Report & Accounts

for the year ended 31 March 2005

EQUITAS

Overview for the year ended 31 March 2005

- Accumulated surplus after tax increased by £16 million from £460 million to £476 million.
- Solvency margin, being accumulated surplus expressed as a percentage of net claims outstanding, increased from 9.8 per cent to 12.2 per cent.

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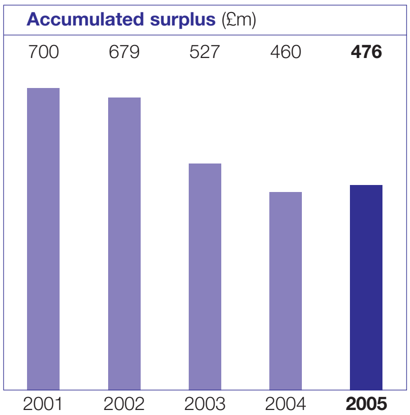
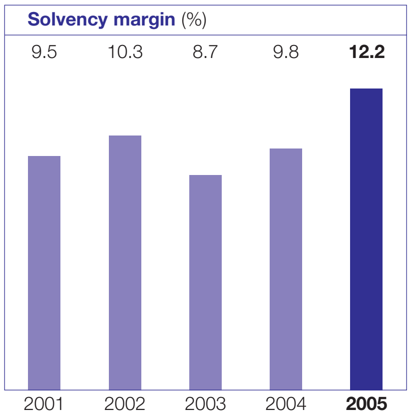
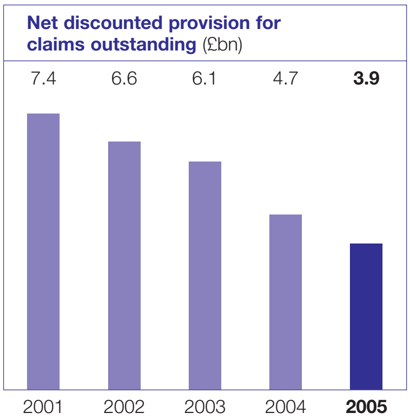
Five year results as at 31 March



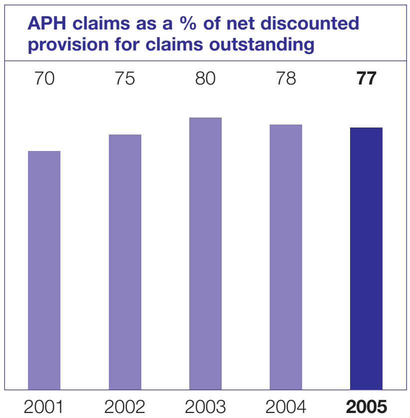
Accumulated surplus up £16m to £476m



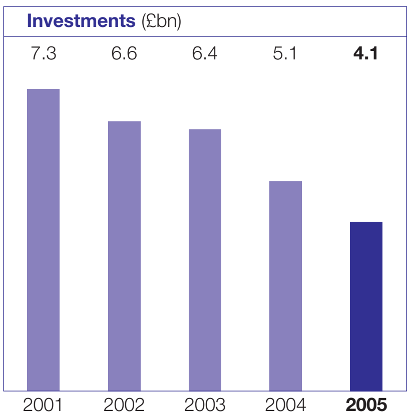
Solvency margin up from 9.8% to 12.2%



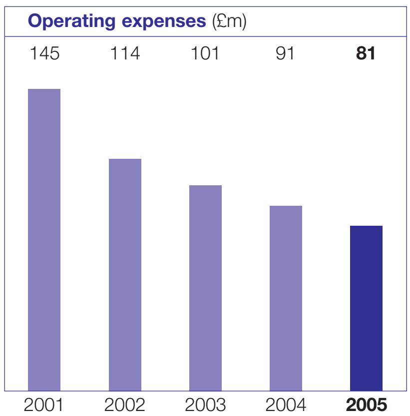
Provision for claims down from £4.7bn to £3.9bn



APH claims stable at 77% of total claims



Investments down from £5.1bn to £4.1bn



Operating expenses down from £91m to £81m

Chairman's statement

In the financial year ended 31 March 2005 accumulated surplus after tax increased by £16 million from £460 million to £476 million. The solvency margin also increased from 9.8 per cent to 12.2 per cent. Each of our key operating areas performed well but our results were adversely affected by a further deterioration in our reserves for asbestos claims.

We have again been successful in resolving a substantial number of claims by reaching settlements on acceptable terms. During the year we negotiated 25 policy buyouts and we have completed a further 85 commutations, thereby extinguishing liabilities as well as realising our reinsurance asset. We have now negotiated almost 200 policy buyouts and over 600 commutations since Equitas began and we expect to complete more in the coming year. The number of agreements we have reached and the terms on which we have done so provide us with a measure of reassurance for our methodology for assessing claims.

Equity markets rose during the last year and our bond portfolios also delivered satisfactory returns. As a result the investment return for the year exceeded the unwinding of the discount by £88 million. For the seventh consecutive year we reduced our costs by more than ten per cent.

Despite our encouraging operational results, asbestos remains the greatest single threat to Equitas. In these accounts we have strengthened our asbestos reserves by £167 million on a gross discounted basis. This has been caused by the need to increase reserves for inwards reinsurance – i.e. claims submitted by other insurers – and for non-US asbestos claims. Our reserves for asbestos claims are inevitably volatile since more than 90 per cent of these reserves are held for claims that have still to be presented to us for payment.

There has been much activity in Washington as a result of proposals to introduce federal asbestos tort reform and during the past year we have lobbied hard to protect the interests of Reinsured Names. As Scott Moser explains in more detail in his Chief Executive Officer's review, at the time of writing the provisions of the bill which had discriminated against Equitas have been withdrawn. It is not clear whether or in what form federal legislation will be enacted and indeed what impact such legislation may have on Equitas. In the meantime a number of important states have now passed tort reform legislation.

Scott Moser provides further details on the performance of our core business activities in his Chief Executive Officer's review on pages 4 to 8. Glenn Brace reports on our strategy for managing our asbestos claims, changes in the asbestos claims environment and developments in non asbestos claims on pages 9 to 12. Jane Barker analyses the accounts and other financial information in her Financial review on pages 13 to 16.

I am aware that many Reinsured Names are sometimes disturbed by rumours and other statements regarding Equitas which circulate from time to time in the media and elsewhere. I should take this opportunity to deal with a number of such issues which have been raised in recent months.

First, I have always made clear that it is impossible to give any assurance that Equitas will never become insolvent. I can however say that the Board is not considering, and never has considered, invoking the proportionate cover regime. As long as Equitas is solvent it is legally obliged to pay claims in full. As stated elsewhere in these financial statements, at the date of this report the Directors believe that the assets should be sufficient to meet all liabilities in full.

Secondly, Reinsured Names' liabilities have not been mutualised as a result of the Equitas reinsurance transaction. Nor will such liabilities be mutualised under proposals to extend the EU Insurers Reorganisation and Winding Up Directive to the Lloyd's market. While all the assets transferred to Equitas have been pooled, Reinsured Names remain severally liable to their policyholders on the policies that they underwrote. In other words, each Reinsured Name remains directly liable to policyholders in respect of the business written by that Name and in respect of that business alone.

Thirdly, Equitas cannot ask Reinsured Names or anyone else for additional capital. We do not of course know what actions other organisations might take if Equitas were to fail. This would depend on many unknown factors over which we may have little or no control such as the attitude of policyholders and their lawyers and the position taken by the courts and regulators (in the UK and elsewhere).

While it is encouraging to be able to report an increase in our surplus and solvency margin, I must reiterate that success is not guaranteed and our stability could be influenced by factors outside our control. The Auditors continue to qualify their report on the Group's accounts, reflecting the significant uncertainties which we still face. We are however fortunate to have in place what I believe to be the best insurance run-off team in the world. In fulfilling the Group's obligations they are dedicated to advancing the interests of Reinsured Names and during the past year they have made considerable progress. I thank them all most sincerely for their efforts.

Hugh Stevenson
Chairman
2 June 2005

Chief Executive Officer's review

This was another year of good progress for Equitas. While our surplus did increase slightly from £460 million to £476 million, changes of this size – upwards or downwards – are not very significant in the context of our balance sheet and should be considered as neutral. However, the claims liabilities in our balance sheet were reduced by a meaningful amount, from £5.4 billion to £4.4 billion and, importantly, our solvency margin increased from 9.8 per cent to 12.2 per cent. In short, Equitas is in a slightly stronger financial condition than it was a year ago.

This result was accomplished in several ways: we successfully settled a large number of claims, we successfully collected reinsurance, through both traditional means and commutations, our investment performance exceeded our targets and we once again reduced our expenses by a substantial amount. Offsetting these achievements, we found it necessary to increase asbestos reserves by £167 million on a gross discounted basis.

Asbestos claims

Asbestos claims represent the most serious threat to Equitas, as they have for many years. While asbestos trust legislation has been under active consideration in Washington for over two years, in dealing with our asbestos claims we made the decision that we would not wait for Washington. Instead, we have actively pursued resolution of asbestos claims and have had another successful year in resolving those claims. Glenn Brace in his report provides more details on these efforts.

As this is written the United States Congress continues to consider establishing a trust to handle all asbestos claims in the United States. The trust would be funded by contributions from business, bankruptcy trusts and insurers, with insurer contributions determined by a newly created commission.

Many versions of the bill discriminated against Equitas. The effect was to prevent Equitas from seeking relief in the event the commission was to assign it a share that threatened its solvency, although every other insurance company in the world was permitted to seek such relief. After extensive efforts, we were able to persuade the Senate Judiciary Committee to remove this discrimination and treat Equitas like other insurers.

At this point, prospects for a trust fund bill remain decidedly uncertain. Moreover, we cannot say for certain whether the trust fund bill, discriminatory or not, would prove either beneficial or harmful to Equitas. We believe our reserves for asbestos are appropriate and that a fair minded commission will seek from Equitas no more, and possibly less, than we have available for such claims. But despite our belief, we cannot guarantee that the commission will not seek more than we can pay. We will do all that we can to prevent a discriminatory bill, to be assigned a share that is fair and to oppose imposition of any share that is not.

We have also worked hard to support efforts in various states to enact asbestos reforms. These efforts have been very successful. In 2004, the Ohio legislature passed two reform bills: one requires asbestos plaintiffs to provide proof of exposure and injury before they can proceed in the State's courts, the other imposes similar requirements on silica and mixed dust claimants. Since 31 March 2005, Florida, Georgia and Texas have also enacted statutes that allow asbestos claims only from individuals manifesting specific symptoms. These are profoundly important developments. They codify that which Equitas has said publicly since 2001: asbestos claims, like any other tort claims, must be supported by evidence of injury and causation. These reforms demonstrate that the United States litigation culture as to asbestos claims is changing to prevent the entrepreneurial practice of rounding up thousands of unimpaired claimants, packaging those claims into a few cases, and extracting significant settlements through blackmail litigation.

Asbestos reserves

At 31 March 2005 gross undiscounted asbestos reserves amounted to £3.4 billion (2004: £4.0 billion). Asbestos claims payments last year were £116 million (2004: £156 million). The undiscounted value of asbestos liabilities extinguished through policy buyouts and commutations during the past year amounted to £670 million (2004: £919 million). Asbestos reserves, discounted to take account of the time value of money, amounted to £2.3 billion (2004: £2.8 billion).

In these accounts we have increased gross discounted asbestos reserves by £167 million. The majority of this increase related to claims submitted by other insurers in respect of US claims, particularly by other London market insurers.

We also increased our reserves for non-US asbestos claims. In part this results from our exposures to Australian asbestos claims and, as was the case for US claims, we have also seen higher than expected levels of UK claims submitted by other London market insurers. Non-US asbestos now accounts for 14 per cent of our gross discounted asbestos reserves.

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 £1.0 billion in the year ended 31 March 2005 (2004: £1.4 billion). We continued to make good progress in nearly all areas of the claims portfolio.

During the last year, we have completed policy buyouts with 25 policyholders, including three of our five largest asbestos exposures. We have now completed almost 200 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.

We have maintained our excellent record in settling environmental pollution claims.

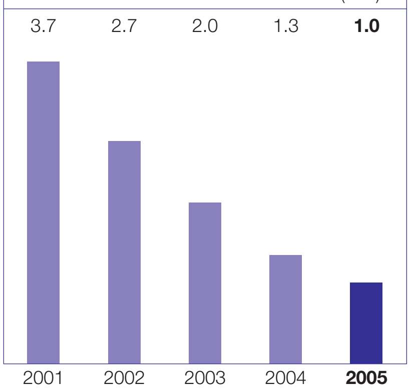
Chief Executive Officer's review (continued)

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 279.

We are also making encouraging progress in settling non-APH (asbestos, pollution and health hazard) claims. Such claims represent just over 20 per cent of total claims, as last year, compared to approximately 60 per cent when Equitas began.

As part of our annual reserve review we thoroughly examine developments regarding actual and potential health hazard claims. This review has resulted in revisions of ultimate claims estimates, both upwards and downwards, in a few reserve categories. 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.

Reinsurance asset – undiscounted (£bn)



Reinsurance recoveries

Reinsurers' share of claims paid amounted to £209 million in the year ended 31 March 2005 (2004: £173 million).

Our reinsurance collection effort has gone well. This year we reached agreements for full or partial commutations with 85 counterparties (2004: 83) and we have collected a significant amount of reinsurance in the traditional, claim by claim, method.

Our commutation strategy has enabled us to realise a substantial portion of our reinsurance asset. Equitas inherited a reinsurance asset of over £7 billion. We have reduced the outstanding asset by over £6 billion to under £1 billion at 31 March 2005. We have commuted with two thirds of the top 50 individual reinsurers we inherited. At the outset of Equitas we were concerned that towards the end of our commutation programme our remaining reinsurance asset would be unmanageable, consisting of thousands of companies with small balances adding up to a significant value. This concern has been allayed as we have significantly reduced these small value balances so that almost all of the reinsurance asset remaining today is with a manageable number of companies.

We seek to commute reinsurance contracts whenever we can do so on appropriate terms. When possible we negotiate 'global' commutations, which not only collect outwards reinsurance proceeds, but also extinguish liabilities for inwards reinsurance. Historically, companies when commuting have normally closed their complete inwards and outwards relationships with us. We are seeing a growing trend for companies wishing to commute on a piecemeal basis. We believe this is generally because the company concerned does not have the financial or administrative resources to undertake a major transaction in one 'bite'. Another trend we are seeing is the growth in 'solvent schemes' – effectively compulsory commutation schemes sponsored by a company and agreed by the majority of the creditors. These schemes can be another good method of closing reinsurer relationships, and we support such schemes where the methodology for valuing the inwards and outwards relationships is fair.

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.

- 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.

- 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.

During the year we have ourselves undertaken more of the functions that brokers have historically performed with respect to our claims on reinsurers. We have done so because we perform these functions better and we perform them at a significantly lower cost.

Investment management

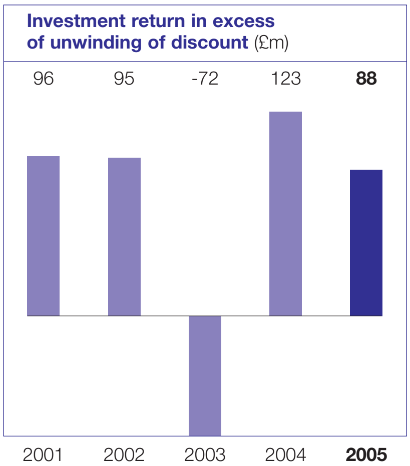
Investment return for the year ended 31 March 2005 amounted to £133 million (2004: £395 million). Because Equitas discounts its liabilities, the key measure for our investment performance is a comparison of the investment return with the unwinding of the discount. In the year ended 31 March 2005, the investment return exceeded the unwinding of the discount by £88 million (2004: £123 million).

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 the rate at which the liabilities are discounted moved to 4.10 per cent (2004: 3.65 per cent) per annum.

Expense management

Operating expenses amounted to £81 million in the year ended 31 March 2005 (2004: £91 million). This represents a year on year reduction of 11 per cent. The Group has made significant cost savings every year since its first full year of operation. While it is becoming harder to achieve reductions, we remain committed to reducing the costs of running the business without reducing our overall effectiveness.

Employment costs represent almost half of our total costs. At 31 March 2005 we had 387 employees (2004: 489). We are very fortunate to have employees willing to work hard to reduce the exposure faced by Equitas even though success inevitably brings reductions in work force and expenditure. I thank all our employees for their great efforts.



Chief Executive Officer's review (continued)

Conclusion

In the last year Equitas continued to make good progress. The long term story is also good. Since inception Equitas has paid claims of over £16 billion, cutting undiscounted liabilities by 70 per cent; collected over £6 billion of reinsurance asset, increasing investable assets and eliminating collection risks and costs; generated investment returns of £820 million in excess of the unwinding of the discount; and reduced the annual cost of running the business from over £240 million to £81 million. In addition, during the same period, we have increased gross discounted reserves by £1.5 billion. Even after these reserve increases, the solvency margin today (12.2 per cent) is much higher than it was when we began (1996: 5.6 per cent). We have made real progress towards finally satisfying the insurance obligations of Reinsured Names. Nevertheless, we recognise that much remains to be done and we are not relaxed about the challenges we still face. Serious threats remain to the ultimate success of Equitas. But we have an able and experienced team, and a history of resolving complex and difficult issues. We will continue to do our best to achieve the best possible outcome for Reinsured Names while fulfilling their insurance obligations.

Scott P. Moser

Scott Moser
Chief Executive Officer
2 June 2005

Claims Director's review

The year ended 31 March 2005, like the year before, saw the resolution of a number of major asbestos liabilities. During that period, some key US courts issued favourable rulings regarding asbestos (and silica) claims. Most of this review is devoted to a discussion of these asbestos related developments. This is appropriate. Asbestos claims continue to be the greatest risk to Equitas.

We have, meanwhile, made advances in other areas of the claims portfolio. We continued to settle pollution claims, including our largest remaining pollution liability. While we have made progress in resolving our direct exposures, our resolution of reinsurance liabilities was not as successful in the year as we had hoped.

Asbestos settlements

While we support fair, affordable asbestos legislation, our long-standing goal has been to resolve our asbestos exposures through comprehensive settlements whenever possible. The following statistics speak for themselves:

- Since April 2001, Equitas has completed 28 major direct asbestos settlements involving the payment of over $2.5 billion.
- 12 of these settlements were agreed during the last year and involved payments of nearly $1 billion.
- Equitas has settled eight of the top ten direct asbestos liabilities it identified in March 2001.
- Since April 2001, Equitas has completed commutations that extinguished more than $800 million in asbestos reinsurance liabilities.
- Equitas has paid over $7 billion in asbestos settlements since it began in 1996, more than any other company in the world.

Asbestos remains a huge and potentially fatal risk to Equitas. However, we are encouraged by our recent asbestos settlements for the following reasons:

Settlements support claim valuations

We are constantly seeking to improve the methods by which we value claims. The most reliable test of claim value is our ability to secure settlements with policyholders at the values we assign. This is the invitation we extend to policyholders – 'we have valued our exposures and we are ready and able to do deals at those values today'. Many major companies have accepted that invitation including industry leaders like Halliburton, Honeywell and Travelers.

Settlements benefit both parties

Equitas could not repeatedly make settlements that benefit Equitas but not the policyholder. Rather, the settlements we have concluded offer advantages both to Equitas and to policyholders. Both parties to a global settlement gain certainty regarding the value of a claim, save transaction costs and escape credit risks. These are important benefits for any business. These settlements are, for both parties, a better alternative than the vagaries and expense of prolonged dispute.

Claims Director's review (continued)

Settlements remove uncertainty

The value of claims from certain policyholders is susceptible to material change depending on the outcome of litigation or variation in claim trends. The liabilities for such policyholders are among the most difficult to value and the most dangerous. We seek to assign reliable and realistic values to these claims. We also carefully monitor our success in resolving them.

Of the 28 major direct asbestos exposures we have settled since April 2001, 20 were among the most unpredictable that we faced. The settlement of these cases is an important measure of Equitas' progress. Their resolution offers Equitas (and the policyholder) protection against wide swings in the value of these cases.

Settlements finalise exposures to bankrupt policyholders

We have always fought to ensure that the search for assets to fund an asbestos bankruptcy trust was not carried out with disregard for the terms of the relevant insurance contracts. Our experience during the year confirms that, while policyholder bankruptcies continue to create risks for Equitas (and other insurers), they also create opportunities to resolve comprehensively asbestos liabilities through settlement. Since 2001, we have concluded four settlements with direct asbestos policyholders in bankruptcy. Three of those were agreed in the last year.

One such settlement resolved our largest remaining asbestos liability. This settlement with Babcock & Wilcox is subject to certain contingencies before it becomes final, including the confirmation of the final bankruptcy plan. It is significant, not only because of its size, but also because it was negotiated directly with the plaintiffs' lawyers who represented the interests of asbestos claimants in that bankruptcy. This experience, along with other such negotiations during this year, confirmed our ability to deal successfully with the varied parties who influence the outcome of an asbestos bankruptcy. These experiences will prove useful in the year ahead. Of the 25 direct policyholders that pose the largest remaining asbestos liabilities to Reinsured Names, five are currently in bankruptcy.

Settlements lead others to negotiate

We recognise that not every policyholder will want to negotiate a final settlement with Equitas. We are prepared, in these cases, to review claims on a transaction by transaction basis. We continue to believe, however, that comprehensive settlements offer greater advantages for both Equitas and policyholders.

We have found that the more policyholders know about our asbestos settlements, the greater their interest in commencing negotiations. This is understandable. When many companies, including some of the world's best known businesses, are agreeing settlements with Equitas, the directors of other policyholders will properly question why they should not do the same.

Our settlements during the year also drive home a point that we often need to emphasise. There is no advantage in postponing settlement with Equitas. As already noted, we have valued our present and future liabilities and we have confidence in those values.

Certain policyholders may conclude that they have to litigate with Equitas. In some cases, this is a regrettable reality. The resolution of some disputes may require the intervention of a court or arbitrator. In those instances, we will do whatever is necessary to enforce the language of the relevant policies. We will fight when we must, but will continue to look for opportunities to settle at the right value.

Judicial reforms

As Scott Moser has discussed, a number of important US states have enacted laws that completely changed the environment in which asbestos (and silica) cases are adjudicated. Courts are playing their part as well. In some jurisdictions, they are leading the fight against asbestos and silica claim abuses.

Mississippi has shown how courts can prevent the improper concentration of asbestos filings in a small number of jurisdictions. Mississippi was long considered a magnet for asbestos claims. In 2004, the Supreme Court of Mississippi invalidated the improper consolidation of claimants and made it more difficult for out-of-state claimants to sue in Mississippi. Trial judges in counties with a large number of pending asbestos cases asked claimants to prove that they resided or were injured where their claims were filed. Failure to comply with this request led to the dismissal of thousands of claims.

The courts in Madison County, Illinois also used to hear asbestos claims without any connection to that jurisdiction. The judge formerly responsible for the asbestos docket resigned in 2004 after intense media focus on the concentration of asbestos claims in Madison County. In January, his replacement dismissed 25 asbestos lawsuits by plaintiffs who had never lived or worked in Illinois.

In Florida, the number of asbestos cases in Palm Beach County decreased after the presiding judge began questioning claims that had no connection to the area. He asserted that local taxpayers should not have to pay for processing lawsuits without a link to Palm Beach County. These actions, like those in Mississippi and Illinois, help to deter the kind of forum shopping that characterised the asbestos claims industry.

Courts are also helping in other ways. In New York City, a court has ruled that asbestos defendants should not be required to bear more than their share of damages because other defendants have filed for bankruptcy protection. This type of ruling helps to ensure that recent bankruptcy filings by asbestos defendants do not unfairly increase the financial burden of solvent defendants.

In Texas a judge in a mesothelioma case has ruled that expert testimony regarding the cause of the disease must be based, not only on accepted scientific tests, but also on an individualised assessment of the plaintiff. This ruling is consistent with our position that asbestos claims require reliable, case-specific evidence of both injury and causation.

Finally, a federal court in Texas is making sure that silica claimants (and their lawyers) also understand that improper filings will not be tolerated. During hearings in that court, the judge said that the way lawyers recruited thousands of plaintiffs for silica lawsuits waved ‘great red flags of fraud’. In that case, many ‘diagnoses’ of silica-related disease were subsequently withdrawn. We have said, with regard to silica, that we will not allow a repeat of the abuses that led to the payment of uncovered asbestos claims. Apparently, we are not alone.

Claims Director's review (continued)

Other claim types

We have spent some time over the past few years reporting on our efforts to resolve pollution liabilities. Equitas has now resolved 48 of the 50 largest pollution claims pending at our inception. During the year, in our settlement with the State of California, we resolved our largest remaining pollution exposure. There are other, much smaller, pollution claims to resolve and the pace of pollution settlements has slowed. This is due, in part, to the fact that a number of these remaining claims will require litigation prior to resolution. On the whole, pollution claims, and our progress in resolving them, continue to be in line with our expectations.

Equitas also deals with a wide variety of other claim types. We have stepped up our efforts to value and resolve relatively small direct claims which involve neither asbestos nor pollution. This added focus has led to the closure of a material number of these claims. During the last year, Equitas reduced this portfolio of claims by 18 per cent. We have set an even higher target for 2005-2006.

Resolution of reinsurance liabilities

At any given time, we are involved in numerous discussions with insurers aimed at resolving both the claims they have submitted and the amounts they owe to us. These negotiations are complicated and time consuming. As noted earlier, we have resolved hundreds of millions of dollars of reinsurance liabilities since 2001. Our disappointment in the year to 31 March 2005 is that, in contrast to our progress in resolving direct exposures, we have not resolved as many reinsurance liabilities as we had hoped.

It is difficult to know precisely why we have commuted fewer reinsurance liabilities in the year than expected. We have certainly found that some reinsureds cling to unrealistic values for their claims, sometimes refusing to acknowledge the weight of relevant legal decisions. However, we have also discovered that several insurers were behind in notifying claims to us and that several others had seen a larger than expected deterioration in their claims experience. We shall intensify our efforts to commute reinsured liabilities in the coming year.

Conclusion

In the year to 31 March 2005, we have made further progress in settling asbestos liabilities. We have resolved some of our most volatile claims. We have accelerated the settlement of other claim types. We are proving that our strategy of closing buyout settlements and commutations is achievable and sustainable.

Although we settled our largest remaining asbestos and pollution exposures during the year, there are still large claims to settle – asbestos, pollution and others. These claims present sizeable risks to Equitas and we have not arrived at the point where success is assured. There will be difficult negotiations ahead and many positions to be defended in both litigation and arbitration.

Glenn Brace

Glenn Brace
Claims Director
2 June 2005

Financial review

Operational performance has been positive in the year. Investment return exceeded the unwinding of the discount by £88 million. Claims and commutation activities produced a further £95 million of contribution making a total of £183 million. After the reassessment of our reserves and exchange movements, the Group made a profit of £16 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 15.

Claims paid

The amount of gross claims paid of £1,030 million compares with £1,381 million in 2004. The reinsurers' share of the gross claims paid is £209 million (2004: £173 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 £81 million (2004: £91 million) have been included in the amount of gross claims paid.

Change in the provision for claims

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

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

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

The methodology we adopt includes the following steps:

- the discounting of all liabilities backed by conventional bonds or financial reinsurances by yields on government fixed interest securities of appropriate currency and duration;

Financial review (continued)

- 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 these 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, the discount rate has increased to 4.10 per cent per annum from 3.65 per cent per annum, reflecting market yields at 31 March 2005 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	168
Effect of increase in the discount rate	(123)
Unwinding of the discount	**45**

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 £2 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 has always been to match our assets to the currencies of our liabilities as closely as possible. This remains the case for liabilities measured in US dollars, Canadian dollars and euros.

We match all other liabilities with sterling assets. This exposes Equitas to a small currency risk which we believe is acceptable since investing relatively small amounts in various currencies would not be efficient.

A large part of our business is conducted in US dollars and so 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 2005 was US$1.89 : £1 compared with US$1.85 at 31 March 2004. 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 increased to £476 million at 31 March 2005. The movements were as follows:

	£m	£m
Retained surplus at 1 April 2004		**460**
Investment return in excess of unwinding of the discount	88	
Reassessment of:		
Claims, including expenses (see below)	(111)	
Reinsurances (see below)	44	
Timing of net future payments	(2)	
Exchange losses	(3)	
Surplus		**16**
Retained surplus at 31 March 2005		**476**

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 discounted provisions from one year to the next comprise the following:

	Claims £m	Reinsurance £m	Net £m
Provisions at 1 April 2004	**5,353**	**(685)**	**4,668**
Payments, receipts and accruals	(1,030)	209	(821)
Unwinding of the discount	57	(12)	45
Reassessment of:			
Liabilities and reinsurances	111	(44)	67
Timing of net future payments	(8)	10	2
Exchange and other movements	(77)	8	(69)
Provisions at 31 March 2005	**4,406**	**(514)**	**3,892**

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 investment portfolios are managed by appointed fund managers whose performance is closely monitored through the year. Benchmarks for the managers are set, where possible, to correspond to the underlying liabilities by duration and currency. In this way, the values of the expected liabilities and the assets matching those liabilities are expected to move in similar directions and similar magnitudes over time.

In the last year global economic growth has moderated while inflationary pressures have remained contained. Long term interest rates in the US have risen slightly and in the UK have remained largely unchanged in spite

Financial review (continued)

of increases in short term interest rates in both countries. Equity markets globally fared well while the US dollar continued to decline against all the major currencies, albeit much less than in the previous year. In this environment, Equitas' fixed income portfolios made modest returns and the equity holdings contributed positively.

The equity portfolio was reduced by £35 million to a targeted proportion of the surplus after gains were made during the year. At 31 March 2005 equities represented approximately 6.5 per cent of the market value of our investment portfolio.

Financial reinsurances

As in all previous years, financial reinsurances are properly disclosed as investments. Since cash receipts are not expected until future accounting periods, they are recorded at values discounted at market yields. The value of financial reinsurances has decreased from £381 million to £32 million in the year as a result of a major commutation together with the collection of amounts that became due during the year.

Bad debts

As in previous years, we have removed the amounts allocated to reinsurance debts that have since been commuted. We have again reassessed our estimate of the amount provided for bad or doubtful reinsurance debts. We believe our estimate remains a prudent provision.

International Financial Reporting Standards

It remains unclear whether International Financial Reporting Standards will be mandatory for the Group in the future. However, as a result of the convergence project currently being undertaken by the Accounting Standards Board in the UK, the Group will adopt a number of these standards under UK GAAP. We will continue to monitor developments.

Integrated Prudential Sourcebook

Equitas Reinsurance Limited and Equitas Limited are authorised and regulated by the Financial Services Authority. From 1 January 2005 the Financial Services Authority's Integrated Prudential Sourcebook has required insurers to maintain overall financial resources which are adequate to ensure there is no significant risk that liabilities cannot be met as they fall due. Equitas is in run-off and there is a risk that it may not be able to meet its liabilities in the future. Accordingly, the Directors do not believe that Equitas can comply with this new rule. The Directors have informed the Financial Services Authority, which has noted the position.

Before approving the accounts, the Board addresses the question of going concern and whether to continue to pay liabilities in full. In deciding that the assets should be sufficient over the lifetime of Equitas to meet all liabilities, the Board concludes that the Group is solvent and thus has a duty to pay valid claims in full.

Jane Barker
Finance Director
2 June 2005

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 62.

Scott Moser #△*
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 law firm Day, Berry & Howard. Age 54.

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, Chairman of British Marine Holdings (Bermuda) Limited and a member of the Lloyd's Market Supervision and Review Committee. 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 61.

Dick Barfield †△
Non-Executive Director; joined the Board in 1997. He is currently a Director of Umbro plc, a number of investment trusts and a member of the Public Oversight Board for Accountancy. He was formerly Chief Investment Manager of The Standard Life Assurance Company. Age 58.

Jane Barker △*
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 55.

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 43.

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 39.

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 and Royal & Sun Alliance USA, Inc. He was formerly President and Chief Executive Officer of Argonaut Insurance Company and a senior executive at CIGNA Corporation. Age 61.

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 60.

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 43.

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 68.

Sir Bryan Nicholson #‡
Senior Independent Director; joined the Board in 1996. He is Chairman of the Financial Reporting Council. 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 72.

Richard Spooner †△
Trustees-nominated Non-Executive Director; joined the Board in 1996. He is Chairman of Euractiv.com plc and 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 58.

† Member of Audit Committee
\# Member of Claims and Commutations Committee
△ 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 2005

The Directors present their report and the audited financial statements for the financial year ended 31 March 2005.

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 made a surplus of £16 million after tax for the year ended 31 March 2005 (2004: £67 million deficit). 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 JPD Heyward retired as a Trustee on 13 April 2005. Mr GD Gilchrist, formerly Chairman of Kiln plc, was appointed a Trustee with effect from 6 May 2005.

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.

Sir Bryan Nicholson is the Senior Independent Director.

Mr IC Agnew is the Lloyd's Appointed Director.

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

Messrs RA Barfield, GE Brace, JA Collins and JW Heap retire by rotation. Sir Bryan Nicholson, having attained the age of 70 years, retires pursuant to Article 74 of the Articles of Association. All of these Directors offer themselves for reappointment at the forthcoming Annual General Meeting, although Sir Bryan Nicholson has indicated that he will step down from the Board on 31 December 2005.

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

Chairman

Mr Stevenson's tenure as Chairman was renewed for a further three years commencing 1 November 2004.

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.

Each Director has the benefit of a standard indemnity under the Articles of Association of the Company, Equitas Limited and Equitas Reinsurance Limited in respect of liabilities (including legal fees and expenses) incurred in defending proceedings, whether civil or criminal, in which he is acquitted, judgment is given in his favour or certain other relief is granted. These indemnities do not cover liability attaching to a Director in connection with any finding of negligence, default, breach of duty or breach of trust by him in relation to the Company, Equitas Limited or Equitas Reinsurance Limited. These companies have also entered into indemnities with the Directors 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 contractual 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, which took effect for listed companies during the reporting year. The Board is nevertheless committed to high standards of corporate governance and during the year it reiterated its previously expressed support for the Combined Code. Accordingly the principles and provisions of the Combined Code have been taken into account in these 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. Mr GE Brace, Mr JAB Joll and Sir Bryan Nicholson attended nine meetings. Mr IC Agnew 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.

During the year the Board established a process for evaluating its own performance and that of its Committees, the Chairman and the Non-Executive Directors. That process continues and is expected to be completed for the first time during this financial year.

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.

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.

Directors' report (continued)

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 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. The committee has implemented a policy on the provision of non-audit services by the external auditors and has 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 during the year.

  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 met four times during the year. Mr Barfield attended three meetings. The other members attended all meetings of the committee held during the year.

- *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 four times during the year. All 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. All 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. The committee met three times during the year. Mr Joll attended two meetings. All other members attended all meetings of the committee held during the year.

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 is monitored and, where 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' 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

Directors' report (continued)

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 £20 million bank deposit as security for this indemnity.

Employees

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

The Group recognises its responsibilities towards disabled people, who receive full and fair consideration for job vacancies for which they are suitable applicants. 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
2 June 2005

Board report on Directors' remuneration for the year ended 31 March 2005

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 executive and general 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 Directors who held executive 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 which reflect that policy.

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. With effect from 1 November 2004, the Chairman's fee was increased from £150,000 per annum to £175,000 per annum, inclusive of his Director's fee and was fixed for the duration of his three year appointment. 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.

Directors' remuneration

Directors' remuneration, excluding LTIP payments, was:

	Salary/ Fees £	Bonus £	Benefits-in-kind £	Total emoluments £	Pension costs £	Total for year ended 31 March 2005 £	Total for year ended 31 March 2004 £
Chairman							
HA Stevenson	160,417			160,417		160,417	150,000
Executive Directors							
SP Moser	411,250	280,000	6,120	697,370	102,813	800,183	765,104
JV Barker	313,250	175,000	2,738	490,988	78,313	569,301	543,755
GE Brace[1]	338,750	210,000	2,388	551,138	84,688	635,826	592,092
JA Collins[1]	255,000	125,000	1,763	381,763	63,750	445,513	411,606
JW Heap[1]	242,500	125,000	1,990	369,490	60,625	430,115	396,668
MJ Crall[2]						–	361,879
Non-Executive Directors							
IC Agnew	35,000			35,000		35,000	35,000
RA Barfield	45,000			45,000		45,000	45,000
MJ Crall[2]	35,000			35,000		35,000	11,667
ME McL Deeny	35,000			35,000		35,000	35,000
JAB Joll	45,000			45,000		45,000	45,000
Sir Bryan Nicholson	45,000			45,000		45,000	45,000
RB Spooner	35,000			35,000		35,000	35,000
Total	1,996,167	915,000	14,999	2,926,166	390,189	3,316,355	3,472,771

Mrs JV Barker was entitled to fees of £53,000 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 2002, for which provision was made in the year ended 31 March 2003, were paid in July 2004. These payments, amounting to £1,012,500, 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 2005.

Based on the results for the year ended 31 March 2004, a total amount of £1,500,000 has been provided as follows for awards under the LTIP to the Executive Directors:

	Total provisional awards outstanding at 31 March 2004 £	Paid during the year £	Provisional awards made during the year in respect of year ended 31 March 2004 £	Total provisional awards outstanding £
SP Moser	517,500	247,500	400,000	670,000
JV Barker	397,500	195,000	300,000	502,500
GE Brace[1]	337,500	150,000	300,000	487,500
JA Collins[1]	225,000	75,000	250,000	400,000
JW Heap[1]	225,000	75,000	250,000	400,000
MJ Crall (as executive)[2]	555,000	270,000	–	285,000
Total	2,257,500	1,012,500	1,500,000	2,745,000

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

LTIP awards relating to the year ended 31 March 2003, for which provision was made in the year ended 31 March 2004, will be paid in 2005 if confirmed by the Board. LTIP awards relating to the year ended 31 March 2004, for which provision was made in the year ended 31 March 2005, are not payable until 2006. 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 2005 were in respect of the following:

	Year ended 31 March 2005 £	Year ended 31 March 2004 £
Trustees' fees	223,000	250,000
Trustees' legal, professional and other costs and expenses	567,272	549,789
Total	790,272	799,789

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 2005 (2004: £41,000 each). They received expenses for secretarial, office and other overheads of £15,886 and £14,427, respectively (2004: £17,579 and £14,897, 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 £4,406 million, reinsurers' share of claims outstanding of £514 million and reinsurance debtors of £245 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 2005 of £476 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 surplus 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 2005 and of the surplus 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
2 June 2005

Group profit and loss account for the year ended 31 March 2005

Technical account – general business

	Note	£m	2005 £m	£m	2004 £m
Investment return transferred from non-technical account			**133**		395
Claims paid					
Gross amount		**(1,030)**		(1,381)	
Reinsurers' share		**209**		173	
Net claims paid		**(821)**		(1,208)	
Change in the provision for claims					
Gross amount		**919**		1,254	
Reinsurers' share		**(165)**		(206)	
Unwinding of the discount		**(45)**		(272)	
Timing of net future payments		**(2)**		(6)	
Change in the net provision for claims	*16*	**707**		770	
Claims incurred, net of reinsurance			**(114)**		(438)
Other technical charges	*4*		**(3)**		(24)
Balance on the technical account for general business			**16**		(67)

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 2005

Non-technical account

	Note	2005 £m	2005 £m	2004 £m	2004 £m
Balance on the technical account for general business			**16**		(67)
Income from financial investments		**190**		232	
Return on financial reinsurances		**–**		14	
Gains on the realisation of investments		**63**		139	
Unrealised gains on investments		**–**		10	
Unrealised losses on investments		**(120)**		–	
Investment return		**133**		395	
Allocated investment return transferred to general business technical account		**(133)**		(395)	
Investment return retained			**–**		–
Surplus/(deficit) on ordinary activities before tax	*5*		**16**		(67)
Tax on surplus/(deficit) on ordinary activities	*8*		**–**		–
Surplus/(deficit) for the year	*15*		**16**		(67)

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 2005

Assets

	Note	2005 £m	2004 £m
Investments			
Financial investments	*9*	**4,087**	4,717
Financial reinsurances	*10*	**32**	381
		4,119	5,098
Reinsurers' share of technical provisions			
Claims outstanding	*16*	**514**	685
Debtors			
Debtors arising out of reinsurance operations	*12*	**317**	419
Other debtors		**21**	23
		338	442
Other assets			
Tangible assets		**3**	4
Cash at bank and in hand		**8**	13
		11	17
Prepayments and accrued income			
Accrued interest		**29**	38
Other prepayments and accrued income	*13*	**20**	23
		49	61
Total assets		**5,031**	6,303

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 2005

Liabilities

	Note	2005 £m	2004 £m
Capital and reserves			
Called up share capital	*14*	**–**	–
Retained surplus	*15*	**476**	460
Shareholders' funds – non-equity interests		**476**	460
Technical provisions			
Claims outstanding	*16*	**4,406**	5,353
Creditors			
Creditors arising out of reinsurance operations	*17*	**112**	398
Other creditors including taxation and social security		**37**	92
		149	490
Total liabilities		**5,031**	6,303

The financial statements on pages 28 to 43 were approved by the Board on 2 June 2005 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 2005

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

	Note	£m	2005 £m	£m	2004 £m
Surplus/(deficit) on ordinary activities before tax			**16**		(67)
Depreciation of tangible fixed assets	*5*	**1**		1	
Exchange (gains)/losses, including losses on retranslation of opening balances*		**(2)**		21	
Return on financial reinsurances		**–**		(14)	
Unrealised gains on investments		**–**		(10)	
Unrealised losses on investments		**120**		–	
Decrease in reinsurers' share of technical provisions – claims outstanding		**158**		148	
Decrease in provision for claims outstanding		**(850)**		(853)	
Decrease in debtors		**108**		213	
(Decrease)/increase in creditors		**(331)**		–	
			(796)		(494)
Net cash outflow from operating activities			**(780)**		(561)
Cash flows were (realised)/invested as follows:					
(Decrease)/increase in cash holdings	*19*		**(4)**		15
Net portfolio investment					
Shares and other variable yield securities and units in unit trusts		**(16)**		(68)	
Debt securities and other fixed interest securities		**(334)**		(381)	
Deposits with credit institutions		**(86)**		8	
Financial reinsurances		**(340)**		(135)	
	19		**(776)**		(576)
Net realisation of cash flows	*20*		**(780)**		(561)

* 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 2005

1 Accounting policies

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

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 2004 to 31 March 2005.

(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 (continued)

(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 provisions for disputed claims are based on the Group's view as to the expected outcomes of such court decisions.

Uncertainty is further increased because of the potential for unforeseen changes in the legal, judicial, technological or social environment, which may increase or decrease the cost, frequency or reporting of claims, and because of the potential for new sources or types of claim to emerge.

Asbestos claims

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

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

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

Notes to the financial statements (continued)

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 assumes 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 per cent proportional reinsurance written in the United Kingdom.

4 Other technical charges
Other technical charges relate to foreign exchange movements.

Notes to the financial statements (continued)

5 Surplus/(deficit) on ordinary activities before tax

The surplus/(deficit) is stated after charging/(crediting):

	Group 2005 £000	Group 2004 £000
Auditors' remuneration – audit fees	**950**	1,064
– non-audit fees	**38**	14
	988	1,078
Depreciation – tangible owned fixed assets	**745**	1,008
Profit on disposal of tangible fixed assets	**(100)**	–
Operating lease rentals incurred – property	**5,648**	5,656
– other	**13**	17
Operating lease rentals receivable – property	**(399)**	(251)

The audit fees for the Company of £2,000 (2004: £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 439 for the year ended 31 March 2005 (2004: 522), all of whom were engaged in run-off and related activities.

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

	Group 2005 £000	Group 2004 £000
Wages and salaries	**32,272**	32,885
Social security costs	**3,557**	3,727
Other pension costs	**4,753**	4,079
	40,582	40,691

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.

An amount of £1 million (2004: £nil) was included in creditors in respect of pension costs.

7 Directors' emoluments

The aggregate remuneration of the Directors was as follows:

	Group 2005 £000	Group 2004 £000
Executive Directors – remuneration	**2,491**	2,629
– LTIP awards paid	**1,013**	937
– pension costs	**390**	442
Non-Executive Directors – fees	**435**	402
	4,329	4,410

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 surplus/(deficit) on ordinary activities

Analysis of charge/(credit) in the year

	Group 2005 £m	Group 2004 £m
United Kingdom corporation tax at 30% (2004: 30%)		
Current tax	**–**	–
Deferred tax – origination and reversal of timing differences	**–**	–
	–	–

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 2005 £m	Group 2004 £m
Surplus/(deficit) on ordinary activities before tax	**16**	(67)
Surplus/(deficit) on ordinary activities multiplied by the standard rate of corporation tax in the UK of 30% (2004: 30%)	**5**	(20)
Effects of:		
Unrealised losses on revaluation of equity investments	**(1)**	(1)
Tax losses brought forward utilised during the year	**(6)**	–
Unutilised tax losses carried forward	**–**	19
Other permanent differences	**2**	2
Current tax charge/(credit) for the year	**–**	–

There is an unrecognised deferred tax asset of £145 million (2004: £132 million) arising on losses carried forward within the Group, which are not expected to be utilised in the foreseeable future.

9 Investments: financial investments

	Group 2005 £m	Group 2004 £m
Listed		
Shares and other variable yield securities and units in unit trusts	**267**	272
Debt securities and other fixed interest securities	**3,367**	3,897
	3,634	4,169
Unlisted		
Deposits with credit institutions	**453**	548
Market value	**4,087**	4,717
Cost	**4,002**	4,511

The Group receives collateral for all securities lent as a condition of the transaction. Included in the above table are lent securities with a market value of £1,190 million (2004: £982 million), which were collateralised at over 100 per cent of their value. A further £14 million (2004: £nil) of lent securities, also collateralised at over 100 per cent of their value, is included under other debtors. Deposits with credit institutions include £70 million (2004: £70 million) that is subject to charge.

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

Notes to the financial statements (continued)

10 Investments: financial reinsurances

The average prospective rate of return on financial reinsurances is 4.31 per cent (2004: 3.13 per cent) per annum. The mean term is four (2004: three) years. The value of the expected receipts from financial reinsurances, before discounting at market yields to recognise the period until receipt, is £38 million (2004: £427 million).

11 Trust funds

Financial investments and cash amounting to £2,053 million (2004: £2,538 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 2005, the value of the letter of credit was A$95 million (2004: A$95 million).

12 Debtors arising out of reinsurance operations

	Group 2005 £m	Group 2004 £m
Reinsurance recoveries	**245**	384
Other	**72**	35
	317	419

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 £17 million (2004: £18 million) which is due after more than one year.

14 Called up share capital

	Company 2005 £	Company 2004 £
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 2004	–	460
Surplus for the year	–	16
At 31 March 2005	**–**	**476**

The retained surplus is not distributable.

16 Provision for claims outstanding

	Claims £m	Reinsurance £m	Group 2005 Net £m	Claims £m	Reinsurance £m	Group 2004 Net £m
Provision before discounting	**6,257**	**751**	**5,506**	7,248	945	6,303
Discount	**(1,851)**	**(237)**	**(1,614)**	(1,895)	(260)	(1,635)
	4,406	**514**	**3,892**	5,353	685	4,668

(a) Claims
Claims are stated after elimination of inter-syndicate transactions.

Provisions for APH liabilities comprised 77 per cent (2004: 78 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 23 per cent (2004: 22 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 4.10 per cent (2004: 3.65 per cent) per annum compound to reflect the time value of money. An adjustment for non-interest bearing assets has been made. As at 31 March 2005, 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 (2004: 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.

17 Creditors arising out of reinsurance operations

Creditors arising out of reinsurance operations include £40 million (2004: £41 million) which is due after more than one year.

Notes to the financial statements (continued)

18 Reconciliation of movements in shareholders' funds

	Group 2005 £m	Group 2004 £m
Opening shareholders' funds	**460**	527
Surplus/(deficit) for the year (see note 15)	**16**	(67)
Closing shareholders' funds	**476**	460

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 2005 £m	Group 2004 £m
Net cash (outflow)/inflow for the year (see note 20)	**(4)**	15
Movement arising from cash flows of portfolio investments	**(776)**	(576)
Changes to market values and discount (see note 20)	**(120)**	24
Other changes, including exchange rate effects (see note 20)	**(83)**	(715)
Total movement in portfolio investments net of financing	**(983)**	(1,252)
Opening portfolio investments net of financing (see note 20)	**5,106**	6,358
Closing portfolio investments net of financing (see note 20)	**4,123**	5,106

20 Movement in cash, portfolio investments and financing

	At 31 March 2004 £m	Cash flow £m	Changes to market values and discount £m	Other changes, including exchange rate effects £m	At 31 March 2005 £m
Cash at bank and in hand	8	**(4)**	**–**	**–**	**4**
Shares and other variable yield securities and units in unit trusts	272	**(16)**	**14**	**(3)**	**267**
Debt securities and other fixed interest securities	3,897	**(334)**	**(134)**	**(62)**	**3,367**
Deposits with credit institutions	548	**(86)**	**–**	**(9)**	**453**
Financial reinsurances	381	**(340)**	**–**	**(9)**	**32**
	5,106	**(780)**	**(120)**	**(83)**	**4,123**

During the year shares and other variable yield securities and units in unit trusts of £123 million (2004: £225 million) were purchased and £139 million (2004: £293 million) were sold. For the same period debt securities and other fixed interest securities of £6,934 million (2004: £5,791 million) were purchased and £7,268 million (2004: £6,172 million) were sold. Cash at bank and in hand as at 31 March 2005 shown above is stated net of £4 million (2004: £5 million) of overdrafts.

21 Contingent liabilities and assets

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

The settlement agreed with a direct policyholder, Babcock & Wilcox, is subject to a number of contingencies. If the contingencies are not satisfied then the £220 million ($415 million) settlement paid during the year will be repaid to the Group. This would result in an increase of £220 million in both the Group's financial investments and provision for claims.

In view of the uncertainties surrounding potential US federal asbestos legislation the Group has negotiated the right to recover certain payments made if such legislation is passed by certain dates. These recoveries would result in an increase to both the Group's financial investments and provision for claims. The rights total over £150 million.

The Group had no other contingent liabilities or assets 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 (2004: £6 million).

Company balance sheet as at 31 March 2005

	Note	2005 £	2004 £
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 2 June 2005 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 9 September 2005 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 2005.

Designed and produced by Fishburn Hedges

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