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The Medical Protection Society Limited
Report & Accounts 2005

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Chairman's statement

During 2005, MPS has built on successes of recent years. It has been busy and productive, and has a record number of members. If someone from outside medicine and dentistry asks what MPS does, it is difficult to summarise its many and varied activities. But the result for members of MPS is peace of mind for busy professionals, so if the unexpected occurs they can obtain the best possible help and support. In the worst case, this may involve expensive legal representation over a prolonged period and the payment of seven-figure sums in damages. So there is no apology for firstly emphasising the financial security of MPS.

Our assets, after deducting the cost of reported claims, have grown in the last year by over 25% and now exceed £500m. This sum is carefully invested to meet the considerable cost of claims arising from mishaps that have already occurred, but which we will not learn about for many years. It is some relief to note the likelihood of any particular doctor being sued for negligence appears not to be rising, at least this is so in the UK and Ireland. However, the median cost of a claim does continue to increase, partly reflecting higher costs of caring for disabled patients. We are proudly confident of our ability to meet all reported, and subject to the exercising of discretion, all unreported claims[1]. We also believe that doctors greatly value the occurrence-based indemnity offered by MPS: if you were in valid membership when an incident occurred, indemnity for that incident is available whenever it is needed in the years to come, subject to Council exercising discretion. The doctor or dentist does not have to worry about possible future lapses of membership which would otherwise result in unintended gaps in indemnity provision. This benefits doctors, dentists and patients. Occurrence-based indemnity for medical mishap is virtually unobtainable from an insurance company in many parts of the world. In addition, MPS can use its discretionary powers to provide indemnity in many unusual individual situations that are likely to be excluded by the small print of an insurance policy.

Because we have to estimate the rising value of claims many years into the future, and because the law is certain to change over those years, there remains an inevitable, if regrettable upward pressure on subscriptions. Many members ask why there cannot be a 'no-claims' bonus. This term owes more to marketing considerations than equity. It really amounts to a surcharge on those who have experienced claims. With such a long interval between incident and claim, it is difficult to identify the claim-free doctor with certainty and it is important not to discourage members from contacting us for advice after an adverse incident. However, it is inequitable for the few doctors whose standard of practice (rather than mere misfortune) results in many claims to become a disproportionate burden on the resources of a mutual society. We wish to encourage, educate and support such members to raise their standards. Medical and dental practice is seldom straightforward. Lessons learnt from success never have the sharpness of those learnt from failures. We will use MPS experience and expertise to promote risk management, producing innovative interactive learning material and collaborating with Royal Colleges and other organisations devoted to raising standards of practice and governance. Such initiatives should benefit all doctors, dentists and their patients as well as protecting MPS's funds.

The sheer volume of work undertaken for members is impressive. For example, our medico- and dento-legal advisers and our lawyers received over 50,000 telephone calls last year. When the telephone rings, they may have to help with a wide range of issues, from a factual enquiry to the personal tragedy of a doctor in a police cell arrested on suspicion of manslaughter. In contrast to our experience with negligence claims, the number of files opened last year for disciplinary or medical council inquiries continued to rise, by nearly 20% in the UK alone. The reasons are complex, but are underpinned by increasing public expectations of organisational and professional excellence when they are unfortunate enough to become patients.

MPS is proud that it has been instrumental in the foundation of a new Faculty of Forensic and Legal Medicine at the Royal College of Physicians in London. This will consist of medico-legal advisers from all medical protection organisations, forensic physicians and medical coroners, and will allow proper recognition of the specialty and act as a new benchmark of quality. One of the Faculty's early external roles will be to help shape proposed changes to the present centuries-old system of examining unexpected deaths.

We sadly have to say goodbye to Brian Mouatt CBE who retires from Council in June. His notable career in dentistry culminated in his appointment as Chief Dental Officer. He has served MPS with great distinction, particularly as Chairman of Dental Protection over the last 5 years.

Nicholas Davies
Chairman of the Council

1 Unreported claims are potential claims and are dependent upon the exercising of discretion and will, to the extent that Council exercise that discretion, become MPS's responsibility.

Chief Executive's report

Non statutory information, (PICTURE) not required by Companies House

I am pleased to report once again a very material strengthening of the company's financial position in the year ending 31 December 2005. Appropriate subscription setting, allied to good investment performance and cost control, has led to a very healthy increase in our surplus of assets over reported and unreported claims. This has been achieved despite a continuing, but anticipated, deterioration in claims experience in most areas of operation; in the main this is related to the value rather than the frequency of claims.

Subscription and other income rose by 12.1% in the year to £186million (2004 – £166million). I have said before, and it is worth repeating now, that adequate pricing of the risks we accept on behalf of members is a *sine qua non*. Subscriptions are set on a non-profit, fully funded basis, which means that we aim to collect in each year enough money to fund all claims arising from adverse incidents occurring in the year, subject to the exercising of discretion when the claim is reported, irrespective of when those claims fall due to be paid. In setting our subscriptions we are advised by independent consulting actuaries and take account of the investment yield that will accrue over time from those subscriptions in order to make provision for the effects of claims inflation, the rate of which is often well above retail price inflation.

The increase in income was accompanied by a 2.9% increase in total expenditure to £139million (£135million). I am pleased to report that, despite the underlying inflation in average claim values, actual expenditure in the year on claims and associated legal costs decreased by 2.8% compared with a 48% increase in 2004. Total expenditure on costs and damages and the movement in the provision for reported claims was £88 million (£91million). Notably, while defence costs rose by just over 1%, claimant costs showed a 10% increase; indeed, rising claimant costs are a feature that has been apparent for a number of years and should be a cause for concern for all those involved in clinical negligence and personal injury litigation.

Total assets, less current liabilities and the pension liability, available to meet reported claims and unreported claims that MPS may be called upon to meet at the year end approached £799million (£649million). Assets available to meet unreported claims, after taking account of claims already reported to MPS, passed the £500 million mark for the first time, an increase of 27% over 2004.

Administration costs, including the costs of medical and dental advisory services and associated legal costs, increased by 8.1% (-6.6%). Administration costs per member have increased marginally during the year due mainly to increased investment management fees, as a result of an increase in funds under management, and increased IT costs, mainly associated with improvements in MPS's business continuity capabilities.

Membership numbers have again shown healthy growth and now stand at 236,000 (228,000) – 3.5% higher than in 2004. This has been achieved despite the reappearance of the green shoots of commercial competition in many areas of operation. Most members recognise the very real differences between the protection offered by discretionary mutuals such as MPS as compared with the often more limited insurance cover provided by commercial competitors.

For some time we have been aware that the catalyst for complaints and litigation frequently lies in the communication, behaviour and attitude of the member. Helping such members to improve this aspect of practice would obviously benefit not only the members concerned, but also their patients and the membership at large. We have had difficulty, however, in finding an effective intervention with the right focus. I am therefore delighted to be able to report that MPS Council has given its full support to the introduction of the Interpersonal Performance Programme. This programme has been developed in collaboration with the Cognitive Institute in Australia. The Cognitive Institute has been using a similar programme for several years, with impressive results: three years after taking part in the programme, the number of complaints against participants had fallen from a pre-programme average of 3 to just 0.4.

The Interpersonal Performance Programme provides a trusting and supportive environment in which highly skilled facilitators work intensively with members. The three phases of the programme – preparation and goal setting; residential workshop and practice, mentoring and review – are conducted over a period of six months. The 20 doctors who have already participated in the MPS programme have been overwhelmingly positive in their evaluation of this approach and MPS looks forward to building on this initiative in 2006.

Review of activities

United Kingdom

In my report for 2004 I referred to a special provision we have made in the claims reserve for the probable financial effects of periodical payments, which can now be imposed by the courts under the Courts Act. To date, it appears that very few orders for periodical payments have been imposed but we have maintained that special provision for the likely future financial effects of such awards.

The problem in the UK is not one of frequency but of average value, or severity, of claims. The claims frequency for general practitioners, for example, maintains its downward trend (it is expected to be some 30% lower in 2006 than it was in 1993), but the average claim size has increased by some 10% over the last year. A similar picture can be seen in the consultant sector. Thus, the driving force for subscriptions remains the severity of claims and this is in the control of the government and the courts. While we believe that patients who have been harmed by a member's negligence should be fairly compensated as quickly as possible, there has been little debate on what is 'fair'. Given that the taxpayer, either indirectly through taxes or directly through insurance premia and subscriptions to organisations such as MPS, is the ultimate compensator, it is surely time for a mature debate on what levels of compensation are appropriate for patients harmed by negligence – and others suffering personal injury through negligence – taking into account what the country can afford.

Membership in the United Kingdom has grown from 108,905 in 2001 to 158,033 at the end of 2005, an increase of 45%, and MPS is now the largest medical protection organisation operating in the UK. During the year we were pleased to enter into a relationship with the Department of Health on the Isle of Man to provide the benefits of MPS membership to the Department and its staff and to renew our arrangements with the Chartered Society of Physiotherapists. At the beginning of 2005 MPS Risk Solutions, a wholly owned subsidiary of MPS, received authorisation by the FSA to write general insurance business for organisations in the healthcare sector in the UK.

in New Zealand. I was pleased to meet with Mr Ron Paterson, the Health and Disability Commissioner, towards the end of 2005 to discuss matters of mutual concern. As might be expected, there are areas of disagreement between us, but it has been our experience that, in general, he and his team adopt a pragmatic and realistic approach which, while allowing him to fulfil his functions, provides in most cases fair and just results. Peter Leslie is stepping down as Chairman of our New Zealand Advisory Panel and I would like to thank him for the work he has put in since 2002.

Towards the end of the year we put our long-standing contract with the New Zealand Medical Association (NZMA) for the provision of administrative services out to tender. At the time of writing, the results of the tender are not known, but I wish to place on the record that the decision to put this contract up for tender was to ensure that members receive the best value for money, and it should not in any way be seen as a criticism of the NZMA.

Caribbean Region

Experience has generally been good in the Caribbean, with average claim values and the frequency of claims remaining relatively stable.

During the year I was pleased to sign a contract with the Queen Elizabeth Hospital (QEH) in Barbados to provide membership benefits for its staff. The contract also includes a commitment by MPS to help the QEH in developing a clinical risk management programme. I was also pleased to meet Dr Jerome Walcott, the Barbados Minister of Health, to discuss matters of mutual concern. MPS continues its work with St. Jude Hospital in St. Lucia including advising on risk management and our arrangement with The Health Service Authority in the Cayman Islands is now in its third year. I believe that these three partnerships will continue to help to raise the standard of care for patients.

Our commitment to the Caribbean region remains strong. On the smaller islands, MPS is the only source of professional indemnity protection for doctors and dentists and, as a mutual organisation that regards itself as part of the medical and dental professions, we feel it our duty to provide, in so far as we can, continued access to our services for these small groups of healthcare professionals.

Hong Kong

After having to implement very substantial subscription-rate rises over the last few years, I am very pleased to report that the average claims size and claims frequency appear to have stabilised, so we were able to moderate rises for 2006. However, there has been an 11% increase in the number of non-claim cases opened over the last year and the Hospital Authority has seen a 31% increase in complaints between 2000 and 2004. These trends and the proposal from the Law Reform Commission for the introduction of conditional fees suggest that the frequency of claims may rise in the next few years.

Singapore

I am pleased to report the continuing stabilisation of the claims experience and, as a result, subscription rates were increased by an average of only 3% for 2006. I was pleased to meet Dr Balaji Sadasivan, Senior Minister Of State (Health) and Dr Pheng Soon, President of the Singapore Medical Association, to discuss matters of mutual concern during my short visit to Singapore during 2005.

Malaysia

In Malaysia membership numbers remain stable, although experience is worsening. This is mainly as a result of an increase in average claim values. Plaintiff lawyers are demanding ever higher sums and we have encountered delays in processing claims through the courts. Such delays are unfair, both to the plaintiff patient and the defendant doctor, and make it ever more difficult to ensure that subscription rates we set are appropriate.

Conclusion

In previous reports I have referred to our commitment to provide a service to members that is second to none. We do receive a very small number of complaints each year and, where appropriate, make changes to the way we deliver our service in our quest for continuous improvement. However, letters of complaint are by far outweighed by the enormous numbers of letters of thanks that we receive, some of which I find humbling. I can do little better than to quote from one letter received at the turn of the year:

'I am most appreciative of your wise and professional advice and in particular the manner in which you put my interests first, in front of the financial interests of the Society. Having been through three years in this case, one is filled with feelings of self-doubt, inadequacy and professional failure – things that are difficult to share with one's wife, let alone colleagues. Your professional advice helped greatly in keeping my head above the water.'

I realise that members pay significant amounts of money to MPS for their professional protection and that the very least I can do in return is to ensure that we continue to protect professional reputations, to the very best of our ability.

I am sorry to report that Dr Gerard Panting and Dr Sherry Williams will be leaving MPS during 2006. I am very grateful to them both for their hard work and all that they have done for MPS over a long period of time. I wish them both well for the future.

John Hickey
Chief Executive

Finance Director's report

Non statutory information, (PICTURE) not required by Companies House

Financial strength – As mentioned in the Chief Executive's report, 2005 has seen a very material strengthening of the company's financial position.

Gross assets before reported claims, but after pension liabilities, increased by £150million to £799million (£649million). MPS has to set against this the value of claims that it has an obligation, subject to the exercising of discretion, to manage on behalf of members. The claims fall into two types: those that have already been reported to MPS by 31 December 2005 and those that have not, so-called unreported claims.

When a claim is reported to MPS, a reserve is placed upon it as an estimate of the expected legal costs and settlement value, based on the circumstances of the incident and the likelihood of settlement. At the end of 2005, the aggregate value of all such reported claims including an estimate of the costs required to manage these claims to conclusion, was £272million (£235million) and this is provided in the balance sheet on page 16. This is a future cost to MPS and must be deducted from the gross assets of £799million. The result is net assets of £526million (£413million), an increase of £113million in the year.

If that were the end of the story, then £526million of 'surplus' assets might seem overly cautious. However, from this sum, MPS needs to provide for the estimated value of unreported claims.

MPS provides occurrence-based indemnity. This means that at the year end, any number of adverse incidents will have occurred but the claims that may subsequently arise have not yet been reported to MPS. Subject to the granting of discretion, these claims will become the responsibility of MPS when reported and so MPS needs to ensure that it has sufficient assets to cover the future costs in anticipation that they will become a liability in the future. The value of the unreported claims is not shown on the balance sheet, because until these claims are reported, discretion cannot be guaranteed and until discretion is exercised, these claims cannot be a true responsibility of MPS. On a prudent basis, however it is right that MPS make financial provision for these claims. The net assets on the balance sheet of £526million exceed the estimated costs of all the unreported claims as at 31 December 2005 as stated in note 22 to the accounts.

However, this still is not quite the end of the story. The estimation of both reported and unreported claims is based on a number of assumptions about the future; when the claim will be settled, how many of the outstanding claims will be settled, how much claims inflation there will be between now and the date of settlement, whether any changes between now and the date of settlement will unexpectedly change the estimated settlement value of claims. These and many more assumptions need to be made in arriving at an estimated value for all reported and unreported claims. If MPS only held sufficient assets to meet the expected future cost of reported and unreported claims based on these assumptions, it would run the risk of having insufficient funds to meet its financial responsibilities if an unanticipated change increases the estimated cost. For this reason, it is imperative that MPS hold assets in excess of the estimated future cost of reported and unreported claims, so that it has a reserve to meet unexpected changes in the value of these claims. How much money MPS should hold in reserve for such an event is debatable, but MPS has worked with its consulting actuaries to arrive at a financial target for such a reserve and the financial results for 2005 have made a significant contribution to achieving this target.

It is true to say that the financial security of MPS has never been better.

Financial performance

The £113million increase in net assets is generated by a £47million (£31million) surplus of income over expenditure (see the Income and Expenditure account on page 14) and a return on investments of £75million (£42million), less tax on investment income and gains of £7million (£5million), less the actuarial loss in the pension scheme of £2million (£0million).

Surplus of income over expenditure

The £47million surplus of income over expenditure compares favourably with the £31million surplus in 2004. The £16million (52.3%) increase is accounted for by the net of a £20million (12.1%) increase in income and a £4million (2.9%) increase in expenditure.

The increase in subscription income is a combination of increased members and increased subscription rates. Members who pay a subscription have increased in all main areas of business except for Malaysia, Hong Kong and Kenya, which all saw small decreases in member numbers as a result of an increase in commercial competition. However, member numbers increased in all other areas, notably in the UK, Ireland, South Africa, Singapore and the Caribbean. Increases in subscription rates have also contributed to the overall increase in subscription income. Rate increases have generally not been as high in the last financial year as in previous years, as in many countries claims frequency has steadied, although severity continues to increase. However, rate increases continue to outstrip retail price indices and this reflects legal costs and awards for damages continuing to grow faster than normal prices. In particular, the elements in large awards to fund loss of earnings and the future cost of care continue to grow faster than retail price inflation, both of which are linked to increases in future earnings, which in turn are influenced by elements such as additional costs for pensions and taxes. The Chief Executive's report provides more information about claims experience and subscription rates for certain key business areas.

The largest element of expenditure, claims costs and associated legal costs, saw a small decrease in the year, which points to strong claims management to control the cost of settlements and good control of external legal costs. The remaining elements of expenditure increased by £7million, almost exclusively due to reduced insurance recoveries and increased administration costs.

MPS insures the risk that claim costs will be more than anticipated. The insurance contracts mean that MPS has to pay claims up to a certain amount and the insurers pay any costs above that amount. Over the years as MPS's financial strength has improved, it has been thought prudent to increase the amount that MPS pays before the insurance takes over, which has helped keep insurance premiums down. A consequence of this is that few claims in recent years have exceeded the limit set, so there is less money recovered by MPS from insurers.

The administration expenses are spread across the claims costs, advisory costs and administration expenses elements of the expenditure analysis in the Income and

Expenditure account and the overall increase has been just under £2million (6.8%). The largest single increase has been in investment management fees resulting from the increase in investment funds. In addition, money has been spent on improving MPS's IT readiness to cope with systems failure, which has included a new disaster recovery contract and additional hardware to mirror operating systems.

Investments

The investment return for the year, net of tax and the investment management fees incurred in managing the funds is 8.3%, compared to 5.5% last year. It has undoubtedly been a good year for investments, both equities and bonds. MPS holds assets in the same currencies as its claim liabilities, to ensure that there is no adverse risk from a change in the relative value of the exchange rate between sterling and the local currency. In addition, assets are also held to match the maturity profile of claims to ensure that there is no adverse inflation risk between assets and claim liabilities. Within these prudent risk constraints, MPS aims to maximise its investment return net of costs and holds a portfolio that is about 30% equities, 65% bonds and 5% cash and money market investments.

Unusually in the year, all asset classes across all countries provided positive returns, with the equities performing particularly well. The net investment return after tax of £68million has accounted for 60% of the total increase in net assets.

Risk

The above provides an insight into the financial performance for the year and the key issues that underlie MPS's financial performance. However, above all of this is the ever-present theme of risk. Risk of accepting new members, risk of existing members, investment risk, inherent risk of estimating claim values, risk of deterioration in claims experience and the risk of business continuity to name but a few. MPS rightly devotes considerable time and energy to risks and their subsequent management and mit-igation to help ensure that it is robust enough to withstand predictable external influences.

Specifically, MPS is reducing its exposure to risk in the following ways:

- by buying insurance to cover the risk of exceptional claims costs
- by matching liability maturity and currency with similar assets to reduce the risk of an adverse movement between assets and liabilities
- by improving contingent IT capabilities to reduce the risk of systems or business failure
- by subjecting applications to pre-defined underwriting criteria to reduce risk of claims
- by delivering risk-management advice and non-clinical risk reduction training to those members whose claims or cases records gives cause for concern.

MPS also has a subsidiary company, MPS Risk Consulting, which provides risk-management services and consultancy to members and non-members to help improve systems risks within primary and secondary care within the UK and abroad.

Simon Kayll
Finance Director

Members of the Council and Committees

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Professor The Lord Turnberg MD FRCP[3]

Vice-Presidents

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Professor Shmuel Penchas MSc MD DIC

New Zealand
Professor Sir John Scott *KBE* MD FRCP FRACP FRSNZ BMedSc

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Chief Executive
John Hickey MB BS FRCA

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Key

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2 *Members of the Remuneration Committee*
3 *Members of the Nominations Committee*
4 *Members of the Board of MPI (London) Limited*
5 *Members of the Board of MPS Risk Solutions Limited*

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Report of the Council

The Council, which for the purposes of the Companies Acts is the Board of Directors, presents its annual report for the year ended 31 December 2005.

Principal activity

MPS is a mutual society, the function of which is to protect, support and safeguard the character and interests of medical and dental practitioners. It is a non-profit-making company limited by guarantee and all income and property must be applied solely towards its objects as defined by MPS's Memorandum of Association.

One of MPS's objects is to grant indemnity to members in respect of claims and demands arising from their professional practice, which may result in the payment of costs and damages. The Articles of Association set down in paragraph 40 that 'the grant of an indemnity shall be entirely in the discretion of the Council who shall have the power to impose such terms and conditions on the grant of any indemnity as it thinks fit and may in its absolute discretion limit or restrict such indemnity or decline altogether to grant the same.'

Review of the business

The results for the year are stated in detail on pages 14 to 30.

The review of the business appears in the Chief Executive's report on pages 2 to 4 and the Finance Director's report on pages 5 to 6.

Donations

Charitable donations made by MPS during the year amounted to £1,000, all in favour of the Royal Medical Benevolent Fund. No political donations were made during the year.

Employees

During the year MPS continued to provide employees with relevant information and seek their views on matters of common concern through the Staff Consultative Group, staff briefings and through line managers. Priority is given to ensuring that employees are aware of all significant matters affecting MPS's trading position and of any significant organisational changes.

The Information and Consultation of Employees Regulations 2005 came into effect in April 2005. These regulations allow employees to submit a formal request for information and consultation, or allow the employer to voluntarily start the process. MPS decided to start the process voluntarily and during 2005, adapted the existing Staff Consultative Group for this purpose.

It is the policy of MPS to support the employment of disabled persons where possible, both in recruitment and by retention of employees who become disabled whilst in the employment of MPS, as well as generally through training and career development.

Members of the Council

The names of the members of the Council of MPS who served during the year are set out on page 7.

Corporate Governance

The Listing Rules of the Financial Services Authority require listed companies to disclose how they have applied the principles set out in Section 1 of the New Combined Code prepared by the Committee on Corporate Governance and whether they have complied with its provisions throughout the period. Although not listed, the Society complies with the New Combined Code where it is considered relevant to MPS's business and constitution. The following is, where relevant, a statement in accordance with the Code.

Council

The Council consists of a non-executive Chairman, a Chief Executive, two further executive members and nine other non-executive members.

All the non-executives are considered to be independent, not being past executives of MPS and not having any financial interest in MPS other than their fees as members of the Council, fees for acting as expert witnesses on behalf of MPS members, which were received by three members of the Council during 2005, fees for providing risk management services to members, which were received by one member of Council during 2005 and, if relevant, their personal membership of MPS. MPS has separate posts of Chairman and Chief Executive to differentiate the running of the Council from the executive responsibility for the running of the business. The Council considers that the non-executive members of the Council as a group are of a sufficient calibre and number to bring strength and independence to the Council and does not propose to nominate any one non-executive to be a senior independent member of the Council. In stating this, the Council recognises that this is not in accordance with the relevant provision of the New Combined Code.

The normal retirement age for executive members of the Council is currently 60 and for non-executive members 70. All Council members, except for the Chief Executive and the Chairman of Dental Protection Limited are subject to election by members at the first opportunity after their appointment by the Council and to re-election (excepting the Chief Executive and the Chairman of Dental Protection Limited) at general meetings at least every three years. The Chief Executive is appointed by the Council and can be removed by the Council. The Council recognises that not subjecting the Chief Executive to re-election is a departure from the relevant section of the New Combined Code, but believes that it does not compromise the independence or integrity of the Council. The Chairman of Dental Protection Limited is a member of Council ex-officio, and is elected to the post by the Board of Dental Protection Limited. Directors of Dental Protection Limited are elected by the shareholder of the Company, which is MPS and thus the Council of MPS has the ability to appoint and remove directors of Dental Protection Limited. Non-executive members of the Council are limited to an eight year term.

The Council met formally ten times during the year and spent an additional day specifically dedicated to considering business strategy. The attendance record of members of the Council at the ten regular meetings is shown in Table 1 on page 10.

The Council has a schedule of matters specifically reserved to it for decision, including strategy, financial policy and major acquisitions and disposals. All Council members have access to the advice and services of the Company Secretary and procedures exist for any member of the Council to take independent advice at the Society's expense.

Non-executive members of the Council met once during the year without the executive members and have the provision to meet without the executive at any time that such a meeting may be required.

Sub-Committees of the Council

The Council has a Nominations, Remuneration and Audit Committee, the members of which are listed on page 7.

The Nominations Committee is chaired by the Chairman of the Council and keeps under review the composition of the Council and makes recommendations concerning all new appointments of non-executive members.

The Remuneration Committee is chaired by the Chairman of the Council and is responsible for making recommendations to the Council concerning matters relating to remuneration policy. See Remuneration Report below.

The Audit Committee is chaired by a non-executive member of the Council (a former audit partner of an international firm of Chartered Accountants) and met twice in the year. MPS's external auditors, Chief Executive, Finance Director, Financial Controller and Operational Review Manager also attend the meetings and the Committee has an opportunity to meet the external auditors without management present. Other senior managers attend for specific agenda items as required. The Audit Committee reviews the adequacy and effectiveness of risk management and control systems and reviews the scope and results of the external audit, its cost effectiveness and the independence and objectivity of the auditors. It also reviews prior to publication the annual financial statements and the other information included in the Annual Report. The Audit Committee also meets annually with, and reviews the work of, the independent consulting actuaries. The Chairman of the Council is a member of the Audit Committee, which is a departure from the relevant section of the New Combined Code, but the Council believes that because of the degree of involvement of the Chairman in the running of the business, this does not compromise the integrity of the Audit Committee.

The attendance record of members of the Audit Committee is shown in Table 2.

The Audit Committee is responsible for ensuring the continued independence of the external auditors. The Committee has a written policy on this, which includes requiring the auditors to make a statement on their continued independence, placing limits on the amount of non-audit work undertaken by the auditors and having a policy covering the commissioning of non-audit services from the auditors.

Several members of the Council are members of the Board of MPI (London) Limited, which manages MPS's investment portfolio, and of the Board of MPS Risk Solutions Limited, which provides general insurance contracts to organisations in the healthcare sector. Both Boards are chaired by the Chairman of the Council and the members are listed on page 7.

The Role of the Council

The Council's principal focus is the overall strategic direction, development and control of the MPS group. In addition, it is also ultimately responsible for the exercising of discretion in response to requests for assistance. In practice, this is delegated on a daily basis to the executive management and employees. However, the Council is specifically involved in exercising discretion in potentially controversial, expensive or unusual requests for assistance.

In support of the overall strategy, the Council approves the group's values, strategic plans, annual budget and overall system of risk identification, management and internal controls. The Council also has control of the group's operating and financial performance.

The Council agrees the group's corporate governance framework, as part of which it has empowered the main management committee, the Executive Committee, who are responsible for day to day operations.

The roles of the Chairman and Chief Executive are written down and the Chairman, together with the Chief Executive and the Secretary are responsible for ensuring that the Council is kept fully informed and is consulted on issues that are reserved to it and that decisions are made in a timely manner.

Newly appointed members of the Council are given an induction appropriate to their level of previous experience.

Board Evaluation

The Council undertook an evaluation of its performance based upon a questionnaire and the invitation for members of the Council to speak to the Chairman on performance issues. The results of the evaluation were presented to the Council by the Chairman in its February 2006 meeting and resulting actions were approved by the Council.

Internal Control

The Council has overall responsibility for MPS's system of internal controls and for reviewing its effectiveness whilst the role of management is to implement the Council's policies on risk and control. The system is designed to manage, rather than eliminate, the risk of failure to achieve the business objectives. In pursuing these objectives, internal controls can only provide reasonable and not absolute assurance against material misstatement or loss.

There is a continuous process for identifying, evaluating and managing the significant risks faced by MPS in line with recommendations in the original and updated Turnbull report. This has been in place for the full financial

Table 1: Council Attendance Record

Member of the Council	Appointed / Retired	No. of Meetings Attended 2005	2004
Frank Attwood	Appointed 9 June 2004	10	5
Alan Crouch	Retired 8 June 2005	5	7
Nicholas Davies		9	9
Mark Dinwoodie	Appointed 8 June 2005	5	N/A
Mary Favier	Appointed 8 June 2005	5	N/A
John Hickey		10	10
Leela Kapila		10	9
Simon Kayll		10	10
Mary King	Retired 8 June 2005	2	6
Kevin Lewis		10	9
Ravinder Maini		9	8
Brian Mouatt		10	9
Susan Sellers	Retired 8 June 2005	4	8
Elizabeth Vallance	Appointed 9 February 2005	9	N/A
John Leighton Williams		9	8
Richard Youell		7	8

Table 2: Audit Committee Attendance Record

Member of the Audit Committee	Appointed / Retired	No. of Meetings Attended 2005	2004
Frank Attwood	Appointed 9 June 2004	2	1
Alan Crouch	Retired 8 June 2005	1	1
Nicholas Davies		2	2
Leela Kapila	Appointed 8 June 2005	1	N/A
Ravinder Maini		1	2
Brian Mouatt		2	2
Susan Sellers	Retired 8 June 2005	1	2
Elizabeth Vallance	Appointed 8 June 2005	1	N/A

year and up to the date of approval of the annual report.

The process involves the undertaking of regular reviews at departmental and corporate level. From these reviews, management identifies the key risks, and determines their likely significance based on the probability of the risk occurring and its likely impact on the Society if it were to do so. Management then determines what action can cost-effectively be taken.

The Council has delegated the function of monitoring the effectiveness of the system of internal control and of the risk management process to the Audit Committee. The Chairman of the Audit Committee reports outcomes of its meetings to the Council and the Council receives the minutes of all its meetings.

In fulfilling its responsibilities to the Council, the Audit Committee:

- Discusses with the external auditors their audit approach, and agrees any particular aspect of internal control or risk management to be reviewed by them beyond their statutory responsibilities
- Discusses with independent consulting actuaries their approach to statistical reserving of reported claims and potential claims that have yet to be reported
- Considers the results of the external auditors' work with them and with management
- Initiates as necessary and considers reports from management on systems of internal control and on the effectiveness of risk management
- Reports the results of its works, with any necessary recommendations, to the Council and ensures that actions required by the Council are implemented. One such report is made at the year-end before producing this statement.

MPS has an operational review manager whose responsibilities include internal audit. Internal audit is concerned with providing assurance over a wide range of issues, including financial, corporate and operational risks. The operational review manager works closely with the external auditors and also attends the Audit Committee meetings. The Audit Committee is responsible for monitoring and reviewing the internal audit function undertaken by the operational review manager. The Audit Committee receives summaries of all internal audit reports, is involved in approving the annual internal audit plan and is able to question the operational review manager about his work at each committee meeting.

Remuneration report

The Remuneration Committee is responsible for recommending to the Council fees for members of the Council, Committees and directors of subsidiaries as well as deciding the remuneration of senior staff and receiving recommendations from the Chief Executive for the remuneration of other employees. In framing its policy, the Remuneration Committee aims to attract and retain senior staff to run the Society successfully without making excessive payments. MPS does not provide any regular bonuses, incentive schemes or performance related payments to any staff or non-executive members of the Council.

Details of the Council Members' remuneration are included at note 7 to the accounts.

Relations with members

The provisions of the New Combined Code relate to communication by companies with their shareholders and thus some of the details do not apply to the different relationship that MPS has with its members. However, the general tenor of the provisions is applicable to MPS and MPS values its dialogue with members. The Council also uses the Annual General Meeting to communicate financial performance with members and encourages their participation. Members of the Audit, Nomination and Remuneration committees will be present at the Annual General Meeting to respond to any relevant questions if necessary.

The notice for the Annual General Meeting is sent to members at least 20 working days before the meeting date.

Derivative Financial Instruments

During the year MPS's investment managers held derivative financial instruments to enhance investment returns. The net recognised gains and losses of these contracts are included in note 5 under other investment income. These instruments were held to take advantage of short term changes in market prices affecting UK Gilt and Corporate Bonds, Euro Bonds and South Africa Bonds. During the year this was achieved by entering into a number of future contracts, which involve the purchase or sale of an underlying asset at a price fixed today for delivery at some date in the future. Table 3 (below) illustrates the future contracts entered into during the year:

Risk characteristics of futures contracts

Interest rate risk

Futures contracts are sensitive to interest rate movements so it is necessary to determine the interest rate risk that such contracts will be exposed to. This is done by comparing the risk of the underlying asset against the risk of the future. For an asset such as a bond the risk is calculated by multiplying the dirty price (the price of the bond plus accrued interest) of the bond by its modified duration. The bond future risk is then calculated by multiplying the bond risk by a conversion factor used in the pricing of the contract. The bond risk and future risk are then compared to determine the number of future contracts that need to be held.

Credit Risk

Credit risk encompasses all forms of counterparty risk. MPS manages this risk through its investment policy, which sets out the type and quality of investments that can be held and the maximum exposure to any particular investment. Credit risk is further managed by all such future contracts being of short term duration.

Going concern

Members of the Council consider that MPS has adequate resources to continue in operation for the foreseeable future and that it is therefore appropriate to adopt the going concern basis in preparing the financial statements. Members of the Council have satisfied themselves that MPS is in a sound financial position.

Table 3: Future Contracts

Currency	Contract Type	Currency	Contract Type
GBP	Long Gilt future	Euro	Schatz future
GBP	Time Warner future	Euro	Bobl future
GBP	90 day sterling future	Euro	Bond future
USD	10 year swap future	Euro	3 month Eurobor future
USD	90 day Euro$ future	Euro	3 month Euribor option
USD	US 2 year note (CBT)	Euro	10 year Euro swapnote
USD	US 10 year note future	Euro	Euro-bund future
USD	US Long bond (CBT)	Euro	Euro-bund option
Rand	Bond future	Euro	30 year Euro BUXL future
CHF	3 month Euro Sfr LIFFE		

Auditors

RSM Robson Rhodes LLP have expressed their willingness to continue in office as auditors and a resolution for their re-appointment will be proposed at the forthcoming annual general meeting.

Statement of the Council's responsibility for the Financial Statements

The Council is responsible for preparing the Annual Report and the financial statements in accordance with applicable law and United Kingdom Generally Accepted Accounting Practice.

Company Law requires the Council to prepare financial statements for each financial year which give a true and fair view of the state of affairs of the Society and the Group and of the surplus or deficit of the Group for that period. In preparing those financial statements, the Council has:

- selected suitable accounting policies and then applied them consistently;
- made judgements and estimates that are reasonable and prudent;
- followed applicable United Kingdom accounting standards; and
- prepared the financial statements on the going concern basis.

The Council is responsible for keeping proper accounting records which disclose with reasonable accuracy at any time the financial position of the Society and the Group and to enable it to ensure that the financial statements comply with the Companies Act 1985. It is also responsible for safeguarding the assets of the Society and the Group and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

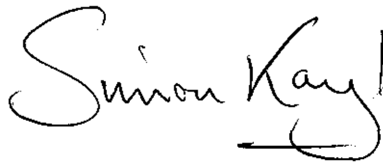
This Annual report is available on MPS's web site. The maintenance and integrity of MPS's web-site is the responsibility of the Council; the work carried out by the auditors does not involve consideration of these matters and, accordingly, the auditors accept no responsibility for any changes that may have occurred to the information contained in the financial statements since they were initially presented on the web site.

Legislation in the United Kingdom governing the preparation and dissemination of the financial statements and other information included in the annual reports may differ *from legislation in other jurisdictions.*

Approval

This report was approved by the Council on 12 April 2006 and signed on its behalf by:

Simon Kayll
Company Secretary
33 Cavendish Square, London, W1G 0PS



Independent auditors' report

to the Members of The Medical Protection Society Limited

We have audited the financial statements on pages 14 to 30. These financial statements have been prepared under the accounting policies set out therein.

This report is made solely to the Society's members, 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 Society'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 Society and the Society's members as a body, for our audit work, for this report, or for the opinions we have formed.

Respective responsibilities of the Council and auditors

The Council's responsibility for preparing the Annual Report and the financial statements in accordance with applicable law and United Kingdom Accounting Standards is set out in the Statement of the Council's Responsibility.

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 are properly prepared in accordance with the Companies Act 1985. We also report to you if, in our opinion, the Council's report is not consistent with the financial statements, if the Society has not kept proper accounting records, if we have not received all the information and explanations we require for our audit, or if information specified by law regarding the Council members' remuneration and transactions with the Society and other members of the group is not disclosed.

We read the information contained in the Annual Report and consider whether it is consistent with the audited financial statements. The other information comprises only the Chairman's Statement, the Chief Executive's Report, the Finance Director's Report and the Report of the Council. We consider the implications for our report if we become aware of any apparent misstatement 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 Council in the preparation of the financial statements, and of whether the accounting policies are appropriate to the Society'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 give a true and fair view, in accordance with United Kingdom Generally Accepted Accounting Practice, of the state of affairs of the Society and the Group as at 31 December 2005 and of the net contribution available to meet future liabilities and charges of the Group for the year then ended and have been properly prepared in accordance with the Companies Act 1985.

RSM Robson Rhodes LLP

RSM Robson Rhodes LLP
Chartered Accountants and
Registered Auditors
Leeds, England
12 April 2006

Consolidated Income and Expenditure Account

For year ended 31 December 2005

	Notes	2005 £'000	2004 £'000 Restated
Income			
Members' subscriptions and other income		185,796	165,805
Expenditure			
Claims costs and associated legal costs (including costs of insurance)	15	107,997	111,129
Insurance recoveries		(555)	(4,663)
Advisory costs and associated legal costs	4a	20,929	19,697
Administration expenses	4a	12,241	10,978
Profit on exchange movements	4b	(1,620)	(2,065)
		138,992	135,076
Excess of members' subscriptions and other income over expenditure		46,804	30,729
Income from investments	5	19,936	19,817
Other finance income	9	144	148
Realised gains from disposal of investments		1,910	5,905
Contribution from ordinary activities before taxation		68,794	56,599
Tax on investment income and gains	6a	(4,780)	(3,850)
Net contribution for the year available to meet future liabilities and charges	17	64,014	52,749

The 2004 comparative figures have been restated where appropriate due to changes in accounting policies in the year relating to FRS17 – *Retirement Benefits,* and the treatment of foreign exchange gains on listed investments. Details of the prior year adjustments are in note 3.

Statement of Total Recognised Gains and Losses

	Notes	2005 £'000	2004 £'000 Restated
Net contribution for the financial year		64,014	52,749
Surplus on revaluation of investments	16	53,435	16,460
Surplus on revaluation of fixed assets		-	847
Actuarial loss on defined benefit scheme	9	(1,630)	(167)
Tax charge on investment gains	6a	(2,499)	(1,427)
Total recognised gains		113,320	68,462
Prior year adjustment	3	(4,404)	-
Total recognised gains since the last annual report and financial statements		108,916	68,462

Note of Historical Cost Income and Expenditure

	Notes	2005 £'000	2004 £'000 Restated
Reported net contribution before tax		68,794	56,599
Realisation of valuation gains/(losses) of previous years	*16*	*9,953*	*(8,701)*
Difference between a historical cost depreciation charge and the actual depreciation charge of the year calculated on the revalued amount	16	69	51
Historical cost net contribution before tax		78,816	47,949
Historical cost net contribution retained after tax		71,537	42,672

Consolidated and Company Balance Sheets

At 31 December 2005

	Notes	2005 Group £'000	2004 Group £'000 Restated	2005 Company £'000	2004 Company £'000 Restated
Fixed assets					
Tangible assets	10	8,134	8,457	8,109	8,425
Investments	11	737,516	575,749	31,001	31,001
		745,650	584,206	39,110	39,426
Current assets					
Debtors – due within one year	13	7,216	8,804	525,150	440,441
– due after one year	13	9,832	9,200	9,832	9,200
Bank deposit accounts		88,075	88,317	30,752	23,402
Cash at bank and in hand		1	1,871	1	1,815
		105,124	108,192	565,735	474,858
Creditors – amounts falling due within one year	14	(51,055)	(39,123)	(45,587)	(35,096)
Net current assets		54,069	69,069	520,148	439,762
Total assets less current liabilities		799,719	653,275	559,258	479,188
Provision for liabilities and charges	15	(271,871)	(235,493)	(271,648)	(235,493)
Net assets excluding pension liability		527,848	417,782	287,610	243,695
Pension liability	9	*(1,150)*	*(4,404)*	*(1,150)*	*(4,404)*
Net assets		526,698	413,378	286,460	239,291
Accumulated funds	16				
Revaluation reserve		79,408	35,995	3,025	3,094
Income and expenditure		447,290	377,383	283,435	236,197
Funds available to meet future liabilities and charges	17	526,698	413,378	286,460	239,291

Nicholas Davies
Chairman of the Council
12 April 2006

Consolidated Cash Flow Statement

For year ended 31 December 2005

	Notes	2005 £'000	2004 £'000
Net cash inflow from operating activities	18	88,024	69,212
Returns on investment and servicing of finance	19	19,936	19,817
Taxation		(5,974)	(4,052)
Capital expenditure and financial investment	20	(134,163)	(61,122)
		(32,177)	23,855
Net cash inflow/(outflow) from management of liquid resources (comprising bank deposits and investment deposits)		29,664	(21,769)
(Decrease)/Increase in cash in the period		(2,513)	2,086

Analysis of changes in net funds

	At 1/1/2005 £'000	Cash flow movement £'000	At 31/12/2005 £'000
Cash at bank and in hand	1,871	(1,870)	1
Bank overdraft	–	(643)	(643)
	1,871	(2,513)	(642)
Bank deposit accounts	88,317	(242)	88,075
Cash with investment managers	37,236	(29,422)	7,814
Net funds	127,424	(32,177)	95,247

Reconciliation of net cash flow to movement in net funds

	2005 £'000	2004 £'000
(Decrease)/increase in cash	(2,513)	2,086
Cash flow from (decrease)/increase in net liquid resources	(29,664)	21,769
	(32,177)	23,855
Net funds at 1 January	127,424	103,569
Net funds at 31 December	95,247	127,424

Notes to the accounts

1. Basis of preparation of the financial statements

The financial statements are prepared in accordance with applicable accounting standards and MPS's constitution.

Convention

The financial statements include investments and freehold property at valuation but in all other respects have been prepared in accordance with the historical cost convention. The principal accounting policies adopted by MPS within that convention are set out below.

2. Accounting policies

(a) Changes in accounting policies

During the year MPS fully adopted the requirements of FRS17 ('Retirement Benefits'), which has resulted in a change of accounting policy. MPS has also changed its accounting policy to disclose foreign exchange movements on listed investments in the income and expenditure account rather than the statement of total recognised gains and losses. These changes have resulted in a prior year adjustment. Details of the impact of these changes on the current year and comparative information are set out in note 3.

(b) Consolidation

The Group financial statements comprise a consolidation of the financial statements of the parent company (the 'Company') and all its subsidiary undertakings (together, the 'Group') as at 31 December and as identified in note 12. In accordance with the exemptions given by Section 230 of the Companies Act 1985, the Company does not publish its own income and expenditure account.

(c) Subscriptions

Subscription income comprises amounts receivable during the year, apportioned to accounting periods on a time basis. No geographical analysis of subscription income is shown because, in the opinion of the Council, it would be seriously prejudicial for the Group to do so.

(d) Tangible fixed assets and depreciation

All freehold land and buildings are included at valuation. Valuations are kept up-to-date. Other tangible fixed assets are included at cost. Depreciation is provided evenly on the cost (or valuation where appropriate) of tangible fixed assets, to write them down to their estimated residual values over their expected useful lives. Where there is evidence of impairment, fixed assets are written down to recoverable amounts. Any such write down would be charged to operating profit unless it was a reversal of a past revaluation surplus in which case it would be taken to the statement of total recognised gains and losses. No depreciation is provided on freehold land. The principal annual rates used for other assets are:

Freehold buildings	- 2% per annum
Leasehold property	- over life of leases
Furniture and fittings	- 5% per annum
Office equipment	- 15% per annum
Computers	- 20%, 25% or 33.3% per annum

(e) Translation of foreign currency transactions

Income and expenditure in foreign currencies are translated to their sterling equivalent at the rate ruling at the transaction date. Monetary assets and liabilities appearing in the balance sheet are translated at the rate of exchange ruling at 31 December or at a rate fixed in advance by way of a forward exchange contract. Any gain or loss is taken to the income and expenditure account.

(f) Dividends and interest receivable

Dividends and interest receivable are brought into account on an accruals basis. Dividend income is recorded net of tax credits.

2. Accounting policies *continued*

(g) Investments

Investments (which include cash held by the investment managers awaiting investment) are included in the balance sheet at market valuation. The net surplus or deficit on revaluation is credited or charged to the revaluation reserve. In accordance with Financial Reporting Standard 3, on disposal the proceeds are compared with the carrying value and the gain or loss credited or charged to the income and expenditure account.

(h) Derivative financial instruments

The Group's investment managers are permitted to hold derivative financial instruments to enhance investment returns.

Derivative financial instruments are recognised initially at cost and then subsequently at fair value. Realised gains and losses are taken directly to the profit and loss account, whilst unrealised gains and losses are credited or charged to the revaluation reserve. On disposal, gains and loses are dealt with in accordance with Financial Reporting Standard 3 as in note (g) above.

(i) Costs and damages

Provision is made at discounted future settlement values for estimated future costs and damages, legal costs and claims handling costs expected to arise from claims that have been notified to MPS by 31 December in respect of which the Council has exercised or is expected to exercise its discretion to provide indemnity. The estimate of these costs is stated before deducting estimated recoveries from insurers, which are disclosed separately and are recognised only when it is virtually certain that reimbursement will be received.

No provision is made for the potential claims that may arise from incidents that occurred before 31 December but had not been reported to MPS at that date.

(j) Tax

Provision is made in the financial statements for tax on investment and trading income received and receivable in the year, revaluation gains and losses recognised in respect of UK and International bonds and on other investments disposed of during the year.

No deferred tax provision is required to be reflected in the financial statements. Whilst there is a timing difference arising between the accounting and taxation treatment of certain non-monetary assets, in accordance with FRS19, deferred tax is not provided on timing differences arising from the revaluation of non-monetary assets, where there is no binding agreement to sell these assets at the balance sheet date.

Deferred tax is measured at the tax rates that are expected to apply in the periods when the timing differences are expected to reverse, based on tax rates and law enacted or substantively enacted at the balance sheet date. Deferred tax assets and liabilities are not discounted.

Where law or accounting standards require gains and losses to be recognised in the statement of total recognised gains and losses, the related taxation is also taken directly to the statement of total recognised gains and losses in due course.

(k) Pensions

MPS operates a defined benefit pension scheme. The assets of the scheme are invested and managed independently of MPS's finances. The pension scheme assets are measured using market values. Pension scheme liabilities are measured using the projected unit actuarial method and are discounted at the current rate of return on a high quality corporate bond of equivalent term and currency to the liability. Any increase in the present value of liabilities within MPS's defined benefit scheme expected to arise from employee service in the period is charged to operating profit. The expected return on the scheme's assets and the increase during the period in the present values of the scheme's liabilities arising from the passage of time are included in other finance income. Actuarial gains and losses are recognised in the consolidated statement of total recognised gains and losses.

Pension scheme surpluses, to the extent they are considered recoverable, or deficits are recognised in full on the face of the balance sheet.

Further information on the structure of the defined benefit scheme is contained within note 9 to these accounts.

(l) Leasing

Rentals under operating leases are charged on a straight-line basis over the lease term.

3. Prior year adjustments

As stated in note 2(a) during the year MPS fully adopted the requirements of FRS17 'Retirement Benefits'. Full make up of the movement on the pension scheme deficit in the year and the amounts charged/credited to the income and expenditure account and statement of total recognised gains and losses are contained in note 9.

MPS also changed its policy on recognition of foreign exchange movements on listed investments, which has resulted in these movements being recognised in the income and expenditure account rather than the statement of total recognised gains and losses.

These changes in accounting policies have resulted in prior year adjustments and comparatives have been restated. Set out below is the impact on the consolidated income and expenditure account, consolidated statement of total recognised gains and losses, and the Group balance sheet for both the current and preceding year.

2004	As Previously Stated £'000	Adjustment for FRS17 £'000	Adjustment for foreign exchange £'000	As Restated £'000
Income and expenditure account				
Excess of income over expenditure	29,904	(116)	941	30,729
Net contribution for the year to meet future liabilities and charges	50,430	32	2,287	52,749
Statement of total recognised gains and losses				
Surplus on revaluation of investments	17,401	–	(941)	16,460
Actuarial loss	–	(167)	–	(167)
Tax charge on investment gains	(81)	–	(1,346)	(1,427)
Balance Sheet				
Net assets	417,782	(4,404)	–	413,378

2005	As Previously Stated £'000	Adjustment for FRS17 £'000	Adjustment for foreign exchange £'000	As Restated £'000
Income and expenditure account				
Excess of income over expenditure	39,541	4,740	2,523	46,804
Net contribution for the year to meet future liabilities and charges	57,364	4,884	1,766	64,014
Statement of total recognised gains and losses				
Surplus on revaluation of investments	55,958	–	(2,523)	53,435
Actuarial loss	–	(1,630)	–	(1,630)
Tax charge on investment gains	(3,256)	–	757	(2,499)
Balance Sheet				
Net assets	527,848	(1,150)	–	526,698

4a. Advisory costs and administration expenses

		2005 £'000	2004 £'000
Included under this classification are:			
Operating lease rentals	– Land and buildings	880	858
	– Motor vehicles	83	88
Auditors' remuneration	– Audit fees	71	63
	– Fees for other services	74	90
Loss on disposal of tangible fixed assets		139	8
Depreciation of fixed assets		788	881

4b. Exchange movements

The majority of profit on exchange movements relates to the restatement of international bonds and cash assets held to match international liabilities. These gains are substantially offset by a corresponding increase in international liabilities, which is included in claims costs through an increase in the overall claims provision (note 15).

5. Income from investments

		2005 £'000	2004 £'000
Dividends: listed investments	– franked	1,432	2,975
	– unfranked	15,210	11,465
Bank interest		3,477	5,154
Other investment income		(183)	223
		19,936	19,817

Other investment income includes net losses arising from derivative financial instruments, which are discussed in more detail in the Report of the Council on pages 9 to 12.

6a. Tax on income and gains from investments

	2005 £'000	2004 £'000 Restated
Tax on income and gains included in the income and expenditure account for the year		
UK corporation tax:		
Current tax on income and gains for the year at 30% (2004: 30%)	4,781	4,123
Adjustment in respect of prior years	(1)	(273)
Double taxation relief	(18)	(26)
	4,762	3,824
Foreign tax:		
Current tax on income for the year	18	26
Tax on investment income and gains in the income and expenditure account	4,780	3,850
Tax on other gains included in the Statement of Total Recognised Gains and Losses for the year		
UK corporation tax:		
Current tax charge on gains for the year at 30% (2004: 30%)	2,499	1,427
Tax on other gains included in the Statement of Total Recognised Gains and Losses for the year	2,499	1,427

6b. Factors affecting tax charge for the year

	2005 £'000	2004 £'000 Restated
Current tax reconciliation		
The tax assessed for the year is lower than the standard rate of corporation tax in the UK of 30%. The differences are explained below:		
Contribution before tax per accounts	68,794	56,599
Less: non-taxable contribution (see below)	(48,310)	(29,405)
Income and gains from investments included in the income and expenditure account for the year	20,484	27,194
Income and gains from investments multiplied by the standard rate of corporation tax in the UK (30%)	6,145	8,158
Effects of:		
Income from UK equities not subject to taxation	(430)	(892)
Realised gains on disposal of investments	(889)	(3,296)
Losses allowed on pre-trading expenditure	(151)	153
Expenses not deductible for tax purposes	2	–
Unrealised gains in MPS Risk Solutions	104	–
Current tax charge for the year	4,781	4,123

The non-taxable contribution above is the surplus of members' subscription income over related expenditure, which, due to MPS's mutual status, is not subject to corporation tax.

6c. Unprovided deferred taxation

A £11.7 million (2004: £1.1 million) tax charge would arise should MPS's equity investments and freehold property be sold at the market values at which they are included in the balance sheet.

7. Emoluments of members of the Council

	2005 £'000	2004 £'000
Aggregate amount of emoluments paid to members of the Council (including executive members)	812	764
Chairman	39	36
Highest paid member of the Council		
Chief Executive – emoluments and taxable benefits	214	175
– accrued annual pension rights	91	81

For 2005 the Chief Executive's emoluments and taxable benefits include a bonus and long service award.

There are 3 (2004: 3) executive members of the Council who are members of MPS's defined benefit pension scheme, details of which are set out in note 9.

The standard remuneration for all non-executive members of the Council (other than the Chairman) was £16,600 (2004: £16,000). An increase of £600 per annum was implemented on 1 March 2005. The following members of Council, who were members of other Boards and Committees, received additional remuneration as detailed below:

Council Member	Additional Remuneration (£)
Frank Attwood	10,533
Alan Crouch	4,945
Leela Kapila	1,129
Ravinder Maini	1,667
Brian Mouatt	14,500

Council Member	Additional Remuneration (£)
Susan Sellers	545
Elizabeth Vallance	1,129
John Leighton Williams	4,867
Richard Youell	1.667

8. Employees

The average number of people employed by MPS during the year was 262 (2004: 247).

Costs in respect of these employees:	2005 £'000	2004 £'000 Restated
Wages and salaries	10,817	10,266
Social security costs	1,114	1,055
Pension costs	2,024	1,768
	13,955	13,089

9. Pensions

MPS operates a defined benefit pension scheme, The Medical Protection Society Limited (1973) Pension and Life Assurance Scheme. The scheme funds are administered by trustees and are independent of MPS's finances. Contributions are paid to the scheme in accordance with the recommendations of an independent actuarial adviser on the basis of triennial valuations.

The most recent full valuation was carried out as at 31 December 2002 using the projected unit method. It was assumed that investment returns would be 6.4% pa. pre retirement and 5.4% pa. post retirement, that increase in earnings would average 3.8% p.a. and that pensions would increase at the rate of 2.3% pa. The valuation showed that the market value of the fund's assets was £15.3m, which represented approximately 99% of the Minimum Funding Requirement liabilities and 72% of the value of the benefits that had accrued to members after allowing for future increases in earnings. A further valuation is underway as at 31 December 2005.

In view of the shortfall revealed by the 2002 valuation, MPS made special contributions to the scheme of £2,500,000 in May 2003 and £5,000,000 in December 2005.

The formal actuarial valuation as at 31 December 2002 was updated to the accounting date by an independent qualified actuary in accordance with FRS17. As required by FRS17, the value of the defined benefit liabilities has been measured using the projected unit method.

The following tables set out the key FRS17 assumptions used for the scheme. The tables also set out, as at the accounting date, the fair values of the assets, analysed by asset class, the present value of the scheme liabilities and the resulting pension deficit. FRS17 requires that this deficit be shown as 'Pension liability' on the face of the balance sheet.

Assumptions:	At 31 December 2005 (% pa)	At 31 December 2004 (% pa)	At 31 December 2003 (% pa)
Price inflation	2.9	2.9	2.7
Discount rate	4.7	5.3	5.4
Pension increases (LPI)	2.9	2.7	2.6
Salary growth	4.4	4.4	4.2

On the basis of the assumptions used for life expectancy, a male pensioner currently aged 60 would be expected to live for a further 24 years (2004: 24 years). Allowance is made for future improvements in life expectancy.

9. Pensions *continued*

Asset distribution and expected returns:	At 31 December 2005		At 31 December 2004		At 31 December 2003	
	Expected return (%pa)	Fair value £'000	Expected return (%pa)	Fair value £'000	Expected return (%pa)	Fair value £'000
Equities	7.3	23,243	7.5	19,041	7.7	17,118
Bonds	4.1	14,002	4.6	6,634	4.8	4,250
Property	5.7	797	6.0	662	6.3	594
Cash	4.2	259	4.5	204	4.6	303
Total		38,301		26,541		22,265

Balance sheet:	At 31 December 2005 £'000	At 31 December 2004 £'000	At 31 December 2003 £'000
Total fair value of assets	38,301	26,541	22,265
Present value of scheme liabilities	*(39,451)*	*(30,945)*	*(26,534)*
Pension liability	(1,150)	(4,404)	(4,269)

Under FRS17, the scheme is represented on the balance sheet at 31 December 2005 as a liability of £1,150,000 (2004: £4,404,000).

Over the year to 31 December 2005, MPS made contributions of £6,763,447 (2004: £1,651,827) to the Scheme. It has been agreed that future employer contributions will continue at a rate of 20% of pensionable salaries.

The post retirement deficit under FRS17 moved over the year as follows:	2005 £'000	2004 £'000
Post retirement deficit at start of year	(4,404)	(4,269)
Current service cost	(2,398)	(2,114)
Contributions	7,138	1,998
Other net finance income	144	148
Actuarial loss	(1,630)	(167)
Post retirement deficit at end of year	(1,150)	(4,404)

No deferred taxation is recognised due to MPS's tax status as a mutual, and accordingly no deferred tax asset in respect of the above deficit has been recognised.

The following amounts are included within the income and expenditure account:	2005 £'000	2004 £'000
Amount charged to operating surplus		
Current service cost	2,024	1,768
Amount credited to other financial income		
Expected return on pension scheme assets	1,828	1,621
Interest on post retirement liabilities	(1,684)	(1,473)
Net return to credit to other financial income	144	148

The following amounts are recognised in the Statement of Total Recognised Gains and Losses:

	2005 £'000	2004 £'000
Actual return less expected return on scheme assets	3,554	1,272
Loss due to changes in assumptions underlying the FRS17 value of scheme liabilities	(5,184)	(1,439)
Actuarial loss	(1,630)	(167)

9. Pensions *continued*

History of experience gains and losses:	2005	2004	2003
Actual return less expected return on scheme assets (£'000)	3,554	1,272	2,078
Percentage of scheme assets	9%	5%	9%
Experience gains arising on scheme liabilities (£'000)	–	–	135
Percentage of the FRS17 value of the scheme liabilities	–	–	1%
Amount recognised in the Statement of Total Recognised Gains and Losses (£'000)	(1,630)	(167)	(494)
Percentage of the FRS17 value of the scheme liabilities	(4%)	(1%)	(2%)

10. Tangible fixed assets	Freehold property £'000	Leasehold property £'000	Computers, furniture, fittings and office equipment £'000	Total £'000
Group				
Cost or valuation				
At 1 January 2005	6,500	665	5,732	12,897
Additions	6	–	611	617
Disposals	–	(260)	(625)	(885)
At 31 December 2005	6,506	405	5,718	12,629
Depreciation				
At 1 January 2005	11	544	3,885	4,440
Provided in year	138	40	610	788
Released on disposals	–	(179)	(554)	(733)
At 31 December 2005	149	405	3,941	4,495
Net book value				
At 31 December 2005	6,357	–	1,777	8,134
At 31 December 2004	6,489	121	1,847	8,457
Company				
Cost or valuation				
At 1 January 2005	6,500	665	5,672	12,837
Additions	6	–	610	616
Disposals	–	(260)	(625)	(885)
At 31 December 2005	6,506	405	5,657	12,568
Depreciation				
At 1 January 2005	11	544	3,857	4,412
Provided in year	138	40	602	780
Released on disposals	–	(179)	(554)	(733)
At 31 December 2005	149	405	3,905	4,459
Net book value				
At 31 December 2005	6,357	–	1,752	8,109
At 31 December 2004	6,489	121	1,815	8,425

All the leasehold properties held at 31 December 2005 are short leaseholds.

10. Tangible fixed assets *continued*

Assets included at valuation

The freehold property was originally revalued on 31 December 1999 on the basis of the Existing Use Value including notional directly attributable acquisition costs. The valuation was independent and external and was carried out by DTZ Debenham Tie Leung, Chartered Surveyors, in accordance with the Appraisal and Valuation Manual of the Royal Institute of Chartered Surveyors. An interim valuation was carried out on 1 November 2002 and a full valuation on 3 December 2004, both by the above Chartered Surveyors in accordance with Financial Reporting Standard 15, Tangible Fixed Assets.

If the freehold property had not been revalued it would have been included in the balance sheet at the following amount:

	£'000
Cost	4,143
Depreciation	(811)
At 31 December 2005	3,332
At 31 December 2004	3,396

Capital commitments

Capital expenditure approved and contracted for amounted to £ nil (2004: £ nil).

11. Investments

		2005 Group £'000	2004 Group £'000 Restated	2005 Company £'000	2004 Company £'000
Valuation or cost at 1 January		575,749	459,823	31,001	20,001
Additions		278,521	490,289	–	11,000
Disposals at carrying value		(143,052)	(423,859)	–	–
Movement in cash and brokers' balances		(29,660)	32,095	–	–
Foreign exchange gains on listed investments		2,523	941	–	–
Surplus on revaluation of listed investments		53,435	16,460	–	–
At 31 December		737,516	575,749	31,001	31,001
Investments comprise					
Listed on UK Stock Exchange	– Equities	86,670	69,021	–	–
	– Government and other bonds	354,396	267,910	–	–
Listed on overseas Stock Exchanges	– Equities	150,289	111,454	–	–
	– Government and other bonds	138,347	89,890	–	–
Shares in group undertakings		–	–	31,001	31,001
Cash		7,814	37,236	–	–
Brokers' balances		–	238	–	–
		737,516	575,749	31,001	31,001
Historical cost of investments		657,669	541,907	31,001	31,001

12. Investment in subsidiary undertakings

MPS has the following direct interests in subsidiary undertakings:

Name	Parent and group interest in ordinary shares and voting rights	Cost of parent investment £'000	Country of incorporation or registration	Nature of business
Dental Protection Limited	100%	–	England	To manage the advisory and administrative affairs of the dental division of MPS.
MPS Risk Consulting Limited	100%	–	England	To provide risk management advice and consultancy and claims management to NHS trusts, health authorities and other healthcare organisations.
MPI (London) Limited	100%	20,001	England	To manage the investment portfolio.
DPL Australia (PTY) Limited	100%	–	Australia	To manage the administrative affairs of Dental Protection Limited in Australia.
MPS Risk Solutions Limited	100%	11,000	England	The provision of general insurance contracts to organisations in the healthcare sector.

All the above subsidiaries operate in their country of incorporation or registration.

MPS Risk Solutions Limited received authorisation from the Financial Services Authority to conduct general insurance business on 7 January 2005.

13. Debtors

	2005 Group £'000	2004 Group £'000	2005 Company £'000	2004 Company £'000
Receivable within one year				
Trade debtors	1,208	460	883	413
Recoverable insurance claims	2,572	5,619	2,572	5,619
Amounts owed by subsidiary undertakings	–	–	518,405	431,705
Other debtors	794	425	684	406
Prepayments	2,642	2,300	2,606	2,298
	7,216	8,804	525,150	440,441
Receivable after one year				
Recoverable insurance claims	9,832	9,200	9,832	9,200
Total Debtors	17,048	18,004	534,982	449,641

14. Creditors: amounts falling due within one year

	2005 Group £'000	2004 Group £'000	2005 Company £'000	2004 Company £'000
Bank overdraft	643	-	792	-
Corporation tax	5,060	3,755	95	130
Other taxes and social security	536	451	488	445
Other creditors and accruals	16,459	14,554	16,121	14,158
Deferred subscription income	28,357	20,363	28,091	20,363
	51,055	39,123	45,587	35,096

15. Provision for liabilities and charges:

		Reported claims £'000	Claims handling £'000	Total £'000
Group				
At 1 January 2005		227,652	7,841	235,493
Movements in the year	– Charged to the income and expenditure account	101,791	6,206	107,997
	– Paid	(66,635)	(4,984)	(71,619)
At 31 December 2005		*262,808*	*9,063*	*271,871*
Company				
At 1 January 2005		227,652	7,841	235,493
Movements in the year	– Charged to the income and expenditure account	101,539	6,206	107,745
	– Paid	(66,606)	(4,984)	(71,590)
At 31 December 2005		262,585	9,063	271,648

The reported claims provision is the estimated discounted ultimate settlement values for damages and legal costs in respect of all claims notified by 31 December. The claims handling provision is the estimated internal cost of managing these claims to conclusion.

The timing of individual claim payments is uncertain, as they are the subject of litigation.

The reported claims provision is stated before insurance recoveries of £12.3m that are estimated to be recoverable from MPS's insurers.

Although Financial Reporting Standard 12 requires that the unwinding of the discount within a provision be shown separately, it is not considered practical for this provision due to the complexities of the many actuarial calculations involved.

16. Movement on reserves:

	Revaluation reserve £'000	Income and expenditure £'000	Accumulated £'000
Group			
At 1 January 2005 as previously stated	36,936	380,846	417,782
Prior year adjustment	(941)	(3,463)	(4,404)
At 1 January 2005 restated	35,995	377,383	413,378
Surplus on revaluation of listed investments	53,435	–	53,435
Realised on disposal of investments	(9,953)	9,953	–
Actuarial loss recognised in pension scheme	–	(1,630)	(1,630)
Tax charge recognised on investment gains	–	(2,499)	(2,499)
Release of depreciation on revalued property	(69)	69	–
Net contribution for the year after tax	–	64,014	64,014
At 31 December 2005	79,408	447,290	526,698

16. Movement on reserves *continued*:

	Revaluation reserve £'000	Income and expenditure £'000	Accumulated £'000
Company			
At 1 January 2005 as previously stated	3,094	240,601	243,695
Prior year adjustment	–	(4,404)	(4,404)
At 1 January 2005 restated	3,094	236,197	239,291
Actuarial loss recognised in pension scheme	–	(1,630)	(1,630)
Release of depreciation on revalued property	(69)	69	–
Net contribution for the year after taxation	–	48,799	48,799
At 31 December 2005	3,025	283,435	286,460

17. Reconciliation of movements in funds available to meet future liabilities

	2005 £'000	2004 £'000 Restated
Net contribution for the financial year	64,014	52,749
Other recognised gains relating to the year	51,805	17,140
Tax charge on investment gains	(2,499)	(1,427)
Total recognised gains	113,320	68,462
Opening funds available to meet future liabilities and charges	413,378	344,916
Closing funds available to meet future liabilities and charges (see note 22)	526,698	413,378

18. Reconciliation of excess of income over expenditure to operating cash flows

	2005 £'000	2004 £'000 Restated
Excess of income over expenditure	46,804	30,729
Depreciation charges	788	881
Loss on disposal of tangible fixed assets	139	8
Increase in claims provision	36,378	40,560
Decrease/(increase) in debtors	1,194	(2,776)
Increase in creditors	9,984	635
Foreign exchange gains on listed investments	(2,523)	(941)
Cash pension contributions (in excess of)/below current service cost	(4,740)	116
Net cash inflow from operating activities	88,024	69,212

19. Returns on investment and servicing of finance

	2005 £'000	2004 £'000
Interest received	3,478	5,154
Dividends received	16,641	14,440
Other interest	(183)	223
Net cash inflow from returns on investments and servicing of finance	19,936	19,817

20. Capital expenditure and financial investment

	2005 £'000	2004 £'000
Purchase of tangible fixed assets	(617)	(604)
Purchase of investments	(278,521)	(490,289)
Proceeds from sale of tangible fixed assets	13	7
Proceeds from sale of investments	144,962	429,764
Net cash outflow from capital expenditure and financial investment	(134,163)	(61,122)

21. Commitments

		2005 Group £'000	2004 Group £'000	2005 Company £'000	2004 Company £'000
Operating lease commitments					
Land and buildings, leases expiring	– Within one year	–	636	–	636
	– Greater than five years	897	880	897	880
		897	1,516	897	1,516
Motor vehicles, leases expiring	– Within one year	4	6	4	6
	– Two to five years	7	8	6	8
		11	14	10	14

MPS has guaranteed that its subsidiaries have adequate resources to meet their liabilities as they fall due.

22. Potential claims that have not yet been reported

Unreported incidents up to 31 December may give rise to claims in the future. These potential claims, which do not constitute a contingent liability because recognition of the liability is dependent on the Council exercising its discretion, will to the extent to which the Council exercises that discretion become MPS's responsibility under the occurrence basis of cover MPS provides. The funds on the balance sheet at 31 December 2005 are sufficient to cover the cost of these potential claims based on an actuarial assessment prepared by an independent firm of consulting actuaries and detailed in a report prepared in accordance with the Guidance Note *General Insurance Business: Actuarial Reports, (GN12)* published by the Faculty of Actuaries and Institute of Actuaries.

23. Obligations of Members

MPS has the right to call each year for additional funds from its members up to an amount equal to the annual subscription.

24. Guarantee

MPS is limited by guarantee not exceeding £1 per member.

Professional advisers

Solicitors

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MPS around the world

MPS operates in many countries; the main ones are listed below.
For a full list of international contacts please visit our websites.

Antigua
Bahamas
Barbados
Bermuda
Cayman Islands
Dominica
Grenada
Hong Kong
Ireland
Israel
Jamaica
Kenya
Malaysia
Malta
New Zealand
South Africa
Singapore
St Lucia
St Vincent
Trinidad and Tobago
United Kingdom

The Medical Protection Society is the world's foremost protection organisation. As a not-for-profit mutual organisation, MPS offers support to health professionals with the legal and ethical problems that arise from their professional practice.

MPS membership offers peace of mind to more than 236,000 health professionals and their patients worldwide. Members commonly seek help with clinical negligence claims, complaints, medical council inquiries, legal and ethical dilemmas, disciplinary procedures, inquests and fatal accident inquiries. They have access to expert advice from a 24-hour emergency helpline and, where appropriate, legal assistance and compensation for patients who have been harmed through negligent treatment. We also run risk-management and education programmes to reduce adverse incidents and promote safer practice.

MPS is not an insurance company. All the benefits of membership of MPS are discretionary as set out in the Memorandum and Articles of Association.

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