

EQUITAS GROUP

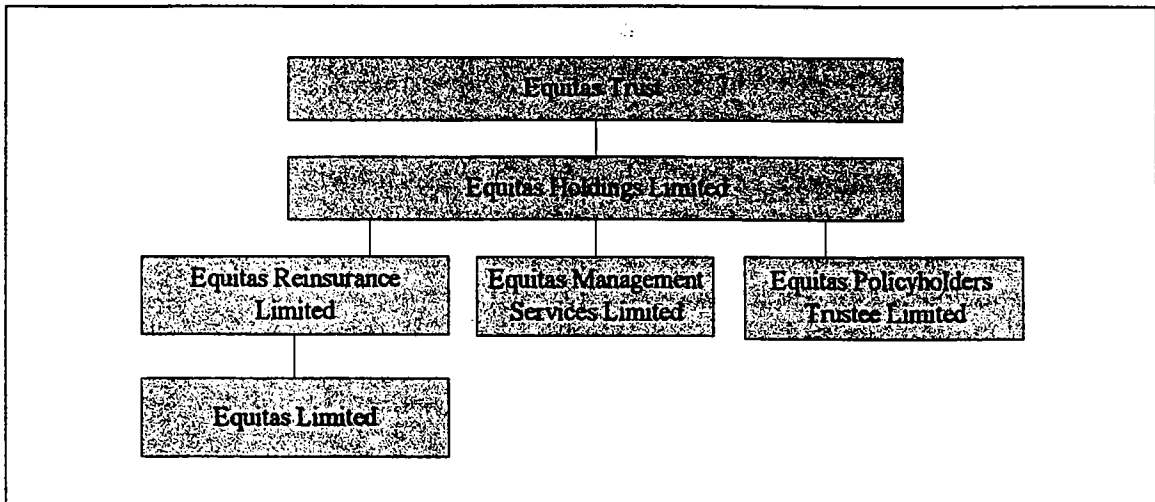
A. Introduction

The Equitas Group has been formed for the purpose of reinsuring the liabilities of Lloyd's syndicates in respect of 1992 and prior business (other than life business). It includes two companies authorised by the DTI pursuant to the Insurance Companies Act on 29 March 1996, subject to the conditions imposed by the Notices of Requirements, which are described below. The authorised companies within the Equitas Group (Equitas Reinsurance and Equitas Limited) are regulated by the DTI and the Equitas Group is not subject to the Lloyd's regulatory regime. The reinsurance is believed to be the largest single series of reinsurance transactions ever written by any one company.

The authorised companies within the Equitas Group are not permitted to reinsure any business except pursuant to the Reinsurance Contract and the Retrocession Agreement and related ancillary transactions connected with the Reconstruction and Renewal plan. The business of the Equitas Group will comprise the run-off of the reinsured liabilities, the settlement and payment of policyholders' claims, investment management and related general administration. The proposed Articles of Association of the Equitas Group companies will contain restrictions on the business which the Equitas Group companies may undertake, which will effectively limit the scope of their activities to running off the 1992 and prior business and related activities. The Insurance Companies Act 1982 restricts the business an insurance company may carry on to activities in connection with or for the purposes of its insurance business.

B. Ownership and Structure

The Equitas Group is currently owned by Lloyd's, but it is intended that ownership will be transferred to a discretionary trust, whose trustees will be required to have regard to the interests of Names reinsured into Equitas. At that stage, the ownership and structure of the Equitas Group will be as shown in the table below:



Equitas Holdings Limited is the holding company for the Equitas Group. It will not conduct any trading activities directly.

Equitas Reinsurance Limited, which is a DTI authorised company, has been established to provide the reinsurance in respect of 1992 and prior business under the terms of the Reinsurance Contract. Equitas Reinsurance will reinsure the business written by Lloyd's syndicates, other than life business, allocated to 1992 and prior years of account, including that reinsured into Centrewrite but not, for the time being, that reinsured into Lioncover. It is intended to reinsure the 1992 and prior years' liabilities of Lioncover within the next few months, subject to outstanding reinsurance disputes being substantially settled. The Reinsurance Contract is described below. Equitas Reinsurance will cede all the business it reinsures to its wholly-owned subsidiary, Equitas Limited. Equitas Reinsurance will act as a conduit for the collection of instalments under Structured Payment Plans and the payment, if any, of return premiums. It will, however, have no ongoing operational role. This structure has been developed in discussion with the DTI.

Equitas Limited, also a DTI authorised company, will be the main operating company in the Equitas Group responsible for the run-off of the 1992 and prior business.

The DTI, as a condition of authorisation, requires an insurance company to show an appropriate surplus of assets over liabilities explicitly on its balance sheet. The premium to be charged by Equitas Reinsurance to syndicates is discounted to reflect the expected timing of claims payments. Equitas believes that it will be able to adopt a longer-term investment strategy than a syndicate which operates as an annual venture and will be able to discount liabilities at a higher rate than that used to set the Equitas premium. The adoption of this higher discount rate will generate a surplus in Equitas Reinsurance. As Equitas Reinsurance will be structured as a mutual company for tax purposes, this surplus will not be taxable. The surplus will be contributed to Equitas Limited as a non-taxable contribution explicitly to support that company's margin of solvency. Equitas Limited will be taxed in the normal way for a proprietary company.

Equitas Management Services Limited is a management services company which will be the principal employer within the Equitas Group. It will provide the services of its employees, together with premises, facilities, information technology and other services, to Equitas Limited. Its constitution will not permit it to provide services to third parties.

Equitas Policyholders Trustee Limited will act as trustee of rights of Names under the Reinsurance Contract (other than rights to return premiums and rights to certain other payments) which it will hold for the benefit of underlying policyholders. Equitas Policyholders Trustee will not have an active role in the payment of policyholders' claims in the ordinary course of business, nor in circumstances where proportionate cover is invoked. However, if any insolvency procedure in relation to Equitas were invoked, Equitas Policyholders Trustee would be entitled to prove in the insolvency and would distribute any funds it received among policyholders on a pro rata basis.

Decision making

Decisions of the Equitas Trustees are to be taken by a majority of at least two thirds in number of the Equitas Trustees voting (except as set out below) on the basis of one vote each, provided that at least four votes in favour shall be required to pass any resolution. The chairman of the Equitas Trustees will not have a casting vote. If at any time there are less than four Equitas Trustees in office, the remaining trustees shall nevertheless be entitled to decide to vote in favour of a resolution at a general meeting of Equitas Holdings to re-elect a director retiring by rotation and to reappoint an auditor offering itself for re-election, but not otherwise. Any decision to appoint a person to be an Equitas Trustee will require the unanimous agreement of the remaining Trustees other than a Trustee retiring by rotation who can be re-appointed by a majority of at least two thirds of the Trustees who are not retiring.

Consultation with Equitas

The Equitas Trustees will appoint one of their number as chairman. In addition to the normal role of chairman of meetings of the Equitas Trustees, the chairman of the Equitas Trustees will be the main channel of communication between the Equitas Trustees and the boards of the Equitas companies (represented by the chairman of Equitas Holdings). It is expected that arrangements will be made for informal consultation between Equitas and the Equitas Trustees in addition to the more formal communications which a company normally has with its shareholders. In particular, the Equitas Trustees would be consulted if the implementation of proportionate cover were ever to arise under the Reinsurance Contract and on the appointment of directors by the board.

Terms of the Equitas Trust

To reflect the fact that the Equitas Trust is essentially a mechanism for protecting and furthering the interests of Names as reinsureds under the Reinsurance Contract, the Trustees are required to exercise their powers to achieve this aim until the end of the trust period, which has been set at 80 years (the longest period allowed under English law). The Trustees cannot declare an end to the trust period unless they believe it is in the interest of Names as reinsureds to do so.

Under the terms of the Equitas Trust, all capital and income arising in respect of the ordinary shares will be held for the benefit of a discretionary class comprising charitable purposes and other worthy causes in the UK. Any such capital or income will be distributed amongst such beneficiaries falling within this class as the Trustees may in their absolute discretion select at the end of the trust period or such earlier period as the Trustees may in their absolute discretion select. It should, however, be noted that in view of the prohibition in the Articles of Association of Equitas Holdings on payment of any dividends or other distributions and the return premium mechanism under the Reinsurance Contract, it is most unlikely that any significant income will arise in respect of the ordinary shares or that the capital value attaching to such shares will amount to any significant value.

Exercise of rights by Trustees

The Trustees owe fiduciary duties to the Names as reinsureds and to the discretionary class of charitable beneficiaries and other worthy causes in respect of the trusts over income and capital referred to above. Subject to these fiduciary duties, the Trustees have absolute discretion as to how to exercise their rights, powers and discretions under the Trust Deed. The Trust Deed does however specifically provide that the Trustees shall not be entitled to sell or otherwise dispose of any interest in the ordinary shares.

Trustees' remuneration and indemnity

The Trustees are entitled to receive payment for their services as Trustees. The terms of the Trustees' remuneration will be set out in a separate fees letter to be agreed at the time they take office. A fee of £15,000 per annum per trustee has been proposed. If the Trustees have to undertake any exceptional duties as Trustees, they may be paid such additional remuneration as may be agreed at such time (or determined by an independent expert if such remuneration cannot be agreed). The Trustees' fees and reasonable expenses will be payable by Equitas.

The Trustees will also be indemnified by Equitas in respect of all costs and expenses which they reasonably and properly incur in their capacity as Trustees.

Powers of Trustees

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The Trust Deed confers upon the Trustees additional powers from those conferred by law, although the powers conferred are usual in relation to trusts of this nature. They include the appointment of experts and delegates and power to seek legal or other expert advice before taking any action under the Trust Deed. In making such appointments or seeking advice, the Trustees have to exercise reasonable care in the selection of the persons concerned. Equitas will meet the reasonable costs of such agents and advisers appointed by the Trustees.

Retirement and appointment of Trustees

Any Trustee may retire at any time upon giving not less than three months' notice in writing and shall be required to retire upon reaching the age of 72. No appointment of a Trustee shall take effect unless the person appointed is acceptable to the DTI as a 'fit and proper' person as a controller of Equitas Reinsurance and Equitas Limited. If the DTI serves a written notice of objection to any Trustee continuing to be a controller, such Trustee shall be deemed to retire.

In the event of a Trustee becoming unfit or unable to act, the other Trustees can without notice remove such Trustee from office. A Trustee is also required to retire if called upon in writing to do so by all the other Trustees. The Trustees are subject to retirement by rotation every three years (starting on the third anniversary of the date of the Trust Deed). The two Trustees who have been longest in office since their last

re-appointment shall offer to retire but may offer themselves for reappointment by the remaining Trustees.

Lloyd's deferred share

The Lloyd's deferred share is a mechanism for allowing Lloyd's to have the right to appoint a director to the board of Equitas Holdings. The director concerned will also serve on the boards of Equitas Reinsurance and Equitas Limited. It carries no other rights and may be redeemed by agreement. The Lloyd's director may not also be a member of the Council. Lloyd's has nominated Mr Stephen Catlin to become the Lloyd's director on these boards following the Settlement Agreement becoming unconditional.

Communications with Names

Equitas proposes to provide Names with copies of its annual report and accounts. It also intends, in conjunction with the Trustees, to hold an open meeting of Names on an annual basis. Arrangements may also be made for open meetings with Names in overseas jurisdictions from time to time. These meetings are intended to give Names the opportunity to hear about the progress of the business and to ask questions.

H. Relationship between Equitas and Lloyd's Central Services

Equitas will continue to use certain services provided by Lloyd's to the ongoing market. These will include the claims adjusting and claims advising facilities of the LCO, the settlement advices and policy signing facilities of the Lloyd's Policy Signing Office and the central accounting settlement services of Market Financial Services. Equitas currently has office facilities in premises leased by Lloyd's. Equitas is assessing its longer-term office accommodation and location requirements and how these should be met.

I. Reinsurance Contract and Related Agreements

Preconditions to signature of the Reinsurance Contract

It is intended that the Reinsurance Contract will be entered into in late August. However, Equitas Reinsurance is not unconditionally committed to enter into the Reinsurance Contract. It will be necessary for Equitas to review known developments in relation to the business which it is to reinsure, which may affect the liabilities which it would assume if it entered into the Reinsurance Contract. Equitas will also need to review any other factors which may materially affect its ability to perform its obligations under the contract.

Once the Reinsurance Contract has been signed, it will be subject to the final DTI consent and to a 'no material adverse change' condition and to certain other conditions of a similar nature, which will need to be satisfied before the Reinsurance Contract can become unconditional.

Reinsurance Contract

The Reinsurance Contract will operate to reinsure to close all 1992 and prior liabilities into Equitas Reinsurance. Equitas Reinsurance will also assume responsibility for the run-off of the 1992 and prior business. A detailed description of the Reinsurance Contract is set out in Appendix 5.

The Reinsurance Contract will provide for:

- a return premium to Names in respect of surpluses generated by Equitas;
- the possibility of the introduction of a proportionate cover plan; that is, a mechanism whereby Equitas may pay claims at a reduced rate if liabilities exceed assets at any time in the future; and
- (subject to the arrangements referred to in Section J below) the assignment of Names' rights under the Reinsurance Contract (other than to return premiums and the right to receive certain other payments) to Equitas Policyholders Trustee for the benefit of underlying policyholders.

The assets of Equitas will be pooled and (subject to regulatory requirements) available to meet any liabilities of Equitas. However, this pooling does not have the result of pooling the underwriting liabilities of Names and a Name cannot have any liability other than in respect of which he has already assumed an underwriting liability.

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Return premium

The Reinsurance Contract provides that if Equitas determines that it will be able to run off its liabilities for less than the amount provided for in its reserves, a proportion of any surplus will be paid to Names solely by way of return of the Equitas premium.

The payment of any return premium would be subject to the consent of the DTI, who would wish to see a significant margin of solvency built up before any payment could be made. Any return premium will be based upon Equitas' aggregate surplus reserves and not upon the outcome of a particular syndicate's liabilities. In deciding whether a return premium is to be paid and, if so, the extent of any such payment, Equitas will consider the need to maintain adequate reserves and an adequate margin of solvency. No return premium is expected to be paid for several years, if at all. Once any amount available for return has been identified, it will be paid to Names pro rata to their respective Equitas premiums (having deducted the debt credits allocated to each Name).

The amount of any return premium will not exceed the amount of the Equitas premium.

A Name's right to receive a return premium will be capable of being transmitted to his successors in title as part of his estate but will not otherwise be capable of transfer by assignment.

'FINALITY'

A. Introduction

An important element of the Reconstruction and Renewal plan is that the reinsurance into Equitas offers Names a form of final reckoning on their liability to policyholders in respect of 1992 and prior business.

The reinsurance into Equitas offers Names such a final reckoning as described below and referred to as 'finality', in respect of such business. The DTI has accepted that the reinsurance into Equitas can be treated as a reinsurance to close and that, having paid their finality bills, Names with no other outstanding Lloyd's liabilities may cease to be members of the Society.

B. Ability to Cease to be a Member of the Society

A member may resign from the Society at any time by giving written notice of resignation. Under paragraph 40 of the Membership Byelaw (No. 17 of 1993), notice of resignation ordinarily takes effect (that is, the member ceases to be a member) at the end of the year next following the year in which the member's remaining open years of account have been closed by reinsurance to close with another Lloyd's syndicate or Equitas. The DTI has accepted that the reinsurance into Equitas can be treated as a reinsurance to close and that, having paid their finality bills, Names with no other outstanding Lloyd's liabilities may resign (if they have not already done so) and cease to be members of the Society, subject to there being no need to retain those Names' membership for disciplinary purposes. Certain additional conditions imposed by the DTI are described in Section E below.

For the purposes of the Reconstruction and Renewal plan, the Council may exercise its power under paragraph 14(5) of the Reconstruction and Renewal Byelaw to shorten the period at the end of which the resigned or resigning member shall cease to be a member of the Society. It is currently intended that, subject to the conditions specified above having been satisfied, the majority of resigned or resigning members will be able to cease as members of the Society shortly after they have paid their finality bills and any remaining funds at Lloyd's of the Name will be released. It is intended that the process of cessation will start during October 1996. However, the Council also has the power, under paragraph 40(8) of the Membership Byelaw, to extend the effective date of resignation as it considers appropriate, and will do so if a Name's finality bill is still outstanding or if there are disciplinary reasons to do so.

The timing of a resigned or resigning Name's cessation of membership will depend on when he ceased to underwrite and whether he has any open years not being reinsured into Equitas. For the large majority of Names who ceased underwriting in 1993 or earlier, all their open years are being reinsured into Equitas and their 1993 years of account are likely to close in the normal way. Names who ceased underwriting in 1993 would cease to be members under the normal procedures at the end of next year. However, such Names' resignations could take effect during late 1996 under paragraph 14(5) of the Reconstruction and Renewal Byelaw when they achieve

'finality' through the reinsurance into Equitas. Names will not, however, be able to cease to be members of the Society if they have open years that are not being reinsured into Equitas this year. There are three categories of open years:

- first, the so-called 'orphan syndicates' (that is, 1993, 1994 and 1995 syndicates without successor years). Further information about these syndicates is set out in Chapter 10;
- secondly, a small number of open life syndicates which remain open. This is because Equitas is not authorised to accept life business. The affected syndicates are syndicates 240 (1991), 240 (1992), 332 (1992) and 1052 (1991). There are also four open 1993 life syndicates; and
- thirdly, the 1994, 1995 and 1996 years which have not been closed.

C. Consequences of Cessation of Membership and Residual Risk for Names in the Event of Failure of Equitas

It is not within the power of Lloyd's to grant Names an absolute release from their liabilities to policyholders. Despite the reserve strengthening agreed with the DTI and the board of Equitas, there will still be a residual risk for Names of failure by Equitas to pay in full liabilities in respect of 1992 and prior business.

The introduction of the proportionate cover plan in the Reinsurance Contract may, in practice, help to mitigate this risk. This procedure has been introduced at the request of the DTI to protect policyholders. After a period during which the proportionate cover plan is being implemented, it would enable Equitas to continue paying a proportion of policyholder claims if it were ever confronted with a shortfall of assets and would enable Equitas to avoid the cessation of claims payment which would otherwise follow if Equitas were forced into insolvency. This procedure will also benefit Names, in that they would avoid the obligation of having to pay the full amount of their liabilities if Equitas were forced to cease paying claims.

If the Settlement Agreement becomes unconditional, a Name who pays his finality bill will benefit from undertakings from Equitas that he has no further liability to Equitas in respect of his Equitas premium (save that he and his agent will still have to account for syndicate assets to Equitas, for example, reinsurance recoveries).

Lloyd's will also provide an undertaking to all Names who accept the settlement offer and pay their finality bills that such acceptance and payment represents a full and final discharge of the Name's obligations to the Society and that no further demands will be made by the Society. This does not, however, affect the DTI's power to pursue Names as discussed below. The undertaking will become effective at different times as follows:

- for those Names who ceased to be members of the Society, or who tendered their resignation before 1 January 1990 under paragraph 20 of the Membership

Byelaw (No. 9 of 1984) in its original version, upon their payment of their finality bills;

- for those Names who cease in 1996 or later to be a member of Lloyd's under paragraph 40 (resignation) of the Membership Byelaw (No. 17 of 1993), upon cessation of their membership; and
- for those Names who have ceased (or cease in the future) to be a member by reason of death or under paragraph 41 (cessation for not underwriting) of the Membership Byelaw (No. 17 of 1993), on the date on which Lloyd's is satisfied that all of their obligations arising out of their underwriting business at Lloyd's have been discharged or otherwise finally provided for.

Names who accept the settlement offer and pay their finality bills will similarly benefit from undertakings from underwriting agents that such payment represents a full and final discharge of their obligations under their agency agreements in respect of 1992 and prior business.

Names who continue to underwrite at Lloyd's must, however, appreciate that, if Equitas were to fail or invoke proportionate cover, their premiums trust funds and funds at Lloyd's will continue to be available to make good any shortfall on their individual 1992 and prior liabilities.

In addition, the DTI has powers of intervention under Part II of the Insurance Companies Act. These would become relevant if a Name or, in certain circumstances, the Lloyd's market or Equitas failed to meet the prescribed solvency tests. The DTI has a number of different powers, including:

- the power to require each Name to maintain sufficient assets in trust to meet all of his obligations. It should be noted that this includes reserves to cover all future insurance liabilities;
- the power to require the preparation of a plan to restore a sound financial position;
- powers to require the supply of information and to accelerate the supply of accounting information; and
- a wide residual power to require the Name to take such action as appears to the DTI appropriate to protect policyholders or potential policyholders against the risk that the Name may be unable or unwilling to meet his liabilities.

The extent to which the DTI's powers might be exercised would depend on the circumstances prevailing at the time. However, the DTI has confirmed that policyholders' rights would be the first priority if the exercise of its powers were invoked.

D. How to Resign and Cease to be a Member of the Society

The procedure for resignation and cessation of membership of the Society is as follows:

- underwriting Names who wish to resign should tick the box in section 2 of the form of acceptance. Such Names will cease to be members in the normal way only after all their open years have closed;
- Names who are not actively underwriting may give notice of their resignation (if they wish to resign) by ticking the box in section 2 of the form of acceptance. Provided they have no open years (which will depend on when they ceased actively underwriting), have paid their finality bills in full and have no other outstanding Lloyd's liabilities and are not subject to any disciplinary proceedings, they will be permitted to cease to be members and will be informed by the Society of that date (see Section B above); and
- those Names who are not actively underwriting and have not done so for three or more consecutive years of account, but who have not formally resigned their membership, and do not give formal notice of their resignation by ticking the box in section 2 of the form of acceptance, may have their membership ceased at the end of 1996.

It is not necessary for any Name who has already given notice of resignation to tick the box in section 2.

E. DTI Requirements for Resigning Members

Names who cease to be members of Lloyd's and who have undischarged insurance liabilities may technically be subject to regulation by the DTI under the Insurance Companies Act until these liabilities have been fully discharged. The DTI has, however, indicated that it is prepared to modify the regulatory requirements applicable to Names who cease to be members of the Society for so long as those liabilities are covered by appropriate reinsurance arrangements, including the reinsurance into Equitas. If Equitas were to fail to meet its liabilities or to invoke proportionate cover, the DTI's regulatory requirements (as described above) could be invoked.

Under the arrangements proposed by the DTI, Equitas will maintain a register of correspondence addresses for ceased Names. Further details are given in a letter to the Chief Executive Officer of Lloyd's from the DTI set out in Appendix 4. By ticking the box in section 2 of the form of acceptance, a Name will be appointing Lloyd's as his attorney, as set out in the Settlement Agreement to execute documents on his behalf and take any other actions on his behalf to give effect to this regime, including making an application on his behalf to the Secretary of State for Trade and Industry for any appropriate modifications to the DTI's regulatory requirements.

F. Potential New Central Fund Levy

If Equitas were to fail or implement proportionate cover, the Society would be required to consider whether it wished to make good any shortfall or replenish the regulatory deposits which may have been used to meet policyholder claims. This might require the use of the New Central Fund following the prior approval of the members in general meeting. If the New Central Fund is used for either of these purposes, any additional Central Fund levy will be imposed, subject to approval by vote, on all members of the Society for the relevant year of account in proportion to their underwriting capacity and will not be weighted towards continuing Names with an exposure to any unpaid 1992 and prior liabilities.

G. Executors

Some executors have expressed concern that they may not be able safely to distribute the assets of an estate to its beneficiaries in reliance on the reinsurance into Equitas. Executors may in appropriate cases consider it sufficient to rely upon indemnification from beneficiaries or others. However, in circumstances where this is not considered adequate, Lloyd's is advised that there are essentially two ways in which executors can be protected. The first is to apply to court to seek an order allowing distribution to take place. The second is to rely on section 61 of the Trustee Act 1925 which gives the court a discretion to excuse executors from any breach after the event has occurred. It is a matter for the executors to obtain their own advice as to the course of action to adopt in the light of the particular circumstances of the estate. Countries other than the UK may have different rules relating to executors.

H. Alternative Means of Achieving 'Finality'

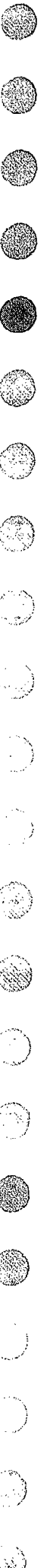
A possible alternative means of achieving finality considered, and ultimately rejected, by Lloyd's was a statutory transfer (or 'novation') of Names' obligations to policyholders from Lloyd's to Equitas Reinsurance. Such a form of transfer may be effected under section 85 and Schedule 2C of the Insurance Companies Act, with the consent of the DTI. As such a transfer would, if available, operate as a novation it would provide a complete release of Names from their obligations to policyholders. Lloyd's explored the use of a statutory novation in detail but was obliged to conclude that the relevant statutory provisions could not be made to operate. In particular, such a transfer would not effect the transfer of the benefit of Names' reinsurance which would be fundamental to reinsurance to close of Names' liabilities. In order to transfer the benefit of such reinsurance to Equitas Reinsurance, it would have been necessary to obtain the separate consent of each reinsurer to the proposed transfer to Equitas Reinsurance (which was not feasible given the thousands of reinsurers that would have been involved). In addition, insurance laws throughout the US permit novations to occur only if the regulator orders it in the context of a rehabilitation or liquidation proceeding, or with the express consent of all of the policyholders. Lloyd's was, therefore, forced to reject a statutory transfer as a means of achieving the reinsurance into Equitas.

I. Conclusion

The Council believes that, although absolute finality cannot be achieved for all Names, the combination of the settlement offer and the Equitas RITC provides Names with the best means of achieving 'finality'.



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APPENDIX 5

REINSURANCE CONTRACT

This Appendix sets out a description of the Reinsurance Contract. The parties to the contract include Equitas Reinsurance, the Substitute Agent, both on its own behalf and in its capacity as substitute managing agent for each Name on each syndicate year of account to be reinsured by Equitas Reinsurance, Equitas Limited, Lloyd's, and Equitas Policyholders Trustee.

A. Reinsurance

Conditions

1.1 It is intended that the Reinsurance Contract will be entered into prior to the Settlement Agreement becoming unconditional. Equitas Reinsurance will at that point assume responsibility for managing the run-off. However, the reinsurance obligation in the Reinsurance Contract will be subject to certain conditions including:

- (a) receipt of consent from the DTI for Equitas Reinsurance to accept unconditionally the reinsurance obligation. This will only be forthcoming once the relevant provisions of the Notices of Requirements have been complied with;
- (b) Equitas Reinsurance making a determination that it has received, or received satisfactory undertakings as to the discharge of, sufficient monies to accept the reinsurance obligation; and
- (c) various business conditions, including, for example, necessary authorisations having been obtained, there being no material new litigation and there having been no material adverse change in relation to the business being reinsured.

Scope of reinsurance obligation

1.2 The Reinsurance Contract will be a reinsurance to close of the 1992 and prior liabilities of each syndicate, after deduction of the amounts recoverable and actually recovered under the syndicate's outward reinsurances and various other amounts which reduce claims (such as additional premiums, return premiums and salvages). The Reinsurance Contract will include reinsurance by Equitas Reinsurance of each closed syndicate year of account reinsured, whether directly or indirectly, into any open syndicate year of account. The obligation to indemnify any closed year of account will only arise if the reinsurance to close of that year is set aside.

1.3 Equitas Reinsurance will take the risk of non-recoverability under outward reinsurances and will potentially be exposed, on any failure of those reinsurances, to the relevant syndicate's gross position. Accordingly, the calculation of the liabilities of the 1992 and prior business net of reinsurance for the purposes of assessing the

Equitas premium took into account an estimate of the risk of non-recoverability of outward reinsurances.

Proportionate cover

1.4 Given the inherent uncertainty in any insurance business, there is a risk that Equitas may not be able to meet the 1992 and prior liabilities in full. At the request of the DTI, the Reinsurance Contract will contain provisions for the implementation of a proportionate cover plan. In making any decision to implement such a plan, Equitas will be obliged to act in good faith.

1.5 If Equitas determines that there are insufficient assets to meet its liabilities in full, it must then decide whether to implement a proportionate cover plan (or, if such a plan is already in place, to amend the existing plan) or pursue normal insolvency procedures (including a scheme of arrangement). If Equitas Limited decides to implement a proportionate cover plan, it will be entitled to pay claims at a reduced rate. Equitas will be entitled to suspend claims while the details of any plan are finalised.

1.6 Assets supporting US dollar and Canadian business (and business in other jurisdictions) will be held subject to separate trusts. Accordingly, Equitas will need separately to value the assets and estimate the liabilities for each of these categories of business. It will then set an appropriate proportionate cover pay-out rate for each of the relevant categories of business.

1.7 Thereafter, Equitas will, on behalf of Equitas Reinsurance and the Names, pay a proportion (defined as the relevant pay-out rate) of each claim in respect of the 1992 and prior business. Since Names retain the ultimate liability for these claims, policyholders will be entitled to pursue Names for the balance of any claim.

1.8 If any pay-out rate were to be increased following the introduction of a proportionate cover plan, adjustment amounts would be due based on the difference between the amount paid on claims at the lower rate by Equitas Limited and the amount which would have been paid had they been paid at the new rate. Such amounts will only be paid directly to a Name where Equitas has resumed payment of claims in full and the Name has satisfied the balance of the reduced claims paid on his behalf. Otherwise, such amounts will be retained by Equitas and applied on behalf of the Name concerned to make up any shortfall to policyholders of that Name who have been or are to be paid at a reduced rate. The need to provide for such adjustment amounts will be taken into account in the process of setting the new pay-out rate. Any payment directly to a Name will be paid into the Name's premiums trust funds for so long as the relevant premiums trust deed remains in force. Where a Name has ceased underwriting and has no further insurance creditors, he will be entitled to receive a make-up payment even if the pay-out rate has not been increased to 100 per cent.

No termination for non-disclosure

1.9 The reinsurance into Equitas is an important element of the Reconstruction and Renewal plan and the settlement offer is conditional on the availability of the reinsurance into Equitas. Accordingly, it is not appropriate to allow termination of the Reinsurance Contract after it has become unconditional. Equitas Reinsurance will therefore waive any right it may otherwise have to terminate the Reinsurance Contract for non-disclosure of material facts.

1.10 This waiver does not affect any other right Equitas Reinsurance may have in respect of such non-disclosure, such as an action against the original managing agent of any syndicate for breach of warranty or misrepresentation under an Information and Administration Agreement (IAA).

Underwriting decision

1.11 The Reinsurance Contract will be mandatory. It will be entered into on behalf of each syndicate by the Substitute Agent pursuant to directions made by the Council under the Reconstruction and Renewal Byelaw requiring Names to become party to the Reinsurance Contract and the Substitute Agent to sign it on their behalf. The Reinsurance Contract will contain an acknowledgement by the Substitute Agent on behalf of the Names that the managing agents are not liable for the determination of the Equitas premium. Similarly, Equitas Reinsurance will not have any liability to Names in relation to the setting of the Equitas premium payable by any syndicate or the terms and conditions of the Reinsurance Contract.

Policyholder protection

1.12 The DTI is concerned to ensure the protection of underlying policyholders. Accordingly, Names' rights to recover under the reinsurance obligation contained in the Reinsurance Contract, including all rights in a winding-up of Equitas Reinsurance, will therefore be assigned to Equitas Policyholders Trustee and will be held on trust for the discharge and payment of obligations to policyholders. These arrangements will be subject to certain exceptions relating to the overseas trusts referred to in paragraph 1.6.

1.13 Currently reinsurance recoveries (and other assets to support a Name's underwriting) are held in premiums trust funds. The premiums trust deeds have been amended so as to exclude recoveries under the Reinsurance Contract from premiums trust deeds and, in their place, to rely on the trust arrangements in the Reinsurance Contract. The principal reasons for this are that existing premiums trust deeds may expire before the reinsured obligations have been run off to extinction and a dedicated trust arrangement will ensure that the benefit of the Equitas Reinsurance is available exclusively for 1992 and prior business. These arrangements will also be subject to certain exceptions relating to the overseas trusts.

1.14 It is expected that, provided Equitas Reinsurance properly complies with its reinsurance obligations, Equitas Policyholders Trustee will not have an active role in

the payment of policyholders' claims in the ordinary course of business nor in circumstances where a proportionate cover plan is implemented. However, if any insolvency procedure were to be invoked in relation to Equitas, Equitas Policyholders Trustee would prove in the insolvency and would distribute any funds it received among policyholders on a pro rata basis. The underlying policyholders should therefore receive the same amount that they would have received if Names had proved individually and paid their underlying policyholders out of the proceeds.

1.15 After Equitas Policyholders Trustee has distributed in full to all underlying policyholders, any surplus (assuming underlying liabilities have been met in full) would be paid to Names by way of return premium. Such amounts will be payable to premiums trust funds, unless the relevant premiums trust deeds have expired. In the case of Names who have ceased underwriting and have no further insurance creditors, such amount will be released to Names.

Obligation to discharge the Equitas premium

1.16 Assets held in respect of 1992 and prior business at syndicate level in Names' premiums trust funds, valued as at 31 December 1995, will be applied towards the Equitas premium. Where appropriate, Names' trustees will enter into assignments to transfer these assets to Equitas. Any additional amounts will have to be provided by Names as shown in Names' finality statements.

1.17 It is intended that once the Equitas premium has been paid there will be no further liability on Names to fund Equitas Reinsurance under the Reinsurance Contract, although Names will remain liable under the underlying policies of insurance and may be exposed to liability to policyholders in the event of an insolvency of Equitas or the implementation of a proportionate cover plan.

1.18 Supervisory Management Agreements, which took effect in January, and the Information and Administration Agreements which replaced them, require assets held in Names' premiums trust funds in respect of 1992 and prior business to be held in a segregated account. Detailed undertakings, representations and warranties in relation to the management and value of the segregated account by managing agents are contained in the Information and Administration Agreements.

1.19 The Reinsurance Contract contains a provision requiring payment of the Equitas premium without any set-off, counterclaim or other deduction, which is broadly equivalent to the 'pay now sue later' provision in the current form of managing agent's agreement.

1.20 Where any part of any Equitas premium payable by a Name is discharged through the application of the settlement fund, this will go towards discharge of the obligation on the Names to pay.

Interest

1.21 Interest will be charged on new money due from Names not received by 30 September 1996. This will not apply in respect of amounts due under any Structured Payment plan, which will itself make provision for interest.

Return premium

1.22 If Equitas determines that it will be able to run off its liabilities for less than the amounts provided in its reserves, a proportion of any surplus will be paid to Names solely by way of a return premium. Any payment would be subject to the consent of the DTI and the DTI has indicated that it would wish to see a significant margin of solvency built up before payments could be made.

1.23 Any return premium would be based on Equitas' aggregate surplus reserves and will be paid to Names pro rata to their Equitas premium (excluding any debt credits allocated to them).

1.24 Any payment would be paid into a Name's premiums trust funds for so long as the relevant trust deeds remain in force.

1.25 As noted in Chapter 7, a Name's right to receive a return premium will be capable of being transmitted to his successors as part of his estate but will not otherwise be capable of transfer by assignment.

B. Run-off of the Reinsured Account

Powers of Equitas Reinsurance

2.1 At or about the time the reinsurance obligation becomes unconditional, Equitas Reinsurance will take over full responsibility for the management of the run-off of the business. The powers and duties which Equitas Reinsurance will have in relation to the business will be broadly similar to those which managing agents have under the current standard managing agent's agreement. These powers and duties will be sub-delegated to Equitas Limited under the Retrocession Agreement.

2.2 Equitas Reinsurance will perform its obligations by procuring payment direct to the underlying insurance creditors (being the policyholder under the policy (whether insurance or reinsurance) by which the business first came into the Lloyd's market), subject to arrangements relating to certain of the overseas trusts referred to in paragraph 1.6.

Syndicate reinsurances etc.

2.3 As part of the consideration for the reinsurance obligation, Equitas Reinsurance will receive the benefit of the outward reinsurances of each syndicate, which will be treated in the same way as all other assets of Equitas Reinsurance, including, upon an

insolvency of Equitas Reinsurance, the fact that the benefit of those reinsurances will not be returned to Syndicates or Names in any circumstances.

2.4 Equitas will also receive the benefit of certain rights against managing agents, brokers and others not waived pursuant to the Settlement Agreement.

Delegation

2.5 In the short term, the Equitas Group will not have the infrastructure or staff necessary to administer the run-off itself in full. Much of the administration will be delegated to third parties, including managing agents and run-off companies currently handling the run-off.

Equitas Reinsurance's powers exclusive and irrevocable

2.6 Equitas will be performing the run-off, including the settlement of underlying claims. It is necessary for the authority given to Equitas Reinsurance to perform this function to be exclusive and irrevocable.

Duties and liability of Equitas Reinsurance

2.7 Equitas Reinsurance will undertake to exercise reasonable skill and care in performing the run-off. Equitas Reinsurance agrees to keep each syndicate indemnified against costs and liabilities arising from any acts or omissions of Equitas Reinsurance in relation to the 1992 and prior business which would not otherwise be covered by the indemnity incorporated in the reinsurance obligation. Any amount payable under this indemnity will be paid direct to the relevant Names and will not be subject to the trust referred to above. Where a claim arises which may give rise to an obligation under this indemnity, Equitas Reinsurance will have the right to assume control of the defence.

2.8 As the performance of the run-off will be delegated to Equitas Limited under the Retrocession Agreement, equivalent provisions will be contained in that Agreement.

C. Interim provisions

Powers in relation to period between run-off date and unconditionality

3.1 For the period from execution of the Reinsurance Contract until it becomes unconditional, the run-off of each syndicate will be delegated by the Substitute Agent to Equitas Reinsurance. Equitas Reinsurance will therefore derive its powers from the Substitute Agent which, under the terms of its appointment, will have powers similar to those of a managing agent under the current standard managing agent's agreement.

3.2 Equitas Reinsurance will delegate the run-off to Equitas Limited which will, in the short term, delegate under ROAAs much of the administrative and processing

functions relating to the run-off. Equitas Limited will itself retain certain executive functions relating to the business.

Non-interference with powers of Equitas Reinsurance

3.3 The Substitute Agent will agree to exercise its powers in such a way as to give effect to the Reinsurance Contract. It will also agree to make such directions as are necessary to trustees to allow payments out of the premiums trust funds, Lloyd's American Trust Funds and Lloyd's Canadian Trust Funds. //

D. General provisions

Books and records

4.1 From the Effective Date, Equitas Reinsurance will be entitled to the books and records relating to the 1992 and prior business of each syndicate, to enable it to perform the run-off. In practice, since under the ROAA most of the run-off will, at least in the short term, be delegated to managing agents and run-off companies currently performing the run-off, the books and records will generally remain for the time being with the managing agent or run-off company which currently maintains them.

4.2 Prior to the Effective Date, Equitas Reinsurance will not have the right to delivery of the books and records. It will, however, need to have access to them in the performance of its delegated function. Accordingly, the parameters of Equitas Reinsurance's access to the books and records and the provisions for their subsequent transfer will be set out in the Reinsurance Contract.

4.3 Where the books and records relate both to 1992 and prior business and to business which is outside the Reinsurance Contract, Equitas Reinsurance will be entitled to copies. The level of access for Names and the Substitute Agent to the information which Equitas Reinsurance will need to maintain in relation to its business will be prescribed. Suitable provisions for managing agents will be included in a separate agreement.

Confidentiality

4.4 There will be restrictions on the use of confidential information relating to 1992 and prior business by both Equitas Reinsurance and the Substitute Agent.

Governing Law

4.5 The Reinsurance Contract is governed by English law.

The facility agreement will also contain events of default. In addition to provisions which are standard in relation to a facility of this nature, these will include:

- (a) the failure of Lloyd's or Equitas to meet DTI solvency requirements;
- (b) the occurrence of an interim event for three consecutive quarters;
- (c) the whole or a substantial part of the Lloyd's market going into run-off;
- (d) the loss of authorisation from the DTI or New York Insurance Department in relation to a material part of the Lloyd's market;
- (e) existence of litigation which would be likely to have a material adverse effect on the ability of Lloyd's to service the facility; and
- (f) factors adversely affecting the Central Fund or the premiums trust funds.

J. Substitute Agent

In order to provide certainty that the Reinsurance Contract will be binding, Lloyd's is proposing to appoint a substitute managing agent as managing agent for every syndicate to be reinsured into Equitas. The Substitute Agent will sign the Reinsurance Contract for itself and on behalf of all Names (on both open and closed years) and in respect of all syndicate years of account.

The Substitute Agent will be appointed in substitution for the present agent (if any) of the Names in relation to that part of their underwriting business which relates to the 1992 and prior business of the relevant syndicate years of account and, where appropriate, the appointment of any existing substitute managing agent would be revoked.

It is proposed that the appointment, to be made pursuant to the Substitute Agents Byelaw (No. 20 of 1983, as amended), will be broadly on the terms of the standard managing agent's agreement set out in Schedule 3 to the Agency Agreements Byelaw (No. 8 of 1988). Accordingly, the Substitute Agent will have all the usual functions, powers and duties of a managing agent for the business concerned including the powers:

- (a) to execute the Reinsurance Contract on behalf of the Names in the form approved by the Council (or a committee of the Council);
- (b) to take any necessary actions to constitute itself or some or all of its directors as trustees of the Lloyd's premiums trust funds and of any other trust of which the present (if any) or previous agent (or any director, agent or employee thereof) of each Name is trustee at the date on which the appointment takes effect; and
- (c) to execute such assignments, novations, declarations of trust and other instruments on behalf of the Name (whether in the Reinsurance Contract or otherwise) as may be necessary or desirable to give effect to the terms of the Reinsurance Contract and the Settlement Agreement; and

- (d) to take all actions necessary or desirable to ensure compliance by the Name with all laws, byelaws, regulations, rules, codes of practice, conditions and requirements applicable to the Name in connection with the Name's business.

From the date of its execution, the Reinsurance Contract operates to delegate the management of the run-off of the business from the Substitute Agent to Equitas. Since the appointment of the Substitute Agent is to take place immediately prior to signature of the Reinsurance Contract, the Substitute Agent will immediately delegate the management of the run-off to Equitas. From the date when the Reinsurance Contract becomes wholly unconditional, Equitas will be managing the run-off as direct agent of the Names and not as delegate of the Substitute Agent.

Other than in providing assistance with certain premium payment functions (and related matters) during the period after execution of the Reinsurance Contract, the Substitute Agent will have no ongoing role other than perhaps a residual role should a proportionate cover plan be implemented under the terms of the Reinsurance Contract.

The Substitute Agent will also enter into the E&O Insurers' Contribution Agreement and the PSL Administration Agreement on behalf of the relevant Lloyd's syndicates.

It is proposed that the Substitute Agent be a wholly-owned subsidiary of the Society and under the direct control of the Council. It is therefore intended that the Society itself be one of the directors of the Substitute Agent and that it would act through the Council in taking actions or decisions in its capacity as a director.

The terms of the draft direction to the Substitute Agent will be available for inspection in accordance with Section K below.

K. Documents for Inspection

Copies of the following documents are available for inspection in the Lloyd's Information Centre at Lloyd's, Gallery 10, One Lime Street, London EC3M 7HA during normal business hours on any weekday (Saturdays and public holidays excepted) while the settlement offer remains open for acceptance:

- (a) the Action Group Settlement Agreements;
- (b) the Reinsurance Contract;
- (c) the Retrocession Agreement;
- (d) the Underwriting Agents' Contribution Agreement;
- (e) the Auditors' Contribution Agreement;
- (f) the Brokers Agreement;
- (g) the E&O Insurers' Contribution Agreement;
- (h) the PSL Administration Agreement;
- (i) the Memorandum and Articles of Association of Equitas Holdings;