# Hiscox Syndicates
## Report and Accounts 2005

05

HISCOX

## Hiscox Syndicates Limited (HSL)

HSL is a subsidiary of Hiscox plc. It manages Syndicate 33 on behalf of the members of the Syndicate. Hiscox supplied 65% of the capital supporting the Syndicate in 2003 and 2004, 71% in 2005 and 73% in 2006. As I said last year, those four years have to be managed as separate business units due to the unnecessarily complicated structure of Lloyd's Syndicates.

We thought we had been tested in 2004 by a turbulent year of storms, but 2005 far surpassed this with three substantial hurricanes striking land. In the event, the combined ratio of 108.1% and the small aggregate loss over the open years was a good result and I congratulate the Syndicate 33 team. The results are covered in more detail in the directors' report.

Lloyd's has just announced the appointment of a new chief executive. The new CEO needs to act with business logic, without pandering to cumbersome market customs and traditional ways of doing business. When the Chairman, Lord Levene, arrived four years ago, he lambasted the market for its old-fashioned paper based trading. He then turned his guns on external expansion and PR while the executive struggled with improving business processes. The costly failure of Kinnect leaves the market still an unnecessarily expensive place to do business, and nothing has been done to tidy up the capital structure of the Syndicates.

Bermuda has now overtaken Lloyd's in reinsurance, and is a serious threat in large internationally traded risks. We need a healthy Lloyd's but it needs to rejuvenate, and the new chief executive will need the support of the market to enforce its role as the centre for internationally traded insurance and reinsurance.

Robert Hiscox

Robert Hiscox
15 March 2006

## MANAGING AGENT:

**Managing agent**
Hiscox Syndicates Limited (HSL) is the managing agent of composite Syndicate 33.
HSL is a wholly owned subsidiary of Hiscox plc.

**Directors**
R R S Hiscox (Chairman)
S J Bridges
D J W Bruce
R S Childs
A N Foster
S H Hall (resigned 31 December 2005)
A G C Howland Jackson
S C Langley
I J Martin
B E Masojada
S J Quick
B C Ritchie
S Smith (resigned 3 January 2006)
I N Thomson
N B Tyler
R C Watson

**Company secretary**
J S Jones

**Managing agent's registered office**
1 Great St Helen's
London EC3A 6HX

**Managing agent's registered number**
02590623

## SYNDICATE:

**Active underwriter**
R S Childs (resigned 31 December 2005)
R C Watson (appointed 1 January 2006)

**Bankers**
Barclays Bank plc
Lloyds TSB Bank plc

**Investment managers**
Alliance Capital Ltd
Wellington Management Company
UBS Global Asset Management

**Registered auditors**
KPMG Audit Plc

The directors of the managing agent present their report for the year ended 31 December 2005.

This annual report is prepared using the annual basis of accounting as required by Statutory Instrument No. 3219 of 2004, the Insurance Accounts Directive (Lloyd's Syndicate and Aggregate Accounts) Regulations 2004 ("the 2004 Regulations").

Separate underwriting year accounts for the closed 2003 account of Syndicate 33 will be made available to the Syndicate members.

## Results

The result for calendar year 2005 is a loss of £29.2 million (2004: profit £52.8 million).

## Principal activity and review of the business

The principal activity of Syndicate 33 remains the transaction of general insurance and reinsurance business in the United Kingdom. The Lloyd's insurance market is, like general market insurers, undergoing a period of change, both in reporting and supervision. We are well prepared for all of these changes.

The Syndicate's result for 2005 was dominated by the three catastrophic hurricanes making landfall in the South East of the United States between August and October. The Syndicate suffered a gross loss of US$1,045 million and a net loss, after reinstatement premiums payable and receivable on reinsurance contracts, of US$403 million. These losses increased the combined ratio for 2005 by 31.5% to 108.1%.

Despite the hurricane losses the overall loss to the Syndicate was only £29 million. The underlying account performed extremely well with most areas contributing to the result. Gross written premium of £882 million represented a small decrease on 2004. Strong growth was achieved in the Syndicate's specialty division which includes household and small commercial property risks written through binding authorities.

The hurricanes have had an impact on rates in 2006 although this has been concentrated in those classes of business most adversely affected; offshore energy, marine reinsurance and property catastrophe reinsurance in the US for those clients with exposure in the Gulf of Mexico. The decline in rates in those classes of business not impacted by the hurricanes has slowed and reversed in some circumstances. The Syndicate has continued to cut back its exposure to the big-ticket property business in 2006 as the rates on this class have not responded to 2005's losses in the way in which we would have hoped. However, we are seeing the first signs of improvement in this class and anticipate the opportunity to write more profitable business as 2006 progresses.

The Syndicate's reinsurance programme was in place at 1 January 2006, albeit at higher prices. In 2006 the Syndicate has purchased more reinsurance on both a pro-rata and excess of loss basis.

## Investment report

The Syndicate’s investment portfolios comprise high quality bonds with selective corporate exposure adding to returns. During the year the majority of investments were rated A or better. The US Dollar, Canadian Dollar and Euro portfolios were all measured against the relevant government bond 1-3 year indices and Sterling the seven day LIBID benchmark.

The Syndicate’s investment performance for the year was satisfactory as all the portfolios generated returns in excess of their respective benchmarks. The US Dollar portfolio returned +2.45% against a benchmark return of +1.67%. This is a creditable performance in a year of rising short-term interest rates and was achieved by maintaining a short duration strategy. The portfolio duration was steadily extended during the year as the end of the Federal Reserve’s interest tightening cycle drew nearer. The Sterling portfolios returned +4.96% compared to the benchmark +4.67%. Again, a short duration strategy was pursued as the inverted yield curve in the Sterling bond markets kept longer dated paper looking unattractive relative to the higher yields at the short end. With the likelihood that short term Euro rates would be increased the Euro portfolios were also conservatively positioned and returned +2.25% against the benchmark +2.05%. In Canada too, interest rates were rising and the cautious approach contributed to our performance as the Canadian portfolio returned +2.57% against the benchmark +1.88%.

## Syndicate capacity and ownership

The capacity of Syndicate 33 and percentage ownership by Hiscox plc on the open and constituted years of account is:

| | Years of account | | | |
|---|---|---|---|---|
| | 2003<br>£000 | 2004<br>£000 | 2005<br>£000 | 2006<br>£000 |
| Syndicate capacity | 841,740 | 846,253 | 774,116 | 832,968 |
| Hiscox plc ownership | 65.0% | 65.0% | 71.1% | 72.5% |

## Working capital

In recent years Lloyd's has worked in co-operation with insurance regulators in the United States and other parts of the world to strengthen further the security of a Lloyd's policy. This has resulted in significant amounts of the Syndicate's funds being held in various trust funds where they cannot be used as ‘working capital’ to pay claims, reinsurance premiums or expenses. This places a strain on the Syndicate's working capital. We continue to have a substantial credit facility from Barclays Bank. It is primarily intended to fund large claims pending recoveries from reinsurers. We do not wish, however, to become overly dependent on this facility. Consequently, we put Names on notice that we may need to make a cash call, at some time in the future, to improve the Syndicate's working capital position.

## Directors interests

The directors of the managing agent who served during the year ended 31 December 2005, and their beneficial interests in the shares of Hiscox plc, were as follows:

| | Hiscox plc<br>Ord shares |
|---|---|
| Issued share capital | 391,406,636 |
| R R S Hiscox (Chairman) | 9,382,500 |
| S J Bridges | 460,877 |
| D J W Bruce | 1,491,690 |
| R S Childs | 1,382,067 |
| A N Foster | 2,585,999 |
| S H Hall (resigned 31 December 2005) | 45,500 |
| A G C Howland Jackson | 65,804 |
| S C Langley | 91,043 |
| I J Martin | 201,413 |
| B E Masojada | 2,702,902 |
| S J Quick | 109,388 |
| B C Ritchie | 48,123 |
| S Smith (resigned 3 January 2006) | 13,616 |
| I N Thomson | 9,315,786 |
| N B Tyler | 90,000 |
| R C Watson | 358,268 |

No directors were underwriting Names at Lloyd’s for the 2003, 2004, 2005 or 2006 years of account.

## Change in reporting basis

The underwriting results are determined on an annual basis of accounting. This represents a fundamental change in reporting basis required by the 2004 Regulations. Previously, results were not determined before the normal date of closure of each year of account at the end of the third year.

Further details regarding the effect of this change are given in notes 2 and 5 to the accounts.

## Statement of Managing Agent’s responsibilities

This statement is set out on page 5 of these accounts.

## Auditors

The managing agent intends to re-appoint KPMG Audit Plc as the Syndicate auditors.

By order of the Board

Jason Jones

J S Jones
Secretary
23 March 2006

The Companies Act 1985 requires the managing agent to prepare Syndicate annual accounts at 31 December each year which give a true and fair view of the state of affairs of the Syndicate as at that date and of its profit or loss for that year.
In preparing the Syndicate annual accounts, the managing agent is required to:

i) select suitable accounting policies which are applied consistently, subject to changes arising on the adoption of new accounting standards in the year;

ii) make judgements and estimates that are reasonable and prudent;

iii) prepare the financial statements on a going concern basis; and

iv) state whether applicable accounting standards have been followed, subject to any material departures disclosed and explained in these accounts.

The managing agent is responsible for keeping proper accounting records which disclose with reasonable accuracy at any time the financial position of the Syndicate and enable it to ensure that the Syndicate's annual accounts comply with the Companies Act 1985. It is also responsible for safeguarding the assets of the Syndicate and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

The only formal business conducted at the Syndicate AGM is the appointment of the Syndicate auditors for the following year. In recent years, when an AGM was held, the number of members attending the meeting had reduced to no more than one or two. Whilst we are mindful of the need to ensure a proper forum is available for members to raise issues related to the Syndicate, nevertheless, given such low level of attendance, we are also keen to limit any unnecessary cost to members of the Syndicate.

The Lloyd's Regulatory Board was also aware of the levels of attendance at such Syndicate meetings and at a meeting on 6 December 2000 the Council of Lloyd's passed the Syndicate Meetings (Amendment No. 1) Byelaw (No. 18 of 2000). This removed the requirement for managing agents to hold Syndicate annual general meetings, providing certain criteria are met.

In accordance with the byelaw criteria, and there being no objections received from members following last year's notice, no AGM was held in 2005. This year, we again give notice that:

i) Hiscox Syndicates Limited does not propose to hold an annual general meeting of the members of Syndicate 33 in 2006.

ii) We propose that KPMG Audit Plc are re-appointed as the Syndicate's registered auditor for a period of one year from the date of this Annual Report.

iii) Members may object to the matters set out above within 21 days of this notice.

If no objections to these proposals are received from any member within the specified period we shall notify the Council of Lloyd's to that effect.

If any objections are received, depending on the level or nature of such objections, we shall then consider whether to:

i) apply for the Council's consent not to hold a meeting, stating the reasons why not. The Council may give its consent subject to any such conditions and requirements as the Council may determine

or

ii) convene an annual general meeting.

By order of the Board

Jason Jones

J S Jones
Secretary
23 March 2006

We have audited the financial statements of Syndicate 33 for the year ended 31 December 2005 which comprise the profit and loss account, the balance sheet, the cash flow statement, the statement of total recognised gains and losses and the related notes. The financial statements have been prepared under the accounting policies set out therein.

This report is made solely to the members of the Syndicate, as a body, in accordance with Section 235 of the Companies Act 1985. Our audit work has been undertaken so that we might state to the Syndicate's members those matters we are required to state to them in an auditors' report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Syndicate's members as a body, for our audit work, for this report, or for the opinions we have formed.

## Respective responsibilities of managing agent and auditors

As described in the statement of managing agent's responsibilities on page 5, the directors of the managing agent are responsible for the preparation of the financial statements which are required to be prepared in accordance with applicable law and UK Accounting Standards (UK Generally Accepted Accounting Practice).

Our responsibility is to audit the financial statements in accordance with relevant legal and regulatory requirements and International Standards on Auditing (UK and Ireland).

We report to you our opinion as to whether the financial statements give a true and fair view and have been properly prepared in accordance with the Companies Act 1985. We also report to you if, in our opinion, the managing agent's report is not consistent with the Syndicate's financial statements, if the managing agent has not kept proper accounting records in respect of that Syndicate, if the financial statements are not in agreement with the accounting records and if we have not received all the information and explanations we require for our audit.

We read the other information attached to the financial statements and consider whether it is consistent with the audited financial statements and the information specified by law regarding Active Underwriters' remuneration. We consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the financial statements. Our responsibilities do not extend to any other information.

## Basis of audit opinion

We conducted our audit in accordance with International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board. 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 judgements made by the managing agent in the preparation of the financial statements, and of whether the accounting policies are appropriate to the Syndicate's circumstances, consistently applied and adequately disclosed.

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.

## Opinion

In our opinion the financial statements:

(a) give a true and fair view in accordance with UK Generally Accepted Accounting Practice, of the state of Syndicate 33's affairs as at 31 December 2005 and of its loss for the year then ended; and

(b) have been properly prepared in accordance with the Companies Act 1985.

KPMG Audit Plc

KPMG Audit Plc
Chartered Accountants
Registered Auditor
23 March 2006

| | Notes | 2005 £000 | 2004 (Restated) £000 |
|---|---|---|---|
| **Earned premiums, net of reinsurance** | | | |
| Gross premiums written | 4 | 882,142 | 902,866 |
| Outward reinsurance premiums | | (222,012) | (117,762) |
| Net premiums written | | 660,130 | 785,104 |
| Change in the provision for unearned premiums: | | | |
| Gross amount | | 43,615 | (16,904) |
| Reinsurers' share | | (1,422) | (28,547) |
| Change in the net provision for unearned premiums | | 42,193 | (45,451) |
| Earned premiums, net of reinsurance | | 702,323 | 739,653 |
| Allocated investment return transferred from the non-technical account | 10 | 27,583 | 15,638 |
| **Claims incurred, net of reinsurance** | | | |
| Claims paid: | | | |
| Gross amount | | (462,773) | (273,520) |
| Reinsurers' share | | 123,642 | 63,171 |
| Net claims paid | | (339,131) | (210,349) |
| Change in the provision for claims: | | | |
| Gross amount | | (497,875) | (257,134) |
| Reinsurers' share | | 333,818 | 14,037 |
| Change in the net provision for claims | | (164,057) | (243,097) |
| Claims incurred net of reinsurance | | (503,188) | (453,446) |
| Net operating expenses | 4 & 7 | (255,934) | (249,047) |
| **Balance on the technical account for general business** | | (29,216) | 52,798 |

All operations are continuing.

| | Notes | 2005 £000 | 2004 (Restated) £000 |
|---|---|---|---|
| **Balance on the general business technical account** | | **(29,216)** | 52,798 |
| Investment income | | **37,917** | 24,330 |
| Gains on the realisation of investments | | **1,159** | 365 |
| Unrealised gains on investments | | **21** | – |
| Losses on the realisation of investments | | **(3,827)** | (2,722) |
| Unrealised losses on investments | | **(6,589)** | (5,446) |
| Investment expenses and charges | | **(1,098)** | (889) |
| Allocated investment return transferred to general business account | | **(27,583)** | (15,638) |
| **Profit/(loss) for the financial year** | 15 | **(29,216)** | 52,798 |

**Statement of total recognised gains and losses**

| | Notes | 2005 £000 | 2004 (Restated) £000 |
|---|---|---|---|
| Profit/(loss) for the financial year | | **(29,216)** | 52,798 |
| Prior year adjustment | 5 | **(900,039)** | – |
| Total recognised gains and losses since last annual report | | **(929,255)** | 52,798 |

| | Notes | 2005 £000 | 2004 (Restated) £000 |
|---|---|---|---|
| **Investments** | | | |
| Financial investments | 11 | **1,083,658** | 895,736 |
| **Reinsurers' share of technical provisions** | | | |
| Provision for unearned premium | | **28,000** | 27,494 |
| Claims outstanding | 6 | **595,431** | 220,537 |
| | | **623,431** | 248,031 |
| **Debtors** | | | |
| Debtors arising out of direct insurance operations | 12 | **233,420** | 255,369 |
| Debtors arising out of reinsurance operations | 13 | **63,409** | 32,632 |
| Other debtors | | **8,748** | 40,905 |
| | | **305,577** | 328,906 |
| **Other assets** | | | |
| Cash at bank and in hand | | **64,060** | 56,144 |
| Overseas deposits | 14 | **77,525** | 59,077 |
| **Prepayments and accrued income** | | | |
| Accrued interest | | **10,493** | 7,208 |
| Deferred acquisition costs | | **85,541** | 107,281 |
| **Total assets** | | **2,250,285** | 1,702,383 |

| | Notes | 2005 £000 | 2004 (Restated) £000 |
|---|---|---|---|
| **Capital and reserves** | | | |
| Members' balances | 15 | **36,131** | 146,900 |
| **Technical provisions** | | | |
| Provision for unearned premium | | **377,652** | 455,432 |
| Claims outstanding | 6 | **1,602,272** | 987,074 |
| | | **1,979,924** | 1,442,506 |
| **Creditors** | | | |
| Creditors arising out of direct insurance operations | 16 | **26,247** | 11,040 |
| Creditors arising out of reinsurance operations | 17 | **144,344** | 79,525 |
| Other creditors | | **63,639** | 22,412 |
| | | **234,230** | 112,977 |
| **Total liabilities** | | **2,250,285** | 1,702,383 |

The financial statements on pages 8 to 21 were approved by the board of Hiscox Syndicates Limited on 23 March 2006 and were signed on its behalf by

R C Watson
Active Underwriter

I J Martin
Director

| | Notes | 2005 £000 | 2004 (Restated) £000 |
|---|---|---|---|
| Net cash inflow from operating activities | 18 | **214,935** | 330,135 |
| Transfer to members in respect of underwriting participations | | **(80,932)** | – |
| Financing: Cash calls unpaid | | **(621)** | (167) |
| | 19 | **133,382** | 329,968 |
| **Cash flows were invested as follows:** | | | |
| Increase in cash holdings | | **3,031** | 14,108 |
| Increase in overseas deposits | | **13,308** | 15,880 |
| Net purchase of portfolio investments | | **117,043** | 299,980 |
| **Net investment of cashflows** | | **133,382** | 329,968 |

## 1 Basis of preparation
The financial statements of the Syndicate have been prepared in accordance with the Companies Act 1985, applicable accounting standards in the United Kingdom as at 31 December 2005 and under historical cost rules, modified by the revaluation of investments. They comply with the Statement of Recommended Practice on Accounting for Insurance Business issued in 2005 by the Association of British Insurers.

## 2 Change in reporting basis
The result for the year is determined on the annual basis of accounting in accordance with UK GAAP. This represents a fundamental change in reporting basis required by the introduction of the 2004 Regulations rather than a series of changes in accounting policies. The prior year figures have been restated and the impact of the change in reporting basis is given in note 5.

## 3 Accounting policies
The following principal accounting policies have been applied consistently in dealing with items which are considered material in relation to the Syndicate's financial statements.

### 3(a) Premiums
Written gross and outwards reinsurance premiums comprise premiums on contracts incepting during the financial year. Written premiums are disclosed gross of commission payable to intermediaries and exclude taxes and duties levied on premiums.

Premiums written include estimates for "pipeline" premiums and adjustments to premiums written in prior accounting periods.

### 3(b) Unearned premiums
The provision for unearned premium comprises the proportion of gross and outwards reinsurance premiums written, which is estimated to be earned in the following or subsequent financial years, computed separately for each insurance contract using the daily pro rata method.

### 3(c) Acquisition costs
Acquisition costs comprise all direct and indirect costs arising from the acquisition of insurance contracts. Deferred acquisition costs represent the proportion of acquisition costs incurred which corresponds to the proportion of gross premiums written which is unearned at the balance sheet date.

### 3(d) Claims
Claims incurred in respect of general business consist of claims and claims handling expenses paid during the financial year, together with the movement in the provision for outstanding claims and future claims handling expenses.

Outstanding claims comprise provisions for the estimated cost of settling all claims incurred but unpaid up to the balance sheet date whether reported or not, together with related claims handling expenses. Anticipated reinsurance recoveries, and estimates of salvage and subrogation recoveries, are disclosed separately as assets.

Whilst the directors consider that the gross provisions for claims and the related reinsurance recoveries are fairly stated on the basis of the information currently available to them, the ultimate liability will vary as a result of subsequent information and events and may result in significant adjustments to the amounts provided. Adjustments to the amounts of claims provisions established in prior years are reflected in the financial statements for the period in which the adjustments are made.

The provision for outstanding claims for the Syndicate is actuarially calculated utilising both the Chain Ladder and Bornhuetter-Ferguson methods. There is close communication between the actuaries and underwriters and allowance is made for the rating environment.

The Chain Ladder method is adopted where sufficient development data is available in order to produce estimates of the ultimate claims and premiums by actuarial reserving group and year of account for the managed Syndicate. This methodology produces optimal estimates when a large claims development history is available and the claims development patterns throughout the earliest years are stable.

Where losses in the earlier underwriting years have yet to fully develop, a 'tail' arises on the reserving data i.e. a gap between the current stage of development and the fully developed amount. The Chain Ladder methodology is used to calculate average development factors which, by fitting these development factors to a curve, allows an estimate to be made of the potential claims development expected between the current and the fully developed amount, known as a 'tail reserve'. This tail reserve is added to the current reserve position to calculate the total reserve required.

The Bornhuetter-Ferguson method is predominantly employed to produce ultimate loss estimates when there is little development data available e.g. in relation to more recent underwriting years. The Bornhuetter-Ferguson method is based on the Chain Ladder approach but utilises estimated ultimate loss ratios. In exceptional cases the required provision is calculated with reference to the actual exposures.

Ultimate premium and claims amounts are projected both gross and net of reinsurance using reinsurance recovery rates based on historical experience, adjusted for the current reinsurance programme. Reinsurance recoveries from Qualifying Quota Share arrangements entered into for the 2002 and 2003 years of account have been calculated separately.

## 3 Accounting policies (continued)

**3(d) Claims (continued)**

Reinsurance security is monitored continuously throughout the year involving both external sources, such as Standard & Poor's and AM Best's rating information on reinsurers, and internal sources. Reinsurer default rates are applied to the expected future reinsurance recoveries to determine a suitable level of bad debt provision.

Adjustments are made within the reserving methodology to remove distortions in the historical claims development patterns from large claims not expected to reoccur in the future.

**3(e) Unexpired risk**

Provision is made for unexpired risks arising from general business where the expected value of the claims and expenses attributable to the unexpired periods of policies in force at the balance sheet date exceeds the unearned premiums provision in relation to such policies after the deduction of any acquisition costs deferred. The provision for unexpired risks is calculated separately by classes of business which are managed together, after taking into account the relevant investment return.

**3(f) Investments**

Investments are stated at their current value. Listed investments comprise those quoted on the London and other International Stock Exchanges. These investments are stated at mid-market prices on the balance sheet date, or on the last stock exchange trading day before the balance sheet date.

**3(g) Investment return**

All investment return is initially recognised in the non-technical account. It is then transferred to the technical account as it all relates to funds supporting underwriting business.

Dividends on ordinary shares are recognised as income on the date the ordinary shares are marked ex-dividend. Other investment income and interest receivable are included in income on an accruals basis.

Realised gains or losses on investments represent the difference between net sales proceeds and their purchase price or their valuation at the commencement of the year.

Unrealised gains and losses on investments represent the difference between the current value of investments at the balance sheet date and their purchase price or their valuation at the commencement of the year. The movement in unrealised investment gains/losses includes an adjustment for previously recognised unrealised gains/losses on investments disposed of in the accounting period.

**3(h) Rates of exchange**

Transactions in US dollars, Canadian dollars and Euros are translated at the average rates of exchange for the period. Underwriting transactions denominated in other foreign currencies are included at the rate of exchange ruling at the date the transaction is processed.

All assets and liabilities denominated in foreign currencies are translated at the rate of exchange at the balance sheet date or if appropriate at the forward contract rate. Any exchange profits or losses arising on the translation of foreign currency amounts are taken to the technical account.

**3(i) Taxation**

Under Schedule 19 of the Finance Act 1993 managing agents are not required to deduct basic rate income tax from trading income. In addition, all UK basic rate income tax deducted from Syndicate investment income is recoverable by managing agents and consequently the distribution made to members or their members' agents is gross of tax. Capital appreciation falls within trading income and is also distributed gross of tax.

No provision has been made for any United States Income Tax payable on underwriting results or investment earnings. Any payments on account made by the Syndicate during the year are included in the balance sheet under the heading 'other debtors'.

No provision has been made for any overseas tax payable by members on underwriting results.

**3(j) Pension costs**

The Hiscox Group operates a defined benefit pension scheme and a defined contribution pension scheme. Pension contributions relating to Syndicate staff are charged to the Syndicate and included within net operating expenses. Movements in surpluses or deficits on the defined benefit pension scheme, on an IAS 19 basis, that relate to the managed Syndicate are allocated equally between all open and constituted years of account.

**3(k) Profit commission**

Profit commission is charged by the managing agent at a rate of 10% on profit for the 2003 account and 12.5% for the 2004 and 2005 accounts. This calculation is subject to the operation of a 2 year deficit clause. Profit commission is not paid until after the appropriate year of account closes, normally at 36 months.

## 4 Segmental analysis

An analysis of the underwriting result before investment return is set out below:

| 2005 | Gross written premiums £000 | Gross premiums earned £000 | Gross claims incurred £000 | Net operating expenses £000 | Reinsurance balance £000 | Total £000 | Technical provisions £000 | Commissions on gross premiums earned £000 |
|---|---|---|---|---|---|---|---|---|
| **Direct insurance:** | | | | | | | | |
| Accident and health | 36,364 | 48,061 | (1,567) | (13,278) | (8,848) | 24,368 | (41,449) | 14,890 |
| Motor (other classes) | 922 | 4,252 | (2,846) | (1,162) | 66 | 310 | (1,820) | 1,015 |
| Marine aviation and transport | 98,394 | 105,419 | (132,932) | (29,116) | 50,735 | (5,894) | (149,188) | 19,558 |
| Fire and other damage to property | 297,416 | 301,917 | (258,635) | (83,036) | 33,197 | (6,557) | (329,737) | 71,998 |
| Third party liability | 174,096 | 196,897 | (140,614) | (54,490) | (1,051) | 742 | (488,145) | 34,432 |
| Miscellaneous | 20,517 | 22,217 | (18,883) | (6,103) | 735 | (2,034) | (33,626) | 3,751 |
| | 627,709 | 678,763 | (555,477) | (187,185) | 74,834 | 10,935 | (1,043,965) | 145,644 |
| **Reinsurance** | 254,433 | 246,994 | (405,171) | (68,749) | 159,192 | (67,734) | (312,528) | 39,053 |
| **Total** | 882,142 | 925,757 | (960,648) | (255,934) | 234,026 | (56,799) | (1,356,493) | 184,697 |

| 2004 (restated) | Gross written premiums £000 | Gross premiums earned £000 | Gross claims incurred £000 | Net operating expenses £000 | Reinsurance balance £000 | Total £000 | Technical provisions £000 | Commissions on gross premiums earned £000 |
|---|---|---|---|---|---|---|---|---|
| **Direct insurance:** | | | | | | | | |
| Accident and health | 43,788 | 45,199 | (39,940) | (12,079) | 1,078 | (5,742) | (55,896) | 11,920 |
| Motor (other classes) | 1,987 | 3,010 | (2,845) | (548) | 192 | (191) | (3,591) | 611 |
| Marine aviation and transport | 113,039 | 109,828 | (66,960) | (31,182) | (4,935) | 6,751 | (134,683) | 17,344 |
| Fire and other damage to property | 282,687 | 304,033 | (184,829) | (77,976) | (30,898) | 10,330 | (358,037) | 61,713 |
| Third party liability | 198,992 | 178,088 | (124,338) | (54,889) | 4,457 | 3,318 | (317,735) | 26,508 |
| Miscellaneous | 22,029 | 23,318 | (21,061) | (6,077) | 1,038 | (2,782) | (26,568) | 3,351 |
| | 662,522 | 663,476 | (439,973) | (182,751) | (29,068) | 11,684 | (896,510) | 121,447 |
| **Reinsurance** | 240,344 | 222,486 | (90,681) | (66,296) | (40,033) | 25,476 | (297,965) | 29,943 |
| **Total** | 902,866 | 885,962 | (530,654) | (249,047) | (69,101) | 37,160 | (1,194,475) | 151,390 |

All premiums were concluded in the UK.

**The geographical analysis of gross earned premiums by destination is as follows:**

| | 2005 £000 | 2004 (restated) £000 |
|---|---|---|
| UK | 194,409 | 177,192 |
| Other EU countries | 83,318 | 88,596 |
| US | 481,394 | 460,700 |
| Other | 166,636 | 159,474 |
| **Total** | 925,757 | 885,962 |

## 5 Change in reporting basis

As set out in note 2, these accounts are determined on the annual basis of accounting. Prior to 1 January 2005, the Syndicate accounts were prepared in accordance with the Lloyd's Syndicate Accounting Byelaw (No. 18 of 1994). Syndicate results were reported on the three year basis whereby each underwriting year of account was normally kept open for three years. The result was ascertained at the end of the third year when the year of account was closed by reinsurance, normally to the Syndicate's following year of account. Under the three year basis, premiums were recognised on a cash basis, net of brokerage, and no technical provisions were made on open years.

This change represents a significant change in the reporting basis rather than a series of changes of accounting policies. Comparative amounts for 2004 have been restated. Because of fundamental differences in the two bases of reporting, it is not considered practicable, or indeed meaningful, to identify the effects of the change on the results for the current or prior year.

The net effect of the change is reflected as a prior year adjustment to members' balances shown in note 15. A reconciliation of members' balances at 31 December 2004 to those published under the previous reporting basis is as follows:

| | | 2004 (Restated) £000 |
|---|---|---|
| **Members' balances under previous basis** | | 1,046,939 |
| Annual accounting adjustments arising from: | | |
| Premiums | | |
| Premiums on earned basis rather than cash basis on open years; Premiums gross of acquisition costs. | 155,818 | |
| Claims | | |
| Provision for claims incurred on open years of account. | (461,740) | |
| Expenses | | |
| Expenses include acquisition costs. | (267,618) | |
| Reinsurance to close | | |
| RITC between years not shown on a grossed-up basis in annual accounts. | (326,499) | |
| | | (900,039) |
| **Members' balances restated under new basis** | | **146,900** |

The accounting policies under the previous basis of accounting can be found in the 2004 report and accounts of Syndicate 33.

## 6 Claims outstanding

The net reserve for claims outstanding, set at 31 December 2004, has been strengthened by £27.5 million in calendar year 2005.

## 7 Net operating expenses

| | 2005 £000 | 2004 (Restated) £000 |
|---|---|---|
| Acquisition costs | **(190,178)** | (187,765) |
| Change in deferred acquisition costs | **(15,339)** | 18,005 |
| Administrative expenses | **(64,914)** | (71,135) |
| Profit/(loss) on exchange | **14,497** | (8,152) |
| | **(255,934)** | (249,047) |

Administrative expenses include:

| | 2005 £000 | 2004 (Restated) £000 |
|---|---|---|
| Auditors' remuneration | | |
| - Audit services | **130** | 134 |

Members' standard personal expenses are included within administrative expenses.
Also included in administrative expenses is the Syndicate's share of the deficit, calculated by the scheme actuary on an IAS 19 basis, on the Hiscox group defined benefit pension scheme. In calendar year 2005 this amounted to £14.7 million (2004: £20.0 million).

## 8 Staff numbers and costs

All staff are employed by a Hiscox group service company. The following amounts were recharged to the Syndicate in respect of salary costs:

| | 2005 £000 | 2004 (Restated) £000 |
|---|---|---|
| Wages and salaries | **11,614** | 10,919 |
| Social security costs | **1,487** | 1,398 |
| Other pension costs (excluding provision for pension deficit) | **2,625** | 2,467 |
| | **15,726** | 14,784 |

The average number of employees employed by Hiscox Underwriting Group Services Limited but working for the Syndicate during the year was as follows:

| | 2005 £000 | 2004 (Restated) £000 |
|---|---|---|
| Administration and finance | **88** | 81 |
| Underwriting | **50** | 50 |
| Claims | **93** | 87 |
| | **231** | 218 |

## 9 Emoluments of the directors of Hiscox Syndicates Limited

The sixteen directors of Hiscox Syndicates Limited received the following aggregate remuneration charged to the Syndicate and included within net operating expenses:

| | 2005 £000 | 2004 (Restated) £000 |
|---|---|---|
| Emoluments | **1,545** | 1,463 |
| Pension contributions (excluding provision for pension deficit) | **349** | 331 |
| | **1,894** | 1,794 |

The active underwriter received the following remuneration charged as a Syndicate expense:

| | 2005 £000 | 2004 (Restated) £000 |
|---|---|---|
| Emoluments | **251** | 227 |
| Pension contributions (excluding provision for pension deficit) | **57** | 51 |
| | **308** | 278 |

## 10 Investment return

| | 2005 £000 | 2004 (Restated) £000 |
|---|---|---|
| Income from investments | **37,917** | 24,330 |
| Gains on investments | **1,180** | 365 |
| Losses on investments | **(10,416)** | (8,168) |
| | **28,681** | 16,527 |
| Investment expenses | **(1,098)** | (889) |
| Total | **27,583** | 15,638 |

## 11 Financial investments

| | 2005 Market value £000 | 2005 Cost £000 | 2004 (Restated) Market value £000 | 2004 (Restated) Cost £000 |
|---|---|---|---|---|
| Debt securities and other fixed income securities | **1,071,627** | **1,080,376** | 893,247 | 897,617 |
| Other loans | **6,509** | **6,509** | – | – |
| Deposits with credit institutions | **5,522** | **5,522** | 2,489 | 2,489 |
| | **1,083,658** | **1,092,407** | 895,736 | 900,106 |

Other loans comprises loans to the Lloyd's New Central Fund.

## 12 Debtors arising out of direct insurance operations

| | 2005 £000 | 2004 (Restated) £000 |
|---|---|---|
| Due from intermediaries | **233,420** | 255,369 |

## 13 Debtors arising out of reinsurance operations

| | 2005 £000 | 2004 (Restated) £000 |
|---|---|---|
| Due from intermediaries | **63,409** | 32,632 |

## 14 Overseas deposits

Overseas deposits comprise funds which are lodged as a condition of conducting underwriting business in certain countries.

## 15 Reconciliation of members' balances

| | 2005 £000 | 2004 (Restated) £000 |
|---|---|---|
| Members' balances brought forward at 1 January as previously stated | **1,046,939** | 777,652 |
| Prior year adjustment | **(900,039)** | (683,383) |
| Members' balances restated at 1 January | **146,900** | 94,269 |
| Profits/(losses) for the financial year | **(29,216)** | 52,798 |
| (Payments of profit to)/collection of losses from members' personal reserve funds | **(81,553)** | (167) |
| Members' balances carried forward at 31 December | **36,131** | 146,900 |

Members participate on Syndicates by reference to years of account and their ultimate result, assets and liabilities are assessed with reference to policies incepting in that year of account in respect of their membership of a particular year.

## 16 Creditors arising out of direct insurance operations

| | 2005 £000 | 2004 (Restated) £000 |
|---|---|---|
| Due to intermediaries | **26,247** | 11,040 |

## 17 Creditors arising out of reinsurance operations

| | 2005 £000 | 2004 (Restated) £000 |
|---|---|---|
| Due to intermediaries | **144,344** | 79,525 |

## 18 Reconciliation of profit to net cash inflow from operating activities

| | 2005 £000 | 2004 (Restated) £000 |
|---|---|---|
| Operating profit/(loss) on ordinary activities | **(29,216)** | 52,798 |
| Realised and unrealised investments (gains)/losses | **(80,904)** | 43,100 |
| Increase in net technical provisions | **162,018** | 233,108 |
| Decrease/(increase) in debtors, prepayments and accrued income | **41,784** | (15,402) |
| Increase in creditors | **121,253** | 16,531 |
| Net cash inflow from operating activities | **214,935** | 330,135 |

## 19 Movement in opening and closing portfolio investments net of financing

| | 2005 £000 | 2004 (Restated) £000 |
|---|---|---|
| Net cash inflow for the year | **3,031** | 14,108 |
| Cash flows | | |
| Increase in overseas deposits | **13,308** | 15,880 |
| Portfolio investments | **117,043** | 299,980 |
| Movement arising from cash flows | **133,382** | 329,968 |
| Changes in market value and exchange rates | **80,904** | (43,100) |
| Total movement in portfolio investments | **214,286** | 286,868 |
| Portfolio at 1 January | **1,010,957** | 724,089 |
| Portfolio at 31 December | **1,225,243** | 1,010,957 |

**Movement in cash, portfolio investments and financing**

| | At 1 January 2005 £000 | Cash flow £000 | Changes to market value and currencies £000 | **At 31 December 2005 £000** |
|---|---|---|---|---|
| Cash at bank and in hand | 56,144 | 3,031 | 4,885 | **64,060** |
| Overseas deposits | 59,077 | 13,308 | 5,140 | **77,525** |
| Portfolio investments: | | | | |
| Debt securities and other fixed income securities | 893,247 | 107,501 | 70,879 | **1,071,627** |
| Other loans | – | 6,509 | – | **6,509** |
| Deposits with credit institutions | 2,489 | 3,033 | – | **5,522** |
| Total portfolio investments | 895,736 | 117,043 | 70,879 | **1,083,658** |
| Total cash, portfolio investments and financing | 1,010,957 | 133,382 | 80,904 | **1,225,243** |

Other loans comprises loans to the Lloyd's New Central Fund.

## 20 Net cash inflow/(outflow) on portfolio investments

| | 2005 £000 | 2004 (Restated) £000 |
|---|---|---|
| Purchase of debt securities and other fixed income securities | (1,445,924) | (1,418,100) |
| Purchase of other loans | (6,509) | – |
| (Purchase)/sale of deposits with credit institutions | (3,033) | 1,407 |
| Sale of debt securities and other fixed income securities | 1,338,423 | 1,118,120 |
| Net cash inflow/(outflow) on portfolio investments | (117,043) | (298,573) |

## 21 Related Parties

**Related companies**

Hiscox Syndicates Limited is a wholly-owned subsidiary of the Hiscox plc Group which includes the following related companies:

Hiscox plc is the group holding company which is listed on the London Stock Exchange. Amvescap plc currently have a 15.9% shareholding in Hiscox plc.

Hiscox Dedicated Corporate Member Limited and Hiscox Select A-J Limited are corporate Names which own/owned capacity in various years of account of Syndicate 33.

Hiscox Underwriting Ltd is an FSA-authorised non-life insurance intermediary and Lloyd's Service Company. It deals directly with insurance brokers as an insurance agent. It currently places business with, and provides premium collection services to, Hiscox carriers, including the Hiscox managed Syndicate 33, as well as to non-Hiscox carriers. It is not obliged to place business with any particular carrier and these arrangements are subject to review from time to time by Hiscox Underwriting Ltd. In January 2005 Hiscox Underwriting Ltd acquired the business and assets of Insurex Expo-Sure, a non-life insurance intermediary specialising in contingency business.

Hiscox Assurances Services Sarl, Hiscox AG, Hiscox bv, Hiscox NV, Harrier Insurance Services Limited and Hiscox Inc. are non-life insurance intermediaries in France, Germany, Netherlands, Belgium, Guernsey and the USA respectively. They currently place business with Hiscox carriers, including the Hiscox managed Syndicate 33, as well as with non-Hiscox carriers. They are not obliged to place business with any particular carrier and these arrangements are subject to review from time to time by these companies.

Harrier Insurance Services Limited was licenced as an insurance intermediary in Guernsey in December 2005.

Hiscox Inc. was incorporated in May 2005 and is a licenced Surplus Lines intermediary in the USA.

Hiscox Insurance Company (Bermuda) Limited was incorporated in October 2005 and is a Class 4 insurer in Bermuda.

Hiscox Insurance Company Limited is an FSA-authorised non-life insurance company which underwrites predominantly high net worth and professions business. Syndicate 33 participates on Hiscox Insurance Company Limited's reinsurance programme. Syndicate 33 also purchases some reinsurance from Hiscox Insurance Company Limited. Such reinsurances are on an arm's length basis and are in the interests of all the Names on the Syndicate.

Hiscox Insurance Company (Guernsey) Limited is a Guernsey-authorised non-life insurance company which underwrites predominantly specialist personal lines business worldwide. It buys reinsurance from various reinsurers including Syndicate 33 and all such contracts are placed on an arm's length basis. It was a corporate controller of Heritage Group Ltd until July 2005, a Guernsey based financial services group. Heritage Group Ltd consists of a number of fee earning businesses whose core activities are captive management, trust management and insurance broking. One of the Heritage Group subsidiaries, Prism Insurance Management Ltd, supplies back office services and office accommodation to Hiscox Insurance Company (Guernsey) Limited. Another Heritage subsidiary, Pentagon Insurance Brokers Limited, places a small number of insurance risks with Hiscox Insurance Company (Guernsey) Limited which have been subsequently reinsured into Syndicate 33.

Hiscox Investment Management Limited is an FSA-authorised investment management company which manages/advises four specialist OEICs which invest in the financial sector. It also advises on the management of Syndicate 33 and Hiscox plc group funds.

CGU Ltd is an Irish-authorised non-life insurance intermediary 26% owned by the Hiscox plc Group. It currently places business with Hiscox Insurance Company Limited. It is not obliged to place business with any particular carrier and these arrangements are subject to review from time to time by CGU Ltd.

Blyth Valley Ltd is an FSA-authorised non-life insurance intermediary 25.2% owned by the Hiscox plc Group. It currently places business with Hiscox Insurance Company Limited. It is not obliged to place business with any particular carrier and these arrangements are subject to review from time to time by Blyth Valley Ltd.

Hiscox Underwriting Group Services Limited is an employment service company which employs all UK Hiscox plc Group staff including underwriters, claims and reinsurance staff.

The Hiscox plc Group also includes a number of intermediate holding companies and non-active companies.

## 21 Related Parties (continued)

At 31 December 2005 Syndicate 33 owed a net amount of £15.5 million, to Hiscox Group companies, on the transactions detailed above. Hiscox Syndicates Ltd charged Syndicate 33 £4.7 million of fee income and £17.5 million of profit commission during the year ended 31 December 2005.

**Combined underwriting divisions**

The Hiscox plc Group organises its core underwriting activities into a number of underwriting divisions which underwrite for both Syndicate 33 and Hiscox Insurance Company Limited. This integrated approach is aimed at maximising business opportunities by using the combined knowledge of the Group to develop new products and markets.

Within each combined underwriting division there are certain predetermined mechanisms for allocating insurance risks to carriers which take into account the licences, business plans and reinsurance programmes of each carrier.

These arrangements are structured to take full and proper account of the duties owed to the members of Syndicate 33 and to manage appropriately any potential conflicts of interest. They have been approved by the Hiscox Conflicts Committee (see below) and are subject to review from time to time.

**Conflicts procedure**

In the event of any potential conflict of interest arising between Syndicate 33 and Hiscox related companies, either involving new projects or existing transactions, arrangements or relationships described above, a formal conflicts procedure is in place under which the particular arrangement is referred to the Hiscox Conflicts Committee comprising nominated independent directors of Hiscox plc.

**Directors**

B E Masojada, an executive director of Hiscox Syndicates Limited, is Deputy Chairman of Lloyd's, appointed January 2001. He is also a non-executive director of Ins-sure Holdings Limited and its subsidiaries, appointed October 2002. These companies operate in a joint venture between Lloyd's, the International Underwriting Association (IUA) and Xchanging. These companies provide policy issuance, premium collection, claims settlement and clearing services to the Lloyd's and London insurance company markets.

R S Childs, Active Underwriter of Syndicate 33, until 31 December 2005, and an executive director of Hiscox Syndicates Limited, was Chairman of the Lloyd's Market Association. He was appointed Chairman of the unincorporated association from 1 January 2003 and re-appointed on the 14 July 2003 following the incorporation of the association. He resigned this position on 11 May 2005.

S J Bridges and A N Foster, executive directors of Hiscox Syndicates Limited, are directors of Hiscox Pension Trustees Limited, the corporate trustee of the Hiscox pension scheme.

## 22 Funds at Lloyd’s

Every member is required to hold capital at Lloyd’s which is held in trust and known as Funds at Lloyd’s (FAL). These funds are intended primarily to cover circumstances where Syndicate assets prove insufficient to meet participating members’ underwriting liabilities.

The level of FAL that Lloyd’s requires a member to maintain is determined by Lloyd’s based on FSA requirements and resources criteria. FAL has regard to a number of factors including the nature and amount of risk to be underwritten by the member and the assessment of the reserving risk in respect of business that has been underwritten. Since FAL is not under the control of the managing agent, no amount has been shown in these financial statements for such capital resources. However, the managing agent is able to make a call on the members’ FAL to meet liquidity requirements or to settle losses.

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