Report & Accounts

for the year ended 31 March 2002

EQUITAS

Overview

In the year ended 31 March 2002:

- Accumulated surplus after tax decreased from £700 million to £679 million.
- Solvency margin, being accumulated surplus expressed as a percentage of net claims outstanding, increased from 9.5 per cent to 10.3 per cent.

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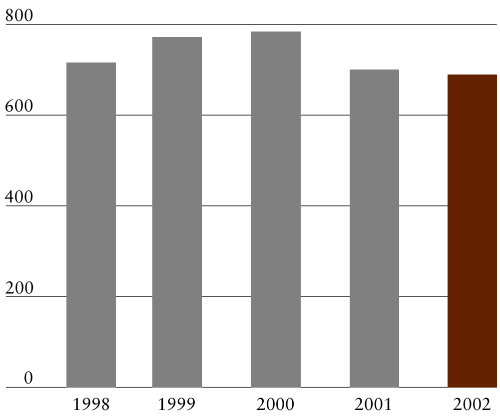
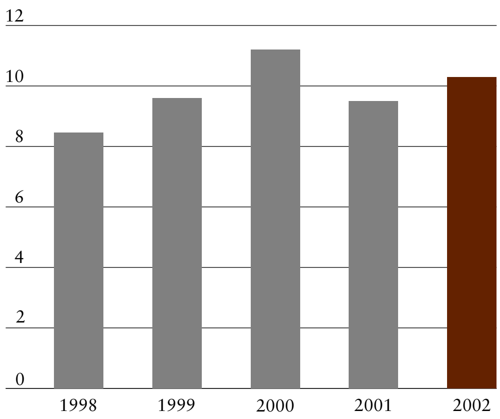
Five year results

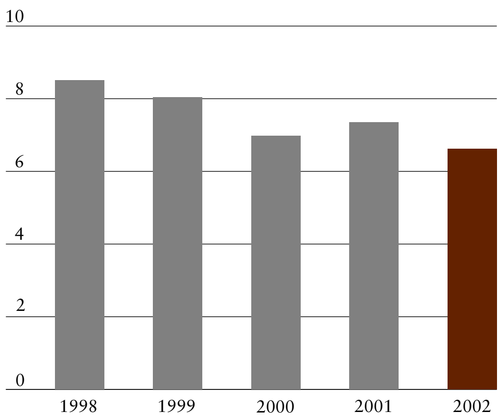
Accumulated surplus (£m)



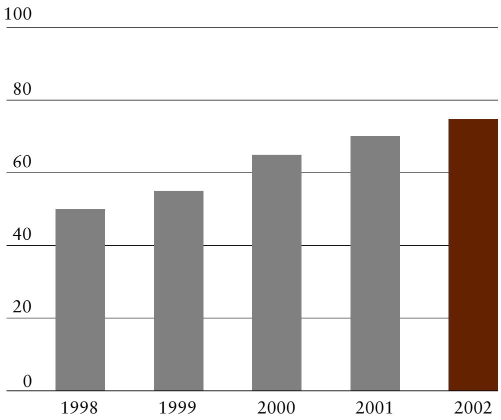
Solvency margin (%)



Net claims outstanding (£bn)[1]

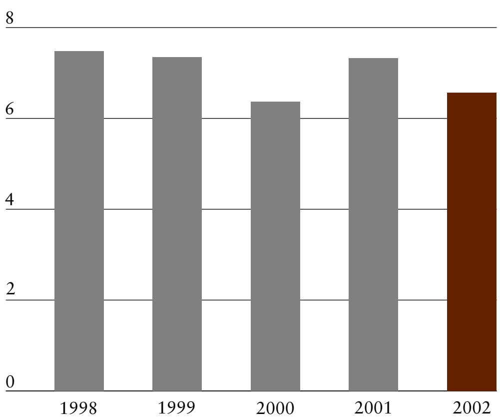


APH claims as a percentage of net claims outstanding (%)[1]

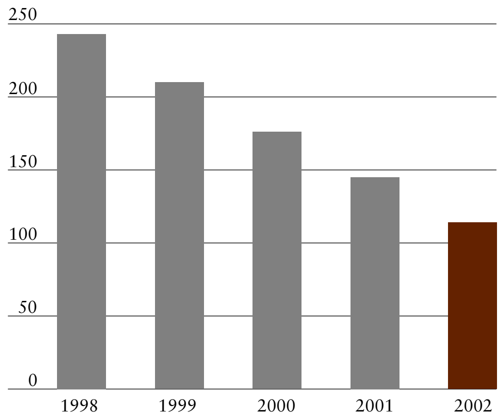


[1] Claims figures are shown net of discounting

Investments (£bn)



Operating expenses (£m)



Chairman's statement

Hugh Stevenson

In the financial year ended 31 March 2002:

- Accumulated surplus after tax decreased from £700 million to £679 million;
- Solvency margin, being accumulated surplus expressed as a percentage of net claims outstanding, increased from 9.5 per cent to 10.3 per cent.

The decrease in surplus is primarily due to technical additions to reserves for a number of categories of business, including a re-estimation of future reinsurance recoveries. Notwithstanding the decrease in surplus, however, the solvency margin has risen as a result of the significant fall in net claims outstanding during the year.

Asbestos claims continue to be the greatest single threat to the stability of Equitas. At 31 March 2002, gross undiscounted asbestos liabilities amounted to £6.4 billion, equivalent to more than 50 per cent of the Group's total gross undiscounted claims reserves.

We are, however, encouraged by the preliminary results of the strategies that we have put in place to manage asbestos claims, and we are optimistic that they will limit the future financial threat to Equitas posed by such claims. In the two years ended 31 March 2001, Equitas strengthened its gross undiscounted provisions for future asbestos claims payments by a total of £3.2 billion. On the basis of the Group's experience during the past year, which included both positive and negative developments, the Directors have concluded that it is not necessary to make any further overall increase in the gross discounted provisions for future asbestos claims payments.

The Group once again made good progress in nearly all other areas of the business. Claims settlements, the collection of reinsurance and the commutation of reinsurance contracts produced significant contributions. Investment income exceeded the unwinding of the discount applied to claims liabilities for the sixth consecutive year. Operating expenses were in line with our budget.

Michael Crall reviews the performance of our core business activities and comments on decisions regarding claims reserves in his Chief Executive Officer's Review on pages 5 to 10. This year, Scott Moser, Equitas' Claims Director, reports on developments regarding asbestos claims and our strategy to manage them. His review appears on pages 11 to 16. Jane Barker analyses the accounts and other financial information in her Financial Review on pages 17 to 21.

Equitas' future remains highly uncertain, and the Auditors rightly point to this uncertainty in their qualified report on the Group's accounts. There are, however, several areas by which Equitas' progress can be measured, as noted in last year's Report & Accounts. It is worthwhile to review these in the light of the developments of the past year:

- Since Equitas was established, it has been necessary to strengthen gross discounted claims reserves by an aggregate of more than £1.5 billion. Notwithstanding this increase, accumulated surplus has risen from £588 million to £679 million and the solvency margin has risen from 5.6 per cent to 10.3 per cent. This performance is a result of the successful actions taken by management in settling claims, negotiating commutations and managing our investment portfolio.

- Even though aggregate claims paid have exceeded £12.6 billion over the life of Equitas up to 31 March 2002, cash and investments amounted to more than £6.5 billion at 31 March 2002. As shown on the chart on page 1, the size of Equitas' investment portfolio has not changed significantly over the past five years.

- Most asbestos claims will not be received – let alone paid – for many years to come. Asbestos claims payments in the past year, excluding payments in respect of commutations and policy buyouts, again represented less than 5 per cent of gross undiscounted asbestos reserves.

- As described in the Chief Executive Officer's and the Claims Director's reviews, the Equitas team continues to maintain an excellent track record in dealing with long tail claims liabilities.

In January, Stephen Catlin, who had served as the Lloyd's Appointed Non-Executive Director since the early days of Equitas, left the Board. Stephen made a significant contribution to Equitas during his more than five years as a Director, for which we are most grateful. Lloyd's has appointed Ian Agnew, a former Lloyd's underwriter and the former Chairman of Wellington Underwriting plc, to succeed Stephen. Ian's long experience as a successful Lloyd's underwriter will be of great value to the Board.

In another context it was once said that you cannot guarantee success, but you can deserve it. I can assure Reinsured Names that Equitas has been able to attract and retain people of the highest calibre, many of whom are now recognised as leaders in their individual disciplines and who have the skills and creativity necessary to implement our strategy. While there are a number of issues over which we have little or no control, the ultimate fortunes of Equitas will to a great degree be determined by the efforts of this team of people. To all of them I offer my sincere thanks for their commitment and hard work during the past year.

Hugh Stevenson
Chairman
18 June 2002

Chief Executive Officer's review

Michael Crall

During the year ended 31 March 2002, we made substantial progress in reducing claims liabilities and realising value from reinsurances. Unlike the previous two years, when results were dominated by reserve adjustments for asbestos, this year's results consisted of solid contributions from each operational area, offset by a number of adjustments to various liability and asset categories. The net result was a reduction in accumulated surplus of £21 million which, representing less than a quarter of one per cent of an £8.8 billion balance sheet, can be viewed as a generally neutral outcome, particularly in the light of the concurrent improvement in our solvency margin.

Asbestos liabilities

Asbestos issues headed the agenda for Equitas during the year ended 31 March 2002. Major events, covered in more detail in the Claims Director's Review on pages 11 to 16, included a continuing stream of asbestos related corporate bankruptcies, a large number of high profile court awards and no relief from the pace of new claims filings. Nonetheless, these developments, after taking into account the expected impact of our own claims management strategies and a more favourable assessment of inwards reinsurance estimates, led us to conclude that it was not necessary to adjust the level of discounted reserves at the year end.

During the year we undertook a review of all inwards reinsurance asbestos liabilities on a more comprehensive basis than had been done at any time since the Lloyd's Reserving Project. Our conclusion was that this category of reserves was overstated in terms of ultimate gross losses, but that actual payment of inwards reinsurance claims would be somewhat more rapid than had been previously forecast. The positive impact derived from this analysis was largely offset by policyholder-specific and other specific reserve increases, and the aggregate result of asbestos reserve re-evaluations on a net discounted basis was negligible.

We have continued to implement and expand on the various strategies to manage asbestos claims discussed in last year's Report & Accounts. Although it will be many years before we can fully evaluate the effectiveness of these initiatives, early indications are promising.

Last year we negotiated policy buyouts with three policyholders with significant asbestos liabilities. This extinguished all current and future claims from these policyholders. Additionally, as part of our strategy to commute the reinsurance asset, we routinely commute inwards liability as well. This activity resulted in closing out a material amount of asbestos exposure during the past year.

At 31 March 2002 gross undiscounted asbestos reserves amounted to £6.4 billion (2001: £8.1 billion), while gross asbestos reserves, discounted to take account of the time value of money, amounted to £3.6 billion (2001: £4.6 billion). Asbestos claims payments and the value of liabilities extinguished through commutations during the past year amounted to £1.1 billion. Excluding policy buyouts and liabilities extinguished through commutations, asbestos claims payments last year were £269 million.

Observers often attempt to compare the adequacy of individual insurers' asbestos reserves. An imprecise tool used by insurance industry analysts to compare reserve adequacy is the 'survival ratio'. This ratio indicates the number of years a company can continue paying claims at a historical rate before it exhausts its reserves. As at 31 March 2002, Equitas' three year asbestos survival ratio, gross of reinsurance recoveries and excluding payments in respect of commutations and policy buyouts, was 23.6 (2001: 26.5). This means it would take 23.6 years before Equitas would exhaust its undiscounted asbestos reserves, assuming that asbestos claims continue to be paid at the same underlying rate as during the previous three years. By comparison, we estimate that the average three year asbestos survival ratio for a representative sample of US insurers, gross of reinsurance recoveries but including payments in respect of commutations and policy buyouts, if any, was 6.1 at 31 December 2001 (2000: 6.8).

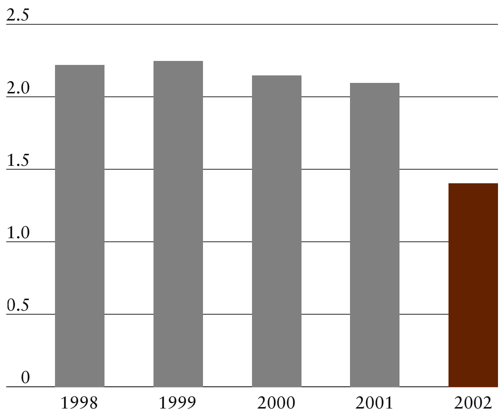
Some commentators also attempt to analyse insurers' asbestos reserves on the basis of inevitably imprecise estimates of 'market share'. We believe such analysis is overly simplistic. Equitas uses a highly developed actuarial framework to estimate asbestos liabilities, which is described in detail in note 2 to the financial statements on page 44.

More than 95 per cent of our asbestos reserves are related to US claims, but we closely monitor events elsewhere as well. The recent ruling in the United Kingdom by the House of Lords will increase compensation to some asbestos claimants. However, it will not have a material impact on Equitas' liabilities. Our UK asbestos reserves anticipated this ruling. Moreover, Lloyd's syndicates reinsured by Equitas wrote relatively modest amounts of coverage affected by the ruling.

Claims management

Gross claims paid for all types of coverage, an amount which includes claims resolved through commutation agreements as well as the Group's operating costs, amounted to £1.4 billion in the year ended 31 March 2002 (2001: £2.1 billion). In addition to the gradual reduction of claims activity over time, the decrease in claims paid reflects the fact that we have by now closed out many of our largest claims, either through policy buyouts or commutations.

Gross claims paid (£bn)



We continued to make good progress in nearly all areas of the claims portfolio. We maintained our excellent record in settling environmental pollution claims. During the past year we closed 72, or 22 per cent, of the 329 open direct pollution claims pending at 1 April 2001. Furthermore, we settled 47 per cent of the direct pollution claims with reserves in excess of £10 million at 1 April 2001. We received a broad release from future claims from the policyholders as part of most of these settlements. After taking into account new claims, the number of open pollution claims decreased during the year to 312.

We also continue to make encouraging progress in settling non-APH (asbestos, pollution and health hazard) claims, also known as 'balance of account' claims. Non-APH claims represent 25 per cent of net discounted liabilities, down from 30 per cent at 31 March 2001 and down from 60 per cent when Equitas began operations. Balance of account claims can be expected to continue to run off more rapidly than APH claims. Thus APH claims will inevitably rise as a percentage of overall reserves.

As part of our annual reserve review we thoroughly examine developments regarding previously identified health hazards. This review has resulted in some minor upwards revisions of ultimate claims estimates in a few reserve categories. With regard to tobacco related exposures, we continue to believe that tobacco claims will not create a significant liability for Equitas. This belief has been reinforced by a recent US court decision that coverage for tobacco related claims is excluded from insurance policies containing a wide variety of exclusionary policy wordings. Additionally, we have not identified any previously unknown health hazard in the past year which we believe could create a material liability for the Group.

Reinsurance management

Reinsurers' share of paid claims amounted to £424 million in the year ended 31 March 2002 (2001: £1 billion). Reinsurance recoverable on claims paid will normally reduce in line with claims payments and as outwards reinsurance contracts are commuted. During the past year, we completed the negotiation of 88 commutation agreements, down slightly from the previous year.

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

- Reinsurance asset does not produce investment income until it is collected. By converting reinsurance asset to cash through commutations, we will increase future investment income. Realising reinsurance asset through commutations has helped keep the value of the investment portfolio at a steady level, even though we have paid more than £12 billion in claims since Equitas began operations.

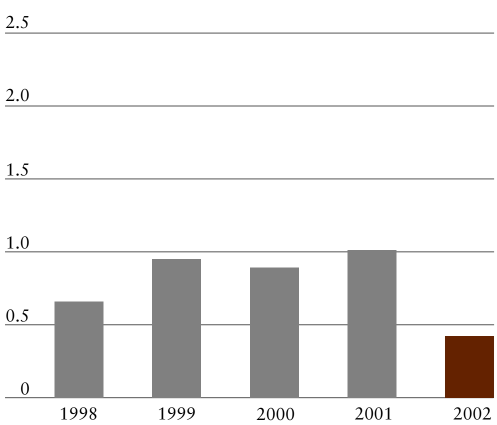
- Reinsurance recovery is an expensive and time consuming process. Commuting reinsurance arrangements will reduce future processing and collection expenses.

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

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

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

Reinsurers' share of claims paid (£bn)



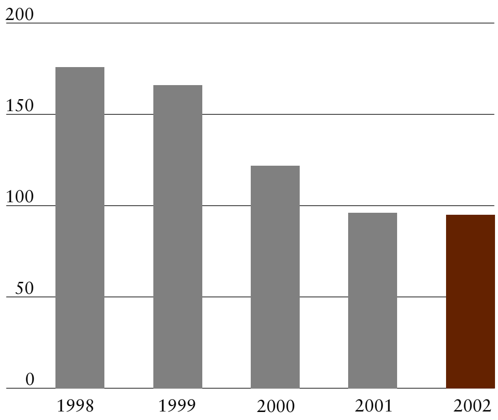
Some reinsurers are unwilling to enter into commutation agreements, and we will collect the reinsurance proceeds owed by these companies through traditional means. We have continued to refine our traditional reinsurance collection processes over the past year, including the consolidation in-house on 1 April 2001 of all of our reinsurance processing activities that had previously been contracted to other companies. This consolidation has significantly reduced costs and greatly improved the co-ordination of traditional reinsurance collection efforts with commutations.

Because of their effect on reinsurers' security, the events of 11 September had some impact on Equitas even though we had no direct policy exposure. The cost to us was not large, but it does reinforce the desirability of commuting the reinsurance asset as rapidly as practicable.

Investment management

Investment return amounted to £277 million in the year ended 31 March 2002 (2001: £696 million). This decrease in investment return was primarily due to the stabilisation and subsequent rise in long term bond yields in both the United Kingdom and the United States, which lowered bond values and partially offset the interest income on our fixed interest

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



portfolio. In addition, equity values fell sharply following the 11 September terrorist attacks, although these losses were recovered as the year progressed.

Because Equitas discounts its liabilities to take account of the time value of money, the investment performance measure most important to the financial health of the Group is the amount by which investment return exceeds the unwinding of the discount applied to the claims liabilities. In the year ended 31 March 2002, investment return exceeded the unwinding of the discount by £95 million (2001: £96 million). In the six years since the formation of Equitas, investment return has exceeded the unwinding of the discount by approximately £680 million, all of which represents funds which we have used to fund increases in claims reserves or to increase accumulated surplus.

The rate at which we discount our liabilities is based on the prospective yield on our investment portfolio. Taking into account the rise in long term interest rates in the past year, we increased the rate at which claims liabilities are discounted from 5 per cent per annum at 31 March 2001 to 5.25 per cent at 31 March 2002. Increasing the discount rate reduced the present value of the liabilities by £107 million at 31 March 2002.

Our investment portfolio remains overwhelmingly invested in high quality fixed interest securities, with a portion of the accumulated surplus invested in equity markets. The currency and duration composition of the fixed interest portfolio is adjusted regularly to comply with our long term policy of matching the expected liabilities by duration and currency. There were no substantive changes to investment policy during the past year.

Expense management

Operating expenses amounted to £114 million in the year ended 31 March 2002 (2001: £145 million). Effective management of operating expenses has been a central element of Equitas' culture since the Group's inception. The steady reduction of costs reflected in the chart on page 1 continued last year, when we reduced operating expenses by 21 per cent in comparison with the prior year.

Expense reductions of this magnitude will become more difficult in the future. During the current year insurance costs and office rental expenses will increase. Looking to the future, we will find that certain expenses – notably those associated with investment management and claims management – will vary in response to the size of the balance sheet and will not necessarily follow a pre-determined percentage reduction.

Employees

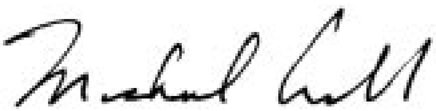
The average number of employees decreased to 660 in the year ended 31 March 2002 (2001: 739). This reduction in headcount takes into account the full effect of our decision to outsource information technology, facilities management and records management functions in the year ended 31 March 2001, although that reduction was somewhat offset by an increase in the number of reinsurance recovery employees due to the consolidation of this function in-house on 1 April 2001.

We expect that headcount will continue to reduce over time as the business handled by the Group runs off. In many cases, employees who leave Equitas are not replaced, and when it is necessary to fill a vacancy we attempt wherever possible to fill the vacancy with a current employee.

Our employees have reacted to the challenges which face Equitas, especially the challenge presented by asbestos claims, with creativity, innovation and teamwork. Our culture rejects routine applications of 'standard' solutions and instead encourages employees to think creatively to find the best possible solution to the problem at hand. The fact that our core activities have performed well during the past year is due to the hard work of our employees, and I thank them for their contributions to Equitas' continued progress.

Conclusion

In the early years of our existence Equitas was characterised by rapid and wide ranging changes aimed at bringing order and efficiency to the processes and systems we inherited. We have now matured into an organisation with clearly focused priorities, well-defined strategies and a highly capable group of people with a proven record of accomplishments. The challenges confronting Equitas, especially those surrounding the asbestos issue, are undiminished, but the capabilities we bring to meet them are stronger than they have ever been.



Michael Crall
Chief Executive Officer
18 June 2002

Claims Director's review

Scott Moser

A year ago, we described in detail the history of asbestos bodily injury claims in the United States, the reasons why asbestos claims filings have surged in recent years and some of the steps which Equitas is taking to manage asbestos liabilities.

A year later, asbestos remains the most serious issue facing Equitas. Many of the adverse asbestos claims trends described in last year's Report & Accounts have continued during the past 12 months. The number of asbestos claims filings in the United States has risen, particularly claims filed by people who have suffered no physical impairment from their alleged asbestos related injuries (and thus are commonly referred to as 'unimpaired'). The average amounts paid by defendant companies to settle asbestos claims by impaired persons have also continued to increase. Additional asbestos defendants in the United States have filed for bankruptcy protection, citing the large numbers of asbestos claims pending against them.

However, Equitas has implemented a comprehensive strategy for managing asbestos claims, especially claims filed by unimpaired persons. There are early indications that our asbestos initiatives could substantially reduce payments for meritless claims and ensure that valid claims are resolved at reasonable values. At this point, however, we cannot say with certainty whether these initiatives will ultimately be successful.

While Equitas has made encouraging progress in managing other areas of the claims portfolio, this review will focus on asbestos claims in the light of Reinsured Names' understandable interest in this issue. A review of other claims related activities appears on page 6 as part of the Chief Executive Officer's Review.

Asbestos related developments during the past year

The number of new asbestos claims filings has continued to increase. It is difficult to determine precisely how many new asbestos claims are filed each year because there is no central database of claims filings. However, the trust which pays asbestos claims filed against Johns-Manville

Corporation, which filed for bankruptcy protection in the early 1980s, makes available reliable statistics on claims filings that provide some insight into the current situation. The Manville Trust reported nearly 90,000 new asbestos claims in 2001, compared with 58,000 in 2000. Furthermore, a group of key policyholders which bought coverage from London Market insurers reported a 25 per cent increase in new asbestos claims filings during 2001. Some estimates suggest that 80 per cent or more of these new claims filings are made by unimpaired persons.

Claimants' lawyers have continued to obtain extraordinary verdicts in a handful of cases. In one recent trial in New York, a claimant with mesothelioma, an invariably fatal form of cancer associated with asbestos exposure, was awarded US$53 million in compensatory damages. In a recent Mississippi trial, six unimpaired claimants received verdicts of US$25 million each in compensatory damages.

Six asbestos defendants – including Kaiser Aluminium Corporation, North American Refractories Co, Harbison-Walker Refractories Co and A P Green Industries Inc – have filed for bankruptcy protection during the past year. These bankruptcies bring to more than 50 the total number of US companies which have filed for bankruptcy during the past two decades because they faced an overwhelming number of asbestos claims. It is probable that additional asbestos defendants will file for bankruptcy in the coming year.

Equitas' asbestos claims initiatives

Equitas, in conjunction with leading London Market insurance companies, is pursuing a wide variety of initiatives aimed at ensuring that policyholders are reimbursed only for valid asbestos claims. These initiatives, which were described in last year's Report & Accounts, were adopted following an intensive review of asbestos claims and the strategies used to handle them. That review continues.

Even though some of these initiatives were announced more than a year ago, it is still too early to measure accurately whether these initiatives will be successful, although the early evidence shows that at least some of them could have a profound impact on Equitas' asbestos liabilities.

These initiatives include:

Documentation requirements

The documentation requirements (DRs) are simple in concept. Before London Market insurers, including Equitas, will reimburse an asbestos bodily injury claim presented by a policyholder, the policyholder must document the existence of a genuine asbestos related injury that was caused by the policyholder's products or premises.

Last year, we expanded upon the existing DRs by adopting what are known as reinsurance documentation requirements (RDRs) for asbestos claims presented by cedants which purchased reinsurance coverage from Lloyd's syndicates and other London Market insurers.

We believe that the DRs and RDRs will have a significant impact on the reimbursement of claims filed by unimpaired persons. The limited experience to date with the DRs has been encouraging. There is evidence that the requirements are beginning to change at least some policyholders' willingness to settle unimpaired claims and the willingness of some claimants' lawyers to pursue such cases.

Five major policyholders have certified that the claims they have submitted for reimbursement comply with the DRs, and we have paid such claims promptly, subject to a right to audit them to verify the accuracy of the certifications. We are encouraging other policyholders to follow these examples, and we are optimistic that additional policyholders will certify claims payments that meet the DRs.

On the other hand, some policyholders have failed to certify that their claims comply with the DRs, and Equitas has consequently declined to pay these claims without proof that the claims are properly reimbursable. In addition, some policyholders and cedants are challenging Equitas' refusal to reimburse claims that do not comply with the DRs or RDRs, but we remain confident that both sets of requirements are supported in law and that their use will be upheld. We will devote the necessary resources to litigating or arbitrating, as appropriate, any challenges to the DRs and RDRs.

Close scrutiny of inventory settlements

Over the past several years, so-called 'inventory settlements' – in which a claimants' attorney settles an entire 'inventory' of claims, sometimes numbering in the thousands, against a particular asbestos defendant – have contributed significantly to the increase in unimpaired claims. While individual claims resolved through inventory settlements are typically settled for relatively modest amounts, the nature of these settlements does not usually require claimants' attorneys to provide meaningful proof to support the payment of such claims. Thus, we believe that inventory settlements have encouraged claimants' attorneys to file more and more claims.

Over the last year, we have scrutinised inventory settlements proposed by policyholders and have frequently declined to approve these settlements because they permit payment of unimpaired claims that would not comply with the DRs. In some cases, policyholders have nonetheless proceeded with the inventory settlements. We have refused to reimburse claims covered by these settlements that do not comply with the DRs. Increasingly, following objections to inventory settlements by Equitas and other London Market insurers, policyholders have instead attempted to settle claims individually, so that the merits and value of each claim can be properly evaluated.

Our focus on inventory settlements has led to a related initiative: the careful review of policyholders' requests for authority to settle particular asbestos claims. We have independently valued these claims, taking into account key factors such as disease type, jurisdiction and the claimant's age. We have concluded that the settlement amounts requested by policyholders in many cases were excessive. In these cases, we either refused to approve any settlement or granted the policyholder authority to settle for a reduced amount. The final outcomes in these cases have supported the accuracy of our valuations: the policyholders have often been able to settle the claims within the reduced authority granted by Equitas. When cases have gone to trial, the policyholder’s ultimate liability has, in most cases, been within the settlement authority we granted. In summary, careful review of claim values has resulted in concrete savings in a substantial number of cases.

Coverage in place agreements

A ‘coverage in place’ agreement is an agreement between a policyholder and its insurers which defines the way in which insurance policies will respond to asbestos claims, including how losses will be allocated among multiple years of coverage. As reported last year, we have terminated a coverage in place agreement with one policyholder based on its terms and filed suit against the policyholder to seek a declaration that, under applicable law, claims should be allocated to policies in a manner that is substantially more favourable to insurers than that provided for in the agreement. We are confident of the merit of our position in that ongoing litigation.

We also commenced a proceeding in the bankruptcy of another policyholder asserting that its proposed reorganisation plan breached an existing coverage in place agreement. While a trial court has rejected our challenge as premature, it has emphasised that the final reorganisation plan must respect London Market insurers’ rights under the coverage in place agreement.

Active participation in bankruptcy proceedings

The increasing number of major policyholders which have filed for bankruptcy protection validates our decision to participate actively in asbestos bankruptcies to achieve fair and equitable results that do not impose unwarranted liabilities on insurers. We have retained national bankruptcy counsel, appointed special counsel in several major bankruptcies, are insisting that we have the opportunity to participate in policyholders’ negotiations to resolve the bankruptcies and are preparing to litigate key issues that will arise in many of these bankruptcy proceedings.

On a positive note, a number of policyholders which have filed for bankruptcy protection have endorsed standards for payment of asbestos claims which are similar to – and in some cases apparently drawn from – the DRs. For example, one major policyholder cited key provisions of the DRs to a bankruptcy judge to support its argument that many claims which have been filed with the bankruptcy court were invalid. Several other policyholders have taken similar steps. One policyholder actually cited the special report on asbestos liabilities published in last year’s Equitas Report & Accounts to encourage a bankruptcy court to apply standards closely resembling the DRs.

Policy buyouts

We continue to attempt to negotiate ‘policy buyouts’ with policyholders with asbestos claims, under which all coverage obligations would be terminated in exchange for a cash payment. Not surprisingly, many policyholders are reluctant to enter into such agreements because of the uncertainty over the ultimate cost of asbestos liabilities. Despite this difficulty, we have negotiated policy buyouts with three major policyholders with asbestos claims during the past year, and we are actively negotiating with other policyholders.

The changing public climate

After many years of little or no public interest, the dysfunctional asbestos compensation system is receiving increased attention from the media in the United States. In the past six months, dozens of articles about asbestos claims and the problems they pose for both businesses and society have been published in respected US publications, including The New York Times, The Wall Street Journal, the Los Angeles Times, the Chicago Tribune, Forbes, and Fortune. A good example is an April 2002 front page article in The New York Times titled 'A Surge in Asbestos Suits, Many by Healthy Plaintiffs'. In the article, a prominent claimants' attorney was quoted as saying: "the overwhelming majority of these cases are brought by people who have no impairment whatsoever."

While several proposals to reform the asbestos compensation system are pending before the US Congress, we are not optimistic that Congress will enact such legislation quickly. However, the changing public climate towards asbestos claims may be laying the groundwork for eventual legislative reform, and the long term prospects for a legislative solution to asbestos claims problems are gradually improving.

Judicial action to address the issue of unimpaired claims

Federal judges have taken positive steps to address the issue of unimpaired claims in recent months by proposing requirements which in many ways are similar to the DRs. For example, the judge responsible for pre-trial activities with regard to all asbestos claims filed in US federal courts recently dismissed thousands of claims filed following mass screenings of prospective claimants. In such screenings, doctors review x-rays but never actually examine the potential claimants. Claims are filed if a doctor concludes that a person's x-rays are 'consistent' with asbestos related disease. These claims are precisely the types of claims that would not comply with the DRs.

In addition, the US Supreme Court has agreed to hear an important case involving an unimpaired asbestos claimant and may provide guidance regarding how such claims should be handled in the future.

Conclusion

The asbestos claims picture remains clouded and uncertain. The number of claims filed, particularly unimpaired claims, continues to rise. However, we are encouraged by the impact which our initiatives, especially the DRs, have made so far. We continue to be optimistic that these initiatives will limit the financial threat posed by asbestos claims, especially those filed by unimpaired people. We hope we can report further progress a year from now. In the meantime, we will continue to pursue vigorously every proper effort to manage asbestos claims.

We are also encouraged by the clear shift in the public perception of the asbestos compensation system in the United States. The current regime under which large amounts of money are paid to unimpaired claimants, forcing an ever increasing number of companies into bankruptcy, is coming under fire from the media, the courts and from prominent claimants' lawyers themselves. We are optimistic that this change in opinion, together with our initiatives, will result in significant changes in the US asbestos compensation system.

Scott Moser
Claims Director
18 June 2002

Financial review

Jane Barker

The Group sustained a deficit of £21 million after tax compared with a deficit of £84 million in 2001.

Our claims and commutations activities produced £263 million of contribution by achieving settlements at favourable values as compared with those in our balance sheet. Our investment return added a further contribution of £95 million in excess of the unwinding of the discount. This total contribution of £358 million which, set against the reassessment of our claims reserves and the reinsurers' share of these reserves, produced the relatively small deficit of £21 million.

Cashflow during the year was negative as we would normally expect and amounted to £688 million, reflecting our claims payments net of receipts from reinsurers.

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 36.

Investment return

Commentary on investment performance appears on pages 8 and 20.

Claims paid

The amount of gross claims paid of £1,413 million compares with £2,096 million in 2001. The reinsurers' share of the gross claims paid is £424 million (2001: £1,013 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 £114 million (2001: £145 million) have been included in the amount of gross claims paid.

Change in the provision for claims

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

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

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

The methodology we adopt includes the following steps:

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

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

The discount rate is reviewed each year to ensure that it remains a prudent estimate of the average annual return expected to be achieved for the period for which these assets are likely to be held. For the year under review, we have increased the discount rate to 5.25 per cent per annum from 5 per cent per annum to reflect current market yields and our expected claims payment patterns.

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

	£m
Reduction of one year in period over which net liabilities are discounted	289
Effect of change in the discount rate from 5% to 5.25% per annum	(107)
Unwinding of the discount	**182**

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 £272 million.

Other technical charges

The other technical charges are made up of foreign exchange items. Liabilities are denominated in a number of currencies, and the Group's policy is to match our assets to the currencies of our liabilities as closely as possible. Regulatory requirements in certain overseas countries require us to maintain surpluses in those currencies. At any given time this may lead to a currency imbalance which can give rise to an exchange difference. Thus, although the closing exchange rate for US dollars used for translation of the balance sheet at 31 March 2002 was US$1.43 to £1 sterling compared with US$1.42 at 31 March 2001, some modest exchange gains were recorded.

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

Results

The Group's retained surplus after tax decreased to £679 million as at 31 March 2002. The movements were as follows:

	£m	*£m*
Retained surplus at 1 April 2001		**700**
Investment return in excess of unwinding of the discount	95	
Reassessment of:		
Claims, including expenses (see below)	230	
Reinsurances (see below)	(82)	
Timing of net future payments	(272)	
		(29)
Exchange gains		8
Retained surplus at 31 March 2002		**679**

Provision for claims outstanding

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

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

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

	Claims *£m*	*Reinsurance* *£m*	*Net* *£m*
Provisions at 1 April 2001	**8,933**	**(1,581)**	**7,352**
Payments, receipts and accruals	(1,413)	424	(989)
Unwinding of the discount	259	(77)	182
Reassessment of:			
Liabilities and reinsurances	(230)	82	(148)
Timing of net future payments	275	(3)	272
Exchange and other movements	(61)	13	(48)
Provisions at 31 March 2002	**7,763**	**(1,142)**	**6,621**

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, the major part of the investment portfolio remains largely invested in high quality fixed interest instruments.

At 31 March 2002 equities represented approximately 7 per cent of the market value of our investment portfolio and 56 per cent of our retained surplus. Although we continue to monitor the equity markets for investment opportunities, it remains our intention to invest only a portion of our surplus in equities.

The Group continually assesses the performance of its fund managers against pre-determined benchmarks, which are established in the light of the overall investment strategy.

Financial markets exhibited periods of extreme volatility, particularly on account of the events following the terrorist attacks in the United States and continued uncertainty over the strength of the US economy. The US Federal Reserve Board and other central banks responded to these events with an easing in monetary policy. Although this facilitated a recovery in the equity markets and ensured that short term interest rates remained low, it has caused long term bond yields to rise slightly.

This rise in US and UK bond yields has reduced the return we were able to achieve from our bond portfolio. Importantly, however, the portfolio as a whole generated a return in excess of the unwinding of the discount.

Bad debts

We have again reassessed our estimates of the amount to be provided for bad or doubtful reinsurance debts. After removing the amounts allocated to reinsurance debts that have since been commuted, the amount that was deducted from the reinsurance asset in the Group's opening accounts continues to be a prudent provision for bad debts and accordingly no further adjustments have been made.

Estimation techniques and uncertainties

In meeting the requirements of Financial Reporting Standard 18 – Accounting Policies, we have taken the opportunity to consolidate and expand in note 2 on page 43 the information concerning estimation techniques and uncertainties previously found in various sections of the Report & Accounts.

Financial risk management

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

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

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

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

During the year we again conducted a review of the effectiveness of our systems of internal control. Further details of that review, which was carried out in line with the guidance issued by the Turnbull Committee, appear in the Directors' Report on page 27.

Jane Barker
Finance Director
18 June 2002

Board of Directors

Hugh Stevenson ‡§

Chairman; joined the Board in 1998. He was formerly Chairman of Mercury Asset Management Group plc, a Managing Director of S G Warburg Group plc's investment banking business and with Linklaters & Paines. He is Chairman of The Merchants Trust PLC and a Director of The Standard Life Assurance Company and other companies. Age 59.

Michael Crall #Δ*

Chief Executive Officer; joined the Board in 1995. He was formerly President and Chief Executive Officer of Argonaut Insurance Company and a senior executive at CIGNA Corporation. Age 58.

Ian Agnew

Lloyd's Appointed Non-Executive Director; joined the Board in 2002. 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 58.

Dick Barfield †Δ

Non-Executive Director; joined the Board in 1997. He is currently a Director of Baillie Gifford Japan Trust plc, Marshalls plc, The Merchants Trust PLC, New Look Group plc, Rio Tinto Pension Investments, The Edinburgh Investment Trust plc and The Fleming Overseas Investment Trust plc. He was formerly Chief Investment Manager of The Standard Life Assurance Company. Age 55.

Jane Barker Δ*

Finance Director; joined the Board in 1995. She was formerly Chief Financial Officer and Chief Operating Officer of the London Stock Exchange and Chief Financial Officer of the insurance broking operations of Marsh & McLennan Inc outside the Americas. Age 52.

Michael Deeny #‡§

Trustees-nominated Non-Executive Director; joined the Board in 1996. He is Chairman of MultiMedia Television plc; Chairman of the Association of Lloyd's Members; and Deputy Chairman of The Equitas Trust. Age 57.

James Joll †§

Non-Executive Director; joined the Board in 1996. He is Chairman of AIB Asset Management Holdings and Deputy Chairman of Jarvis Hotels plc. He was formerly Finance Director of Pearson plc. Age 65.

Scott Moser *

Claims Director; joined the Board in 1997. He was formerly President of Envision Claims Management Corporation; Vice President of Environmental/Excess Claims at Aetna Casualty & Surety Company; and a Partner with the law firm Day, Berry & Howard. Age 51.

Sir Bryan Nicholson #‡

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

Richard Spooner †Δ

Trustees-nominated Non-Executive Director; joined the Board in 1996. He is Managing Director of Team User Systems Company Limited. He was formerly a member of the Names Committee and the Assistance and Recovery Committee of Lloyd's. Age 55.

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

Directors' report

for the year ended 31 March 2002

The Directors present their report and the audited financial statements for the financial year ended 31 March 2002.

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. Since 1 December 2001 Equitas Reinsurance Limited and Equitas Limited have been regulated under the Financial Services and Markets Act 2000 by the Financial Services Authority. Prior to that date those companies were regulated under the Insurance Companies Act 1982 by the Financial Services Authority on behalf of HM Treasury.

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 21 report on the progress of the business during the financial year and outline future developments.

Results

The Equitas Group incurred a deficit of £21 million after tax for the year ended 31 March 2002 (2001: £84 million). The Company's Articles of Association do not permit the payment of a dividend.

Share capital

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

Substantial shareholding

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

Mr CK Murray retired as a Trustee on 30 September 2001. Mr RJR Keeling, formerly a Lloyd's underwriter, Chairman of Murray Lawrence & Partners and Chief Executive of Amlin plc, was appointed as a Trustee with effect from 30 September 2001.

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

Directors

The names of the Directors at the date of this report, together with brief biographical details, are listed on pages 22 and 23.

Mr IC Agnew joined the Board as the Lloyd's Appointed Director with effect from 1 February 2002. Mr SJO Catlin served as the Lloyd's Appointed Director during the year until he left the Board on 1 February 2002.

Mr PA Jardine served as a Director during the year. As disclosed in the Group's Report & Accounts for the year ended 31 March 2001, Mr Jardine left the Board and the Group with effect from 30 September 2001.

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

Messrs RA Barfield and SP Moser and Sir Bryan Nicholson retire by rotation. They offer themselves for reappointment at the forthcoming Annual General Meeting. Sir Bryan Nicholson will have attained the age of 70 years before that Meeting.

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

Chairman

Mr HA Stevenson was re-elected as a Director at the last Annual General Meeting, having retired by rotation. His initial three year appointment as Chairman, which ended on 31 October 2001, has been renewed for a further three years.

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 have an interest in the business of the Company as former underwriting members 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. Mr SJO Catlin, who also served as a Director during the year, had an interest in the business of the Company through his shareholding in Catlin Westgen Limited, the sole member of Syndicate 2003.

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

None of the Directors has an interest in shares in any Group company other than Messrs ME McL Deeny and RB Spooner who, since 3 September 1996, have held the two ordinary shares in the Company jointly with the other Trustees of The Equitas Trust.

Corporate governance

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

The Board

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

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

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

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

Company Secretary

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

Board committees

The Board has established five committees with clearly defined terms of reference. In addition to the Audit and Compliance Committee and the Remuneration Committee, whose roles and responsibilities are outlined on pages 27 and 30, respectively, these committees are as follows:

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

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

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

Internal controls

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

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

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

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

As noted on page 24, since 1 December 2001 the Company's insurance subsidiaries – Equitas Reinsurance Limited and Equitas Limited – have been 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 41 set out the issues relevant to the going concern basis for the preparation of the financial statements.

Indemnification of Trustees

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

Employees

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

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

Suppliers

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

Charitable and political donations policy

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

Auditors

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

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

By Order of the Board
Stephen Britt
Company Secretary
18 June 2002

Board report on Directors' remuneration
for the year ended 31 March 2002

Policy on Executive Directors' remuneration

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

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

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

Performance related incentive arrangements

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

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

Details of provisional awards made under the LTIP in respect of the Executive Directors are shown on page 32.

The Remuneration Committee administers the annual cash bonus plan and the LTIP under its delegated powers and decides on participation and the amounts of incentive payments. The Board determines at its discretion the amount which is available to be awarded under the LTIP.

Payments under performance related incentive arrangements are not pensionable.

Service agreements

Messrs MJ Crall and SP Moser and Mrs JV Barker have service agreements with Equitas Management Services Limited ('EMSL') which are subject to 12 months' notice on a rolling basis. Mr PA Jardine also had a service agreement with EMSL that was subject to such notice. That service agreement came to an end when Mr Jardine left the Board on 30 September 2001.

Non-Executive Directors' fees

Non-Executive Directors, including the Chairman, do not have service agreements. They do not have bonus or pension arrangements. With effect from 1 November 2001, the Chairman's fee was increased from £125,000 per annum to £150,000 per annum, in each case inclusive of the Director's fee. In each case, the fee was fixed for the duration of the Chairman's three year appointment. Non-Executive Directors receive a fee of £30,000 per annum, unchanged from the previous four years. Non-Executive Directors who chair Board committees receive an additional fee of £10,000 per annum for these services, which is also unchanged. Mr HA Stevenson did not receive an additional fee for chairing committees.

Directors' remuneration

Directors' remuneration, excluding LTIP payments, in respect of the financial year ended 31 March 2002 was:

	Salary/ Fees £	*Bonus £*	*Benefits-in-kind £*	*Total emoluments £*	*Pension costs £*	*Total for year ended 31 March 2002 £*	*Total for year ended 31 March 2001 £*
Chairman							
HA Stevenson	135,417			135,417		135,417	125,000
Executive Directors							
MJ Crall	393,750	230,000	7,675	631,425	98,437	729,862	687,792
JV Barker	261,250	150,000	1,693	412,943	65,312	478,255	454,329
PA Jardine[1]	125,000	–	1,128	126,128	31,250	157,378	472,845
SP Moser	325,000	220,000	3,438	548,438	81,250	629,688	582,836
Non-Executive Directors							
IC Agnew[2]	5,000			5,000		5,000	–
RA Barfield	40,000			40,000		40,000	40,000
SJO Catlin[3]	25,000			25,000		25,000	30,000
ME McL Deeny	30,000			30,000		30,000	30,000
JAB Joll	40,000			40,000		40,000	40,000
Sir Bryan Nicholson	40,000			40,000		40,000	40,000
RB Spooner	30,000			30,000		30,000	30,000
Total	1,450,417	600,000	13,934	2,064,351	276,249	2,340,600	2,532,802

[1] Mr Jardine left the Board on 30 September 2001

[2] Mr Agnew joined the Board on 1 February 2002

[3] Mr Catlin left the Board on 1 February 2002

LTIP awards relating to the year ended 31 March 1999, for which provision was made in the year ended 31 March 2000, were paid in August 2001. These payments, amounting to £632,100, are analysed below and are included in note 7 on page 48.

No LTIP awards have yet been made in respect of the year ended 31 March 2002.

Based on the results for the year ended 31 March 2001, a total amount of £682,500 has been provided as follows for awards under the LTIP to the Executive Directors:

	Total provisional awards outstanding at 31 March 2001 £	*Paid during the year* £	*Provisional awards made during the year in respect of year ended 31 March 2001* £	*Total provisional awards outstanding* £
MJ Crall	471,300	208,800	270,000	532,500
JV Barker	324,400	136,900	195,000	382,500
PA Jardine[1]	122,000	122,000	–	–
SP Moser	374,400	164,400	217,500	427,500
Total	1,292,100	632,100	682,500	1,342,500

[1] Mr Jardine left the Board on 30 September 2001

LTIP awards relating to the year ended 31 March 2000, for which provision was made in the year ended 31 March 2001, will be paid in 2002 if confirmed by the Board. LTIP awards relating to the year ended 31 March 2001, for which provision was made in the year ended 31 March 2002, are not payable until 2003. Payments are subject to the Board's determination that all of the conditions governing the plan have been met.

A provisional award of £187,500 made to Mr PA Jardine in respect of the year ended 31 March 2000 lapsed on 30 September 2001 as a consequence of his resignation and will therefore not be payable.

Messrs ME McL Deeny and RB Spooner also received fees for services as Trustees of The Equitas Trust. Details are shown on page 33.

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 2002 were in respect of the following:

	Year ended 31 March 2002 £	*Year ended 31 March 2001* £
Trustees' fees	245,250	200,000
Trustees' legal, professional and other costs and expenses	560,763	653,128
Total	806,013	853,128

Messrs ME McL Deeny and RB Spooner, who are also Directors of the Company, received Trustees' fees of £38,447 each for the year ended 31 March 2002 (2001: £33,340 each). They received expenses for secretarial, office and other overheads of £21,883 and £15,149, respectively (2001: £19,414 and £14,983, respectively). Included in legal expenses is an amount of £14,276 (2001: £31,020) paid to Viscount Bledisloe QC, a Trustee, in respect of the provision of legal services to The Equitas Trust.

Independent Auditors' report
to the Members of Equitas Holdings Limited

1. We have audited the financial statements which comprise the group profit and loss account, the group balance sheet, the group cashflow statement, the company balance sheet and the related notes set out on pages 36 to 54 which have been prepared in accordance with the accounting policies set out in note 1 on page 41.

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 on page 28.

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.

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 Group has not kept proper accounting records, if we have not received all the information and explanations we require for our audit, or if information specified by law regarding directors' remuneration and transactions is not disclosed.

5. We read the other information contained in the annual report and consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the financial statements. The other information comprises only the Directors' Report, the Chairman's Statement, the Chief Executive Officer's Review, the Financial Review and the Claims Director's 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 below. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the financial statements. It also includes an assessment of the significant estimates and judgments made by the directors in the preparation of the financial statements, and of whether the accounting policies are appropriate to the Group's circumstances, consistently applied and adequately disclosed.

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

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

Uncertainties

8. In forming our opinion, we have considered the uncertainties, described in notes 1 and 2 to the financial statements, relating to the provision for claims outstanding of £7,763 million, reinsurers' share of claims outstanding of £1,142 million and reinsurance debtors of £923 million. Future experience may show material adjustments are required to these amounts particularly in respect of:

   (a) assumptions made in estimating provisions and the reliability of the underlying data upon which estimates are based;
   (b) the potential for unforeseen change in the legal, judicial, technological or social environment and the potential for new sources or types of claim to emerge;
   (c) assumptions in relation to expected interest yields and the timing of settlement of claims and reinsurance recoveries which influence the discount calculation; and
   (d) assumptions in relation to estimating the reinsurers' share of claims outstanding and the extent to which these and amounts due from reinsurers will be collected.

Consequences of uncertainties

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 2002 of £679 million. If at any time the directors determine that there are insufficient assets to meet liabilities in full as they fall due then, under the contract by which the Group reinsured the 1992 and prior years' liabilities, the directors may implement a proportionate cover plan under which the Group will then be entitled to pay claims at a reduced rate, and liabilities will be restricted in aggregate to assets available such that shareholders' funds would not become negative though they may be reduced to nil.

Qualified opinion arising from uncertainties in our audit

10. Except for material adjustments in respect of the matters described in paragraph 8 above, which may ultimately be required to the provision for claims outstanding, reinsurers' share of claims outstanding, reinsurance recoveries and consequent adjustments to shareholders' funds and the deficit for the year, in our opinion the financial statements give a true and fair view of the state of the Company's and of the Group's affairs at 31 March 2002 and of the deficit and cashflows of the Group for the year then ended and have been properly prepared in accordance with the Companies Act 1985.

PricewaterhouseCoopers
Chartered Accountants and Registered Auditors
London
18 June 2002

Group profit and loss account

for the year ended 31 March 2002

Technical account – general business

	Note	£m	2002 £m	£m	2001 £m
Investment return transferred from non-technical account			**277**		696
Claims paid					
Gross amount		**(1,413)**		(2,096)	
Reinsurers' share		**424**		1,013	
Net claims paid		**(989)**		(1,083)	
Change in the provision for claims					
Gross amount		**1,643**		986	
Reinsurers' share		**(506)**		(690)	
Unwinding of the discount		**(182)**		(600)	
Timing of net future payments		**(272)**		608	
Change in the net provision for claims	15	**683**		304	
Claims incurred, net of reinsurance			**(306)**		(779)
Other technical charges	4		**8**		(12)
Balance on the technical account for general business			**(21)**		(95)

The accounting policies and notes on pages 41 to 53 form an integral part of these financial statements.

Group profit and loss account

for the year ended 31 March 2002

Non-technical account – general business

	Note	£m	2002 £m	£m	2001 £m
Balance on the technical account for general business			**(21)**		(95)
Income from financial investments		**299**		341	
Return on financial reinsurances		**39**		160	
Gains on the realisation of investments		**36**		55	
Unrealised gains on investments		**–**		140	
Unrealised losses on investments		**(97)**		–	
Investment return		**277**		696	
Allocated investment return transferred to general business technical account		**(277)**		(696)	
Investment return retained			**–**		–
Deficit on ordinary activities before tax	5		**(21)**		(95)
Tax on deficit on ordinary activities	8		**–**		11
Deficit for the year	14		**(21)**		(84)

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 41 to 53 form an integral part of these financial statements.

Group balance sheet
as at 31 March 2002

Assets

	Note	2002 £m	2001 £m
Investments			
Financial investments	9	**5,681**	6,187
Financial reinsurances	10	**878**	1,142
		6,559	7,329
Reinsurers' share of technical provisions			
Claims outstanding	15	**1,142**	1,581
Debtors			
Debtors arising out of reinsurance operations	12	**950**	1,190
Other debtors		**20**	144
		970	1,334
Other assets			
Tangible assets		**6**	8
Cash at bank and in hand		**19**	30
		25	38
Prepayments and accrued income			
Accrued interest		**70**	70
Other prepayments and accrued income		**4**	4
		74	74
Total assets		**8,770**	10,356

The accounting policies and notes on pages 41 to 53 form an integral part of these financial statements. The Company's balance sheet is shown on page 54.

Group balance sheet
as at 31 March 2002

Liabilities

	Note	*2002* *£m*	*2001* *£m*
Capital and reserves			
Called up share capital	13	**–**	–
Retained surplus	14	**679**	700
Shareholders' funds – non-equity interests		**679**	700
Technical provisions			
Claims outstanding	15	**7,763**	8,933
Creditors			
Creditors arising out of reinsurance operations	16	**256**	313
Other creditors including taxation and social security	17	**72**	410
		328	723
Total liabilities		**8,770**	10,356

The financial statements on pages 36 to 53 were approved by the Board on 18 June 2002 and were signed on its behalf by:

HA Stevenson
MJ Crall
JV Barker

The accounting policies and notes on pages 41 to 53 form an integral part of these financial statements.

Group cashflow statement

for the year ended 31 March 2002

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

	Note	£m	2002 £m	£m	2001 £m
Deficit on ordinary activities before tax			**(21)**		(95)
Depreciation of tangible fixed assets	5	**2**		3	
Loss on disposal of tangible fixed assets	5	**–**		4	
Exchange (gains)/losses on retranslation of opening balances*		**(5)**		26	
Unrealised gains on investments		**–**		(140)	
Unrealised losses on investments		**97**		–	
Return on financial reinsurances		**(39)**		(160)	
Decrease in provision for claims outstanding		**(1,118)**		(1,016)	
Decrease in reinsurers' share of technical provisions – claims outstanding		**430**		702	
Decrease in debtors		**358**		615	
(Decrease)/increase in creditors		**(404)**		175	
			(679)		209
Net cash (outflow)/inflow from operating activities			**(700)**		114
Taxation recovered/(paid)			**12**		(9)
Capital expenditure			**–**		(2)
Net cash (outflow)/inflow for the year			**(688)**		103
Cashflows were (realised)/invested as follows:					
Decrease in cash holdings	19		**(10)**		(7)
Net portfolio investment					
Deposits with credit institutions		**(338)**		33	
Financial reinsurances		**(296)**		(185)	
Shares and other variable yield securities and units in unit trusts		**(9)**		130	
Debt securities and other fixed interest securities		**(35)**		132	
	19		**(678)**		110
Net (realisation)/investment of cashflows	20		**(688)**		103

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

The accounting policies and notes on pages 41 to 53 form an integral part of these financial statements.

Notes to the financial statements
for the year ended 31 March 2002

1 Accounting policies

The provisions of Financial Reporting Standard 18 – Accounting Policies ('FRS 18') were adopted in the current year, but their adoption did not require any changes in accounting policies. The Board has reviewed these accounting policies and considers them to remain the most appropriate. The provisions of Financial Reporting Standard 19 – Deferred Tax have been adopted for the first time in the financial statements, although their adoption did not require any adjustment to amounts previously reported.

Going concern

Significant uncertainties exist as to the accuracy of the provision for claims outstanding established by Equitas Limited and recoveries due from reinsurers shown in the balance sheet, further details of which are set out in note 2 on page 43. 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 consider implementing a proportionate cover plan. At the date of this report, the Directors believe that the assets should be sufficient to meet all liabilities in full.

Basis of accounting

The financial statements of the Group have been prepared in accordance with applicable accounting standards in the United Kingdom, the Statement of Recommended Practice on accounting for insurance business issued by the Association of British Insurers in December 1998 and in accordance with Section 255A of, and Schedule 9A to, the Companies Act 1985. The balance sheet of the Parent Company has been prepared in accordance with Section 226 of, and Schedule 4 to, the Companies Act 1985. A summary of the more important accounting policies, which have been applied consistently, is set out below.

The financial statements have been prepared in accordance with the historical cost convention modified by the revaluation of certain assets and liabilities. An annual basis of accounting has been adopted.

(a) Basis of consolidation

The consolidated financial statements incorporate the financial statements of the Company and its subsidiaries from 1 April 2001 to 31 March 2002.

(b) Claims and related reinsurance recoveries

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

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

(c) Discounting

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

(d) Tangible assets

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

(e) Deferred taxation

Provision is made for deferred taxation, using the liability method, on all material timing differences. Deferred tax, which is calculated at the rates at which it is expected that the tax will arise, is recognised in the profit and loss account for the period. Deferred tax balances are not discounted.

(f) Investments

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

(g) Financial reinsurances

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

(h) Investment return

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

(i) Foreign exchange

Assets and liabilities are translated into sterling at the rates of exchange ruling at the balance sheet date and the exchange differences taken to the profit and loss account. Transactions during the period are translated into sterling using the rate of exchange prevailing at the time of the transaction, with the exchange differences taken to the profit and loss account.

(j) Pension costs

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

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

(k) Leases

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

2 Estimation techniques and uncertainties

Introduction

As required by FRS 18, this note describes the estimation techniques employed by the Group.

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 thereof. Because of the uncertainties inherent in the Group's liabilities, there are many assumptions and estimation techniques described below which individually could have a material impact on the amounts of liabilities, related reinsurance assets and reported surplus disclosed in the financial statements. Actual experience will often vary from these assumptions, and any consequential adjustments to amounts previously reported will be reflected in the results of the year in which they are identified. Adjustments arising in the future could, if adverse in the aggregate, exceed the amount of shareholders' funds. In that event, and as stated under 'Going Concern' in note 1, the Directors of Equitas Reinsurance Limited may consider implementing 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 finally determined by the courts. In many cases the outcome is difficult to predict with certainty. The provision for a disputed claim is based on the Group's view as to the expected outcomes of such court decisions.

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 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. The ceded liabilities that cannot be explicitly modelled are estimated by reference to the current and historical claims experience of the cedants. This change to the estimation techniques is an improvement over previous years when the reinsurance liabilities that were not explicitly modelled were based upon estimates made at the time of the Lloyd's Reserving Project and on an assumed relationship between the level of direct and reinsurance exposures facing the Group.

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

- the projected level of future claims filings for each policyholder by disease type;
- the proportion of claims filings that will ultimately lead to claims payments;
- future changes in the level of claims settlements;
- the impact of actual and potential bankruptcy of policyholders on the amount and timing of claims payments;
- the outcome of litigation, based upon legal advice received;
- the legal interpretation of insurance policies; and
- the period between the filing and payment of claims.

The assumptions on the proportion of current and future 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 application of insurance coverage where the policyholder is found to be liable; 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, and 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 arising as a result of centralisation and reduction of transaction volumes over time.

Reinsurance recoveries

Reinsurance recoveries on claims outstanding (including IBNR claims) are estimated based upon the historical 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 achieved recoveries against historical claims are 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 coverage remaining after horizontal and vertical exhaustion on key risks. Recovery rates are adjusted, if necessary, as a result of this work. The reinsurance asset is then adjusted, if necessary, in respect of bad debts. 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 where companies are currently, or are considered to be at risk of being in the future, unable to settle their liabilities in full when due; and
- the period required to recover the reinsurance asset through traditional means.

Discounting

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

The calculation of an appropriate discount rate is based on the concept that the prospective return on what is essentially a duration and currency matched fixed income portfolio, if held to maturity, can be estimated based upon current market yields to maturity.

The discount rate is reviewed each year to ensure that it remains a prudent estimate of the average annual return expected to be achieved for the period for which the investment assets are likely to be held.

3 Segmental information

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

4 Other technical charges

Other technical charges relate to foreign exchange differences.

5 Deficit on ordinary activities before tax

The deficit is stated after charging:

	Group 2002 £m	*Group 2001 £m*
Auditors' remuneration – audit fees	**1.5**	1.8
– non-audit fees	**0.1**	0.6
	1.6	2.4
Depreciation – tangible owned fixed assets	**1.6**	3.0
Loss on disposal of tangible fixed assets	**–**	4.4
Operating lease rentals incurred – property	**3.6**	3.0
– other	**0.2**	0.3

The audit fees for the Company of £2,000 (2001: £2,000) were borne by a subsidiary company.

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

Details of related party transactions, as defined by Financial Reporting Standard 8, are given on page 32.

6 Employees

The monthly average number of persons employed by the Group, including Directors, was 660 for the year ended 31 March 2002 (2001: 739), all of whom were engaged in run-off and related activities.

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

	Group 2002 £m	*Group 2001 £m*
Wages and salaries	**34**	36
Social security costs	**4**	4
Pension costs	**4**	4
	42	44

7 Directors' emoluments

The aggregate remuneration of the Directors was as follows:

	Group 2002 £000	Group 2001 £000
Executive Directors – remuneration	**1,719**	1,907
– LTIP awards paid	**632**	464
– pension costs	**276**	291
Non-Executive Directors – fees	**346**	335
	2,973	2,997

In addition to the above amounts, provisional awards under the long term incentive plan were made to the Executive Directors as detailed on page 32. Full details of the remuneration of, and transactions with, Directors are given in the Board Report on Directors' Remuneration on page 30.

8 Tax on deficit on ordinary activities

Analysis of charge/(credit) in the year

	Group 2002 £m	Group 2001 £m
United Kingdom corporation tax at 30% (2001: 30%)		
Current tax charge/(credit)	**–**	(11)
Adjustment in respect of prior years	**–**	–
Current tax	**–**	(11)
Deferred tax – origination and reversal of timing differences	**–**	–
	–	(11)

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

The tax charge/(credit) assessed for the year is lower than the standard rate of corporation tax in the UK. The differences are explained below:

	Group 2002 £m	Group 2001 £m
Deficit on ordinary activities before tax	**(21)**	(95)
Deficit on ordinary activities multiplied by the standard rate of corporation tax in the UK of 30% (2001: 30%)	**(6)**	(29)
Effects of:		
Unrealised losses on revaluation of equity investments	**(4)**	10
Unutilised tax losses carried forward	**8**	6
Other permanent differences	**2**	2
Current tax charge/(credit) for the year	**–**	(11)

9 Investments: financial investments

	Group 2002 £m	*Group 2001 £m*
Listed		
Shares and other variable yield securities and units in unit trusts	**383**	378
Debt securities and other fixed interest securities	**4,984**	5,154
	5,367	5,532
Unlisted		
Deposits with credit institutions	**314**	655
Market value	**5,681**	6,187
Cost	**5,689**	6,096

These investments include sterling denominated assets of US$410 million (2001: US$410 million) equivalent which are charged in favour of the New York Insurance Department.

Included in the above table are lent securities with a market value of £557.2 million (2001: £121.4 million), which were fully collateralised.

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

10 Investments: financial reinsurances

The average prospective rate of return on financial reinsurances is 5 per cent (2001: 5 per cent) per annum. The mean term is four (2001: four) years. The value of the expected receipts from financial reinsurances, before discounting at market yields to recognise the period until receipt, is £1,060 million (2001: £1,366 million).

11 Trust funds

Financial investments amounting to £3,239 million (2001: £3,561 million) and cash amounting to £0.2 million (2001: £2.8 million) were held in trust funds in the United States and Canada. In addition, all proceeds of financial reinsurances are assigned to a trust fund in the United States. These trust funds were established under the laws of those countries for the settlement of claims relating to those jurisdictions. The amounts held in these trust funds cannot be used for any other purpose and can only be released with the appropriate regulatory consent if there is a surplus of assets over the liabilities they support.

The Equitas Australian Trust Fund was established under a trust deed to support obligations undertaken in Australia. It is financed by a letter of credit, which is supported by a charge over a proportion of Australian dollar financial investments. As at 31 March 2002, the value of the letter of credit was A$90 million (2001: A$180 million).

12 Debtors arising out of reinsurance operations

	Group 2002 £m	*Group 2001 £m*
Unpaid premium	**1**	4
Reinsurance recoveries	**923**	1,164
Other	**26**	22
	950	1,190

The unpaid premium of £1.4 million (2001: £4.0 million) is receivable through a structured payment plan secured upon bank guarantees and is being collected by the Corporation of Lloyd's on the Group's behalf.

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

13 Called up share capital

	Company 2002 £	*Company 2001 £*
Authorised, allotted and called up		
1 deferred share of £1	**1**	1
2 ordinary shares of £50 each	**100**	100
	101	101

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

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

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

14 Retained surplus

	Company £	*Group £m*
At 1 April 2001	**–**	700
Deficit for the year	**–**	(21)
At 31 March 2002	**–**	**679**

The retained surplus is not distributable.

15 Provision for claims outstanding

	Claims £m	Reinsurance £m	Group 2002 Net £m	Claims £m	Reinsurance £m	Group 2001 Net £m
Provision before discounting	**12,010**	**1,804**	**10,206**	14,085	2,545	11,540
Discount	**(4,247)**	**(662)**	**(3,585)**	(5,152)	(964)	(4,188)
	7,763	**1,142**	**6,621**	8,933	1,581	7,352

(a) Claims

Claims are stated after elimination of inter-syndicate transactions.

APH liabilities comprised approximately 75 per cent (2001: 70 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.

Non-APH liabilities comprised approximately 25 per cent (2001: 30 per cent) of the net discounted provision for claims outstanding.

(b) Reinsurance recoveries

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

(c) Discounting

The provision for claims outstanding and the cost of undertaking the run-off has been discounted at a rate of 5.25 per cent (2001: 5 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 2002, the mean term of the liabilities, that is the weighted average period to settlement where the weights are the undiscounted expected cashflows in each future period, was approximately 11 (2001: 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 43.

16 Creditors arising out of reinsurance operations

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

17 Other creditors including taxation and social security

These balances include corporation tax payable of £15 million (2001: £3 million). This is payable in more than one year.

18 Reconciliation of movements in shareholders' funds

	Group 2002 £m	*Group 2001 £m*
Opening shareholders' funds	**700**	784
Deficit for the year (see note 14)	**(21)**	(84)
Closing shareholders' funds	**679**	700

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 2002 £m	*Group 2001 £m*
Net cash outflow for the year (see note 20)	**(10)**	(7)
Movement arising from cashflows of portfolio investments	**(678)**	110
Changes to market values and discount (see note 20)	**(58)**	300
Other changes, including exchange rate effects (see note 20)	**(34)**	552
Total movement in portfolio investments net of financing	**(780)**	955
Opening portfolio investments net of financing (see note 20)	**7,353**	6,398
Closing portfolio investments net of financing (see note 20)	**6,573**	7,353

20 Movement in cash, portfolio investments and financing

	At 31 March 2001 £m	*Cashflow £m*	*Changes to market values and discount £m*	*Other changes, including exchange rate effects £m*	*At 31 March 2002 £m*
Cash at bank and in hand	24	**(10)**	**–**	**–**	**14**
Deposits with credit institutions	655	**(338)**	**–**	**(3)**	**314**
Financial reinsurances	1,142	**(296)**	**39**	**(7)**	**878**
Shares and other variable yield securities and units in unit trusts	378	**(9)**	**15**	**(1)**	**383**
Debt securities and other fixed interest securities	5,154	**(35)**	**(112)**	**(23)**	**4,984**
	7,353	**(688)**	**(58)**	**(34)**	**6,573**

During the year shares and other variable yield securities and units in unit trusts of £147 million (2001: £380 million) were purchased and £156 million (2001: £250 million) were sold. For the same period debt securities and other fixed interest securities of £5,882 million (2001: £6,543 million) were purchased and £5,917 million (2001: £6,411 million) were sold. Cash at bank and in hand as at 31 March 2002 shown above is stated net of £5 million (2001: £6 million) of overdrafts.

21 Contingent liabilities

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

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

22 Investments in Group undertakings

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

**Held via a subsidiary*

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

23 Financial commitments

The Group had annual commitments under non-cancellable operating leases, expiring in over five years, of £6 million (2001: £4 million).

Company balance sheet
as at 31 March 2002

	Note	2002 £	2001 £
Fixed assets			
Investments – investments in Group undertakings	22	**300**	300
Current assets			
Amounts due from a Group undertaking		**1**	1
Net current assets		**1**	1
Total assets less current liabilities		**301**	301
Creditors – amounts falling due after more than one year			
Amounts owed to Group undertakings		**200**	200
Net assets		**101**	101
Capital and reserves			
Called up share capital	13	**101**	101
Profit and loss account	14	**–**	–
Shareholders' funds – non-equity interests		**101**	101

The financial statements on pages 41 to 54 were approved by the Board on 18 June 2002 and were signed on its behalf by:

HA Stevenson
MJ Crall
JV Barker

The accounting policies and notes on pages 41 to 53 form an integral part of these financial statements.

Notice to Reinsured Names

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

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

Open Meeting of Reinsured Names

The annual Open Meeting of Reinsured Names will be held at 10.30am on Friday 13 September 2002 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 2 September 2002.

Designed and produced by Fishburn Hedges

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

Registered in England; Registered Number 3136296