Report & Accounts

for the year ended 31 March 2004

Overview for the year ended 31 March 2004

Accumulated surplus after tax decreased by £67 million from £527 million to £460 million.

Solvency margin, being accumulated surplus expressed as a percentage of net claims outstanding, increased from 8.7 per cent to 9.8 per cent.

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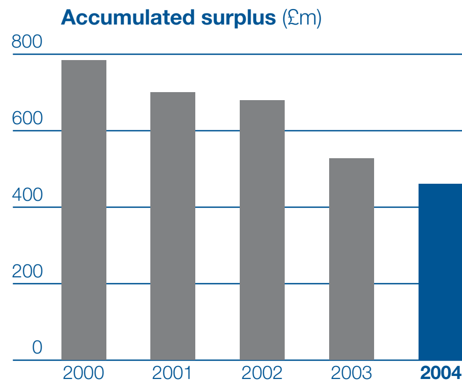
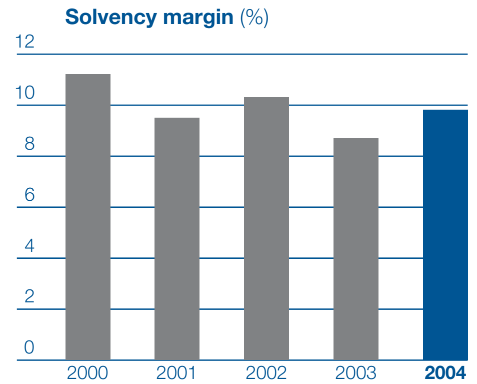
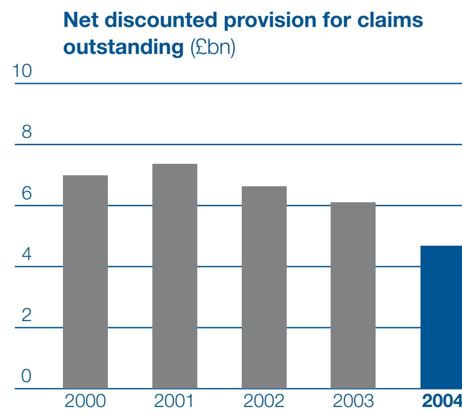
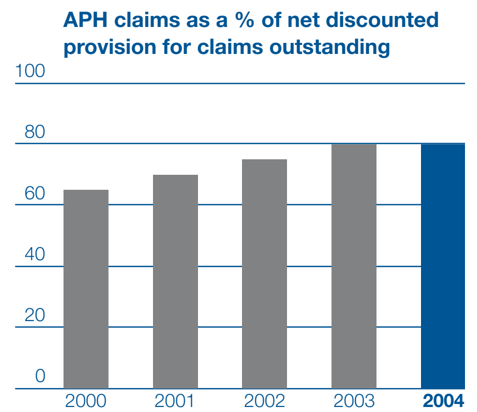
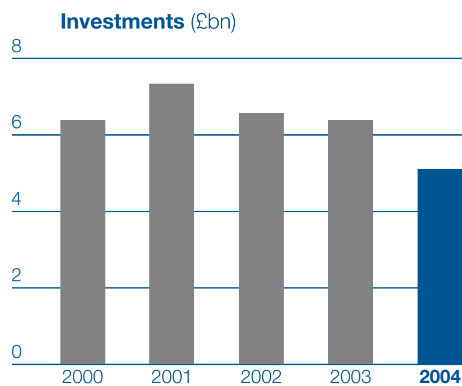
Five year results as at 31 March

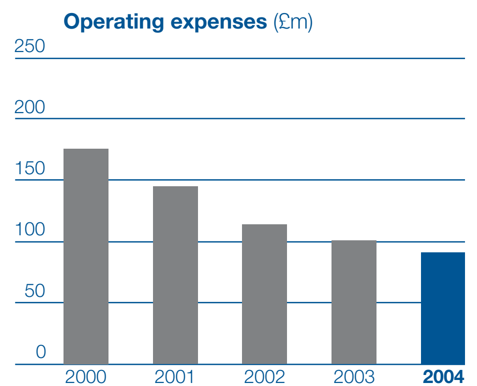












Chairman's statement

In the financial year ended 31 March 2004 accumulated surplus after tax decreased by £67 million from £527 million to £460 million but the solvency margin increased from 8.7 per cent to 9.8 per cent.

This apparent paradox is principally explained by the interaction of five factors: the need once again to increase our reserves for asbestos claims, the progress which we have made in resolving major claims and reinsurance exposures, the performance of our investments, the control of our costs and the weakness of the US dollar.

Asbestos

When I wrote to Reinsured Names last December I stated that it might be necessary to increase our reserves again at the year end following our annual comprehensive review of claims liabilities and future reinsurance recoveries.

This has indeed proved to be necessary and in these accounts we have increased our gross discounted asbestos reserves by £296 million. This significant increase has been caused by two factors; first the actual claims experience of some individual assureds and, secondly, the trend for higher payments to mesothelioma victims.

I have stated many times that asbestos is the greatest single threat to Equitas and this remains the case. Our asbestos reserves now total £4.0 billion on a gross undiscounted basis. This represents more than 55 per cent of our total reserves. While it is not surprising that our asbestos reserves should change annually as a result of our detailed actuarial review, the overall claims experience of some assureds and, in particular, the increasing levels of mesothelioma payments are grounds for concern.

Resolution of major claims and reinsurance exposures

Even against this background we have been able to reduce our outstanding asbestos liabilities by closing out asbestos claims on acceptable terms. We have completed seven asbestos policy buyouts in the last year, most notably with Halliburton, our largest direct exposure. We have also agreed a commutation with Travelers, our largest reinsurance exposure, along with 82 other commutations. These agreements are important not only because they extinguish the uncertainties relating to these policies but also because they provide support for our reserving. We expect to complete more of these global settlements in the coming year.

Investment performance

Equity markets saw a significant recovery in the financial year and the return on our bond portfolios was satisfactory. As a result investment return exceeded the unwinding of the discount by £123 million.

Cost control

Expenses were again lower than in the previous year and below our target.

The weakness of the US dollar

During the year the US dollar fell by 17 per cent from 1.58 : £1 to 1.85 : £1. We match our core assets and liabilities in currency, so that the change in the exchange rate reduced the value of both our US dollar assets and liabilities when translated into

sterling. We do however have an accounting exposure to movements in the US dollar because it has been and remains our policy to hold a portion of our surplus assets in dollars. Last year this gave rise to the majority of the exchange loss of £24 million.

Scott Moser reviews the performance of our core business activities and comments further on decisions regarding claims reserves in his Chief Executive Officer's review on pages 4 to 8. Glenn Brace reports on developments regarding asbestos claims and our strategy to manage them on pages 9 to 12. Jane Barker analyses the accounts and other financial information in her Financial review on pages 13 to 16.

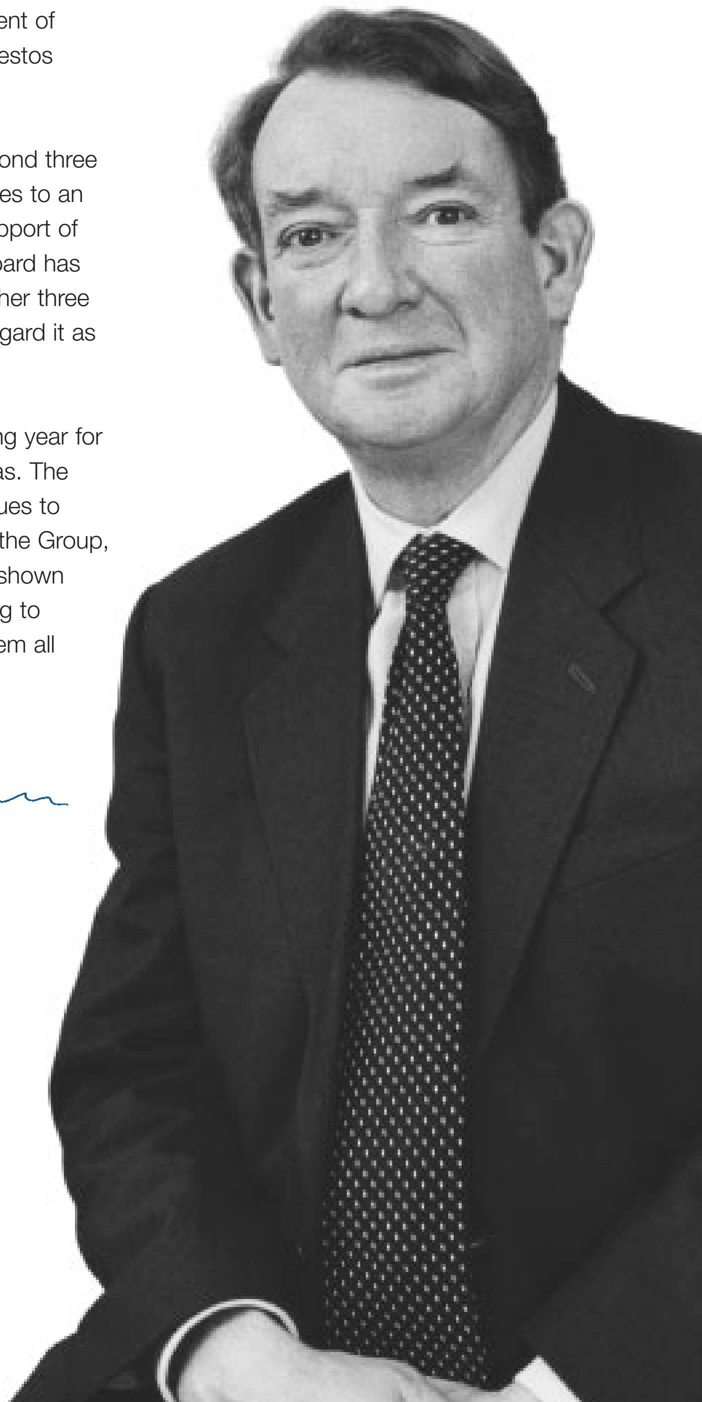
As I have often stated in the past, there are many remaining uncertainties which are fundamental to the stability of Equitas. Our success cannot be guaranteed. In the light of these uncertainties, the Auditors have once again qualified their report on the Group's Accounts. However, as in previous years, the Board has taken into account the following points when making judgments about the future:

- Our solvency margin remains stronger than when Equitas commenced and has increased in the last year. This has been achieved despite the fact that gross discounted reserves have been strengthened by £1.4 billion over the past eight years.
- Since the inception of Equitas, aggregate paid claims have exceeded £15 billion. Despite this, cash and investments amounted to £5.1 billion at 31 March 2004.
- Equitas has an established track record of dealing with long tail claims. The significant increase in major policy buyouts, and the terms of those buyouts, provide support for our methodology for assessing asbestos claims.
- The majority of asbestos claims will not be received or paid for many years. Excluding policy buyouts and commutations, asbestos payments in the last year represented just 4 per cent of gross undiscounted asbestos reserves.

On a personal note, my second three year term as Chairman comes to an end in October. With the support of the Equitas Trustees, the Board has asked me to serve for a further three years until 2007 and I will regard it as a privilege to do so.

This has been another testing year for all those who work at Equitas. The external environment continues to pose difficult challenges for the Group, but the staff at Equitas has shown remarkable resilience in rising to these challenges. I thank them all for their contribution.

Hugh Stevenson
Chairman
3 June 2004



Chief Executive Officer's review

The Group suffered a loss in the year of £67 million; however the solvency margin improved from 8.7 per cent to 9.8 per cent. The reduction in surplus was caused primarily by the need to increase gross asbestos reserves by £296 million, discounted to take account of the time value of money.

Much of this asbestos reserve increase was offset by successful results in other areas of operations – investments, claims settlements and reinsurance collections. These successes, along with the effects of exchange rate movements on our net claims outstanding, also produced the improvement in the solvency margin.

Asbestos liabilities

The past year has again seen many developments with respect to asbestos claims, particularly in the United States. Extensive efforts have been devoted to achieving a Federal asbestos reform bill. As this review is being written that effort seems to have failed. Equitas has been at the forefront of efforts to achieve fair and affordable Federal legislation. Unfortunately, the legislation that was drafted did not meet our criteria. Certain US insurers sought to use the legislation to require Equitas to pay more than it can or it should. At the behest of US insurance companies the draft bill was tailored to leave Equitas as the only company in the world not protected from the risk of being rendered insolvent by operation of the Act. This was neither fair nor reasonable and we could not support a bill in this form. However, if the legislative process recommences, we will do our utmost to improve the legislation so that we are able to support it. In any case, prospects for any Federal bill in the next twelve months now seem remote.

There have also been many legislative and judicial developments at the State level. In the Claims Director's review on pages 9 to 12, Glenn Brace reports on these and other asbestos-related developments.

Every year we carry out a comprehensive review of our asbestos liabilities. Because most of our asbestos reserves are not due to be paid for many years, we must apply numerous assumptions and estimation techniques. The actuarial framework we use to estimate asbestos liabilities is described in detail in note 2 to the financial statements on page 35. Since we need to make complex estimates of future claims in an extremely dynamic external environment, it is not a surprise that reserves usually require some adjustment at each annual review.

This year asbestos reserves have been increased, primarily due to a general trend of higher payouts to mesothelioma victims and a worsening of claims for some key assureds. Significantly, however, there is no epidemiological evidence to lead us to change our views on the number of future mesothelioma victims. We believe a portion of these additional payments to mesothelioma victims reflects the success we and others have had in calling attention to the problem of paying asbestos claimants who are not actually injured. As payments to the uninjured have been avoided, some of these sums have gone to persons genuinely injured.

In order to reduce the uncertainties that face us, we have also continued to try to identify currently unknown assureds who may present claims in the future. We have increased reserves based on our findings. Our reserves

have not taken any account of possible legislative reform.

Most of our asbestos reserves are held in dollars; gross undiscounted reserves at 31 March 2004 were $7.4 billion (2003: $8.4 billion), with claims payments (including commutations and policy buyouts) and reserving adjustments accounting for the movement. Translated into sterling, at 31 March 2004 gross undiscounted asbestos reserves amounted to £4.0 billion (2003: £5.3 billion). Asbestos claims payments last year were £156 million (2003: £170 million). The undiscounted value of asbestos liabilities extinguished through policy buyouts and commutations during the past year amounted to £919 million (2003: £440 million). Asbestos reserves, discounted to take account of the time value of money, amounted to £2.8 billion (2003: £3.7 billion).

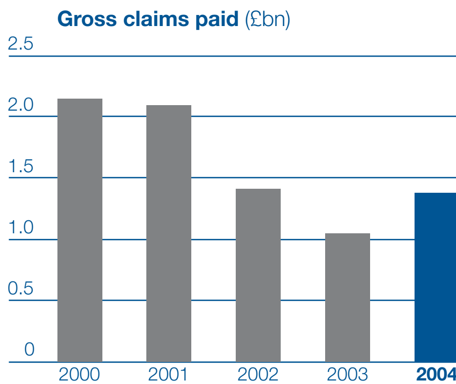
In view of the uncertainties surrounding the potential Federal asbestos legislation we have negotiated the right to recover certain payments made or, in some instances, to withhold certain future payments promised, if such legislation is passed by certain dates. These rights total over £400 million.

In the last year, we have completed policy buyouts with seven policyholders, including three of our five largest asbestos exposures. We have now completed over 180 buyout agreements with some of the most sophisticated corporations in the world. We believe policy buyouts are in the interest of both parties, delivering certainty, reducing transaction costs and eliminating credit risk. We are ready to complete more of these agreements. Our track record gives us confidence that our reserves will support agreements with realistic counterparties.

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 £1.4 billion in the year ended 31 March 2004 (2003: £1.1 billion). Gross claims paid were higher this year because of the large asbestos buyouts and commutation agreements we were able to conclude.

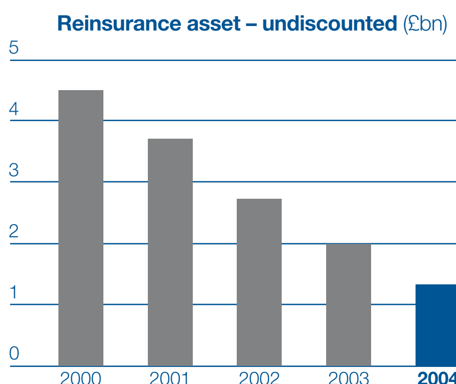
Chief Executive Officer's review



We continued to make good progress in nearly all areas of the claims portfolio. I have already mentioned the significant progress made in settling asbestos claims. We have also maintained our excellent record in settling environmental pollution claims. 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 272, and 46 of the 50 largest pollution claims that were pending at our inception have been resolved.

As part of our annual reserve review we thoroughly examine developments regarding actual and potential health hazard claims. This review has resulted in some revisions of ultimate claims estimates in a few reserve categories. This led to a modest aggregate increase to health hazard reserves. We have not identified in the past year any previously unknown health hazard which we believe is likely to create a material liability for the Group.

We are also making encouraging progress in settling non-APH (asbestos, pollution and health hazard) claims. Non-APH claims represent 20 per cent of net discounted liabilities, compared to 60 per cent when Equitas began operations. Non-APH claims run off more rapidly than APH claims. Thus non-APH claims will inevitably fall as a percentage of overall reserves.



Reinsurance Recoveries management

Reinsurers' share of claims paid amounted to £173 million in the year ended 31 March 2004 (2003: £222 million). Reinsurance recoverable on claims paid will normally reduce as outwards reinsurance contracts are commuted. During the past year, we completed the negotiation of 83 commutation agreements (2003: 83).

Our commutation strategy has enabled us to realise a substantial proportion of our reinsurance asset. Equitas inherited reinsurance asset of over £7 billion. We have realised over £6 billion of our reinsurance asset and reduced the outstanding asset to just over £1 billion at 31 March 2004. This is a remarkable achievement in just over seven and a half years.

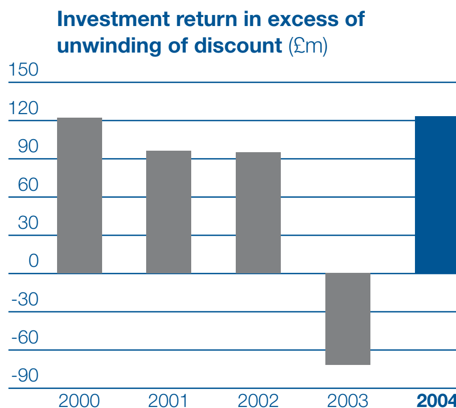
We seek to commute reinsurance contracts whenever we can do so on appropriate terms. When possible, Equitas negotiates 'global' commutations, which not only collect outwards reinsurance proceeds, but also extinguish liabilities for inwards reinsurance. This year we concluded global commutations with three of our largest ten inwards reinsurers. Terminating complex reinsurance arrangements in exchange for a cash settlement has many advantages for both parties:

- Commutations can reduce outstanding claims and the uncertainties associated with them.
- Commutations eliminate the risk of non-payment due to reinsurer insolvency.
- Reinsurance asset does not produce investment income until it is collected. Converting reinsurance asset to cash through commutations increases future investment income. Realising reinsurance through commutations has helped keep the value of our investment portfolio at a high level, even though we have paid more than £15 billion in claims since Equitas began operations.

- Reinsurance recovery is an expensive and time consuming process. Commuting reinsurance arrangements reduces future processing and collection expenses.
- Collection of reinsurance debt is hampered by individual and market-wide disputes which affect most reinsurers, not only Equitas. These disputes can often be settled more easily through a commutation than through litigation or arbitration.

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.

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



Investment management

Investment return for the year ended 31 March 2004 amounted to £395 million (2003: £693 million). Although our absolute investment income was lower this year than last, our investment performance was actually markedly better. Because Equitas discounts its liabilities, the key measure for our investment performance is a comparison of the investment return with the unwinding of the discount. In the year ended 31 March 2004, the investment return exceeded the unwinding of the discount by £123 million (compared with a deficit of £72 million in 2003). This achievement results largely from the strong recovery in equity markets, vindicating our decision to retain our equity holdings despite the losses incurred in the year to 31 March 2003.

The rate at which we discount our liabilities is based on the prospective yield on our investment portfolio. As a direct result of changes in the yield curve we reduced the rate at which the liabilities are discounted to 3.65 per cent (2003: 3.90 per cent) per annum. Reducing the discount rate had the effect of increasing the present value of our liabilities by £73 million. However, since we hold bonds which match these liabilities, our assets have increased by a similar amount as the value of those 'matching' bonds increased because the interest rate declined.

The vast majority of the investment portfolio remains invested in high quality fixed interest securities. Only a portion of our surplus is invested in equities. 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.

Expense management

Operating expenses amounted to £91 million in the year ended 31 March 2004 (2003: £101 million). This represents a year on year reduction of ten per cent. The Group has made significant cost savings every year since the first full year of operation. Going forward, it is becoming harder to achieve reductions but we remain committed to reducing the costs of running the business without reducing our overall effectiveness.

The most significant portion of our expenses relates to employment costs, representing almost half of our total costs. At 31 March 2004 we had 489 employees (2003: 549). As a result, we were able to sublet one entire floor at our St Mary Axe facility nearly three years before we were

Chief Executive Officer's review

entitled to surrender the lease on that floor. Despite the constant requirement to reduce both overall costs and employee numbers, Equitas employees continue to demonstrate genuine commitment to the job at hand and to achieve considerable success, and I thank them for their substantial efforts.

Conclusion

In the last year Equitas continued to make good progress. But sometimes a focus on the short term can obscure even more revealing long term achievement. Since inception Equitas has paid claims of over £15 billion, cutting undiscounted liabilities by 65 per cent; collected over £6 billion of reinsurance asset, increasing investable assets and eliminating collection risks and costs; generated investment returns £732 million in excess of the unwinding of the discount; and reduced the annual cost of running the business from over £240 million to £91 million. In addition, during the same period, we have increased gross discounted reserves by £1.4 billion. Even after these reserve increases, the solvency margin today (9.8 per cent) is much higher than it was when we began (1996: 5.6 per cent). This performance represents considerable progress towards the goal of finally satisfying the insurance obligations of Reinsured Names. However, we have much more to do and we are by no means complacent. Serious threats remain to the ultimate success of Equitas. We have a highly professional team in place to deal with the forthcoming challenges and a proven track record of achievement. We will continue to do our utmost to achieve the best possible outcome for Reinsured Names while fulfilling their insurance obligations.

Scott Moser
Chief Executive Officer
3 June 2004

Claims Director's review

Last year we devoted several pages of this report to the changes that were occurring in the environment in which asbestos claims were made and resolved. Those changes have continued in this year. In fact, we believe that the asbestos claims landscape today is permanently altered.

Asbestos reform developments

This year the US Senate has made a serious effort at legislative asbestos reform – an effort that brought the proposed Federal asbestos reform bill to the floor of the Senate. It is the culmination of years of work to inform the Congress of the real scope and nature of the asbestos crisis. While the prospects for such legislation are remote, it is now clear that the positions of both Republicans and Democrats have, in several critical respects, merged. Both parties now condemn the flow of money to those who are not ill and call for a comprehensive solution to the problem.

Certain states are also showing that they will no longer accept unchecked asbestos litigation. Mississippi and Texas, both home to counties previously identified by the American Tort Reform Association as judicial 'hell holes', enacted omnibus tort reform laws in 2003 and Texas may consider asbestos-specific reforms within the next year. The Ohio legislature has recently passed an asbestos reform bill. These state reform efforts seek to establish acceptable medical and causative criteria for asbestos claims. In other words, these jurisdictions are now questioning the wisdom of recoveries by those who are not ill against those who did them no harm.

The precarious condition of the Federal asbestos bill confirms that legislative reform is difficult to achieve. However, these legislative efforts help even when they fail. The process of law making (press conferences, statements by Senators and/or Governors, meetings with industry leaders, etc) focuses the public on the need to deal with asbestos abuses. Serious legislative efforts send a signal that, although legislation may be defeated initially, the legislature will eventually have to act if the abuses continue.

Most importantly, these legislative efforts influence the courts. They are sensitive to assertions that they allow asbestos abuses to continue. Changes in court rules and practices have a direct and substantial impact on the volume and value of asbestos claims. Those rules and practices have changed in the past year.

Claims Director's review

Several of the unfavourable jurisdictions are problematic because they allow claimants from all over the country to proceed in their courts. West Virginia, one of the worst of these jurisdictions, passed legislation that limits the right of out of state residents to sue in West Virginia. In Mississippi, another notoriously 'hospitable' jurisdiction, the legislature is now considering a venue provision substantially similar to the new West Virginia law.

Courts across the country are taking other steps that mitigate the asbestos litigation problem. Many jurisdictions now employ inactive case lists. These preclude litigation until the claimant has evidence of injury. In addition, courts are experimenting with consolidated dockets and court-appointed experts as ways of managing asbestos claims abuses. The presiding judge in San Francisco has formed a committee of Bay Area judges to create procedures for tackling the asbestos litigation problem.

Most recently, the Mississippi Supreme Court held that the law of allocation in Mississippi permits the jury to consider the fault of all parties (including immune parties such as employers and governmental entities) and that judgments should be reduced accordingly. This very significant decision makes Mississippi's allocation rules among the fairest in the country. This decision confirms our right to consider the liability of other potentially responsible parties in determining what constitutes a reasonable settlement amount. This decision also evidences a change of attitude in the Mississippi Supreme Court that cannot escape the attention of judges and lawyers throughout the state.

Not all courts show signs of reform. Those that do not are attracting the attention of the media. The courts in Madison County, Illinois have come under enormous scrutiny in the past year, including a press conference by the US Chamber of Commerce on the courthouse steps.

The impact of Equitas strategies

This year Equitas has further advanced its position regarding the essential characteristics of a valid asbestos claim. Currently, nineteen major asbestos assureds use the process provided by the Documentation Requirements ('DRs') to verify that some or all of the claims they submit are covered. At least six significant reinsured policyholders have taken the principles of injury and causation that underlie the Reinsurance Documentation Requirements ('RDRs') and applied them to their own assureds. In a number of important instances, the DRs and RDRs have provided common ground for Equitas and policyholders regarding the handling of asbestos claims.

Some disputes over the DRs and RDRs continue, but not many. The ones that persist do so primarily because of misunderstanding (or intentional mischaracterisation) of the DRs and RDRs. We have worked hard this year to make sure that the DRs and RDRs are understood. Claims that are covered are ones that are imposed on the policyholder by law. This means, at the very least, that the claims must be made by an individual who is injured and against the party that injured him. We must be able to investigate whether a claim that is submitted possesses these characteristics. The DRs and RDRs

are one way to achieve this type of claim review.

Three years since they were issued, no litigation has invalidated the concepts that underlie the DRs and RDRs. During this year, a California judge dismissed all but one count in a complaint challenging the RDRs (and sent what was left off to arbitration). Two arbitrations under the Wellington Agreement continue and there have been some developments in one of those matters during this year. Wellington arbitrations are confidential. However, any subscriber to the Wellington Agreement is welcome to obtain and review those decisions involving the London Documentation Requirements.

Policy buyouts

The most vivid evidence that Equitas' positions are gaining wide acceptance are the deals we have done this year with major policyholders. During 2001, 2002 and 2003, we confirmed Equitas' intention to resolve asbestos liabilities through comprehensive settlements whenever possible. Settlements of that type require extensive analysis and negotiation from both parties. They also require that the parties seek a common understanding of the essential elements of a covered claim. This year, however, many policyholders, particularly those with major asbestos liabilities, have risen to the challenge of global settlement. This is the result of long efforts to prepare for policy buyout negotiations and to ensure that our policyholders understand, as the foundation of negotiation, that not every claim is a covered one.

These efforts have been especially fruitful. This year we agreed to pay nearly $1 billion as a result of asbestos direct settlements. We concluded buyout deals with Halliburton and six others and, in doing so, eliminated some of our most volatile liabilities. These asbestos settlements achieved the release of at least $2.8 billion in policy limits. This year also saw multiple commutations with reinsured policyholders seeking recovery for the payment of asbestos claims, including a settlement with Travelers that resolved our largest reinsurance exposure.

Our strategy of seeking comprehensive resolutions of claims is working. Since 2001, the year we publicly stated our commitment to the fundamental legal principles of injury and causation, we identified 34 direct policyholders with asbestos claims valued in excess of $20 million. Today, one third of these claims have been resolved through policy buyout settlements. Five of the top ten direct asbestos liabilities at March 2001 are now extinguished.

Each time we concluded a major deal in the past year, we considered whether we could publicise the settlement. We did this because we want all policyholders to know that, if they are interested in such negotiations, we will devote the resources necessary to achieving them. In addition, we want to speak directly to those policyholders who are being advised, incorrectly, that they cannot strike a fair deal with Equitas. When we negotiated our settlements with Honeywell, Halliburton, Travelers and with other multinational corporations, we dealt with some of the most sophisticated businesses in the world. Each of those negotiations involved an assessment of the volume and value of covered claims. Companies of that size and sophistication are, without exception, fully-informed participants in negotiations regarding the value of their claims. Part of our message to the other policyholders is this: If you are being told that you cannot do a fair deal with Equitas, you need new advisers.

Future risks

Despite our progress in resolving major asbestos liabilities this year, there are still many risks that Equitas must face. These risks include the possibility of increased payments to mesothelioma victims, the deterioration in claims experience of existing asbestos policyholders and the emergence of new claims types. These developments are partly outside of the control of Equitas. However, we recognise that the best strategy for mitigating these (and other) major risks is our current effort to pursue policy buyouts and commutations whenever possible.

We devote time and resources to understanding those risks that, left unchecked, can threaten Equitas. This type of analysis requires us to distinguish between those risks that are real and those that are the product of press speculation, rumour or industry conjecture. During this year, we have seen (or heard) reports that a real threat to Equitas is posed by silica, or non-US asbestos claims or a resurgence of pollution claims. None of these claim categories should be ignored or trivialised. Yet, upon analysis, none of them, at least on the evidence so far, poses the risks to Equitas that some have claimed.

Silica is not the 'new asbestos'. The demographics of silica exposure are materially different from asbestos; our defences to coverage are distinct; and

Claims Director's review

our approach to claims handling is sufficiently mature to ensure that we will not allow a repeat of the abuses that led to the payment of uncovered asbestos claims.

Non-US asbestos claims are also the subject of ongoing analysis. Some commentators have highlighted the emergence of US-style asbestos liabilities in the UK, Australia or Europe. We look closely and regularly at the liabilities from these jurisdictions. We feel confident in our ability to manage those claims. Of course, the legal systems of those jurisdictions might change radically. It is difficult, however, to conclude that those nations would adopt the very features of US asbestos litigation that have led to inefficiency, multiple bankruptcies and widespread criticism.

Similarly, some commentators have suggested this year that US insurers under-reserve pollution liabilities and that there will be an increase in the number of pollution exposures. We cannot be certain of the accuracy of the first assertion. With regard to the second, we look closely at our own pollution experience. Currently, the number of new pollution claims is in line with our expectations.

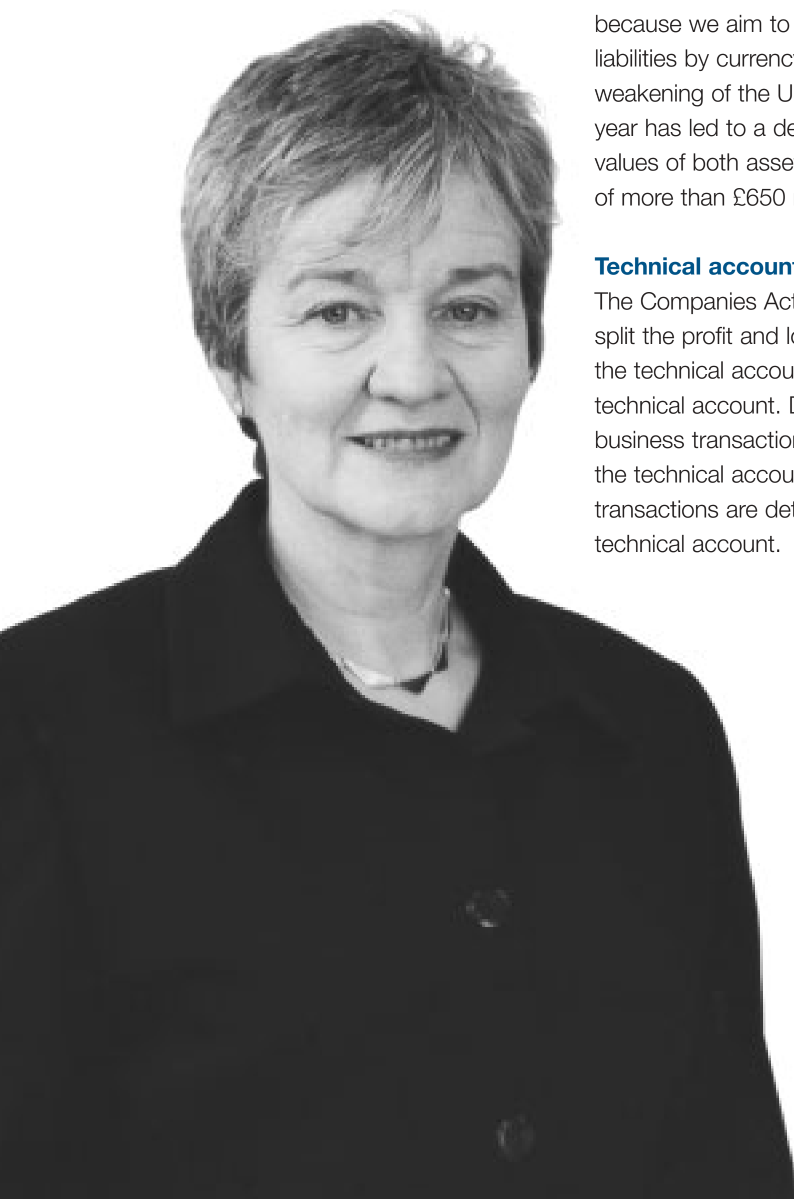
Equitas' outlook with regard to emerging risks (or the inflation of existing ones) is one of constant vigilance. We analyse our own claims experience and research the law governing both the underlying claims and our coverage obligations. We also seek to apply the lessons we have learned from our asbestos experience when developing our claims adjustment procedures.

Conclusion

This has been a year of good progress in nearly all areas of the claims portfolio. The centrepiece of this activity has been our success in concluding policy buyouts with policyholders claiming large asbestos exposures. Asbestos exposure remains a huge risk for Equitas; the changeable and often dangerous climate in which Equitas operates offers no guarantees. But policy buyouts, like those which we were able to agree this year, will remain central to our strategy in the next year. If we can repeat this year's success in the years to come, we should significantly lower our asbestos exposure, avoid future negative developments and reduce our risks and uncertainties in the best interests of Reinsured Names.

Glenn Brace
Claims Director
3 June 2004

Financial review



The Group made a loss of £67 million after tax compared with a loss of £152 million after tax in 2003.

Despite the deficit, operational performance has been positive in the year. Investment return exceeded the unwinding of the discount by £123 million. Claims and commutation activities produced a further £97 million of contribution making a total of £220 million. The significant strengthening of claims reserves has more than absorbed this strong operational performance.

The net impact of currency fluctuations is relatively insignificant because we aim to match assets and liabilities by currency. However, the weakening of the US dollar in the past year has led to a decrease in the values of both assets and liabilities of more than £650 million.

Technical account

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

Set out below is a description of some of the key items included in the technical account on page 28.

Investment return

Commentary on investment performance appears on pages 7 and 16.

Claims paid

The amount of gross claims paid of £1,381 million compares with £1,051 million in 2003. Claims are classified as paid when they have been agreed for payment and recorded in our underwriting system or have been contractually settled. Some claims, classified as paid under this definition, are recorded within creditors arising out of reinsurance operations until actual cash payment takes place. In the current year a material claim of £336 million contractually settled, but not yet paid, is included within gross claims paid.

The reinsurers' share of the gross claims paid is £173 million (2003: £222 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 £91 million (2003: £101 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

Financial review

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 3.65 per cent per annum from 3.90 per cent per annum to reflect market yields at 31 March 2004 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	199
Effect of change in the discount rate	73
Unwinding of the discount	272

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 £6 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. Since a large part of our business is conducted in US dollars, we hold a portion of our surplus in that currency. 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 2004 was US$1.85 : £1 compared with US$1.58 at 31 March 2003. Regulatory requirements in certain other overseas countries also require us to maintain surpluses in those currencies, and this creates further exposures.

Results

The Group's retained surplus after tax decreased to £460 million at 31 March 2004. The movements were as follows:

	£m	£m
Retained surplus at 1 April 2003		527
Investment return in excess of unwinding of the discount	123	
Reassessment of:		
Claims, including expenses (see below)	(127)	
Reinsurances (see below)	(33)	
Timing of net future payments	(6)	
Deficit before exchange losses		(43)
Exchange losses		(24)

There is no tax payable or recoverable in the year.

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 2003	7,039	(949)	6,090
Payments, receipts and accruals	(1,381)	173	(1,208)
Unwinding of the discount	309	(37)	272
Reassessment of:			
Liabilities and reinsurances	127	33	160
Timing of net future payments	15	(9)	6
Exchange and other movements	(756)	104	(652)
Provisions at 31 March 2004	5,353	(685)	4,668

Financial review

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 90 per cent of the investment portfolio is invested in high quality fixed interest instruments.

The Group's investments are managed externally by several fund managers. We assess the performance of each manager throughout the year against pre-determined benchmarks, which are established in the light of the overall investment strategy.

In spite of a difficult political environment, global economic growth rebounded during the year, assisted by low interest rates. This provided the backdrop for strong gains in global equity markets that have recently begun to moderate. Short term interest rates in the UK started to rise in contrast to the US, where interest rates remained at historic lows. The generally positive inflation outlook and stable credit conditions have meant that the bond portfolios have delivered modest capital gains.

At 31 March 2004 equities represented approximately 5.8 per cent of the market value of our investment portfolio. As equity values rose during the year, the proportion of our surplus invested in equities increased. As a result, we took the opportunity in March 2004 to sell a portion of our equity portfolio, realising £65 million, to restore the balance to be within our target holding.

Bad debts

We have again reassessed our estimates of the amount 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.

International Financial Reporting Standards

It is not yet clear whether International Financial Reporting Standards will be mandatory for the Group in the future. We will continue to monitor developments.

Jane Barker
Finance Director
3 June 2004

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. He is Chairman of The Merchants Trust PLC and a Non-Executive Director of the Financial Services Authority and The Standard Life Assurance Company. Age 61.

Scott Moser [#Δ*]
Chief Executive Officer since December 2003; joined the Board as Claims Director in 1997; appointed Managing Director in 2003. 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 53.

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 60.

Dick Barfield [†Δ]
Non-Executive Director; joined the Board in 1997. He is currently a Director of Baillie Gifford Japan Trust plc, The Merchants Trust PLC, Rio Tinto Pension Investments, The Edinburgh Investment Trust plc, The J.P. Morgan Fleming Overseas Investment Trust plc, Standard Life Investments Property Income Trust Ltd and Umbro plc. He was formerly Chief Investment Manager of The Standard Life Assurance Company. Age 57.

Jane Barker [Δ*]
Finance Director; joined the Board in 1995. She is a Non-Executive Director of Alliance & Leicester plc. 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 54.

Glenn Brace [*]
Claims Director; joined the Board in 2003. From 1998 until his appointment as Claims Director, he was Head of Asbestos Pollution and Health Hazard Claims. He was formerly a Partner with the law firm Day, Berry & Howard. Age 42.

Jon Collins [*]
Chief Actuary; joined the Board in 2003. With Equitas since 1996, he was formerly seconded to the Lloyd's Reconstruction and Renewal Project with Watson Wyatt, consulting actuaries. Age 38.

Michael Crall [#]
Non-Executive Director; he was Chief Executive Officer from 1995 to 2003. He is a Non-Executive Director of the Catlin Group of companies. He was formerly President and Chief Executive Officer of Argonaut Insurance Company and a senior executive at CIGNA Corporation. Age 60.

Michael Deeny [#‡§]
Trustees-nominated Non-Executive Director; joined the Board in 1996. He is Chairman of the Association of Lloyd's Members, Deputy Chairman of MultiMedia Television plc and Deputy Chairman of The Equitas Trust. Age 59.

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 42.

James Joll [†§]
Non-Executive Director; joined the Board in 1996. He was formerly Finance Director of Pearson plc, a Director of N M Rothschild & Sons Limited and a member of the editorial staff of the Financial Times. Age 67.

Sir Bryan Nicholson [#‡]
Senior Independent 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 71.

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 57.

† Member of Audit 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 2004

The Directors present their report and the audited financial statements for the financial year ended 31 March 2004.

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 Director's review and the Financial review on pages 2 to 16 report on the progress of the business during the financial year and outline future developments.

Results

The Equitas Group incurred a deficit of £67 million after tax for the year ended 31 March 2004 (2003: £152 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 then seven Trustees of The Equitas Trust jointly.

Mr John Mays retired as a Trustee of the Equitas Trust with effect from 25 March 2004. The continuing six Trustees continue to hold the issued ordinary shares jointly.

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

Directors

The names of the Directors at the date of this report, together with brief biographical details, are listed on page 17.

Mr SP Moser succeeded Mr MJ Crall as Chief Executive Officer of the Group with effect from 1 December 2003. Mr Crall remains on the Board in a non-executive capacity.

Sir Bryan Nicholson is the Senior Independent Director.

Mr I C Agnew is the Lloyd's Appointed Director.

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

Messrs HA Stevenson, SP Moser, ME McL Deeny and JAB Joll retire by rotation. 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.

Chairman

During the year, the Board agreed that Mr Stevenson's tenure as Chairman should continue for a further three years commencing 1 November 2004 (subject only to his being re-elected as a Director at the forthcoming Annual General Meeting).

Directors' interests

Mr ME McL Deeny has an interest in the business of the 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.

During the year, the Group purchased directors' and officers' insurance. The Directors also 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. These indemnities and similar indemnities in favour of employees are 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 and are therefore not subject to the requirements of the Combined Code. The Board is nevertheless committed to high standards of corporate governance and during the year it reiterated its previously expressed support for the principles and provisions of the Combined Code. The requirements introduced into the Combined Code in June 2003 do not take effect in the current reporting year. The Board has nonetheless decided that these requirements should be taken into account in the current year's statements and reports.

Under the Combined Code, the Trustees-nominated Directors, the Lloyd's Appointed Director and Messrs Crall and Joll are not deemed to be independent. These appointments are indispensable to the unique circumstances and structure of the Company. Moreover, in the opinion of the Board, all Non-Executive Directors are, in fact, independent of management except Mr MJ Crall by virtue of his previous appointment as Chief Executive Officer. The Board has therefore concluded that it is neither necessary nor appropriate to attempt to achieve strict compliance with the provisions of the Combined Code in relation to the number of 'independent' directors.

In the light of the foregoing, the Board does not report on areas of non-compliance by exception. It does, however, aim to reflect in this report those elements of the Combined Code with which the Company is able to comply and which are relevant to its circumstances.

The Group has in place a framework for sound corporate governance that 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 Group has also established confidential 'whistle blowing' arrangements, which are reviewed and monitored by the Audit Committee.

The Board

The Board comprises the Chairman, five Executive Directors and seven Non-Executive Directors. The Non-Executive Directors include two Trustees-nominated Directors and one Director appointed by the Corporation of Lloyd's.

The Board is responsible for policy and strategy and for monitoring the performance of executive management. There is a formal schedule of matters reserved to the Board for collective decision. In addition, there are matters that require the consent of The Equitas Trustees as holders of the ordinary shares pursuant to the Company's Articles of Association.

The Board met on ten occasions during the year. It receives detailed reports from management, including in those months in which no Board meeting is held. Messrs IC Agnew and GE Brace each attended nine meetings. Sir Bryan Nicholson and Mr ME McL Deeny each attended eight meetings. All other Directors attended all meetings.

The roles of Chairman and Chief Executive Officer are split. Day to day management is delegated to the Chief Executive Officer. The Chairman leads the Board and is responsible, in consultation with the Executive Directors, for setting its agenda. During the year the Chairman met the Non-Executive Directors without Executive Directors being present. The Board intends to give consideration during the year to whether it may be appropriate to establish a formal process for appraising the Chairman's and the Board's performance.

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.

Directors' report for the year ended 31 March 2004

The Equitas Trustees

The Board keeps The Equitas Trustees, as holders of all of the issued ordinary shares of the Company, informed of significant developments affecting the Group through a range of scheduled and ad hoc meetings. This process, which facilitates an exchange of views, is supported by the presence on the Board of the two Trustees-nominated Directors.

Board committees

The Board has established five committees with clearly defined written terms of reference. These committees and their respective responsibilities and activities during the year are as follows:

- *Audit Committee*

  Members
  James Joll (Chairman)
  Dick Barfield
  Richard Spooner

  Secretary
  Stephen Britt

  The Audit Committee (formerly the Audit and Compliance Committee) 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 and the Head of Internal Audit are generally invited to attend meetings of the committee. The committee receives regular reports from the Group's internal audit function and is responsible for reviewing the effectiveness of the internal audit function. During the year, the committee met the Head of Internal Audit in the absence of other members of management.

  The committee is responsible for overseeing the process for selecting the external auditors and for making appropriate recommendations to the shareholders through the Board. During the year, the committee developed and implemented a policy on the provision of non-audit services by the external auditors and reviewed their objectivity and independence. The committee concluded that in all the circumstances the external auditors ought properly to be regarded as independent. The committee, with the assistance of the external auditors, also reviewed the effectiveness of the audit process.

  The external auditors are invited to attend certain meetings of the committee. They contribute an independent perspective on aspects of financial control and annually report their findings to the committee and the Board. The committee met the external auditors during the year in the absence of management. The committee's terms of reference were reviewed during the year and revised in the light of the recommendations contained in the Guidance for Audit Committees published by the Financial Reporting Council appointed group chaired by Sir Robert Smith.

  The committee met four times during the year. All members of the committee attended each of these meetings.

- *Claims and Commutations Committee*

  Members
  Sir Bryan Nicholson (Chairman)
  Scott Moser
  Ian Agnew
  Michael Crall
  Michael Deeny

  Secretary
  Stephen Britt

  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 met three times during the year. Mr Moser attended both of the meetings held during the year following his appointment to the committee in June 2003. All other members attended all meetings of the committee held during the year.

- *Investment Committee*

  Members
  Dick Barfield (Chairman)
  Scott Moser
  Jane Barker
  Richard Spooner

  Secretary
  Stephen Britt

  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 met four times during the year. Mr Moser attended each meeting held during the year following his appointment to the committee in June 2003. Mr Crall also served as a member of the

committee during the year, and attended all meetings of the committee held during the year until his retirement in November 2003. All other members attended all meetings of the committee held during the year.

- *Nominations Committee*

  Members
  Hugh Stevenson (Chairman)
  Michael Deeny
  Sir Bryan Nicholson

  Secretary
  Stephen Britt

  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 was not necessary for this committee to meet during the year.

- *Remuneration Committee*

  Members
  Hugh Stevenson (Chairman)
  Michael Deeny
  James Joll

  Secretary
  Stephen Britt

  The role and responsibilities of the committee are set out in the Board report on Directors' remuneration on page 23. These roles and responsibilities were reviewed during the year and revised in the light of the Combined Code. The committee met three times during the year. All members of the committee attended each of these meetings.

The terms of reference of the audit, nominations and remuneration committees will be made available to Reinsured Names and their representatives upon written request to the Company Secretary at the Company's registered office.

Internal control framework

The Board has overall responsibility for the system of internal control and for reviewing its effectiveness. 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 other operational transactions. These are reviewed and changed where necessary in the light of any new circumstances.

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

Other financial risks include counterparty risks such as amounts due from reinsurers, balances at banks and custodians, and obligations of specific insurers. 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 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 18, 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' report for the year ended 31 March 2004

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 33 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 bank deposit as security for this indemnity. The amount of this deposit, which had not been increased since 1997, was increased during the year from £10 million to £20 million.

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. The Group will take reasonable steps to help employees who become disabled during their working life to continue in employment.

Suppliers

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

Charitable and political donations policy

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

Auditors

A resolution to reappoint PricewaterhouseCoopers LLP as auditors to the Company will be put to the forthcoming Annual General Meeting.

As permitted by the Company's Articles of Association, indemnities have been given to PricewaterhouseCoopers 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
3 June 2004

Board report on Directors' remuneration for the year ended 31 March 2004

Policy on Executive Directors' remuneration

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

- set reward structures which enable the Group to attract, retain and motivate executives with the appropriate skills, background and experience to operate effectively in a run-off environment;
- pay basic salaries approximately at the median of market rates for comparable companies; 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 engaged Watson Wyatt to provide information about market remuneration for Directors (including the Chairman), senior executives and other staff.

The remuneration of the Non-Executive Directors is determined by the Board as a whole, having regard to the provisions of the Company's Articles of Association. No Director is involved in setting his own remuneration.

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 for cash payments in recognition of the performance of the Group during a financial year. Payments are deferred for two additional years and are dependent on the continued performance of the Group during this period. The payment of an award is also conditional upon the employee continuing in the employment of the Group throughout the three-year period.

Details of provisional awards made under the LTIP in respect of those Executive Directors who held office during the year are shown on page 24.

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 that 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 SP Moser, GE Brace, JA Collins, JW Heap and Mrs JV Barker all have service agreements with Equitas Management Services Limited ('EMSL') which reflect that policy. Mr Crall also had a service agreement with EMSL, which ended on his retirement in November 2003.

The Executive Directors are required under the terms of their service agreements to assign to a Group company the benefit of any fees received in respect of outside directorships.

It is not the Group's policy to make ex-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 but do have letters of appointment. 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. Non-Executive Directors who chair Board committees receive an additional fee of £10,000 per annum for these services. Mr HA Stevenson did not receive an additional fee for chairing committees.

The terms and conditions of appointment of the Non-Executive Directors, including the Chairman, will be made available to Reinsured Names and their representatives upon written request to the Company Secretary at the Company's registered office.

Board report on Directors' remuneration for the year ended 31 March 2004

Directors' remuneration

Directors' remuneration, excluding LTIP payments, was:

	Salary/ Fees £	Bonus £	Benefits-in-kind £	Total emoluments £	Pension costs £	Total for year ended 31 March 2004 £	Total for year ended 31 March 2003 £
Chairman							
HA Stevenson	150,000			150,000		150,000	150,000
Executive Directors							
MJ Crall [1]	286,667		3,545	290,212	71,667	361,879	783,063
SP Moser	400,000	260,000	5,104	665,104	100,000	765,104	694,691
JV Barker	300,000	166,500	2,255	468,755	75,000	543,755	511,989
GE Brace [2]	320,000	190,000	2,092	512,092	80,000	592,092	–
JA Collins [2]	240,000	110,000	1,606	351,606	60,000	411,606	–
JW Heap [2]	220,000	120,000	1,668	341,668	55,000	396,668	–
Non-Executive Directors							
IC Agnew	35,000			35,000		35,000	33,333
RA Barfield	45,000			45,000		45,000	43,333
MJ Crall [1]	11,667			11,667		11,667	–
ME McL Deeny	35,000			35,000		35,000	33,333
JAB Joll	45,000			45,000		45,000	43,333
Sir Bryan Nicholson	45,000			45,000		45,000	43,333
RB Spooner	35,000			35,000		35,000	33,333
Total	2,168,334	846,500	16,270	3,031,104	441,667	3,472,771	2,369,741

Mrs Barker was entitled to fees of £13,000 in respect of her services as a Non-Executive Director of Alliance & Leicester plc. In accordance with the terms of her service agreement, this amount was paid directly to a Group company.

LTIP awards relating to the year ended 31 March 2001, for which provision was made in the year ended 31 March 2002, were paid in July 2003. These payments, amounting to £937,500, are analysed below and are included in note 7 on page 38. No LTIP awards have yet been made in respect of the year ended 31 March 2004.

Based on the results for the year ended 31 March 2003, a total amount of £1,245,000 has been provided as follows for awards under the LTIP to the Executive Directors:

	Total provisional awards outstanding at 31 March 2003 £	Paid during the year £	Provisional awards made during the year in respect of year ended 31 March 2003 £	Total provisional awards outstanding £
MJ Crall (as executive) [1]	540,000	270,000	285,000	555,000
SP Moser	465,000	217,500	270,000	517,500
JV Barker	390,000	195,000	202,500	397,500
GE Brace [2]	285,000	135,000	187,500	337,500
JA Collins [2]	135,000	60,000	150,000	225,000
JW Heap [2]	135,000	60,000	150,000	225,000
Total	1,950,000	937,500	1,245,000	2,257,500

1 Mr Crall retired from executive office with effect from 30 November 2003 but continues in a non-executive capacity.
2 Messrs Brace, Collins and Heap were appointed Directors with effect from 1 April 2003.

LTIP awards relating to the year ended 31 March 2002, for which provision was made in the year ended 31 March 2003, will be paid in 2004 if confirmed by the Board. LTIP awards relating to the year ended 31 March 2003, for which provision was made in the year ended 31 March 2004, are not payable until 2005. Payments are subject to the Board's determination that all of the conditions governing the plan have been met.

Messrs GE Brace, JA Collins and JW Heap were appointed to the Board with effect from 1 April 2003 and their total provisional LTIP awards have been included in the above table. Mr MJ Crall's LTIP entitlements are included as they were earned in respect of his services as Chief Executive Officer.

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 2004 were in respect of the following:

	Year ended 31 March 2004 £	Year ended 31 March 2003 £
Trustees' fees	250,000	250,000
Trustees' legal, professional and other costs and expenses	549,789	521,701
Total	799,789	771,701

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 2004 (2003: £41,000 each). They received expenses for secretarial, office and other overheads of £17,579 and £14,897, respectively (2003: £17,087 and £14,525, respectively).

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 note 1 to the financial statements.

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 Claims Director's review and the Financial review.

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 in paragraph 8 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 debtors

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 £5,353 million, reinsurers' share of claims outstanding of £685 million and reinsurance debtors of £384 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 2004 of £460 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 debtors 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 2004 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
3 June 2004

Group profit and loss account for the year ended 31 March 2004

Technical account – general business

	Note	£m	2004 £m	£m	2003 £m
Investment return transferred from non-technical account			**395**		693
Claims paid					
Gross amount		**(1,381)**		(1,051)	
Reinsurers' share		**173**		222	
Net claims paid		**(1,208)**		(829)	
Change in the provision for claims					
Gross amount		**1,254**		1,319	
Reinsurers' share		**(206)**		(265)	
Unwinding of the discount		**(272)**		(765)	
Timing of net future payments		**(6)**		(294)	
Change in the net provision for claims	*16*	**770**		(5)	
Claims incurred, net of reinsurance			**(438)**		(834)
Other technical charges	*4*		**(24)**		(26)
Balance on the technical account for general business			**(67)**		(167)

The accounting policies and notes on pages 33 to 43 form an integral part of these financial statements.

Group profit and loss account for the year ended 31 March 2004

Non-technical account

	Note	£m	2004 £m	£m	2003 £m
Balance on the technical account for general business			**(67)**		(167)
Income from financial investments		**232**		289	
Return on financial reinsurances		**14**		76	
Gains on the realisation of investments		**139**		83	
Unrealised gains on investments		**10**		245	
Investment return		**395**		693	
Allocated investment return transferred to general business technical account		**(395)**		(693)	
Investment return retained			**–**		–
Deficit on ordinary activities before tax	*5*		**(67)**		(167)
Tax on deficit on ordinary activities	*8*		**–**		15
Deficit for the year	*15*		**(67)**		(152)

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 33 to 43 form an integral part of these financial statements.

Group balance sheet as at 31 March 2004

Assets

	Note	2004 £m	2003 £m
Investments			
Financial investments	*9*	**4,717**	5,780
Financial reinsurances	*10*	**381**	587
		5,098	6,367
Reinsurers' share of technical provisions			
Claims outstanding	*16*	**685**	949
Debtors			
Debtors arising out of reinsurance operations	*12*	**419**	705
Other debtors		**23**	41
		442	746
Other assets			
Tangible assets		**4**	5
Cash at bank and in hand		**13**	9
		17	14
Prepayments and accrued income			
Accrued interest		**38**	57
Other prepayments and accrued income	*13*	**23**	3
		61	60
Total assets		**6,303**	8,136

The accounting policies and notes on pages 33 to 43 form an integral part of these financial statements.
The Company's balance sheet is shown on page 44.

Group balance sheet as at 31 March 2004

Liabilities

	Note	2004 £m	2003 £m
Capital and reserves			
Called up share capital	*14*	**–**	–
Retained surplus	*15*	**460**	527
Shareholders' funds – non-equity interests		**460**	527
Technical provisions			
Claims outstanding	*16*	**5,353**	7,039
Creditors			
Creditors arising out of reinsurance operations	*17*	**398**	496
Other creditors including taxation and social security		**92**	74
		490	570
Total liabilities		**6,303**	8,136

The financial statements on pages 28 to 43 were approved by the Board on 3 June 2004 and were signed on its behalf by:

HA Stevenson
SP Moser
JV Barker

The accounting policies and notes on pages 33 to 43 form an integral part of these financial statements.

Group cash flow statement for the year ended 31 March 2004

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

	Note	£m	2004 £m	£m	2003 £m
Deficit on ordinary activities before tax			**(67)**		(167)
Depreciation of tangible fixed assets	*5*	**1**		1	
Exchange losses, including losses on retranslation of opening balances*		**21**		24	
Unrealised gains on investments		**(10)**		(245)	
Return on financial reinsurances		**(14)**		(76)	
Decrease in provision for claims outstanding		**(853)**		(89)	
Decrease in reinsurers' share of technical provisions – claims outstanding		**148**		94	
Decrease in debtors		**213**		157	
Increase in creditors		**–**		264	
			(494)		130
Net cash outflow from operating activities			**(561)**		(37)
Cash flows were (realised)/invested as follows:					
Increase/(decrease) in cash holdings	*19*		**15**		(23)
Net portfolio investment					
Deposits with credit institutions		**8**		320	
Financial reinsurances		**(135)**		(280)	
Shares and other variable yield securities and units in unit trusts		**(68)**		(10)	
Debt securities and other fixed interest securities		**(381)**		(44)	
	19		**(576)**		(14)
Net realisation of cash flows	*20*		**(561)**		(37)

* 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 33 to 43 form an integral part of these financial statements.

Notes to the financial statements for the year ended 31 March 2004

1 Accounting policies

No changes in respect of accounting policies have been made this year. The Association of British Insurers ('ABI') revised its Statement of Recommended Practice ('SORP') on accounting for insurance business in November 2003. The revised SORP has been applied in preparing these financial statements. The adoption of its provisions did not lead to any changes in accounting policy.

Going concern

The financial statements have been prepared on a going concern basis. 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 35. 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 SORP on accounting for insurance business issued by the ABI in November 2003 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 2003 to 31 March 2004.

(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 investment portfolio to match its expected net liability stream. Accordingly, the rate of discount applied to those liabilities is calculated having regard to the current prospective yields associated with its investment portfolio.

Notes to the financial statements for the year ended 31 March 2004

(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. Potential 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.

Notes to the financial statements for the year ended 31 March 2004

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, related reinsurance recoveries 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.

Notes to the financial statements for the year ended 31 March 2004

5 Deficit on ordinary activities before tax

The deficit is stated after charging:

	Group 2004 £000	Group 2003 £000
Auditors' remuneration – audit fees	**1,064**	1,257
– non-audit fees	**14**	28
	1,078	1,285
Depreciation – tangible owned fixed assets	**1,008**	1,258
Profit on disposal of tangible fixed assets	**–**	(3)
Operating lease rentals incurred – property	**5,405**	4,798
– other	**17**	17

The audit fees for the Company of £2,000 (2003: £2,000) were borne by a subsidiary company.

Details of related party transactions, as defined by Financial Reporting Standard 8, are given on page 25.

6 Employees

The monthly average number of persons employed by the Group, including Directors, was 522 for the year ended 31 March 2004 (2003: 596), all of whom were engaged in run-off and related activities.

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

	Group 2004 £000	Group 2003 £000
Wages and salaries	**32,885**	33,506
Social security costs	**3,727**	3,518
Other pension costs	**4,079**	4,203
	40,691	41,227

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 2004 £000	Group 2003 £000
Executive Directors – remuneration	**2,629**	1,726
– LTIP awards paid	**937**	660
– pension costs	**442**	264
Non-Executive Directors – fees	**402**	380
	4,410	3,030

In addition to the above amounts, provisional awards under the LTIP were made to the Executive Directors as detailed on page 24. Full details of the remuneration of, and transactions with, Directors are given in the Board report on Directors' remuneration on page 23.

8 Tax on deficit on ordinary activities

Analysis of charge/(credit) in the year

	Group 2004 £m	Group 2003 £m
United Kingdom corporation tax at 30% (2003: 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 charge/(credit) 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 2004 £m	Group 2003 £m
Deficit on ordinary activities before tax	**(67)**	(167)
Deficit on ordinary activities multiplied by the standard rate of corporation tax in the UK of 30% (2003: 30%)	**(20)**	(50)
Effects of:		
Adjustment in respect of prior years	**–**	(15)
Unrealised losses on revaluation of equity investments	**(1)**	(1)
Unutilised tax losses carried forward	**19**	49
Other permanent differences	**2**	2
Current tax charge/(credit) for the year	**–**	(15)

There is an unrecognised deferred tax asset of £132 million (2003: £44 million) arising on losses carried forward within the Group which may not be utilised in the foreseeable future.

9 Investments: financial investments

	Group 2004 £m	Group 2003 £m
Listed		
Shares and other variable yield securities and units in unit trusts	**272**	265
Debt securities and other fixed interest securities	**3,897**	4,901
	4,169	5,166
Unlisted		
Deposits with credit institutions	**548**	614
Market value	**4,717**	5,780
Cost	**4,511**	5,550

These investments include sterling denominated assets of US$nil (2003: US$410 million) equivalent in respect of which the New York Insurance Department has registered a security interest. The contractual conditions governing the release of this charge have been satisfied.

Notes to the financial statements for the year ended 31 March 2004

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 £982 million (2003: £1,681 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 3.13 per cent (2003: 3.14 per cent) per annum. The mean term is three (2003: three) years. The value of the expected receipts from financial reinsurances, before discounting at market yields to recognise the period until receipt, is £427 million (2003: £657 million).

11 Trust funds

Financial investments and cash amounting to £2,538 million (2003: £3,383 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 certain sterling denominated financial investments. As at 31 March 2004, the value of the letter of credit was A$95 million (2003: A$80 million).

12 Debtors arising out of reinsurance operations

	Group 2004 £m	Group 2003 £m
Reinsurance recoveries	**384**	661
Other	**35**	44
	419	705

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

13 Other prepayments and accrued income

Other prepayments and accrued income include an amount of £18 million (2003: £nil) which is due after more than one year.

14 Called up share capital

	Company 2004 £	Company 2003 £
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.

15 Retained surplus

	Company £	Group £m
At 1 April 2003	–	527
Deficit for the year	–	(67)
At 31 March 2004	**–**	**460**

The retained surplus is not distributable.

16 Provision for claims outstanding

	Claims £m	Reinsurance £m	Group 2004 Net £m	Claims £m	Reinsurance £m	Group 2003 Net £m
Provision before discounting	**7,248**	**945**	**6,303**	9,636	1,333	8,303
Discount	**(1,895)**	**(260)**	**(1,635)**	(2,597)	(384)	(2,213)
	5,353	**685**	**4,668**	7,039	949	6,090

(a) Claims

Claims are stated after elimination of inter-syndicate transactions.

Provisions for APH liabilities comprised approximately 80 per cent (2003: 80 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 (2003: 20 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, related reinsurance recoveries and the cost of undertaking the run-off has been discounted at a rate of 3.65 per cent (2003: 3.90 per cent) per annum compound to reflect the time value of money. An adjustment for non-interest bearing net assets has been made. As at 31 March 2004, 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 (2003: ten) 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 35.

Notes to the financial statements for the year ended 31 March 2004

17 Creditors arising out of reinsurance operations

Creditors arising out of reinsurance operations include £41 million (2003: £nil) which is due after more than one year.

18 Reconciliation of movements in shareholders' funds

	Group 2004 £m	Group 2003 £m
Opening shareholders' funds	**527**	679
Deficit for the year (see note 15)	**(67)**	(152)
Closing shareholders' funds	**460**	527

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 2004 £m	Group 2003 £m
Net cash inflow/(outflow) for the year (see note 20)	**15**	(23)
Movement arising from cash flows of portfolio investments	**(576)**	(14)
Changes to market values and discount (see note 20)	**24**	321
Other changes, including exchange rate effects (see note 20)	**(715)**	(499)
Total movement in portfolio investments net of financing	**(1,252)**	(215)
Opening portfolio investments net of financing (see note 20)	**6,358**	6,573
Closing portfolio investments net of financing (see note 20)	**5,106**	6,358

20 Movement in cash, portfolio investments and financing

	At 31 March 2003 £m	Cash flow £m	Changes to market values and discount £m	Other changes, including exchange rate effects £m	At 31 March 2004 £m
Cash at bank and in hand	(9)	**15**	**–**	**2**	**8**
Deposits with credit institutions	614	**8**	**–**	**(74)**	**548**
Financial reinsurances	587	**(135)**	**14**	**(85)**	**381**
Shares and other variable yield securities and units in unit trusts	265	**(68)**	**91**	**(16)**	**272**
Debt securities and other fixed interest securities	4,901	**(381)**	**(81)**	**(542)**	**3,897**
	6,358	**(561)**	**24**	**(715)**	**5,106**

During the year shares and other variable yield securities and units in unit trusts of £225 million (2003: £199 million) were purchased and £293 million (2003: £209 million) were sold. For the same period debt securities and other fixed interest securities of £5,791 million (2003: £5,017 million) were purchased and £6,172 million (2003: £5,061 million) were sold. Cash at bank and in hand as at 31 March 2004 shown above is stated net of £5 million (2003: £18 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 in respect of land and buildings, expiring in over five years, of £6 million (2003: £6 million).

Company balance sheet as at 31 March 2004

	Note	2004 £	2003 £
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	*14*	**101**	101
Profit and loss account	*15*	**–**	–
Shareholders' funds – non-equity interests		**101**	101

The financial statements on pages 33 to 44 were approved by the Board on 3 June 2004 and were signed on its behalf by:

HA Stevenson
SP Moser
JV Barker

The accounting policies and notes on pages 33 to 43 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 in writing 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 10 September 2004 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 2004.

Designed and produced by Fishburn Hedges

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