiality provisions. Despite those confidentiality provisions, unfavourable reports of one of those arbitrations circulated widely during the early part of this year. Those reports were inaccurate. We have strongly encouraged those entities that are signatories to the Wellington Agreement, and therefore eligible to view both the arbitration decisions, to read those decisions in their entirety.

Some challenges have criticised the DRs and RDRs but it is clear that:

- No insurance company could survive if asked to pay a virtually unlimited number of uncovered claims.
- The past two years have led many commentators to the conclusion that the payment of unimpaired claims is harmful to the entire system by which personal injury claims are resolved.
- Legitimate efforts to avoid paying uncovered claims are entirely appropriate.

Bankruptcy proceedings of asbestos assureds

In last year's Report, we indicated our intention to become as involved as we can in the bankruptcy proceedings filed by major asbestos assureds. We were encouraged last year by the filings that certain policyholders made in the bankruptcy court – filings that sought the application of meaningful claims payment standards.

Disappointingly, not all policyholders that took such positions maintained them. The pressures to come to terms with the asbestos creditors' committees, generally composed of asbestos plaintiffs' lawyers, have led some policyholders to seek the approval of bankruptcy trusts that lack appropriate standards or otherwise ignore the legitimate interests of insurers.

Equitas will continue to fight for a fair hearing in all proceedings involving bankruptcy trusts that seek to include London insurance assets. We are concerned that the bankrupt policyholder's efforts to protect those assets may flag or disappear once a possible deal with creditors is in reach. If our interests are not properly protected in the bankruptcy court, we will seek the protection of the appellate courts. We will not allow insurance proceeds to be used to create trusts that allow the routine payment of unimpaired claims or otherwise distort the terms of the policyholder's insurance coverage.

Looking ahead

One of the disturbing aspects of the current asbestos crisis is the imposition of liability on an ever-widening circle of defendants. We launched a project this year to examine the potential liability of companies that might become targets for the asbestos claims industry. We took a closer look at a large number of companies, some of which have only remote connections to the use of asbestos or asbestos-containing products.

The results of this exercise resulted in some reserve strengthening. They also provided us with confidence that we were taking the steps necessary to spot negative developments before they had an impact on us.

This analysis is not a guarantee against negative developments. Current asbestos claims practices have created a list of potential asbestos defendants that includes scores of Fortune 500 corporations, some of whom may not yet have received a single claim. Meaningful asbestos reform may make this analysis unnecessary. Until then, we will keep a cautious eye on the road ahead.

Conclusion

Asbestos claims remain the biggest single threat facing Equitas. Our efforts to manage these claims are promising, but success is not assured. However, US legislatures, courts and the media now widely recognise the problems presented by such claims and offer promising potential for rational solutions to emerge. We will continue to resist invalid claims and will do all we can to see that permanent changes are made in the way asbestos claims are handled.

Scott P. Moser.

Scott Moser
Managing Director
5 June 2003

Financial review

Jane Barker

The Group sustained a deficit of £152 million after tax compared with a deficit of £21 million in 2002.

Our claims and commutations activities produced £142 million of contribution by achieving settlements at favourable values compared with those in our balance sheet. Investment return did not exceed the unwinding of the discount resulting in a negative contribution of £72 million. The net contribution, therefore, of £70 million has been more than absorbed by the reassessment of our reserves.

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 transactions are provided in the technical account; non-insurance transactions are detailed in the non-technical account.

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

Investment return

Commentary on investment performance appears on pages 5 and 18.

Claims paid

The amount of gross claims paid of £1,051 million compares with £1,413 million in 2002. The reinsurers' share of the gross claims paid is £222 million (2002: £424 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 £101 million (2002: £114 million) have been included in the amount of gross claims paid.

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 adopt 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 margin for prudence.

The margin for prudence takes account of the fact that the liabilities are not perfectly matched, since the investment benchmarks we set 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 decreased the discount rate to 3.90 per cent per annum from 5.25 per cent per annum to reflect current market yields and our expected claims payment patterns.

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	264
Effect of change in the discount rate	501
Unwinding of the discount	**765**

The last element in the change in provision for claims arises from our re-evaluation of the discounting effect of the likely timing of future payments and receipts. This resulted in an increase in net claims provisions of £294 million.

Other technical charges

The other technical charges are made up of foreign exchange items. 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. As discussed in the Chairman's statement we hold a portion of our surplus in US dollars. This policy exposes us to movements in the US dollar exchange rate against sterling. The closing exchange rate for US dollars used for translation of the balance sheet at 31 March 2003 was US$1.58 to £1 sterling compared with US$1.43 at 31 March 2002.

Regulatory requirements in certain other overseas countries also require us to maintain surpluses in those currencies, and this creates further exposures.

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 £527 million as at 31 March 2003. The movements were as follows:

	£m	£m
Retained surplus at 1 April 2002		**679**
Difference between investment return and unwinding of the discount	(72)	
Reassessment of:		
Claims, including expenses (see below)	268	
Reinsurances (see below)	(43)	
Timing of net future payments	(294)	
Deficit before exchange losses and tax		(141)
Exchange losses		(26)
Tax		15
Retained surplus at 31 March 2003		**527**

Provision for claims outstanding

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

- payments, receipts and accruals in the year;
- reassessment of liabilities and associated reinsurances;
- changes in discount; and
- movements in exchange rates.

The movements on the provision for claims outstanding are summarised below:

	Claims £m	*Reinsurance* £m	*Net* £m
Provisions at 1 April 2002	**7,763**	**(1,142)**	**6,621**
Payments, receipts and accruals	(1,051)	222	(829)
Unwinding of the discount	899	(134)	765
Reassessment of:			
Liabilities and reinsurances	(268)	43	(225)
Timing of net future payments	329	(35)	294
Exchange and other movements	(633)	97	(536)
Provisions at 31 March 2003	**7,039**	**(949)**	**6,090**

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.

In order to meet these dual objectives, over 95 per cent of the investment portfolio is invested in high quality fixed interest instruments.

At 31 March 2003 equities represented approximately 4.6 per cent of the market value of our investment portfolio and 50 per cent of our retained surplus. Our equity portfolios lost value, incurring realised and unrealised losses of £114 million, tracking the falls in value experienced in both the UK and US markets.

Overall the total investment return on our bond portfolio and our financial reinsurances was more than sufficient to match the unwinding of the discount. The negative return on equities has eliminated this positive performance giving rise to the deficit after unwinding of the discount of £72 million.

Worries over global economic growth prospects persisted throughout the year and were compounded by uncertainties with respect to the recent conflict in Iraq. A combination of poor economic growth and the uncertainty with respect to future growth led to further cuts in interest rates by central banks in the US, UK and Europe. This encouraged a substantial fall in long term interest rates, producing significant gains in our bond portfolio. Although there was some recovery in equity markets in the last quarter of 2002 and early 2003, global markets registered significant declines in the year to 31 March 2003.

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. Over the past year, as they have done previously, our investment managers have in aggregate matched these benchmarks.

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 continues to be a prudent provision for bad debts and accordingly no further adjustments have been made.

Financial risk management

In previous years, I have commented on the Group's financial risk management. This analysis is now included in the Directors' report.

Jane Barker
Finance Director
5 June 2003

Board of Directors

Hugh Stevenson ‡§

Chairman; joined the Board in 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 and other companies. Age 60.

Michael Crall #Δ*

Chief Executive Officer; joined the Board in 1995. He was formerly President and Chief Executive Officer of Argonaut Insurance Company and a senior executive at CIGNA Corporation. Age 59.

Scott Moser *

Managing Director and Chief Executive Officer Designate; joined the Board as Claims Director in 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 52.

Ian Agnew

Lloyd's Appointed Non-Executive Director; joined the Board in 2002. He is Chairman of the Jubilee Group of Companies at Lloyd's. He was formerly Chairman of Wellington Underwriting plc; Chairman of I C Agnew Underwriting Limited; and underwriter of Lloyd's syndicate 672. He is a past Deputy Chairman of Lloyd's. Age 59.

Dick Barfield †Δ

Non-Executive Director; joined the Board in 1997. He is currently a Director of Baillie Gifford Japan Trust plc, Marshalls plc, The Merchants Trust PLC, New Look Group plc, Rio Tinto Pension Investments, The Edinburgh Investment Trust plc and The J.P. Morgan Fleming Overseas Investment Trust plc. He was formerly Chief Investment Manager of The Standard Life Assurance Company. Age 56.

Jane Barker Δ*

Finance Director; joined the Board in 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 53.

Glenn Brace *

Claims Director; joined the Board in 2003. From 1998 until his appointment as Claims Director was head of Asbestos Pollution and Health Hazard Claims. He was formerly a Partner with the law firm Day, Berry & Howard. Age 41.

Jon Collins *

Chief Actuary; joined the Board in 2003. Worked on secondment to Lloyd's on the Equitas Reserving Project, with Equitas since 1996. He was formerly with Watson Wyatt, consulting actuaries. Age 37.

Michael Deeny #‡§

Trustees-nominated Non-Executive Director; joined the Board in 1996. He is Chairman of MultiMedia Television plc, Chairman of the Association of Lloyd's Members and Deputy Chairman of The Equitas Trust. Age 58.

Jeremy Heap *

Reinsurance Recoveries Director; joined the Board in 2003. With Equitas since 1996 holding responsibilities in both the Finance Division and as Head of Commutations. He was formerly seconded to the Lloyd's Reconstruction and Renewal Project with Coopers & Lybrand. Age 41.

James Joll †§

Non-Executive Director; joined the Board in 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 66.

Sir Bryan Nicholson #‡

Non-Executive Director; joined the Board in 1996. He is Chairman of the Financial Reporting Council and Chairman of the Council of The Open University. He was formerly Chairman of Cookson Group plc; President of the Confederation of British Industry; Chairman of the Manpower Services Commission; Chairman and Chief Executive of the Post Office; and Chairman of BUPA. Age 70.

Richard Spooner †Δ

Trustees-nominated Non-Executive Director; joined the Board in 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 56.

† 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 2003

The Directors present their report and the audited financial statements for the financial year ended 31 March 2003.

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 only authorised to effect these reinsurances and related activities and to perform the run-off of the reinsured liabilities. Equitas Reinsurance Limited and Equitas Limited are authorised and regulated under the Financial Services and Markets Act 2000 by the Financial Services Authority.

Business review and future developments

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

Results

The Equitas Group incurred a deficit of £152 million after tax for the year ended 31 March 2003 (2002: £21 million). 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 pages 20 and 21.

Messrs GE Brace, JA Collins and JW Heap were appointed Directors with effect from 1 April 2003. All other Directors held office as such throughout the year.

Mr MJ Crall has indicated his intention to retire as Chief Executive Officer of the Group in November 2003. He will be succeeded by Mr SP Moser. It is intended that Mr Crall will remain on the Board in a non-executive capacity.

Messrs ME McL Deeny and RB Spooner are the Trustees-nominated Directors.

Messrs MJ Crall and RB Spooner and Mrs JV Barker retire by rotation. Messrs GE Brace, JA Collins and JW Heap, having been appointed Directors during the year, retire pursuant to Article 72 of the Articles of Association. Sir Bryan Nicholson, having attained the age of 70 years, retires pursuant to Article 74 of the Articles of Association. They offer themselves for reappointment at the forthcoming Annual General Meeting.

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

Directors' interests

Mr ME McL Deeny has an interest in the business of the Company as an underwriting member of Lloyd's who resumed underwriting in 1999 after having ceased to do so in 1994. Messrs IC Agnew, JAB Joll and RB Spooner each has an interest in the business of the Company as a former underwriting member of Lloyd's who ceased underwriting in 1998, 1991 and 1993, respectively. Mr Agnew also has an interest in the business of the Company through his shareholding in Fortw Underwriting Limited, a corporate member of Lloyd's which is a member of a number of syndicates and through his shareholding in members of the Jubilee Group of Companies at Lloyd's.

The Directors have indemnities from the Company, Equitas Reinsurance Limited and Equitas Limited in respect of liabilities (including legal fees and expenses) incurred to third parties relating to their position as a Director, except where a court in the United Kingdom determines that the Director did not act honestly or acted in breach of his duties as a Director. Since the year end these indemnities and similar indemnities in favour of employees have been secured by a charge over a £50 million bank deposit.

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 Board's policy is to keep that framework under review.

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 the Chairman, six Executive Directors and six Non-Executive Directors. With effect from Mr Crall's retirement as Chief Executive Officer in November 2003, there will be five Executive Directors and seven Non-Executive Directors plus the Chairman. The Non-Executive Directors include 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. These committees are as follows:

- **Audit and Compliance Committee**
  James Joll (Chairman)
  Dick Barfield
  Richard Spooner

  The 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 committee.

The external auditors also contribute an independent perspective on aspects of financial control and annually report their findings to the committee and the Board.

- **Claims and Commutations Committee**
  Sir Bryan Nicholson (Chairman)
  Michael Crall
  Scott Moser (from 5 June 2003)
  Ian Agnew
  Michael Deeny

  The committee has certain decision making authorities delegated to it by the Board in respect of the approval of the settlement of major claims or commutations. It meets three or four times a year.

- **Investment Committee**
  Dick Barfield (Chairman)
  Jane Barker
  Michael Crall
  Scott Moser (from 5 June 2003)
  Richard Spooner

  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. Mr Crall intends to step down from this committee on his retirement in November 2003.

- **Nominations Committee**
  Hugh Stevenson (Chairman)
  Michael Deeny
  Sir Bryan Nicholson

  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.

- **Remuneration Committee**
  Hugh Stevenson (Chairman)
  Michael Deeny
  James Joll

  The role and responsibilities of the committee are set out in the Board report on Directors' remuneration on page 29.

Internal control framework

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 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 financial statements. The internal control framework is in accordance with the guidance issued by the Turnbull Committee. That framework will be monitored and if appropriate adjusted to reflect relevant developments in the regulatory environment.

The Group has 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 and the outcome of significant litigations, arbitrations and related procedures 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. The means by which these risks are managed include regular reviews and assessment of relevant balances against established criteria.

The Group undertakes a regular review of the effectiveness of its system of internal control. During the year, that included a quarterly systematic self-appraisal carried out across all business areas, involving consideration of both risk exposures and the effectiveness of controls. The results of the 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 key risks to the Group are not fully within its control. The principal risk remains that the Group may not be able to settle its liabilities in full.

As noted on page 22, Equitas Reinsurance Limited and Equitas Limited are authorised and regulated by the Financial Services Authority under the Financial Services and Markets Act 2000. The Financial Services Authority has promulgated Statements of Principle and Codes of Practice, some of which are required to be observed by regulated companies and certain individuals within such companies. The Board supports and endorses these Statements and Codes of Practice, to the extent they are relevant to the activities carried on within the Group.

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 39 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.

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

Following the transfer of the business of PricewaterhouseCoopers to PricewaterhouseCoopers LLP with effect from 1 January 2003, PricewaterhouseCoopers resigned as Auditors of the Company. The Board appointed PricewaterhouseCoopers LLP, the limited liability partnership, as Auditors to fill the casual vacancy. PricewaterhouseCoopers LLP are willing to continue in office and offer themselves for re-election at the forthcoming Annual General Meeting.

As permitted by the Company's Articles of Association, indemnities have been given to PricewaterhouseCoopers LLP 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
5 June 2003

Board report on Directors’ remuneration

for the year ended 31 March 2003

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 at approximately 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 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 during the year obtained independent professional advice from Watson Wyatt. The Committee met three times during the year.

Performance related incentive arrangements

The Group has an annual cash bonus plan in which all 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 senior employees. This provides 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 employee 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 under the LTIP in respect of those Executive Directors who held office during the year are shown on page 31.

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

The Group’s policy is that Executive Directors’ service agreements should generally be terminable on 12 months’ notice on a rolling basis. Messrs MJ Crall, GE Brace, JA Collins, JW Heap and SP Moser and Mrs JV Barker all have service agreements with Equitas Management Services Limited which reflect that policy. Mr Crall’s service agreement will come to an end on his retirement in November 2003.

It is not the Group's policy to make extra-contractual payments to Executive Directors on termination of their service agreements.

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 £150,000 per annum, inclusive of the Director's fee. Non-Executive Directors receive a fee of £35,000 per annum. This was increased from £30,000 per annum with effect from 1 August 2002, the first increase in four years. Non-Executive Directors who chair Board committees receive an additional fee of £10,000 per annum for these services, which is unchanged from the previous five years. 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 2003 was:

	Salary/ Fees £	*Bonus* £	*Benefits-in-kind* £	*Total emoluments* £	*Pension costs* £	*Total for year ended 31 March 2003* £	*Total for year ended 31 March 2002* £
Chairman							
HA Stevenson	150,000			150,000		150,000	135,417
Executive Directors							
MJ Crall	422,500	250,000	4,938	677,438	105,625	783,063	729,862
JV Barker	280,000	160,000	1,989	441,989	70,000	511,989	478,255
PA Jardine[1]						–	157,378
SP Moser	352,500	250,000	4,066	606,566	88,125	694,691	629,688
Non-Executive Directors							
IC Agnew	33,333			33,333		33,333	5,000
RA Barfield	43,333			43,333		43,333	40,000
SJO Catlin[2]						–	25,000
ME McL Deeny	33,333			33,333		33,333	30,000
JAB Joll	43,333			43,333		43,333	40,000
Sir Bryan Nicholson	43,333			43,333		43,333	40,000
RB Spooner	33,333			33,333		33,333	30,000
Total	1,434,998	660,000	10,993	2,105,991	263,750	2,369,741	2,340,600

1 Mr Jardine left the Board on 30 September 2001.
2 Mr Catlin left the Board on 1 February 2002.

LTIP awards relating to the year ended 31 March 2000, for which provision was made in the year ended 31 March 2001, were paid in July 2002. These payments, amounting to £660,000, are analysed on the following page and are included in note 7 on page 46.

No LTIP awards have yet been made in respect of the year ended 31 March 2003.

Based on the results for the year ended 31 March 2002, a total amount of £712,500 has been provided as follows for awards under the LTIP to the Executive Directors in office on 31 March 2003:

	Total provisional awards outstanding at 31 March 2002 *£*	*Paid during the year* *£*	*Provisional awards made during the year in respect of year ended 31 March 2002* *£*	*Total provisional awards outstanding* *£*
MJ Crall	532,500	262,500	270,000	540,000
JV Barker	382,500	187,500	195,000	390,000
SP Moser	427,500	210,000	247,500	465,000
Total	1,342,500	660,000	712,500	1,395,000

LTIP awards relating to the year ended 31 March 2001, for which provision was made in the year ended 31 March 2002, will be paid in 2003 if confirmed by the Board. LTIP awards relating to the year ended 31 March 2002, for which provision was made in the year ended 31 March 2003, are not payable until 2004. Payments are subject to the Board's determination that all of the conditions governing the plan have been met.

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

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 of the Trustees met by the Group in the year ended 31 March 2003 were in respect of the following:

	Year ended 31 March 2003 *£*	*Year ended 31 March 2002* *£*
Trustees' fees	250,000	245,250
Trustees' legal, professional and other costs and expenses	521,701	560,763
Total	771,701	806,013

Messrs ME McL Deeny and RB Spooner, who are also Directors of the Company, received Trustees' fees of £41,000 each for the year ended 31 March 2003 (2002: £38,447 each). They received expenses for secretarial, office and other overheads of £17,087 and £14,525, respectively (2002: £21,883 and £15,149, respectively). Legal expenses in the prior year included an amount of £14,276 paid to Viscount Bledisloe QC, a Trustee, in respect of the provision of legal services to The Equitas Trust.

Independent Auditors' report

to the members of Equitas Holdings Limited

1. We have audited the financial statements which comprise the Group profit and loss account, the Group balance sheet, the Group cash flow statement, the Company balance sheet and the related notes which have been prepared in accordance with the accounting policies set out in the statement of accounting policies.

Respective responsibilities of directors and auditors

2. The directors' responsibilities for preparing the annual report and the financial statements in accordance with applicable United Kingdom law and accounting standards are set out in the statement of Directors' responsibilities.

3. Our responsibility is to audit the financial statements in accordance with relevant legal and regulatory requirements and United Kingdom Auditing Standards issued by the Auditing Practices Board. This report, including the opinion, has been prepared for and only for the Company's members as a body in accordance with Section 235 of the Companies Act 1985 and for no other purpose. We do not, in giving this opinion, accept or assume responsibility for any other purpose or to any other person to whom this report is shown or into whose hands it may come save where expressly agreed by our prior consent in writing.

4. 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 Companies Act 1985. We also report to you if, in our opinion, the Directors' report is not consistent with the financial statements, if the Company 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.

5. We read the other information contained in the annual report and consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the financial statements. The other information comprises only the Directors' report, the Chairman's statement, the Chief Executive Officer's review, the Financial review and the Claims Management report.

Basis of audit opinion

6. 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 Group's circumstances, consistently applied and adequately disclosed.

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

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

Uncertainties

8. In forming our opinion, we have considered the uncertainties, described in notes 1 and 2 to the financial statements, relating to the provision for claims outstanding of £7,039 million, reinsurers' share of claims outstanding of £949 million and reinsurance debtors of £661 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 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

9. The potential adjustments referred to in paragraph 8, if adverse in the aggregate, could be material enough to exceed the amount of shareholders' funds at 31 March 2003 of £527 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 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

10. Except for material adjustments in respect of the matters described in paragraph 8 above, which may ultimately be required to the provision for claims outstanding, reinsurers' share of claims outstanding, reinsurance recoveries and consequent adjustments to shareholders' funds and the deficit for the year, in our opinion the financial statements give a true and fair view of the state of the Company's and of the Group's affairs at 31 March 2003 and of the deficit and cash flows of the Group for the year then ended and have been properly prepared in accordance with the Companies Act 1985.

PricewaterhouseCoopers LLP
Chartered Accountants and Registered Auditors
London
5 June 2003

Group profit and loss account

for the year ended 31 March 2003

Technical account – general business

	Note	£m	2003 £m	£m	2002 £m
Investment return transferred from non-technical account			**693**		277
Claims paid					
Gross amount		**(1,051)**		(1,413)	
Reinsurers' share		**222**		424	
Net claims paid		**(829)**		(989)	
Change in the provision for claims					
Gross amount		**1,319**		1,643	
Reinsurers' share		**(265)**		(506)	
Unwinding of the discount		**(765)**		(182)	
Timing of net future payments		**(294)**		(272)	
Change in the net provision for claims	*15*	**(5)**		683	
Claims incurred, net of reinsurance			**(834)**		(306)
Other technical charges	*4*		**(26)**		8
Balance on the technical account for general business			**(167)**		(21)

The accounting policies and notes on pages 39 to 51 form an integral part of these financial statements.

Group profit and loss account

for the year ended 31 March 2003

Non-technical account

	Note	£m	2003 £m	£m	2002 £m
Balance on the technical account for general business			**(167)**		(21)
Income from financial investments		**289**		299	
Return on financial reinsurances		**76**		39	
Gains on the realisation of investments		**83**		36	
Unrealised gains on investments		**245**		–	
Unrealised losses on investments		**–**		(97)	
Investment return		**693**		277	
Allocated investment return transferred to general business technical account		**(693)**		(277)	
Investment return retained			**–**		–
Deficit on ordinary activities before tax	*5*		**(167)**		(21)
Tax on deficit on ordinary activities	*8*		**15**		–
Deficit for the year	*14*		**(152)**		(21)

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

The accounting policies and notes on pages 39 to 51 form an integral part of these financial statements.

Group balance sheet

as at 31 March 2003

Assets

	Note	2003 £m	2002 £m
Investments			
Financial investments	*9*	**5,780**	5,681
Financial reinsurances	*10*	**587**	878
		6,367	6,559
Reinsurers' share of technical provisions			
Claims outstanding	*15*	**949**	1,142
Debtors			
Debtors arising out of reinsurance operations	*12*	**705**	950
Other debtors		**41**	20
		746	970
Other assets			
Tangible assets		**5**	6
Cash at bank and in hand		**9**	19
		14	25
Prepayments and accrued income			
Accrued interest		**57**	70
Other prepayments and accrued income		**3**	4
		60	74
Total assets		**8,136**	8,770

The accounting policies and notes on pages 39 to 51 form an integral part of these financial statements. The Company's balance sheet is shown on page 52.

Group balance sheet
as at 31 March 2003

Liabilities

	Note	2003 £m	2002 £m
Capital and reserves			
Called up share capital	*13*	**–**	–
Retained surplus	*14*	**527**	679
Shareholders' funds – non-equity interests		**527**	679
Technical provisions			
Claims outstanding	*15*	**7,039**	7,763
Creditors			
Creditors arising out of reinsurance operations	*16*	**496**	256
Other creditors including taxation and social security	*17*	**74**	72
		570	328
Total liabilities		**8,136**	8,770

The financial statements on pages 34 to 51 were approved by the Board on 5 June 2003 and were signed on its behalf by:

HA Stevenson
MJ Crall
JV Barker

The accounting policies and notes on pages 39 to 51 form an integral part of these financial statements.

Group cash flow statement

for the year ended 31 March 2003

Reconciliation of deficit on ordinary activities before tax to net cash outflow from operating activities

	Note	£m	2003 £m	£m	2002 £m
Deficit on ordinary activities before tax			**(167)**		(21)
Depreciation of tangible fixed assets	*5*	**1**		2	
Exchange losses/(gains) on retranslation of opening balances*		**24**		(5)	
Unrealised gains on investments		**(245)**		–	
Unrealised losses on investments		**–**		97	
Return on financial reinsurances		**(76)**		(39)	
Decrease in provision for claims outstanding		**(89)**		(1,118)	
Decrease in reinsurers' share of technical provisions – claims outstanding		**94**		430	
Decrease in debtors		**157**		358	
Increase/(decrease) in creditors		**264**		(404)	
			130		(679)
Net cash outflow from operating activities			**(37)**		(700)
Taxation recovered			**–**		12
Net cash outflow for the year			**(37)**		(688)
Cash flows were (realised)/invested as follows:					
Decrease in cash holdings	*19*		**(23)**		(10)
Net portfolio investment					
Deposits with credit institutions		**320**		(338)	
Financial reinsurances		**(280)**		(296)	
Shares and other variable yield securities and units in unit trusts		**(10)**		(9)	
Debt securities and other fixed interest securities		**(44)**		(35)	
	19		**(14)**		(678)
Net realisation of cash flows	*20*		**(37)**		(688)

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

The accounting policies and notes on pages 39 to 51 form an integral part of these financial statements.

Notes to the financial statements

for the year ended 31 March 2003

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 2 on page 41. 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.

If at any time the Directors of Equitas Reinsurance Limited believe that the reinsured liabilities cannot be met in full, they may implement 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 2002 to 31 March 2003.

(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, including those incurred but not reported ('IBNR') at the balance sheet date, 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.

(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. 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. Deferred tax, which is calculated at the rates at which it is expected that the tax will arise, is recognised in the profit and loss account for the period. Deferred tax balances are not discounted.

(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, where substantially all the risks and rewards of ownership remain with the Group, are retained on the balance sheet. Collateral received in respect of securities lent is not recorded in the balance sheet.

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 is reported on an accruals basis and includes realised gains and losses, movements on unrealised gains and losses and net income from securities lent. It 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 employees.

(k) Leases

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

2 Estimation techniques and uncertainties

Introduction

During the year the Group continued to refine many assumptions and estimation techniques used to establish the provision for claims outstanding and the reinsurers' share of those claims. Because of the uncertainties inherent in the Group's liabilities, there are many assumptions and estimation techniques described below which individually could have a material impact on the amounts of liabilities, related reinsurance assets and reported surplus disclosed in the financial statements. Actual experience will often vary from these assumptions, and any consequential adjustments to amounts previously reported will be reflected in the results of the year in which they are identified. Adjustments arising in the future could, if adverse in the aggregate, exceed the amount of shareholders' funds. In that event, and as stated under 'Going concern' in note 1, the Directors of Equitas Reinsurance Limited may implement a proportionate cover plan.

The provision for claims outstanding is based upon actuarial and other studies of the ultimate cost of liabilities including exposure based and statistical estimation techniques.

Significant delays occur in the notification and settlement of certain claims, and a substantial measure of experience and judgment is involved in making the assumptions for 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 related reinsurance recoveries is estimated on the basis of information currently available.

The provision for claims outstanding includes significant amounts in respect of notified and potential IBNR claims for long tail liabilities. The settlement of these claims is not expected to occur for many years, and there is considerable uncertainty as to the amounts at which they will be settled.

Where a claim is disputed, the validity of the claim is ultimately an issue that can only be determined by the courts. The provision for a disputed claim is based on the Group's view as to the expected outcomes of such court decisions.

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.

Asbestos claims

In estimating asbestos liabilities, the Group follows a highly developed actuarial framework. The majority of asbestos reserves is estimated by modelling the expected claims from policyholders of the reinsured syndicates.

The number of future claims is projected for direct policyholders based on past claims experience combined with the results of epidemiological and other relevant studies that predict the incidence of asbestos related diseases into the future. This is then combined with estimates of the average cost of settling different types of claims for each policyholder to give a total value of claims to the relevant underlying policyholders. The results of these projections are then applied to the insurance coverage available for those policyholders, resulting in an estimation of the Group's liabilities arising from claims against those policyholders. The results are then adjusted to take into account liabilities in respect of policyholders that are not modelled explicitly, including an amount for those liabilities of which the Group may be currently unaware.

A similar modelling process is used to estimate asbestos liabilities for the largest inwards reinsurance accounts ceded to the reinsured syndicates, but with the additional step of applying the ceding companies' expected liabilities to the reinsurance cover available. The ceded liabilities that cannot be explicitly modelled are estimated by reference to the current and historical claims experience of the cedants, taking into account cedant specific characteristics where appropriate.

The techniques described above include a number of important assumptions, including:

- the projected level of future valid claims filings for each policyholder by disease type;
- future levels of claims settlement values;
- the impact of bankruptcy of policyholders on the amount and timing of claims payments;
- the legal interpretation of insurance policies and the outcome of litigation, based upon legal advice received; and
- the period between the filing and payment of claims.

The assumptions on the proportion of claims filings that will ultimately lead to claims payments reflect an assessment that the claims management strategies adopted by the Group will reduce claims payments below the level that they would otherwise have been.

Pollution and health hazard claims

Pollution liabilities are estimated for policyholders of the reinsured syndicates by evaluating the expected costs to be incurred by the policyholders in cleaning up polluted sites and then applying these costs to the insurance coverage available. The pollution liabilities expected by means of inwards reinsurance are evaluated in a similar manner, but with the additional step of applying the ceding companies' expected liabilities to the reinsurance cover available.

Allowance is then made for liabilities in respect of policyholders for which either sufficient information is unavailable to carry out the above analysis or which have not yet been identified.

Health hazard liabilities are estimated using similar principles to the above, in that the liabilities of the policyholder are estimated for the majority of reserves and then applied to the insurance coverage.

These evaluation techniques involve a number of important assumptions, including:

- the validity and quantum of the claims potentially faced by the policyholder;
- the legal interpretation of insurance policies and the outcome of litigation, based upon legal advice received; and
- the degree to which potential or unforeseen health hazards may have an effect on the liabilities.

Other claims

The estimation of the majority of other liabilities involves a projection, based upon historical claims experience, of separate homogeneous sub-divisions by underwriting year. The techniques used include calendar year and development year projections, as well as curve-fitting.

Operating expenses

The provision for the cost of handling and settling the claims to extinction is based on an analysis of the expected costs to be incurred in run-off activities, incorporating expected savings from the reduction of transaction volumes over time.

Reinsurance recoveries

Reinsurance recoveries on claims outstanding (including IBNR claims) are estimated based upon the recovery rate experience for notified and paid claims by class of business for all reinsured syndicates. In assessing the level of reinsurance to be recovered from future claims, the actual recoveries experience for notified and paid claims is compared with previous expectations of those claims.

Individual reinsured syndicates are further analysed where recovery rates do not conform to the expected result. An analysis is also carried out on the reinsurance coverage remaining on key risks for particular syndicates. Recovery rates are adjusted, if necessary, as a result of this work. The reinsurance asset is then adjusted, if necessary, in respect of any bad debt provision required where reinsurance companies are currently, or are considered to be at risk of being in the future, unable to settle their liabilities in full when due. This adjustment is made using the Group's and published information on the security of counterparties.

These evaluation techniques involve a number of important assumptions, including:

- the distribution of claims and how this will impact the reinsurance programmes of the reinsured syndicates;
- the provision required for bad debt; and
- the period required to recover the reinsurance asset through traditional means.

Discounting

The provision for claims outstanding and the cost of undertaking the run-off is discounted. The period of time that will elapse before the liabilities are settled is modelled using the estimated settlement patterns of the claims and associated reinsurance recoveries separately.

The ability to settle the liabilities in full is 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. Assumptions made with regard to the generation of such investment income, include:

- interest rates;
- exchange rates; and
- the timing of claims settlements and reinsurance recoveries.

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, can be estimated based upon current market yields to maturity.

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 the investment assets are likely to be held.

3 Segmental information

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

4 Other technical charges

Other technical charges relate to foreign exchange differences.

5 Deficit on ordinary activities before tax

The deficit is stated after charging:

	Group 2003 £000	*Group 2002 £000*
Auditors' remuneration – audit fees	**1,257**	1,498
– non-audit fees	**28**	134
	1,285	1,632
Depreciation – tangible owned fixed assets	**1,258**	1,573
Profit on disposal of tangible fixed assets	**(3)**	–
Operating lease rentals incurred – property	**4,798**	3,641
– other	**17**	174

The audit fees for the Company of £2,000 (2002: £2,000) were borne by a subsidiary company.

Details of related party transactions, as defined by Financial Reporting Standard 8, are given on page 31.

6 Employees

The monthly average number of persons employed by the Group, including Directors, was 596 for the year ended 31 March 2003 (2002: 660), all of whom were engaged in run-off and related activities.

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

	Group 2003 £000	*Group 2002 £000*
Wages and salaries	**33,506**	34,097
Social security costs	**3,518**	3,803
Pension costs	**4,203**	4,189
	41,227	42,089

The Group operates a defined contribution pension scheme that provides benefits on a money purchase basis. A cash alternative is also offered and is included in pension costs.

No amounts were included in creditors or debtors in either year in respect of pension costs.

7 Directors' emoluments

The aggregate remuneration of the Directors was as follows:

	Group 2003 £000	Group 2002 £000
Executive Directors – remuneration	**1,726**	1,719
– LTIP awards paid	**660**	632
– pension costs	**264**	276
Non-Executive Directors – fees	**380**	346
	3,030	2,973

In addition to the above amounts, provisional awards under the LTIP were made to the Executive Directors in office on 31 March 2003 as detailed on page 31. Full details of the remuneration of, and transactions with, Directors are given in the Board report on Directors' remuneration on page 29.

8 Tax on deficit on ordinary activities

Analysis of (credit)/charge in the year

	Group 2003 £m	Group 2002 £m
United Kingdom corporation tax at 30% (2002: 30%)	**–**	–
Current tax charge	**–**	–
Adjustment in respect of prior years	**(15)**	–
Current tax	**(15)**	–
Deferred tax – origination and reversal of timing differences	**–**	–
	(15)	–

Factors affecting the tax (credit)/charge for the year

The tax assessed for the year differs from the standard rate of corporation tax in the UK. The differences are explained below:

	Group 2003 £m	Group 2002 £m
Deficit on ordinary activities before tax	**(167)**	(21)
Deficit on ordinary activities multiplied by the standard rate of corporation tax in the UK of 30% (2002: 30%)	**(50)**	(6)
Effects of:		
Adjustment in respect of prior years	**(15)**	–
Unrealised losses on revaluation of equity investments	**(1)**	(4)
Unutilised tax losses carried forward	**49**	8
Other permanent differences	**2**	2
Current tax (credit)/charge for the year	**(15)**	–

There is an unrecognised deferred tax asset of £44 million (2002: £6 million) arising on losses carried forward within the Group which may not be fully utilised in the foreseeable future.

9 Investments: financial investments

	Group 2003 £m	*Group 2002 £m*
Listed		
Shares and other variable yield securities and units in unit trusts	**265**	383
Debt securities and other fixed interest securities	**4,901**	4,984
	5,166	5,367
Unlisted		
Deposits with credit institutions	**614**	314
Market value	**5,780**	5,681
Cost	**5,550**	5,689

These investments include sterling denominated assets of US$410 million (2002: US$410 million) equivalent which are charged in favour of the New York Insurance Department.

The Group receives collateral for all securities lent as a condition of the transaction. Included in the above table are lent securities with a market value of £1,681 million (2002: £557 million), which were collateralised at over 100% of their value.

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

10 Investments: financial reinsurances

The average prospective rate of return on financial reinsurances is 3.14 per cent (2002: 4.97 per cent) per annum. The mean term is three (2002: four) years. The value of the expected receipts from financial reinsurances, before discounting at market yields to recognise the period until receipt, is £657 million (2002: £1,060 million).

11 Trust funds

Financial investments and cash amounting to £3,383 million (2002: £3,239 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 supports obligations undertaken in Australia. It is financed by a letter of credit, which is secured by a charge over a proportion of Australian dollar financial investments. As at 31 March 2003, the value of the letter of credit was A$80 million (2002: A$90 million).

12 Debtors arising out of reinsurance operations

	Group 2003 £m	Group 2002 £m
Unpaid premium	**–**	1
Reinsurance recoveries	**661**	923
Other	**44**	26
	705	950

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

13 Called up share capital

	Company 2003 £	Company 2002 £
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 the Company (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. Accordingly, it is 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.

14 Retained surplus

	Company £	Group £m
At 1 April 2002	–	679
Deficit for the year	–	(152)
At 31 March 2003	**–**	**527**

The retained surplus is not distributable.

15 Provision for claims outstanding

	Claims £m	Reinsurance £m	Group 2003 Net £m	Claims £m	Reinsurance £m	Group 2002 Net £m
Provision before discounting	**9,636**	**1,333**	**8,303**	12,010	1,804	10,206
Discount	**(2,597)**	**(384)**	**(2,213)**	(4,247)	(662)	(3,585)
	7,039	**949**	**6,090**	7,763	1,142	6,621

(a) Claims

Claims are stated after elimination of inter-syndicate transactions.

Provisions for APH liabilities comprised approximately 80 per cent (2002: 75 per cent) of the net discounted provision for claims outstanding. These liabilities are expected to be paid out over a period in excess of 40 years.

Provisions for non-APH liabilities comprised approximately 20 per cent (2002: 25 per cent) of the net discounted provision for claims outstanding.

(b) Reinsurance recoveries

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

(c) Discounting

The provision for claims outstanding and the cost of undertaking the run-off has been discounted at a rate of 3.90 per cent (2002: 5.25 per cent) per annum compound to reflect the time value of money. An adjustment for non-interest bearing assets has been made. As at 31 March 2003, the mean term of the liabilities, that is the weighted average period to settlement where the weights are the undiscounted expected cash flows in each future period, was approximately ten (2002: 11) years.

(d) Estimation techniques and uncertainties

Details of the estimation techniques employed in the setting of the provision for claims outstanding and the associated uncertainties appear in note 2 on page 41.

16 Creditors arising out of reinsurance operations

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

17 Other creditors including taxation and social security

These balances include corporation tax payable of £nil (2002: £15 million).

18 Reconciliation of movements in shareholders' funds

	Group 2003 £m	*Group 2002 £m*
Opening shareholders' funds	**679**	700
Deficit for the year (see note 14)	**(152)**	(21)
Closing shareholders' funds	**527**	679

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

19 Movement in portfolio investments net of financing

	Group 2003 £m	*Group 2002 £m*
Net cash outflow for the year (see note 20)	(23)	(10)
Movement arising from cash flows of portfolio investments	**(14)**	(678)
Changes to market values and discount (see note 20)	**321**	(58)
Other changes, including exchange rate effects (see note 20)	**(499)**	(34)
Total movement in portfolio investments net of financing	**(215)**	(780)
Opening portfolio investments net of financing (see note 20)	**6,573**	7,353
Closing portfolio investments net of financing (see note 20)	**6,358**	6,573

20 Movement in cash, portfolio investments and financing

	At 31 March 2002 £m	*Cash flow £m*	*Changes to market values and discount £m*	*Other changes, including exchange rate effects £m*	*At 31 March 2003 £m*
Cash at bank and in hand	14	**(23)**	**–**	**–**	**(9)**
Deposits with credit institutions	314	**320**	**–**	**(20)**	**614**
Financial reinsurances	878	**(280)**	**76**	**(87)**	**587**
Shares and other variable yield securities and units in unit trusts	383	**(10)**	**(94)**	**(14)**	**265**
Debt securities and other fixed interest securities	4,984	**(44)**	**339**	**(378)**	**4,901**
	6,573	**(37)**	**321**	**(499)**	**6,358**

During the year shares and other variable yield securities and units in unit trusts of £199 million (2002: £147 million) were purchased and £209 million (2002: £156 million) were sold. For the same period debt securities and other fixed interest securities of £5,017 million (2002: £5,882 million) were purchased and £5,061 million (2002: £5,917 million) were sold. Cash at bank and in hand as at 31 March 2003 shown above is stated net of £18 million (2002: £5 million) of overdrafts.

21 Contingent liabilities

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

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

22 Investments in Group undertakings

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

**Held via a subsidiary*

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

23 Financial commitments

The Group had annual commitments under non-cancellable operating leases, expiring in over five years, of £6 million (2002: £6 million).

Company balance sheet
as at 31 March 2003

	Note	2003 £	2002 £
Fixed assets			
Investments – investments in Group undertakings	*22*	**300**	300
Current assets			
Amounts due from a Group undertaking		**1**	1
Net current assets		**1**	1
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	*13*	**101**	101
Profit and loss account	*14*	**–**	–
Shareholders' funds – non-equity interests		**101**	101

The financial statements on pages 39 to 52 were approved by the Board on 5 June 2003 and were signed on its behalf by:

HA Stevenson
MJ Crall
JV Barker

The accounting policies and notes on pages 39 to 51 form an integral part of these financial statements.

Notice to Reinsured Names

Reinsured Names should note that the Reinsurance and Run-Off Contract dated 3 September 1996 calls for Equitas to request confirmation of, or notification of any amendment to, Reinsured Names' addresses annually. A separate card seeking such information accompanies this report. Pursuant to Clause 22.2 of the Reinsurance and Run-Off Contract, Reinsured Names must provide Equitas Reinsurance Limited with such information within 21 business days of this request.

Reinsured Names whose addresses change during the year are asked to report these changes promptly to the Company Secretary, Equitas Reinsurance Limited, 33 St Mary Axe, London EC3A 8LL, United Kingdom.

Open Meeting of Reinsured Names

The annual Open Meeting of Reinsured Names will be held at 10.30am on Friday, 12 September 2003 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 1 September 2003.

Designed and produced by Fishburn Hedges

Equitas Holdings Limited
Registered Office and Operating Head Office:
33 St Mary Axe, London EC3A 8LL, United Kingdom
Telephone: +44 (0)20 7342 2000
Facsimile: +44 (0)20 7342 2001

Registered in England; Registered Number 3136296