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The Medical Protection Society Limited

Report and Accounts 2004

Supporting healthcare professionals – worldwide

Contents

Supporting healthcare
professionals – worldwide

Chairman's statement

Over the last year, doctors and dentists in many countries have seen continuing changes in their working environment, new contracts and increasing professional regulation. As expected, these changes have had considerable impact on the daily work of MPS. While we continue to strive to provide the high standard of service demanded by members, we have also been able to help shape some of the regulatory changes where we felt they might unfairly disadvantage the professions or their patients. These are tributes to the expertise and dedication of all our staff.

In addition, and most importantly, our financial position has strengthened further. Experience has varied between the countries in which MPS operates and is reflected in differences in the subscriptions we charge in those countries. We set all subscriptions on the advice of independent consulting actuaries with extensive experience in the clinical negligence field. In doing so, your Council remains resolved to ensure MPS generates sufficient funds to meet future demands from members. As any reasonable member would expect, MPS has also adopted a prudent approach to the investment of your subscriptions over the years, and has more than sufficient capital resources to pay not only all claims that we know about, but also our estimate of future claims that may stem from past incidents, under the discretionary basis of indemnity that MPS offers.

Some claims do not surface for decades. While it would be much simpler to set subscriptions to reflect only those claims likely to be received that year, benefits would have to be restricted to claims reported during that year. In other words benefits would have to be offered on a so-called claims made basis. However our research indicates that is not what doctors and dentists want. When they pay a year's subscription they want access to benefits for claims arising from all clinical incidents occurring during that year, whenever those claims might be made in the future. A member can then retire, take a career break, perhaps for maternity, study or travel, or be forced to stop work through illness, without need for further payment, secure in the knowledge that their membership benefits are retained, even after death.

We continue to see a rising workload unrelated to negligence claims. This arises from the increasingly severe regulatory environments in which members work. We try to maintain good relationships with medical and dental boards and councils wherever we operate and also actively lobby politicians to attempt to make governments aware of the difficulties that members face in their daily lives. It is only by doing this that we gain opportunities to prevent excessive regulation. While regulation is important – and indeed the professions will lose their powers of self regulation if they are not seen to adequately regulate themselves – defensive practice because of an oppressive regulatory environment is detrimental to patient care. The Shipman Inquiry in the UK has produced some radical proposals for additional regulation which may have knock-on effects in other countries and it is important that legislators do not over-react to an extreme set of circumstances or the criminal activities of a single individual. In this climate, it seems unlikely that we will see an early decrease in requests for assistance from members facing challenges from licensing and regulatory bodies.

We remain committed to our present mutual status providing discretionary benefits of membership. Obvious advantages are that there is no need to provide profit for shareholders, and no need to pay insurance premium tax on subscriptions. In addition, members do not have to worry about an insurance policy's 'small print'. One doctor found recently that another organisation's insurance policy did not cover a negligence claim flowing from his work as an expert witness. MPS Council, with a majority of practising doctors and dentists, is unhampered by such small print and normally exercises discretion to assist a doctor in this position, as we feel such work is part of professional life. The main consideration is to act fairly and equitably to all members and in the interests of MPS as a whole.

Non-executive members of council are limited to an eight year term of office. Three senior medical members of Council, Alan Crouch, Sue Sellers and Mary King, have to step down at the AGM this June at the end of their allotted term. However, I am pleased to say that Alan Crouch continues as Chair of the Claims Advisory Committee. Professor John Bonnar is also retiring, after a particularly distinguished association with MPS, having served on Council, Claims Committee and the Irish Advisory Panel over many years. I would like to thank them for their immense contribution over the years; we will greatly miss all their expertise.

Nicholas Davies
Chairman of the Council

Chief Executive's report

2004 Performance

The Company's financial performance has, once again, been very good; our financial position has been strengthened further, and membership has continued to grow in most regions in which we operate, thereby reinforcing MPS's position as the largest organisation of its type in the world.

Welcome though new members are, membership growth is not the primary objective of MPS: as I mentioned in my report last year, our overriding goal is financial strength. I am therefore pleased to report that we have not only maintained, but have also increased our surplus of assets. Our assets as they now stand (and not taking into account a call upon members) exceed by a significant margin our claims costs in the form of both reported and unreported[1] claims. This has been achieved despite a number of factors, particularly in the UK, South Africa and Hong Kong, that have increased the likely demands upon members' funds. I refer to these factors later in this report.

Discretionary occurrence-based protection

Many non-medical professionals to whom I talk have told me that they envy the medical and dental professions' access to the services provided by organisations such as MPS. The cause of this envy is the occurrence-based protection provided by not-for-profit mutuals constituted with the sole purpose of protecting their members' professional reputations. Compared to this model, relying on the sometimes fickle nature of the commercial insurance market seems, to them, less than ideal.

Through organisations such as MPS, the medical and dental professions retain control of their professional indemnity arrangements. In 2005 I will have worked at MPS for 20 years; during that time I have seen, in different countries, very many commercial insurers enter the market looking to make a profit from doctors and dentists. Almost invariably they launch their new professional indemnity insurance products with a stinging attack on the discretionary mutuals. The gist of their message is that the mutuals offer 'only' discretionary protection and that the mutual concept is 'outmoded'. I have also watched as they later quietly leave the market because they have not been able to make the profits that their shareholders rightly demand. And sometimes they leave mayhem behind them, with doctors and dentists suddenly discovering the limitations of claims-made insurance.

In stark contrast, MPS has protected and defended the interests of members since the nineteenth century and has often had to step in to pick up the pieces when the commercial insurers leave the market. This track record of service is testimony to the strength of the mutual concept: if members did not require our services then there would be no need for MPS. There are no other reasons for its existence.

2004 experience

Subscription and other income grew by 6% (15.8%) in the year to £166 million (£156 million). As in 2003, this increase arose from a combination of membership growth (membership numbers now stand at 227,680) and increases in subscription rates in nearly all areas of operation. The percentage increase in subscription income is lower than in previous years because the income from Ireland was reduced once the state's Clinical Indemnity Scheme was introduced in February 2004 and as a result of the ending of our relationship with the Hadassah Hospital in Israel.

Although no-one likes price increases, it is a fundamental tenet of our approach to subscription setting that it is foolhardy to underprice the risks we accept on behalf of members, and we will not do so merely to attract market share. However, MPS is committed to setting subscription rates that are commensurate with financial prudence and sufficient to achieve our funding target, but no more. If experience is better than expected in certain countries or in certain specialty groups then we will reflect those trends. Indeed, in 2004, many members saw no increase in their subscriptions since experience in their specialty or practice profile did not justify any change.

Demand for our services continues to grow; in 2004 we received more than 14,000 written requests (medical and dental) for assistance and our medico- and dento-legal and legal advisers around the world again fielded in excess of 50,000 telephone calls. In addition, our Leeds-based membership team received more than 69,000 telephone calls; our main switchboard in the UK receives over 700 calls a day. In this context, I might add that we are committed to providing a personal and friendly service; a member ringing MPS will be answered by a human voice and never by one of the complicated automated menus prevalent in so many businesses today.

The increase in income was accompanied by a 36% (12%) increase in total expenditure to £136 million (£100 million), which was only 4.8% above budget. Claims costs and associated legal costs increased by 48% to £111 million (£75 million) of which, claimant costs and damages and the movement in the provision for reported claims accounted for £91 million (£55 million) of the total expenditure. I am pleased to report that legal costs overall (including internal legal costs and claimant costs) only rose by 4.8%. This compares well with the significantly higher costs we have seen in recent years. Most of this increase was attributable to greater claimant costs (8.5%). In contrast, the costs incurred in defending claims and representing members in matters other than claims grew by only 3.2%. This includes the costs of the internal legal teams and, in fact, expenditure on external legal services fell marginally.

Administration costs, including the costs of medical and dental advisory services, fell compared with 2003. This decrease, when combined with the larger membership numbers, equates to lower administration costs per member. All this was achieved despite staff numbers growing from 247 in 2003 to 256 in 2004. This illustrates one of the advantages of belonging to a large mutual fund, as significant economies of scale can be achieved. Although we keep administration costs under close scrutiny and are always looking for excellent value for money, members who pay us (sometimes very substantial sums) by way of subscriptions, rightly expect a service that is second to none. Our regular surveys of members show, I am pleased to report, very high scores, both for membership and medico/dento-legal services.

[1] Unreported claims are potential claims dependent on the Council exercising its discretion and will, to the extent that the Council exercises that discretion, become MPS's responsibility.

In 2004, as in the previous year, we have augmented the numbers of medical and dental legal advisers and the number of in-house lawyers. This fact alone demonstrates our commitment to providing a first-class service to members.

Total assets available to meet reported claims and future claims that MPS may be called upon to meet (under the discretionary basis of indemnity that it offers) passed the £600 million mark in 2004 and stood at £653 million (£544 million) by the year end. Assets available to meet unreported claims, after taking account of claims already reported to MPS, increased by 20% to £418 million (£349 million) by the year end.

Experience

United Kingdom

Last year I mentioned our concerns in the UK about the provision in the Courts Act that allows the courts to impose periodical payments and the retrospective effects of this legislation, which could impose large extra cost burdens on organisations such as MPS, and on the insurance industry. At the time of writing we still do not know to what extent the courts will use these new powers, but as a matter of prudence we have made a special provision in the claims reserve for the probable financial effects of these awards.

Although the frequency of claims of negligence in the UK is levelling out, the average size or severity of claims is increasing, particularly in claims valued between £0.5 million and £1 million, and from the specialty of general practice. This dictates subscription rate rises for GP members in 2005, but we will take into account the changes that the new GMS contract has brought about in general practice. We will continue to monitor the effect of these changes, and alter our rate structure accordingly. We welcomed our twenty-thousandth UK GP into membership this year, and I am pleased to report that our GP membership has grown by over 20% in the last three years. This, combined with growth in member numbers in other specialties and professions, means that MPS is now the largest medical protection organisation, both in the UK and the world.

During the latter part of 2004, the Government published its proposed changes to the Dentists' Act 1984. Of crucial interest to us was the wording of the proposal to make having 'indemnity insurance' a condition of registration. Despite those who clamoured, for their own ends, for a compulsory insurance-based product for dentists I am pleased to report that the Minister for Health and the Chief Dental Officer have made unequivocal statements to the effect that discretionary indemnity is perfectly acceptable.

South Africa

Experience in South Africa continues to give cause for concern, as claim values continue to rise. As a result, we have had to implement substantial subscription rate rises for many specialties, especially those that represent the highest risks. During 2004 we continued our programme of meeting government officials, and will be sponsoring, under the auspices of the South African Medical Journal, a conference on tort reform early in 2005. It is important that both the government and the judiciary recognise that the effects of escalating awards of damages will be felt not only in the private healthcare sector, but also in the public healthcare system.

Ireland

As foreshadowed in my report last year, one of our competitors in Ireland has now refused a number of requests for assistance, both from current and former members. I believe that these actions are completely unjustified and agree with the Tanaiste and Minster for Health that they are 'disgraceful'. Not unnaturally, this has provoked consternation in the profession and attracted widespread publicity in the national media – most of it extremely critical of that competitor. I offer my sympathies to those consultants who find themselves, through no fault of their own, in this position. Unsurprisingly, we have seen spectacular increases in membership numbers in Ireland in the last year in all sectors, but particularly consultants, GPs and dentists, most of whom have transferred from the competitor mentioned previously. Welcome though this growth is, it is not something that MPS was seeking, as we would have preferred stability in the market rather than the prospect of unindemnified doctors and uncompensated patients. We maintain close and productive relationships with the Irish Hospital Consultants Association and the Irish Medical Organisation at this difficult time.

Following these events and the introduction of the Clinical Indemnity Scheme we held a series of seminars in Ireland for consultants to talk about indemnity issues and the medico-legal environment. I was delighted to meet a large number of members at these seminars, which will continue into 2005. I am also pleased to report that subscription rates for members in Ireland for GPs and consultants will not need to rise by more than 3% in 2005.

New Zealand

New Zealand continues to be one of the most hostile medico-legal environments in any of the places in which MPS operates, despite the no-fault compensation system that has been in operation for over 30 years. Our three medico-legal advisers, who receive proportionately more requests for assistance than we see elsewhere, continue to provide sterling support for the 10,000 plus members.

Hong Kong

As members in Hong Kong will be all-too painfully aware, we have found it necessary to make substantial increases in subscription rates – especially for the higher-risk specialties – for two successive years. It is to be hoped that the adverse trend in claims experience will begin to level off soon; we continue to work with the HKMA to apprise government of these issues.

Singapore, Malaysia and the Caribbean

The claims environment in Singapore, Malaysia and the Caribbean region remains relatively stable, albeit that we see rises in claims frequency and severity year on year. Malaysia in particular is starting to see an increase in claim frequency and severity that has necessitated steep subscription rate rises for the higher risk specialties. In the interests of fairness to all members, we continue to stretch the differentials between the lower- and higher-risk specialties to reflect more closely the difference in risk. However, in line with MPS policy worldwide, we believe that we have a duty as a not-for-profit mutual to try and ensure that subscriptions remain affordable for all specialties.

In Singapore, which has one of the highest standards of medical care in the world, the effect a successfully defended high-value claim can have on the litigation environment is noticeable. To defend the defensible and not settle on the grounds of commercial expediency is of paramount importance – something the commercial insurance world sometimes forgets. If doctors, dentists and other healthcare professionals are seen as easy targets because their indemnifiers settle defensible claims, then another twist is added to the vicious spiral of increasing litigation. While we believe that patients should receive fair compensation if they have suffered demonstrable harm as a result of a member's negligence, we believe equally strongly that claims that can be defended must be defended. The Singapore experience is a classic example of this effect.

In conclusion, 2005 finds your Society in fine fettle; challenges abound in all areas of operation, both for you in your daily lives and for MPS in ensuring that you receive a superior quality of service at a price you can afford.

John Hickey
Chief Executive

Finance Director's report

MPS has had another very good financial year, with an increase in net assets after allowing for reported claims of £69 million (£99 million). At the end of 2004, there was £418 million (£349 million) available to meet, subject to discretion, the costs of potential claims, arising from adverse incidents that have not yet been reported to MPS as a claim.

Financial aims

It is worth reiterating the Chief Executive's comment that MPS exists solely to provide a service to members. Increasing member numbers and an increase in advisory and claims statistics show that healthcare professionals want to join MPS and have a need for its services. It is thus incumbent upon management to ensure that MPS can continue to meet these needs well into the future. After all, the costs of some claims arising from incidents in 2004 may not be paid out for 20 years or more.

The surest way to achieve this essential longevity is to ensure that MPS is financially secure. MPS can measure its current financial security by comparing the amount of assets that it has to the cost of claims for which it is, or may be, liable on behalf of members.

Measure of financial position

The claims for which MPS is already responsible are known as *reported claims* – that is, where MPS has already received a third-party request for compensation. These are shown on the balance sheet and had an estimated value of £235 million (£195 million) at the end of the year. However, MPS provides the benefits of membership on an occurrence basis, which means that a member is entitled to apply for assistance at any time in the future as the result of an incident that occurred during any period in which an appropriate subscription was paid. There will inevitably be a delay between an incident that gives rise to a claim and the actual third-party demand for compensation. Sometimes this delay may be just a few weeks, sometimes it can be years. Because a member was paying a subscription at the time of the adverse incident, they will look to MPS for assistance with the claim whenever it is finally made. These potential but as yet unreported claims cannot be assumed to be a definite responsibility of MPS, because the benefits of membership are discretionary and this discretion can only be exercised once a claim has been reported. However, as MPS will not exercise its discretion capriciously, it is prudent and proper to make sure there are sufficient assets to cover the estimated cost of these potential claims that have not yet been reported.

As well as having sufficient assets to cover the expected costs of reported claims and potential claims that are as yet unreported, prudence dictates that MPS should have some additional assets to call upon in case the actual costs prove to be greater than expected. In assessing the cost of claims and potential claims that have yet to be reported, many assumptions are made about the development of these claims from today's date to the date of settlement, which in some cases can be years. There are bound to be times when, due to legislative changes or unexpected developments in a claim, the ultimate cost is more than originally envisaged. For this reason, MPS should have a suitable reserve to protect against these unexpected costs.

The above sets out MPS's aim to be financially secure and the different costs that MPS needs to provide for, reported claims, potential claims as yet unreported and a reserve for unexpected costs. The accounts in this report show how MPS is meeting this aim of financial security. From the balance sheet it can be seen that, after providing for the cost of the reported claims, MPS has £418 million to go towards the cost of the potential claims as yet unreported and the reserve for unexpected costs. Because the costs of the unreported claims are not MPS's definite responsibility until they are reported and discretion has been exercised, they are not included in the balance sheet. However, they are estimated by our retained firm of independent consulting actuaries and note 21 informs the reader that the surplus assets on the balance sheet of £418 million is sufficient to cover the total estimated cost of these potential claims, with a small surplus for unexpected costs. The surplus, which has grown by £32 million (£31 million) in the year, is the largest that MPS has had, but it needs to be larger still to reinforce the confidence that there will be sufficient funds to allow for all unexpected future costs.

Trading for 2004

The above explains MPS's financial aims and current financial position, based on the balance sheet at 31 December 2004. To know how the trading in 2004 has contributed to the financial position, it is necessary to look at the Income and Expenditure account.

The increase in assets for the year is £69 million (£99 million), being the difference between the balance-sheet totals for 2003 and 2004 (£418 million less £349 million). This £69 million (£99 million) is made up of the net of subscription income less costs incurred of £30 million (£56 million), total return from investments (income and capital) of £43 million (£50 million), plus the increase in the value of MPS's freehold office building of £1 million (nil), less tax of £5 million (£7 million).

Subscription income

Subscription and other income increased by £9.4 million (£21 million), 6% in the year. This headline figure belies the actual increase in subscription rates and paying members, because in Ireland the State took responsibility for the indemnity of hospital consultants working in state hospitals, with the introduction of the Clinical Indemnity Scheme; in Israel, the arrangement with the Hadassah hospital was discontinued. These two events aside, the number of paying MPS members increased by 8% in the UK, 34% in Ireland and, more modestly, by 3% in South Africa and 4% in New Zealand. Steady membership numbers were maintained in all other major areas of business. The large increase of members in Ireland is a reflection of the dissatisfaction with MPS's major competitor.

Expenditure

Total costs were up by £36 million (£11 million) in the year to £136 million (£100 million). Administration and defence and advisory legal costs were within budget for the year. The same is not true for damages and claimant costs, which were higher than expected.

The total cost of claims for the year, including damages, claimant legal costs, MPS defence legal costs, a share of administration costs and the increase during the year in claims values, was £111 million (£75 million), up 48% on 2003. The large increase on 2003 is partly a reflection of the exceptionally low level of costs in 2003 and partly a reflection of the higher than expected costs for 2004 and the potential impact of the Courts Act. The defence legal and administration costs are close to expectation; it is the £91 million (£55 million) cost of damages, claimant legal costs and increase in reported claims value that is higher than expected. Most of this has been incurred in the UK, although South Africa has also incurred more costs than expected.

MPS continues to exert tight control on both legal and administrative costs, with a high degree of success.

Investments

Most of the funds accumulated to meet MPS's liabilities are invested. At the end of 2004, £664 million (£558 million) was held in long- and short-term investments. The investment vehicles are chosen with the aim of achieving the best return for an acceptable level of risk. One risk is that the economic climate alters in such a way that MPS's investments go down in value at the same time that its liabilities go up in value. We limit this risk first by ensuring that non-sterling liabilities are matched as far as is possible by equivalent amounts of non-sterling assets. So if the local exchange rate with sterling moves, the sterling value of the assets and liabilities will move equally and there will be no improvement or deterioration in the net value of the assets less liabilities. Thus, MPS holds assets in Euros, Rand, and US dollars, the latter acts as an approximate match for the relatively small currency liabilities that it is not economic to match with assets in their own currency. In addition, MPS must match the maturity dates of the liabilities with the maturity dates of the assets.

Finally, MPS can reduce risk by holding a diversified portfolio of assets. MPS's portfolio at the end of 2004 was about 27% in equities, 19% in short money-market investments and 54% in government bonds.

During the year, MPS amalgamated its equity investments with one manager and also changed the management strategy to enhanced index tracking. These changes necessitated the sale and repurchase of much of MPS's equity holdings, and this explains why the amounts for additions and disposals shown in the investment note (note 10) are much larger than the previous year.

MPS achieved an after-tax after-fees return on its cash and investments of 5.4% (7.5%) for the year. This overall return is the weighted average of the returns on the underlying asset classes. All asset classes achieved a positive return in sterling terms, with the main contributors being UK and Euro equities and Eurobonds.

Controlling risk

Control of risk is also an important aspect of managing the finances of an organisation like MPS. In my report last year, I mentioned that MPS had set up a dedicated resource with responsibility for operational risk. I have also described above how we control the risk of a mis-match between investments and claims liabilities. When it comes to claims costs, the largest cost element of the business, we have a number of strategies for controlling risk. First, all new applications for membership are reviewed to determine whether the applicant represents an acceptable risk; second, MPS insures the outer margins of its risk with third parties, to protect itself from unexpectedly high costs; third, MPS undertakes risk-management education and training with both the medical and dental professions at large and, more specifically, with a minority of members who have incurred costs considerably above those one would expect.

Simon Kayll
Finance Director

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Members of the board of Dental Protection Limited and details of DPL staff are set out in the separate DPL annual review.

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 2004.

Principal activity

The Society 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 the Society's Memorandum of Association. Members are not entitled to dividends or other distributions, and the balance on the income and expenditure account is retained by the Society to set against future liabilities.

One of the objects of the Society 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 28 that 'the grant of indemnity shall be entirely in the discretion of the Council who shall have 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 27.

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 and 6.

Donations

Charitable donations made by the Society 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 the Society 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 the Society's trading position and of any significant organisational changes.

The Information and Consultation of Employees Regulations 2004 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 has decided to voluntarily start the process and has decided to adapt the existing Staff Consultative Group for this purpose.

It is the policy of the Society 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 the Society, as well as generally through training and career development.

Members of the Council

The names of the members of the Council of the Society 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 is committed to maintaining the highest standards of corporate governance and thus complies with the New Combined Code where it is considered relevant to the Society's business and constitution. During 2004, MPS conducted a gap analysis to identify the areas where its current corporate governance systems failed to meet the New Combined Code and made amendments accordingly. The following is a statement in accordance with the Code.

Council

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

All the non-executives are considered to be independent, not being past executives of the Society and not having any financial interest in the Society 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 2004 and, if relevant, their personal membership of the Society. The Society has separate posts of Chairman and Chief Executive to differentiate the running of the Council from the executive responsibility for the running of the Society's 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 60 and for non-executive members 70. All Council members are subject to election by members at the first opportunity after their appointment by the Council and to re-election (excepting the Chief Executive) 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. Non-executive members of the Council are limited to an eight year term.

The Council met formally ten times during the year. The attendance record of members of the Council is shown below:

Member of the Council	Appointed / Retired	No. of Meetings Attended 2004	2003
Frank Attwood	Ap 9/06/04	5	N/A
Alan Crouch		7	10
Nicholas Davies		9	9
Martin Gairdner	Rt 9/06/04	5	9
John Hickey		10	10
Richard Hobbs	Rt 9/06/04	4	7
Leela Kapila	Ap 11/06/03	9	5
Simon Kayll	Ap 11/06/03	10	5
Mary King		6	6
Kevin Lewis	Ap 11/06/03	9	4
Ravinder Maini		8	9
Brian Mouatt		9	10
Susan Sellers		8	8
Robert Seward	Rt 9/06/04	4	8
John Leighton Williams		8	8
Richard Youell	Ap 11/06/03	8	4

The Council has a schedule of matters specifically reserved to it for decision, including strategy and 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 Committee, a Remuneration Committee and an 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. The Society's external auditors, Chief Executive, Finance Director, Financial Controller and the Operational Review Manager also attend the meetings and the Committee has an opportunity to meet the external auditors without management present. 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 below:

Member of Audit Committee	Appointed / Retired	No. of Meetings Attended 2004	2003
Frank Attwood	Ap 9/06/04	1	N/A
Alan Crouch	Ap 11/06/03	1	1
Nicholas Davies	Ap 11/06/03	2	1
Martin Gairdner	Rt 9/06/04	1	2
Ravinder Maini		2	2
Brian Mouatt		2	2
Susan Sellers		2	1

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. The Board is 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 2005 meeting.

Internal Control
The Council has overall responsibility for the Society'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 the Society in line with recommendations in the Turnbull report. This has been in place for the full financial 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 copies 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. The Society 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 6 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 the Society has with its members. However, the general tenor of the provisions is applicable to the Society and the Society 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 the Society's investment managers held derivative financial instruments to enhance investment returns. The net recognised gains and losses of these contracts are included in note 4 under other investment income. These instruments were held to take advantage of short term changes in market prices affecting UK Gilt and Corporate Bonds and Euro 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. Although no derivative financial instruments were held at 31 December 2004; the following future contracts were entered into during the year:

Currency	Contract Type
GBP	Long Gilt future
GBP	90 days GBP libor future
Euro	Schatz future
Euro	Bobl future
Euro	Bond future
Euro	3 month Eurobor future

The investment managers implemented both duration and yield curve strategies in their management of these instruments. Average contribution to duration was 0.3, which meant that if the market moves by 100 basis points in either yield or spread terms (depending on the strategies implemented) the fund gains or loses 30 basis points.

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 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.

Foreign currency risk

Foreign currency risk is managed by only holding future contracts in the currency of each relevant portfolio, thus not exposing the portfolio to movements in exchange rates.

Credit risk

Credit risk encompasses all forms of counterparty risk. The Society 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 contracts being of short term duration.

Going concern

Members of the Council consider that the Society 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 the Society is in a sound financial position.

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

Company Law in the United Kingdom 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 13 April 2005 and signed on its behalf by:

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

Simon Kayll

Independent auditors' report to the Members of The Medical Protection Society Limited

We have audited the financial statements on pages 14 to 27.

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 United Kingdom Auditing Standards.

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 United Kingdom Auditing Standards 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 of the state of affairs of the Society and the Group as at 31 December 2004 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
13 April 2005

Consolidated Income and Expenditure Account

year ended 31 December 2004

	notes	2004 £'000	2003 £'000
Income			
Members' subscriptions and other income		165,805	156,379
Expenditure			
Claims costs and associated legal costs (including costs of insurance)	14	111,129	75,362
Insurance recoveries		(4,663)	(3,917)
Advisory costs and associated legal costs	3a	19,697	20,447
Administration expenses	3a	10,862	12,280
Profit on exchange movements	3b	(1,124)	(4,192)
		135,901	99,980
Excess of members' subscriptions and other income over expenditure		29,904	56,399
Income from investments	4	19,817	16,803
Realised gains from disposal of investments		5,905	3,658
Contribution from ordinary activities before taxation		55,626	76,860
Tax on investment income and gains	5a	(5,196)	(6,219)
Net contribution for the year available to meet future liabilities and charges	16	50,430	70,641

Statement of Total Recognised Gains and Losses

	notes	2004 £'000	2003 £'000
Net contribution for the financial year		50,430	70,641
Surplus on revaluation of investments	15	17,401	29,104
Surplus on revaluation of fixed assets	15	847	–
Tax charge on investment gains	5a	(81)	(644)
Total recognised gains		68,597	99,101

Note of Historical Cost Income and Expenditure

	notes	2004 £'000	2003 £'000
Reported net contribution before tax		55,626	76,860
Realisation of valuation (losses)/gains of previous years	15	(8,701)	9,296
Difference between a historical cost depreciation charge and the actual depreciation charge of the year calculated on the revalued amount	15	51	50
Historical cost net contribution before tax		46,976	86,206
Historical cost net contribution retained after tax		41,699	79,343

Consolidated and Company Balance Sheets

at 31 December 2004

	notes	2004 Group £'000	2003 Group £'000	2004 Company £'000	2003 Company £'000
Fixed assets					
Tangible assets	9	8,457	7,902	8,425	7,874
Investments	10	575,749	459,823	31,001	20,001
		584,206	467,725	39,426	27,875
Current assets					
Debtors – *due within one year*	12	8,804	7,419	440,441	381,935
– due after one year	12	9,200	7,800	9,200	7,800
Bank deposit accounts		88,317	98,652	23,402	24,847
Cash at bank and in hand		1,871	1	1,815	1
		108,192	113,872	474,858	414,583
Creditors: amounts falling due within one year	13	(39,123)	(37,479)	(35,096)	(34,694)
Net current assets		69,069	76,393	439,762	379,889
Total assets less current liabilities		653,275	544,118	479,188	407,764
Provision for liabilities and charges	14	(235,493)	(194,933)	(235,493)	(194,933)
Net assets		417,782	349,185	243,695	212,831
Accumulated funds	15				
Revaluation reserve		36,936	10,038	3,094	2,298
Income and expenditure		380,846	339,147	240,601	210,533
Funds available to meet future liabilities and charges	16	417,782	349,185	243,695	212,831

Nicholas Davies
Chairman of the Council
13 April 2005

Consolidated Cash Flow Statement

year ended 31 December 2004

	notes	2004 £'000	2003 £'000
Cash flow from operating activities	17	69,212	76,728
Returns on investments	18	19,817	16,803
Tax		(4,052)	(8,597)
Capital expenditure and financial investment	19	(61,122)	(73,546)
		23,855	11,388
Net cash outflow from management of liquid resources *(comprising bank deposits and investment deposits)*		(21,769)	(13,204)
Increase/(decrease) in cash in the period		2,086	(1,816)

Analysis of changes in net funds

	At 1/1/2004 £'000	Cash flow movement £'000	At 31/12/2004 £'000
Cash at bank and in hand	1	1,870	1,871
Bank overdraft	(216)	216	–
Bank deposit accounts	98,652	(10,335)	88,317
Cash with investment managers	5,132	32,104	37,236
Net funds	103,569	23,855	127,424

Reconciliation of net cash flow to movement in net funds

	2004 £'000	2003 £'000
Increase/(decrease) in cash	2,086	(1,816)
Cash flow from increase in net liquid resources	21,769	13,204
	23,855	11,388
Net funds at 1 January	103,569	92,181
Net funds at 31 December	127,424	103,569

Notes to the accounts

1 Basis of preparation of the financial statements
The financial statements are prepared in accordance with applicable accounting standards and the constitution of the Society.

2 Accounting policies
(a) 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 the Society within that convention are set out below.

(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. 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.

(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 losses 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 the Society 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 the Society at that date.

2 Accounting policies: continued

(j) Tax

Provision is made in the financial statements for tax on investment and trading income received and receivable in the year and on capital gains on investments disposed of during the year.

Deferred tax is provided, except as noted below, on timing differences that have arisen but not reversed by the balance sheet date, where the timing differences result in an obligation to pay more tax, or a right to pay less tax, in the future. Timing differences arise because of differences between the treatment of certain items for accounting and taxation purposes.

In accordance with FRS19 deferred tax is not provided on timing differences arising from:

(i) revaluation gains on land and buildings, unless there is a binding agreement to sell them at the balance sheet date;
(ii) gains on the sale of non-monetary assets, where on the basis of all available evidence it is more likely than not that the taxable gain will be rolled over into replacement assets; and
(iii)extra tax payable if the overseas retained profits of subsidiaries and associates are remitted in future.

Deferred tax assets are recognised to the extent that it is regarded as more likely than not that they will be recovered.

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

The Society operates a defined benefits pension scheme. The assets of the scheme are invested and managed independently of the finances of the Society. Pension costs are assessed in accordance with the advice of an independent qualified actuary. Costs include the regular cost of providing benefits which it is intended should remain a substantially level percentage of current and expected future earnings of the employees covered. Variations from the regular costs are spread evenly through the income and expenditure account over the average remaining service lives of current employees.

(l) Leasing

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

3a Advisory costs and administration expenses		2004 £'000	2003 £'000
Included under this classification are:			
Operating lease rentals	– Land and buildings	858	1,411
	– Motor vehicles	88	95
Auditors' remuneration	– Audit fees	63	59
	– Fees for other services	90	55
Loss on disposal of tangible fixed assets		8	61
Depreciation of fixed assets		881	1,026

3b Exchange movements

The majority of the profit on exchange movements relates to the restatement of international cash assets (principally in South Africa and Ireland) 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 14).

4 Income from investments		2004 £'000	2003 £'000
Included under this classification are:			
Dividends: listed investments	– Franked	2,975	2,435
	– Unfranked	11,465	9,810
Bank interest		5,154	4,558
Other investment income		223	–
		19,817	16,803

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

5a Tax on income and gains from investments	2004 £'000	2003 £'000
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% (2003: 30%)	5,469	5,017
Adjustment in respect of prior years	(273)	1,173
Double taxation relief	(26)	(61)
	5,170	6,129
Foreign tax:		
Current tax on income for the year	26	90
Tax on investment income and gains in the income and expenditure account	5,196	6,219
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% (2003: 30%)	81	644
Tax on other gains included in the Statement of Total Recognised Gains and Losses for the year	81	644

5b Factors affecting tax charge for the year *Current tax reconciliation*	2004 £'000	2003 £'000
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	55,626	76,860
Less: non-taxable contribution (see below)	(29,373)	(54,092)
Income and gains from investments included in the income and expenditure account for the year	26,253	22,768
Income and gains from investments multiplied by the standard rate of corporation tax in the UK of 30%	7,876	6,830
Effects of:		
Income from UK equities not subject to taxation	(892)	(731)
Non-taxable Inland Revenue interest	–	7
Foreign exchange losses not subject to taxation	–	8
Realised gains on disposal of investments	(1,668)	(1,097)
Losses disallowed on pre-trading expenditure	153	–
Current tax charge for the year	5,469	5,017

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

5c Unprovided deferred taxation

A £1.1 million (2003: £ nil) tax charge would arise should the Society's equity investments and freehold property be sold at the market values at which they are included in the balance sheet.

6 Emoluments of members of the Council		2004 £'000	2003 £'000
Aggregate amount of emoluments paid to members of the Council (including executive members)		764	604
Chairman	– for 2004	36	–
Chairman	– to 11 June 2003	–	15
Chairman	– from 11 June 2003	–	21
Highest paid member of the Council			
Chief Executive:	– emoluments and taxable benefits	175	170
	– accrued annual pension rights	81	74

There are 3 (2003: 3) executive members of the Council who are members of the Society's defined benefit pension scheme.

6 Emoluments of members of the Council: continued

The standard remuneration for all non-executive members of the Council (other than the Chairman) was £16,000 (2003: £16,000) per annum except for:

Council Member	Additional Position Held	Annual Remuneration £
Frank Attwood	Chairman, Audit Committee	19,200
Alan Crouch	Chairman, Claims Advisory Committee	22,400
Brian Mouatt	Chairman, Dental Protection Limited	28,000
John Leighton Williams	Chairman, Pension Scheme Trustees	19,200

7 Employees

The average number of people employed by the Society during the year was 256 (2003: 247).

Costs in respect of these employees:	2004 £'000	2003 £'000
Wages and salaries	10,266	9,663
Social security costs	1,055	949
Pension costs (including special contribution for 2003 – note 8)	1,652	4,031
	12,973	14,643

8 Pensions

The Society operates a defined benefits pension scheme, The Medical Protection Society Limited (1973) Pension and Life Assurance Scheme. The scheme funds are administered by trustees and are independent of the Society'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% pa 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.

In view of the shortfall revealed by the valuation, in May 2003, the Society made a special contribution to the scheme of £2,500,000.

The Society has continued to account for pensions in accordance with SSAP24 "Accounting for pension costs". FRS17 was issued in November 2000 and updated in November 2002. However, full recognition will not be mandatory for the Society until the year ending 31 December 2005. Prior to this, phased transitional disclosures have been required from 30 June 2001.

The formal actuarial valuation as at 31 December 2002 was updated to the accounting date by an independent qualified actuary in accordance with the transitional arrangements of 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, a breakdown of the assets into the main asset classes, the present value of the FRS17 liabilities and the deficit of assets below the FRS17 liabilities (which equals the gross pension liability).

Assumptions:	At 31 December 2004 % pa	At 31 December 2003 % pa	At 31 December 2002 % pa
Price inflation	2.9	2.7	2.3
Discount rate	5.3	5.4	5.6
Pension increases (LPI)	2.7	2.6	2.3
Salary growth	4.4	4.2	3.8

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 (2003: 24 years). Allowance is made for future improvements in life expectancy.

8 Pensions: continued

Asset distribution and expected returns:

	At 31 December 2004 Expected return % pa	At 31 December 2004 Fair value £'000	At 31 December 2003 Expected return % pa	At 31 December 2003 Fair value £'000	At 31 December 2002 Expected return % pa	At 31 December 2002 Fair value £'000
Equities	7.5	19,041	7.7	17,118	7.4	11,743
Bonds	4.6	6,634	4.8	4,250	4.5	1,966
Property	6.0	662	6.3	594	6.0	562
Cash	4.5	204	4.6	303	4.0	1,045
Total		26,541		22,265		15,316

Balance sheet:	At 31 December 2004 £'000	At 31 December 2003 £'000	At 31 December 2002 £'000
Total fair value of assets	26,541	22,265	15,316
FRS17 value of liabilities	(30,945)	(26,534)	(21,348)
Gross pension liability	(4,404)	(4,269)	(6,032)

Under FRS17, the scheme would be represented on the balance sheet at 31 December 2004 as a liability of £4,404,000 (2003: £4,269,000).

Over the year to 31 December 2004, contributions by the Society of £1,651,827 (2003: £4,030,559 including a special contribution of £2,500,000) were made 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 period as follows:	2004 £'000	2003 £'000
Post retirement deficit at start of year	(4,269)	(6,032)
Current service cost	(2,114)	(2,013)
Contributions	1,998	4,348
Other net finance income	148	(78)
Actuarial loss	(167)	(494)
Post retirement deficit at end of period	(4,404)	(4,269)

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

If the Society had recognised FRS17 in the financial statements, the following would have been the movements during the year:	2004 £'000	2003 £'000
Amount that would have been charged to operating surplus:		
Current service cost	1,768	1,696
Amount that would have been charged to other financial income:		
Expected return on pension scheme assets	1,621	1,156
Interest on post retirement liabilities	(1,473)	(1,234)
Net return to credit/(charge) to other financial income	148	(78)
Amount that would have been recognised in the Statement of Total Recognised Gains and Losses:		
Actual return less expected return on scheme assets	1,272	2,078
Experience gains arising on scheme liabilities	–	135
Loss due to changes in assumptions underlying the FRS17 value of scheme liabilities	(1,439)	(2,707)
Actuarial loss	(167)	(494)

8 Pensions: continued

History of experience gains and losses:	2004	2003	2002
Actual return less expected return on scheme assets (£'000)	1,272	2,078	(4,176)
Percentage of scheme assets	5%	9%	(27%)
Experience gains/(losses) arising on scheme liabilities (£'000)	–	135	(45)
Percentage of the FRS17 value of the scheme liabilities	0%	1%	(0%)
Total amount that would have been recognised in the Statement of Total Recognised Gains and Losses (£'000)	(167)	(494)	(5,100)
Percentage of the FRS17 value of the scheme liabilities	(1%)	(2%)	(24%)

The Society's net assets, including the disclosed FRS17 balance sheet item above, would be £413,378,000 at 31 December 2004 (£344,916,000 at 31 December 2003). The Society's income and expenditure reserve, including the disclosed FRS17 balance sheet item above, would be £376,442,000 at 31 December 2004 (£334,878,000 at 31 December 2003).

9 Tangible fixed assets	Freehold property	Leasehold property	Computers, furniture, fittings and office equipment	Total
Group	£'000	£'000	£'000	£'000
Cost or valuation				
At 1 January 2004	5,900	665	5,992	12,557
Additions	–	–	604	604
Disposals	–	–	(864)	(864)
Revaluation	600	–	–	600
At 31 December 2004	6,500	665	5,732	12,897
Depreciation				
At 1 January 2004	139	482	4,034	4,655
Provided in year	119	62	700	881
Released on disposals	–	–	(849)	(849)
Released on revaluation	(247)	–	–	(247)
At 31 December 2004	11	544	3,885	4,440
Net book values				
At 31 December 2004	6,489	121	1,847	8,457
At 31 December 2003	5,761	183	1,958	7,902
Company				
Cost or valuation				
At 1 January 2004	5,900	665	5,943	12,508
Additions	–	–	593	593
Disposals	–	–	(864)	(864)
Revaluation	600	–	–	600
At 31 December 2004	6,500	665	5,672	12,837
Depreciation				
At 1 January 2004	139	482	4,013	4,634
Provided in year	119	62	693	874
Released on disposals	–	–	(849)	(849)
Released on revaluation	(247)	–	–	(247)
At 31 December 2004	11	544	3,857	4,412
Net book values				
At 31 December 2004	6,489	121	1,815	8,425
At 31 December 2003	5,761	183	1,930	7,874

All the leasehold properties held at 31 December 2004 are short leaseholds.

9 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	4,138
Depreciation	(742)
At 31 December 2004	3,396
At 31 December 2003	3,464

Capital commitments

Capital expenditure approved and contracted for amounted to £ nil (2003: £ nil).

10 Investments	2004 Group £'000	2003 Group £'000	2004 Company £'000	2003 Company £'000
Valuation or cost at 1 January	459,823	351,990	20,001	20,001
Additions	490,289	244,606	11,000	–
Disposals at carrying value	(423,859)	(167,974)	–	–
Movement in cash and brokers' balances	32,095	2,097	–	–
Surplus on revaluation of listed investments	17,401	29,104	–	–
At 31 December	575,749	459,823	31,001	20,001
Investments comprise:				
Listed on UK Stock Exchange:				
– Equities	69,021	85,700	–	–
– Government and other bonds	267,910	230,218	–	–
Listed on overseas Stock Exchanges:				
– Equities	111,454	76,280	–	–
– Government and other bonds	89,890	62,246	–	–
Shares in group undertakings	–	–	31,001	20,001
Cash	37,236	5,132	–	–
Brokers' balances	238	247	–	–
	575,749	459,823	31,001	20,001
Historical cost of investments	541,907	452,083	31,001	20,001

Additions in the year for the Company relate to an investment in a newly formed subsidiary, MPS Risk Solutions Limited. (Note 11).

11 Investment in subsidiary undertakings
The Medical Protection Society 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 Ltd	100%	–	England	To manage the advisory and administrative affairs of the dental division of the Society.
MPS Risk Consulting Ltd	100%	–	England	To provide risk management advice and consultancy and claims management to NHS trusts, health authorities and other healthcare organisations.
M P I (London) Ltd	100%	20,001	England	To manage the investment portfolio.
D P L Australia (PTY) Ltd	100%	–	Australia	To manage the administrative affairs of Dental Protection Limited in Australia.
MPS Risk Solutions Ltd	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.

12 Debtors	2004 Group £'000	2003 Group £'000	2004 Company £'000	2003 Company £'000
Receivable within one year				
Trade debtors	460	814	413	714
Recoverable insurance claims	5,619	3,974	5,619	3,974
Amounts owed by subsidiary undertakings	–	–	431,705	374,629
Other debtors	425	148	406	135
Prepayments	2,300	2,483	2,298	2,483
	8,804	7,419	440,441	381,935
Receivable after one year				
Recoverable insurance claims	9,200	7,800	9,200	7,800
Total Debtors	18,004	15,219	449,641	389,735

13 Creditors: amounts falling due within one year	2004 Group £'000	2003 Group £'000	2004 Company £'000	2003 Company £'000
Bank overdraft	–	216	–	220
Corporation tax	3,755	2,530	130	126
Other taxes and social security	451	465	445	457
Other creditors and accruals	14,554	14,761	14,158	14,384
Deferred subscription income	20,363	19,507	20,363	19,507
	39,123	37,479	35,096	34,694

14 Provision for liabilities and charges: Group and Company	Reported claims £'000	Claims handling £'000	Total £'000
At 1 January 2004	188,451	6,482	194,933
Movements in the year			
Charged to the income and expenditure account	104,621	6,508	111,129
Paid	(65,420)	(5,149)	(70,569)
At 31 December 2004	227,652	7,841	235,493

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 £13.8m that are estimated to be recoverable from the Society'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.

15 Movement on reserves

Group	Revaluation reserve £'000	Income and expenditure £'000	Accumulated £'000
At 1 January 2004	10,038	339,147	349,185
Surplus on revaluation of listed investments	17,401	–	17,401
Realised on disposal of investments	8,701	(8,701)	–
Surplus on revaluation of fixed assets	847	–	847
Tax charge recognised on investment gains	–	(81)	(81)
Release of depreciation on revalued property	(51)	51	–
Net contribution for the year after tax	–	50,430	50,430
At 31 December 2004	36,936	380,846	417,782

Company	Revaluation reserve £'000	Income and expenditure £'000	Accumulated £'000
At 1 January 2004	2,298	210,533	212,831
Surplus on revaluation of fixed assets	847	–	847
Release of depreciation on revalued property	(51)	51	–
Net contribution for the year after taxation	–	30,017	30,017
At 31 December 2004	3,094	240,601	243,695

16 Reconciliation of movements in funds available to meet future liabilities	2004 £'000	2003 £'000
Net contribution for the financial year	50,430	70,641
Other recognised gains relating to the year	18,248	29,104
Tax charge on investment gains	(81)	(644)
Total recognised gains	68,597	99,101
Opening funds available to meet future liabilities and charges	349,185	250,084
Closing funds available to meet future liabilities and charges (see note 21)	417,782	349,185

17 Reconciliation of excess of income over expenditure to operating cash flows

	2004 £'000	2003 £'000
Excess of income over expenditure	29,904	56,399
Depreciation charges	881	1,026
Loss on disposal of tangible fixed assets	8	61
Increase in claims provision	40,560	9,156
Increase in debtors	(2,776)	(1,950)
Increase in creditors	635	12,036
Net cash inflow from operating activities	*69,212*	*76,728*

18 Returns on investment and servicing of finance

	2004 £'000	2003 £'000
Interest received	5,154	4,558
Dividends received	14,440	12,245
Other interest	223	–
Net cash inflow from returns on investments and servicing of finance	19,817	16,803

19 Capital expenditure and financial investment

	2004 £'000	2003 £'000
Purchase of tangible fixed assets	(604)	(577)
Purchase of investments	(490,289)	(244,606)
Proceeds from sale of tangible fixed assets	7	5
Proceeds from sale of investments	429,764	171,632
Net cash outflow from capital expenditure and financial investment	(61,122)	(73,546)

20 Commitments

	2004 Group £'000	2003 Group £'000	2004 Company £'000	2003 Company £'000
Operating lease commitments				
Land and buildings, leases expiring:				
Within one year	636	–	636	–
Greater than five years	880	1,150	880	1,150
	1,516	1,150	1,516	1,150
Motor vehicles, leases expiring:				
Within one year	6	3	6	3
Two to five years	8	14	8	14
	14	17	14	17

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

21 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 the Society's responsibility under the occurrence basis of cover the Society provides. The funds on the balance sheet at 31 December 2004 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.

22 Obligations of Members

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

23 Guarantee

The Society is limited by guarantee not exceeding £1 per member.

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