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THE MEDICAL PROTECTION SOCIETY LIMITED

Annual Report and Accounts 2006

PROFESSIONAL SUPPORT AND EXPERT ADVICE

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Chairman's statement

It cannot be denied that around the world the practice of medicine and dentistry is going through a period of rapid change to establish the highest standards of responsibility and performance expected by the professions

In the UK, government was forced to intervene following the public outcry after various scandals such as those at Bristol and Alder Hey, and Shipman's criminal activities Similarly, in Ireland the outcome of the Lourdes Hospital Inquiry has led to the new Medical Practitioners' Bill

The profession is also coming under ever greater scrutiny in New Zealand and South Africa The outcome has been more state involvement in professional regulation, a trend replicated throughout the developed world MPS has to monitor, lobby and hopefully play a significant part in determining the shape of these changes – which is no easy task when we serve members in more than forty countries

While we welcome many of the proposed changes, we must ensure that the regulation of doctors and dentists is not oppressive We should not stifle innovation and destroy hard-won professional autonomy, but instead promote changes that contribute to the effective overall delivery of healthcare Over-regulation will make medicine an unattractive choice of career The dedicated and diligent doctor who becomes disheartened is not welcomed by patients

It is a mistake to portray MPS as an organisation that, because of the varied circumstances in which it supports doctors and dentists, is in some way not always supportive of the patient We know members would not wish to see patients uncompensated for genuine harm arising from negligent actions Indeed, in response to a valid claim, we have repeatedly said that we have never allowed this to happen To do otherwise would be bad for the professions and contrary to the mutual principles of MPS Yet damages awarded by courts continue to rise inexorably Indeed, the most seriously injured patients in the UK are awarded sums as high as anywhere else in the world Despite this, there has not been a proper debate as to whether taxpayers, who end up paying for most of these awards, consider this fair when balanced against other demands on their funds by the public services

The recent UK High Court ruling[1] concerning Lee Thompstone, a boy with profound hypoxic birth injuries, required the annual cost of caring for him to be increased in line with an earnings index currently nearly 3% higher than the Retail Prices Index It has been estimated that the precedent set by this one ruling could cost the NHS more than £250 million per annum

Of course, MPS funds will also suffer It seems certain that similar unpredictable legislative changes will occur in the future, and these may have a significant retrospective effect It should therefore be comforting to members to know that MPS assets now approach £1 billion and, by a margin, are expected to cover all claims, both reported and unreported, stretching decades into the future

During 2006 there was significant unwelcome adverse publicity for another medical defence organisation This sprang from the resignations of four non-executive directors An article and leader in the *The Times* voiced serious concerns about governance Doctors and dentists expressed considerable interest and anxiety on internet sites This may have alarmed MPS members, and we want to reassure them that MPS Council has always been careful to enact the highest standards of governance, transparency and accountability

Although, at its heart, MPS is an organisation for healthcare professionals to provide mutual support to each other, we recognise the crucial role played by non-executive members of Council with specialised skills and experience outside medicine It would be nonsense

[1] Thompstone v Thameside and Glossop Acute Services NHS Trust

to claim (as others have done) that practising clinicians have on their own, sufficient knowledge or experience to sustain a large international mutual organisation Indeed, our current strong financial position is largely due to the specialist expertise of non-medical Council and committee members and MPS greatly values their contribution

On a different note, one object of MPS is to help maintain high standards of professional practice in healthcare We have always had a strong interest in risk management and education Our medicolegal advisers and lawyers have their own unique perspective on this subject and welcome opportunities to share their expertise at seminars and meetings around the world We also provide risk-management services directly through our subsidiary, MPS Risk Consulting Limited, and intend to build substantially on this base in the coming year

Two Council members will be leaving in the summer John Leighton Williams sadly retires after his 8-year term As a QC whose practice includes clinical negligence, he has informed and entertained Council in equal measure Our Chief Executive, John Hickey retires in September, after 22 years with MPS He started his medical career as an anaesthetist, and moved to MPS as a medicolegal adviser in 1985 It soon became clear his skills ranged much more widely and he moved to Australia in 1987 On his return, he led the joint MPS/Willis Corroon team that set up the Clinical Negligence Scheme for Trusts (CNST) He has led MPS since 2002 with tremendous flair He has inspired confidence and loyalty from all our staff, guided Council with the surest of hands and strengthened MPS's pre-eminent position in all the countries in which we operate We will all miss him, but none more than me and I am glad to have this opportunity to express my gratitude to him

In October we will extend a very warm welcome to his successor, Tony Mason, recently managing partner at our actuaries Lane Clark & Peacock LLP, who has been closely associated with MPS for many years

Nicholas Davies
Chairman of the Council

Chief Executive's report on 2006

I am pleased to report another excellent year for MPS in 2006 with good growth in membership numbers and a very significant strengthening in your company's financial position

For the first time in MPS history, in 2006 earned subscription income passed the £200 million mark However, while growth in subscription income and in membership numbers is welcome, it is only part of the story During the period of my tenure as Chief Executive, and under my predecessor, the overriding aim has been to continue to improve the funding position of MPS

The reason for this is simple, members pay a significant amount of money in the not unreasonable expectation that MPS will be in a position to help them if they run into problems from their professional practice, perhaps many years hence It is, therefore, of utmost importance to ensure that MPS remains fully funded What this means is that if, at 31 December 2006, MPS had closed its doors and not accepted a single further penny in subscription income, it would have had sufficient assets to meet both the claims that have already been reported to it by members and expected future claims as yet unreported from incidents that have already occurred

However, one of the problems with providing indemnity for clinical negligence liabilities is that it is subject to great uncertainty We have to make many assumptions today about the amount of money that will be needed to settle claims in the future Claims inflation (to which I will refer later) usually well outstrips consumer price inflation and this is but one reason why subscriptions almost invariably have to rise at a rate in excess of consumer price inflation Given these uncertainties, it is of paramount importance for members and patients that MPS's financial position remains strong

MPS first reached a fully funded position in 1999, but the adverse investment environment in the early part of this decade meant that the funding position deteriorated slightly However, in 2002 the improvement in the investment environment, combined with prudent subscription setting and close attention to expenditure, ensured that the company returned to its fully funded position Since then, it has never looked back As a result, total assets available to meet reported claims, of £926 million (2005 £799 million) on the balance sheet, are more than sufficient to meet the value of both reported and unreported claims

Net assets, after providing for all reported claims and associated legal costs, and claims-handling reserve, rose in the year by £90 million (17 9%) to £596 million The actual provision for reported claims, including associated legal costs and the claims-handling reserve, rose by 12 4% from £293 million to £329 million (2005 15 7%) A substantial proportion of this increase was due to the Council's decision to increase the provision for periodical payments partly in light of the recent Thompstone judgment in the UK to which the Chairman has referred in his report Similar provision has been made in the valuation of unreported claims on the assumption that the Council exercises its discretion to accept these claims

Those of you who have, over the years, read my covering letters to the MPS's journal, Casebook, will know that increasing value, or severity, of claims is a topic that has exercised me greatly This important issue affects not only clinical negligence claims, but all personal injury claims and is too often dismissed as just a problem for insurers or indemnifiers This is a misunderstanding of the true position In many countries in which MPS operates, it is the government, and therefore the taxpayer, that is the largest compensator Similarly, insurers or indemnifiers have only one source from which to fund claims – the premiums or subscriptions paid by their customers – who are, of course, the very same taxpayers who fund the public claims

Many states in America and the federal and state governments in Australia have recognised the very great difficulties that unfettered damages can cause One has every sympathy with the individual who is injured by the negligence of another, certainly that person deserves fair compensation, but the question of what is fair cannot be left to the judiciary which, quite rightly in such cases, has to focus on the interests of the individual rather than the public interest

In clinical negligence terms, at a time when taxpayers in many of the countries in which MPS operates are facing a rationing of healthcare, we are seeing erosion of healthcare funding by ever-increasing awards for damages by the courts We have tried, for instance in the UK, Ireland and South Africa, to stimulate debate on this topic, so far with little success We will continue our efforts to try to make politicians and the public realise that the levels of compensation must be the subject of public debate followed by a determination by government of what is fair compensation After all, if healthcare provision has to be rationed, should not compensation also be rationed and directed towards those who need it most?

Another very important contributor to the seemingly unending rise in the cost of compensation is the increase in claimant costs Other indemnifiers, for example the NHSLA in the UK, have identified unjustifiable claimant costs as a problem In our experience worldwide, for claims valued below US$20,000, the ratio of claimant costs to claimant damages has increased significantly

We recently conducted a study based on MPS claims, with striking results On average, our legal costs for defending a claim are 50% lower than the claimants' costs In contrast, for small claims, for every US$100 of compensation received by claimants, their lawyers and experts are now receiving US$177 When statistics such as these are examined in the light of stable or even diminishing claim frequencies, it is difficult to avoid the conclusion that lawyers are compensating for the reduction in the number of claims, by simply charging far more for their work on the remaining claims

Inflated claimant costs are a silent scandal that should be brought to the attention of governments and the public The former chairman of the NHSLA in the UK, in his valedictory report, referred to the climate of increasing claimant costs as the "vulture culture" I cannot but agree with him

One of the most important functions of the MPS Council is to ensure that the members' funds are prudently invested As total assets grow, this function becomes ever more important MPS's investments are managed by the Board of MPI (London) Limited (MPI), a wholly owned subsidiary The Board of MPI carries out a formal review of investment strategy every few years (another will take place in 2007) to ensure that the profile of investments matches the expected future claims costs in terms of maturity and currency

The investments consist of a mixture of government and corporate bonds, equities and cash MPS invests for the medium to long term and although changes in the value of investments affect the balance sheet, there is no need to sell the investments to pay claims whilst cash flow remains strong

During 2006, we initiated discussions with the Cognitive Institute of Australia, one of the world's largest providers of communication skills and risk-management training to healthcare professionals I am pleased to report that shortly after the year end, MPS, through MPS Risk Consulting Limited – MPS's consultancy and training company

– acquired the Cognitive Institute, whose portfolio of training and education fits well with MPS's overall objectives of improving the quality of patient care

The position of Cognitive Institute gives MPS the opportunity to expand its support for members through training which may reduce their risk The MPS mission statement commits the company to work with members through education to prevent avoidable harm to patients The acquisition of Cognitive Institute is entirely in line with this aim

As I will be retiring in 2007, this will be my last report to members When I joined MPS as a medicolegal advisor in April 1985, the *Annual Report and Accounts* for the prior year showed the total subscription income was just over £14 million (2006 £214 million) and total funds available to meet the claims were just over £16 million (2006 £926 million) MPS employed 16 medical and dental legal advisers in 1985, whereas in 2006 they numbered 73 Despite these massive changes in the size of MPS's business over the last twenty-two years, the fundamental ethos of the company has not changed – doctors for doctors, dentists for dentists We have worked hard, both with the professions and with governments over the past two decades to improve patient safety (and in this context, the acquisition of the Cognitive Institute is a very important further step)

During my time at MPS I have observed at least twenty commercial insurers trying to enter the market in different parts of the world Their messages are always the same "the day of the discretionary mutual is over", "insurance is much better than discretionary indemnity for medical and dental practitioners", and so on and so forth Some of the tactics that I have seen employed by these companies go beyond the expected rough-and-tumble of fair competition I am yet to see any of these companies stay for the long term, when they realise that profits cannot be made easily they withdraw from the market, often leaving the professions exposed to the very great limitations of claims-made cover

At the end of my career I am more convinced than ever that indemnity provided on a discretionary occurrence basis by true mutuals with full control over claims settlement, combined with a responsible approach to financial management, is by far the best for the medical and dental professions and, most importantly, for patients

I am proud to say that I have worked for MPS for all this time and I would like to thank the Council of MPS – and in particular the Chairman, Dr Nick Davies, whose wise counsel I have most appreciated – for the confidence which they have placed in me I would also like to extend my heartfelt thanks to the staff of MPS, not only for the support they have given me but for their commitment to service excellence, which is greater than in any other organisation with which I am familiar

Finally, I leave MPS in the most capable hands of Mr Tony Mason and I wish him and the company every success in the future

John Hickey
Chief Executive

Finance Director's report on 2006

I echo the Chief Executive's comment that it has been another excellent year of financial performance for MPS

Financial strength

The main measure of MPS's financial strength is the ability to meet all its claim obligations As explained in both the Chief Executive's Report and the Business Review, there are significant uncertainties surrounding the estimation of the claim obligations and there is also short-term volatility surrounding MPS's invested assets Thus, to be sure that MPS can meet its claim obligations, it is necessary to hold funds somewhat in excess of the estimated value of these obligations, to allow for these uncertainties

Members should be assured that MPS does have more than sufficient assets to cover its unreported claims and also has a strategy in place over the coming years to increase the margin of assets above such obligations to a level which Council feels provides an appropriate degree of financial strength

At the end of 2006, MPS had £926 million (2005 £799 million) of assets before allowing for the cost of reported claim obligations, which is an increase of £127 million (15 9%) in the year Of the £926 million (2005 £799 million), £329 million (2005 £293 million) is to meet the value of reported claims, which is provided on the balance sheet That leaves £596 million (2005 £506 million), an increase of £90 million (17 9%), to meet the cost of unreported claims Unreported claims, or potential future claims, are those claims for which MPS will be responsible, subject to discretion, but that have not yet been reported

The assets available to meet these unreported claims, represents 181% of the value of reported claims, up from 173% at the end of 2005

The £90 million (2005 £110 million) increase in net assets after providing for reported claims, is derived from a trading contribution, income less costs incurred, of £49 million (2005 £42 million) and a net of tax total return from the investments of £41 million (2005 £68 million) As can be seen from this, and as explained below, the trading results for 2006 were better than 2005, but the investment performance was worse, although in line with the benchmark

Financial performance

Trading resulted in a surplus of income over costs of £49 million (2005 £42 million), which is a 23 2% margin on subscription and other income, a slight improvement on last year's margin of 22 5%

Subscription and other income

Subscription and other income rose by £28 million (15 4%) (2005 £20 million) to £214 million (2005 £186 million) in the year, as a result of an increase in members and an increase in subscription rates

Rate increases are necessary to meet the costs of claims and advisory services expected to arise from business written in 2006 and of the administration costs necessary to provide the service in the year Whilst the trend noted in the last two years of a levelling or even slight decline in the frequency of claims in nearly all of MPS's geographical areas of business continues, this has been more than outweighed by a continued increase in the average cost of a claim, which has risen in nearly all areas of geographical business and, as noted in the Chief Executive's Report, this rise is much greater than any rise in consumer price indices

Subscription income is also used to pay legal costs to represent members at disciplinary and regulatory council hearings and other forums and MPS continues to see a significant increase in the number of members seeking such assistance and in the cost of providing such assistance

It is these rises in subscription rates, coupled with a tight control of costs and good investment performance in the last four years, which has helped cement MPS's financial position

Claims costs and associated legal costs

Claims costs and associated legal costs (also called incurred claims costs) represent the costs of negligence claims paid in the year, the internal and external costs of managing these claims and the change in the year of the estimated value of all reported claims In addition, it also includes the costs paid by MPS to claimants, which MPS is sometimes obliged to pay, and which is commented on in the Chief Executive's report These costs are £115 million (2005 £108 million) for the year, an increase of £7 million (6 8%) compared to 2005

It is difficult to predict the incurred claims costs, as it is highly susceptible to the movement in a very small number of high-value claims Having said that, with an increasing membership, increasing claims severity, and as mentioned in the Chief Executive's report, a strengthening of the provision for periodical payments it is very pleasing to see a relatively small percentage increase, which points to the strength of MPS internal claims management Although as explained below, exchange rate movements during the year have helped to limit, in Sterling terms, rises in reported claim values in some international territories

Advisory and associated legal costs

The advisory costs and associated legal costs represent the change in value of the provisions for claims other than for negligence, the internal and external legal costs of managing these claims and the costs of employing doctors and dentists to provide advisory services This cost was £23 million (2005 £24 million) for the year, a decrease of £1 million (6 5%) in the year A small reduction in the overall charge for the year is welcomed, costs of servicing these claims has nearly doubled in the last five years and although strenuous efforts are made to control these costs without diminishing the level of service there is little expectation that this year's results mark a new trend As has been reported by MPS in past years, doctors and dentists are increasingly being held to account by employers, patients and governments and whilst this is appropriate to protect patients from poor clinicians, the way in which these systems are operated is not always equitable MPS incurs considerable expense assisting members with cases that either should never have been started or which have to be pursued further than originally envisaged to ensure a just outcome for the member – it is unlikely that a commercial insurer would go to such lengths

Administration costs

Administration costs represent the remaining costs of running the business These costs include finance, customer service, IT, marketing, rent and rates, energy, etc Despite an increase in staff numbers (see note 8), growth in member numbers and considerable investment in IT systems and resources as part of an ongoing project to improve service and administrative efficiency, it is noteworthy that these costs have barely changed from 2005 As a proportion of subscription and other income, administration costs were 5 7% for 2006, compared with 6 6% for 2004 and 2005

Loss/(profit) on exchange movements

One cost element of striking change from 2005 is the loss on exchange movements of £15 million, compared to a profit in 2005 of £2 million MPS has a number of international bank accounts through which it receives subscription income from international members and pays costs In addition, it holds assets in a number of currencies to match the currencies of the claim liabilities that it is obliged to pay at some future date It is vital to hold assets to the same value as claim liabilities in the same currency, so that if the Sterling to local currency exchange rate fluctuates, there is no change in the relative values of assets and liabilities and so no change in MPS's overall ability to meet claims obligations

Apart from Sterling, assets are mainly held in Euro, Rand and the US dollar, the latter being held as a proxy match for currencies in which MPS has smaller claim liabilities, but for which it is not practical to maintain segregated investment assets However, because MPS is based in the UK, it reports its financial results in Sterling and has to covert the value of its non-Sterling cash held in bank accounts and assets (and liabilities) into Sterling at the end of the year This is then compared to the value at the start of the year (or during the year when the asset/cash is acquired if appropriate) and any movement is either a gain or a loss

During the year, Sterling strengthened against nearly all major currencies, so the overall value in Sterling of non-sterling assets at the end of the year is less than it was either at the start of the year or during the year There is thus a 'loss' on exchange movements for assets The magnitude of the loss for 2006 reflects the unusual degree of movement between exchange rates during the year, such that Sterling strengthened by 14% against the US and Hong Kong dollars and by about 27% against the Rand There is, of course, a similar impact on liabilities, in that the Sterling value of the non-Sterling claim liabilities will also have reduced due to exchange rate movements The impact of this is accounted for in the value of the claims reserve, the movement year on year is through the claims costs and associated legal costs and not set off against the impact of exchange rate movements on assets

Investments

The value of MPS's investments and cash on deposit stands at £946 million (2005 £826 million) at the year end, an increase of £120 million (14 6%) in the year This increase is the result of a combination of investment of trading surplus, the receipt of investment income from invested assets and the capital growth of invested assets

Investment income for the year before tax increased by £0 5 million and capital growth before tax was £21 million, down from £55 million in 2005 These figures indicate that investment performance in 2006 was not as good as 2005, indeed after tax and management fees the investment return on the whole portfolio was 3 1%, compared with 8 3% for 2005, however, this is a reflection of the general investment climate, rather than specific poor performance of MPS's funds Investment performance for 2006 was in line with the benchmark

These performance figures mask a considerable variation in performance from different elements of the investment portfolio There was excellent performance from UK and European equities which returned, in Sterling terms, 16 8% and 18 5% respectively However, the mainstay of the portfolio, UK government bonds, returned on average 3 4%, reflecting a fall in value as a result of increases in interest rates But the total return was also tempered by the Sterling return of some non-Sterling assets For example, the return on the South African Rand bond portfolio was 7 2% in Rand terms, but when converted to Sterling (reflecting the weakening of the Rand through the year) the performance fell to a negative 16 4% The experience for US Treasury Inflation Proof Stocks (TIPS) and European bonds was similar, but slightly less extreme

An assessment of business risks is contained within the Business Review in the Report of the Council on pages 12 to 24

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Finance Director

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Keith Haynes MSc LLB DipHSM

Head of Marketing and Business Development
John Lamb BSc(Hons)

Head of Communications
Shelley McNicol BA(Hons)

Membership Manager
Carol Sherlock BSc(Hons)

Members of the board of Dental Protection Limited (DPL) 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 2006

Business review and principal activity

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 and other healthcare professionals 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 state 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 '

In addition to the principal activity of the holding company, the group has two main trading subsidiaries, MPS Risk Solutions Limited and MPS Risk Consulting Limited MPS Risk Solutions Limited is a general insurance company, regulated by the Financial Services Authority, which provides professional indemnity, malpractice, product and public liability cover to corporate healthcare providers MPS Risk Consulting Limited provides education and risk management consultancy to individuals and corporations in the healthcare sector There is a further major subsidiary, MPI (London) Limited (MPI), which holds the invested assets on behalf of MPS MPI has a separate board (see page 10) and the board is responsible for agreeing an appropriate investment strategy, which is then approved by MPS Council and subsequently implemented by MPI Funds are invested with third party fund managers and MPI does not undertake any direct investment activity MPI board is responsible for overseeing the investment performance of the third party managers

Business purpose

MPS exists to serve its members MPS aims to ensure that it remains a strong viable entity to meet its current and future commitments to members and that it continues to provide much-needed services to members for years to come

In providing services to members, subject to discretion and the scope of the benefits of membership, MPS will meet the costs of assisting members provided that the request stems from an incident that occurred at a time when the member was paying an appropriate subscription

This means that if a member has need to seek advice or an indemnity relating to an incident in 2006, providing the member was paying an appropriate subscription during 2006 and assistance is granted when the application is made, then MPS will pay all reasonable costs related to that incident These costs may include representation at a regulatory council, assistance with disciplinary proceedings and full indemnity for damages and costs in cases of negligence Payment may be made even though it may be years after the incident before the member is aware of a problem and seeks assistance, it may be many more years before costs are incurred and the issues are resolved Applying for the benefits of membership years after the adverse incident, subject only to having paid the appropriate subscription for the period of the adverse incident, is known as claims-incurred cover

Principal business risks

All businesses face risks of one kind or another and prudent management of the business requires identification, quantification and mitigation of these risks, MPS is no exception

The principal risks facing MPS are

- Reserving risk

  MPS provides an indemnity to members for the costs and damages associated with claims of negligence and the costs associated with other claims For MPS to provide this support on a claims-incurred basis means that at any time there are, as a result of past adverse incidents, claims that have already been reported and potential claims that have not yet been reported (unreported claims) Subject to discretion, MPS will be responsible for all of these claims

  For MPS to be responsible for paying these claims, it needs to be able to assess the value of these claims and ensure that it has sufficient assets to meet the expected total costs

  There is a lot of uncertainty around estimating the value of claims This uncertainty is greater for unreported claims, than for those that have been reported For the unreported claims, these uncertainties include determining how many claims and of what severity are expected, in relation to the number and specialty of members paying a subscription, how long it is likely to take from the date of the adverse incident to the making of a claim, and how many may be large claims The uncertainties for the reported claims are a little narrower, but still considerable There may be uncertainty over causation, over prognosis and the cost of future care and over the time it is likely to take to settle the claim

  There is also considerable risk for both reported and unreported claims from changes in legislation MPS has seen a number of changes in legislation over the last ten years, nearly all of which resulted in an increase in the cost of claims This includes the introduction of periodicals and reductions in the discount rate

  Mitigation

  MPS uses the skill, and on-going training to maintain the skill, of its internal staff to determine accurate estimates for individual claims It also has many checks and balances in its internal systems to review and monitor these estimates to achieve a high degree of consistency Finally, MPS uses the experience of its consulting actuary, Lane Clark & Peacock LLP, to use the internal individual claim estimates and membership data to arrive at a statistical reserve of the likely cost of all claims

- Underwriting risk

  MPS charges a subscription based on the expected claims of those members paying the subscription There is a risk that the resulting claims from those members will turn out to exceed the expectations contained within the subscriptions and thus MPS will not have collected sufficient subscription income

  Mitigation

  Again the skill of staff and advisers is important as are the quality of internal systems In addition, MPS carefully reviews all applications and makes an assessment on those risks that it is willing to accept MPS also operates an internal programme to identify individual members who appear to represent a higher than normal risk and tries to work with them to reduce their risk In addition MPS purchases insurance for the risk that claims experience will be worse than anticipated when setting subscriptions

- Investment risk

  Subscriptions collected in any one year are invested until they are needed to pay the costs arising from the year in which the subscriptions were received The greater the return MPS can achieve from investments, the less it would theoretically need to charge in subscriptions However, the greater the investment return, the greater the risk that the assets will not achieve the expected return and may even fall in value

Mitigation
MPS has adopted a prudent investment strategy that carefully identifies the levels of risk and return acceptable in its portfolio of assets External professional advice is regularly sought and investment performance is subject to detailed review in conjunction with advisers Wherever practical, risks arising from currency fluctuation and investment liquidity are minimised

- Operational risk

Any organisation will be exposed to operational risk, that is to say the risk that a failure in its operations may incur an additional cost Examples for MPS might include costs associated with a major failure of IT systems, or resulting from a fire in one of the offices, or theft of its assets

Mitigation
MPS has done much to ensure that it has IT back up systems and contingency plans in the event of failures or disasters, such that there will be minimal disruption to its business It also spends time reviewing and testing its internal business systems, to ensure that they are sufficiently robust to ensure accuracy of data on which business decisions are based, and to prevent fraud and theft

- Currency risk

MPS holds assets to meet claims obligations The claim obligations are in a number of different currencies If the assets are held in different currencies, then there is a risk that relative movements in exchange rates will alter the relative value of assets to liabilities Sometimes this might be beneficial, sometimes not This is a risk that is outside of the scope of MPS's business and skill and should be removed as much as is possible

Mitigation
MPS ensures that all major non-Sterling claim obligations are fully matched with assets to the same value in the same currency This is fully complied with for Euro and Rand claim obligations For currencies where the liabilities are smaller, it is not practical to operate a local currency designated investment portfolio, so MPS uses US dollar denominated assets to act as a proxy match for such obligations Many of these currencies are closely linked to the US dollar anyway

- Liquidity risk

Liquidity risk is the risk that there will be insufficient liquid assets available to meet payments when they fall due This could either result in an inability to make the payment or the need to terminate an illiquid investment at an inopportune time, which could be costly

Mitigation
In managing liquidity risk, MPS needs to balance the ability to gain an investment return on its assets and the ability to have sufficient funds to pay liabilities as they fall due MPS operates a sophisticated system through major clearing banks to ensure that funds are available on a daily basis when required, but otherwise are invested in pooled money market funds In addition to this, the invested assets include a short-term money market portfolio with an average weighted maturity of a maximum of 12 months, which provides additional liquidity if needed

- Credit risk

Credit risk is the risk that someone

who owes money to MPS will fail to pay MPS has little risk from a failure to pay subscriptions by members, because if payments are not made, no services will be provided MPS's main credit risk arises from either a failure of its insurers or from a failure of some of the counterparties involved in derivative financial instruments as part of MPS's investment portfolio

Specific comment on this risk in relation to derivative financial instruments is provided on page 22

Mitigation
MPS has a stated policy on the acceptable risk profile for its insurers This policy states the need to spread the risk across a number of insurers and dictates the acceptable financial security rating for insurers MPS does not review the credit risk of counterparties in derivative financial instruments, but instead agrees parameters with its investment managers as to what security rating is acceptable for such counterparties

- Interest rate/inflation risk
MPS's exposure to interest rates is referred to in the sections on investment risk and reserving risk, but this section spells it out in more detail MPS holds about 70% of its invested assets in bonds and bond prices move inversely to changes in interest rates, thus an increase in interest rates will cause a fall in the price of bonds The impact on MPS's liabilities is more complicated The main influence on the cost of large claims (in the UK) is that element to reflect compensation for future costs or losses, these are mainly loss of earnings and cost of future care An estimate of the lump sum required to provide for these future costs is determined by reference to a discount factor The discount factors might be expected to change with changing interest rate expectations, but in the UK it is in fact fixed, by the Lord Chancellor However, with the introduction in 2005 of periodical payments as an alternative to lump sum settlements or structured settlements, compensation can be provided as a regular monthly payment for the life of the claimant, and these payments are to be indexed according to the retail price index

Mitigation
Interest rate exposure for bond assets is mitigated firstly by having a broad range of bond holdings, with different sensitivities to interest rate movements and secondly by holding a predominance of index linked bonds, so that interest rate rises due to increasing inflation is somewhat mitigated by the ability to reduce the tax charge as a result of indexation MPS's response to the risk inherent in periodicals is firstly to ensure that it has an appropriate investment make up to closely match the liabilities and secondly to ensure that it has sufficient assets to allow a margin in case of unexpected changes in interest and inflation rates

Specific comment on this risk in relation to derivative financial instruments is provided on page 22

Financial targets
Despite the risk mitigation identified above, it is impossible to eliminate risk Consequently, MPS needs to ensure that it has the financial resources to cope with the remaining unmitigated risk so that it can provide members with the assurance they need that MPS will be in a position to respond to their requests for assistance no matter when these are made

To this aim, MPS has set financial targets that will ensure that its assets exceed the estimated value of both its reported and unreported claim obligations The financial targets have been set such that even if these values were, within certain parameters, to be higher than expected, or, again within certain parameters, the value of invested assets was to be lower than expected, then MPS would still have sufficient funds to meet all its obligations

Financial performance for the year

Good progress has been made during the year in reaching the required financial targets More detail of the financial performance for the year is provided within the Finance Director's report on pages 7 to 9

Key markets

MPS operates in a number of different international markets This international perspective allows many members to practice around the world and still enjoy the benefits of MPS membership It also allows MPS to use its wide and diverse experience for the benefit of all its members

MPS's principal markets are

Bermuda	New Zealand
Hong Kong	Singapore
Ireland	South Africa
Kenya	United Kingdom
Malaysia	West Indies

In addition, MPS is able to provide the benefits of membership in many other countries (except USA and Canada) and if members intend to work abroad, they should contact their membership administrator to see if continued membership of MPS is possible

MPS is a leading provider of professional indemnity in all of the above key markets

Member numbers

The business aim is to grow membership in a controlled manner without increasing the overall risk exposure of the organisation Member numbers have increased in 2006 in nearly all areas

In addition to the growth in member numbers, internal measurements also show that the risk profile of the membership improved in all areas

Staff and the provision of services

Staff are a vital ingredient in providing the service to members MPS does much to ensure effective recruitment of staff, appropriate training once recruited and the provision of appropriate management, reward and working conditions to help ensure retention of a skilled resource

MPS has invested considerable time over the last year to help senior staff with managing performance, to ensure consistency of management across the organisation and to ensure that managers feel supported in taking the decisions necessary for the business In addition, much has been done to improve internal communication, so that staff are more aware of their contribution to the success of MPS and more aware of issues within the business

All of this has done much to improve the satisfaction of staff and the service provided to members MPS conducts a regular internal staff survey and the one conducted in 2006 shows considerable improvement over the previous 2002 survey in all of the eleven result areas This is coupled with recent member satisfaction surveys for the medicolegal telephone advice and membership services, which show stable or improving satisfaction ratings from members

Future developments

MPS has done much over the years to attract and retain members It has been very successful in this, by providing an excellent service at competitive prices This has resulted in a strong membership base in all of MPS's main geographical areas of operation MPS is keenly aware that members demand a high level of service and that there is always actual or threatened competition in the market so subscriptions need to be competitive Thus, the main focus of MPS's efforts in the future will continue to be the provision of exceptionally high quality medico and dentolegal advice and support for members seeking MPS's assistance, in addition, MPS will continue to set subscription rates that are commensurate with the risk and the need to attain the necessary financial targets

In January 2007 the MPS group, through MPS Risk Consulting Limited, acquired Cognitive Consulting Group Pty Limited (CCG) trading as Cognitive Institute, a company based in Australia and also operating in New Zealand and Singapore, that is a world leader in the provision of risk management and communication skills training to healthcare professionals In acquiring CCG, MPS aims to build on the range of courses already available and to provide these courses to MPS members around the world firstly, to help reduce the risk of claims and complaints incurred by members, secondly some special courses will be specifically targeted at those members that make an above average demand on MPS resources to try and mitigate this cost and thirdly, to provide such courses to non-members to enhance the reputation and recognition of MPS

MPS Risk Solutions Limited will continue to develop its client base within the market of corporate providers of healthcare services, by providing competitive insurance cover for malpractice, professional indemnity and where appropriate public and product liability risks

Donations

Charitable donations made by MPS during the year amounted to £7,574 £1,000 in favour of the Royal Medical Benevolent Fund, £6,449 in favour of the Charities Aid Foundation in lieu of fees waived by a Director of MPI (London) Limited, £125 in favour of the Royal British Legion 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

MPS also seeks regular feedback from its employees and a number of different mechanisms exist for this, including a company wide staff survey that is conducted every two years

In 2005, MPS decided to adapt the existing Staff Consultative Group in order to comply with the requirements of the Information and Consultation of Employees Regulations 2005

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 10

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 Combined Code prepared by the Committee on Corporate Governance and whether they have complied with its provisions throughout the period Although not listed, MPS complies with the Combined Code where it is considered relevant to its 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 ten other non-executive members MPS's constitution requires that the majority of Council members are doctors or dentists and that the Chairman is a doctor or dentist

Of the non-executives (including the Chairman), seven are doctors or dentists and four are not All the non-executives are considered to be independent The four non-executives who are not a doctor or dentist, have no financial interest in MPS other than their fees as members of Council The seven non-executives who are a doctor or dentist, have varying financial interests in MPS, but these are not felt sufficient to compromise their independence They receive fees as members of the Council and in addition, two received fees for acting as expert witnesses on behalf of MPS members, one received fees for providing risk management services to members and six had personal membership with 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 Combined Code

The normal retirement age for executive members of the Council was 60 at the beginning of the year, but following a review of recent UK age discrimination legislation the retirement age was increased to 65 for all employed staff Transition provisions were made for those within 10 years of retirement at the date of the change The same legislation has prompted a review of the retirement requirements for non-executives and whilst it is currently 70, members are asked to approve a change to the Articles of Association, which would remove this limit 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 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 opposite

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 MPS'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 There is also the provision for the non-executive members to meet without the Chairman and executive if they wish – this was not thought necessary during 2006

Sub-Committees of the Council

The Council has a Nominations, Remuneration and Audit Committee, the members of which are listed on page 10

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, Frank Attwood, (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 Combined Code, and although Council

Table 1 Council attendance record

MEMBER OF THE COUNCIL	APPOINTED/RETIRED	NO OF MEETINGS ATTENDED 2006	2005
Frank Attwood		9	10
Alan Crouch	Retired 8 June 2005	N/A	5
Nicholas Davies		9	9
Mark Dinwoodie	Appointed 8 June 2005	10	5
Mary Favier	Appointed 8 June 2005	10	5
Kathryn Harley	Appointed 14 June 2006	6	N/A
Taj Hassan	Appointed 14 June 2006	4	N/A
John Hickey		10	10
Leela Kapila		10	10
Simon Kayll		9	10
Mary King	Retired 8 June 2005	N/A	2
Kevin Lewis		8	10
Ravinder Maini		7	9
Brian Mouatt	Retired 14 June 2006	5	10
Susan Sellers	Retired 8 June 2005	N/A	4
Elizabeth Vallance	Appointed 9 February 2005	8	9
John Leighton Williams		8	9
Richard Youell		10	7

believes that this does not compromise the integrity of the Audit Committee, it has been agreed in order to comply with the Code, that the Chairman will cease to be a member of the Audit Committee with effect from 13 June 2007

The attendance record of members of the Audit Committee is shown in table 2 below

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 corporate healthcare providers Both Boards are chaired by the Chairman of the Council and the members are listed on page 10

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

Table 2 Audit committee attendance record

MEMBER OF THE AUDIT COMMITTEE	APPOINTED/RETIRED	NO OF MEETINGS ATTENDED 2006	2005
Frank Attwood		2	2
Alan Crouch	Retired 8 June 2005	N/A	1
Nicholas Davies		2	2
Mark Dinwoodie	Appointed 14 June 2006	1	N/A
Leela Kapila	Appointed 8 June 2005	2	1
Ravinder Maini		2	1
Brian Mouatt	Retired 14 June 2006	–	2
Susan Sellers	Retired 8 June 2005	N/A	1
Elizabeth Vallance	Appointed 8 June 2005	2	1

Board Evaluation

The Council undertakes an annual 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 2006 evaluation were presented to the Council by the Chairman in its February 2007 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 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 MPS 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 Because MPS is not a listed company, this report is not required to comply with the rules on Remuneration Reports

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

Relations with members

The provisions of the 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 opposite illustrates the future contracts that were 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

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 regulations

Company Law requires the Council to prepare financial statements for each financial year Under the law the Council are required to prepare financial statements in accordance with United Kingdom Generally Accepted Accounting Practice (United Kingdom Accounting Standards and applicable law) The financial statements are required by law to 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 these financial statements, the Council is required to

- select suitable accounting policies and then apply them consistently,
- make judgements and estimates that are reasonable and prudent, and
- state whether applicable United Kingdom accounting standards have been followed, subject to any material departures disclosed and explained in the financial statements

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

Table 3 Future contracts

CURRENCY	CONTRACT TYPE	CURRENCY	CONTRACT TYPE
GBP	Long Gilt future	JPY	10 year bond future (LIF)
GBP	90 day sterling future	JPY	10 year bond future (TSE)
CAD	10 year bond future	JPY	3 month Euroyen TFX
AUD	10 year bond future	EUR	Schatz future
CHF	Bond future	EUR	Schatz option
USD	10 year future option	EUR	Bond future
USD	5 year note future (CBT)	EUR	Bobl future
USD	2 year note future (CBT)	EUR	3 month Euribor option
USD	10 year note future	EUR	10 year Euro swapnote
USD	Long bond future (CBT)	EUR	Euro-bund future
USD	90 day Eurodollar future	EUR	Euro-bund option
ZAR	Bond future	EUR	30 year Euro BUXL future

MPS 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

Disclosure of information to auditors

At the date of making this report, each of the Members of The Council, as set out on page 10, confirm the following

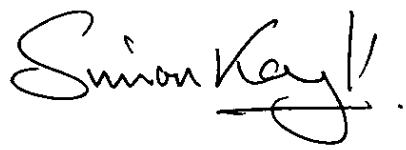
- so far as each Council Member is aware, there is no relevant information needed by the company's auditors in connection with preparing their report of which the company's auditors are unaware, and

- the Council Members each have taken all the steps that they ought to have taken as a Council Member in order to make themselves aware of any relevant information needed by the company's auditors in connection with preparing their report and to establish that the company's auditors are aware of that information

Approval

This report was approved by the Council on 11 April 2007 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 26 to 43 These financial statements have been prepared under the accounting policies set out therein

This report is made solely to MPS'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 MPS'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 MPS and MPS'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 (United Kingdom Generally Accepted Accounting Practice) 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 whether, in our opinion, the information given in the Council's report is consistent with the financial statements The information in the Council's report includes specific information presented in the Chief Executive's report and the Finance Director's report that is cross-referenced from the financial performance for the year section in the Council's report

In addition, we report to you if, in our opinion, the Group has not kept proper accounting records, if we have not received all the information and explanations we require for our audit, or if information specified by law regarding Council members' remuneration and other transactions 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 the Group'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 MPS and the Group as at 31 December 2006 and of the net contribution available to meet future liabilities and charges of the Group for the year then ended, the financial statements have been properly prepared in accordance with the Companies Act 1985, the information given in the Council's report is consistent with the financial statements

RSM Robson Rhodes LLP

RSM Robson Rhodes LLP
Chartered Accountants and
Registered Auditors
Leeds, England
11 April 2007

Consolidated income and expenditure account

Year ended 31 December 2006

	Notes	2006 £'000	2005 £'000 Restated
Income			
Members' subscriptions and other income		**214,379**	185,796
Expenditure			
Claims costs and associated legal costs (including costs of insurance)	15	**115,352**	107,997
Insurance recoveries		**(713)**	(555)
Advisory costs and associated legal costs	15	**22,800**	24,397
Administration expenses	4a	**12,180**	12,241
Loss/(profit) on exchange movements	4b	**15,459**	(1,620)
		165,078	142,460
Excess of members' subscriptions and other income over expenditure		**49,301**	43,336
Income from investments	5	**20,279**	19,936
Other finance income	9	**470**	144
Realised (losses)/gains from disposal of investments		**(8,069)**	1,910
Contribution from ordinary activities before taxation		**61,981**	65,326
Tax on investment income and gains	6a	**7**	(4,780)
Net contribution for the year available to meet future liabilities and charges	17	**61,988**	60,546

Statement of total recognised gains and losses

	Notes	2006 £'000	2005 £'000 Restated
Net contribution for the financial year		61,988	60,546
Surplus on revaluation of investments	16	28,745	53,435
Actuarial loss on defined benefit scheme	9	(101)	(1,630)
Tax charge on investment gains	6a	–	(2,499)
Total recognised gains		90,632	109,852
Prior year adjustment	3	(21,100)	-
Total recognised gains since the last annual report and financial statements		69,532	109,852

Note of historical cost income and expenditure

	Notes	2006 £'000	2005 £'000 Restated
Reported net contribution before tax		61,981	65,326
Realisation of valuation gains of previous years	16	19,452	9,953
Difference between a historical cost depreciation charge and the actual depreciation charge of the year calculated on the revalued amount	16	69	69
Historical cost net contribution before tax		81,502	75,348
Historical cost net contribution retained after tax		81,509	68,069

Consolidated and company balance sheets

At 31 December 2006

	Notes	2006 Group £'000	2005 Group £'000 Restated	2006 Company £'000	2005 Company £'000 Restated
Fixed assets					
Tangible assets	10	8,047	8,134	7,981	8,109
Investments	11	834,116	737,516	31,001	31,001
		842,163	745,650	38,982	39,110
Current assets					
Debtors – due within one year	13	8,460	7,216	623,330	525,150
– due after one year	13	9,902	9,832	9,902	9,832
Bank deposit accounts		111,847	88,075	29,979	30,752
Cash at bank and in hand		2,310	1	2,237	1
		132,519	105,124	665,448	565,735
Creditors – amounts falling due within one year	14	(48,851)	(51,055)	(47,995)	(45,587)
Net current assets		83,668	54,069	617,453	520,148
Total assets less current liabilities		925,831	799,719	656,435	559,258
Provision for liabilities and charges	15	(329,302)	(292,971)	(328,537)	(292,748)
Net assets excluding pension liability		596,529	506,748	327,898	266,510
Pension liability	9	(299)	(1,150)	(299)	(1,150)
Net assets		596,230	505,598	327,599	265,360
Accumulated funds	16				
Revaluation reserve		88,632	79,408	2,956	3,025
Income and expenditure		507,598	426,190	324,643	262,335
Funds available to meet future liabilities and charges	17	596,230	505,598	327,599	265,360

Nicholas Davies
Chairman of the Council
11 April 2007

Consolidated cash flow statement

Year ended 31 December 2006

	Notes	2006 £'000	2005 £'000
Net cash inflow from operating activities	18	97,143	88,024
Returns on investment and servicing of finance	19	20,279	19,936
Taxation		(5,053)	(5,974)
Capital expenditure and financial investment	20	(80,317)	(134,163)
		32,052	(32,177)
Net cash (outflow)/inflow from management of liquid resources (comprising bank deposits and investment deposits)		(29,100)	29,664
Increase/(decrease) in cash in the period		2,952	(2,513)

Analysis of changes in net funds

	At 1/1/2006 £'000	Cash flow movement £'000	At 31/12/2006 £'000
Cash at bank and in hand	1	2,309	2,310
Bank overdraft	(643)	643	–
	(642)	2,952	2,310
Bank deposit accounts	88,075	23,772	111,847
Cash with investment managers	7,814	5,328	13,142
Net funds	95,247	32,052	127,299

Reconciliation of net cash flow to movement in net funds

	2006 £'000	2005 £'000
Increase/(decrease) in cash	2,952	(2,513)
Cash flow from increase/(decrease) in net liquid resources	29,100	(29,664)
	32,052	(32,177)
Net funds at 1 January	95,247	127,424
Net funds at 31 December	127,299	95,247

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) Change in accounting policy

During the year MPS changed its accounting policy in order to comply with FRS12 *"Provisions, contingent liabilities and contingent assets'*, to provide for the estimated future costs of claims other than for negligence Such claims relate, amongst other things to representation at regulatory council and disciplinary hearings The costs of these claims has increased significantly over the last five years and as part of an actuarial exercise to value these claims, it is clear that they have a longer tail than previously thought Taking these factors in to account and having developed a suitable method for estimating these potential future costs with MPS's consulting actuaries, it is felt appropriate that these costs be provided for in the financial statements

This change has resulted in a prior year adjustment to correct this Details of the impact of this change 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 gains or losses are taken to the income and expenditure account, except for those arising from international equities, which are taken to the statement of total recognised gains and losses

2 *Accounting policies continued*

(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 FRS3, 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

Realised gains and losses are taken directly to the income and expenditure account

(i) Costs and damages for claims of negligence

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) Costs related to all other claims

Provision is made at discounted future settlement values for estimated future costs of these 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 assistance

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

(k) 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

Notes to the accounts: continued

(l) 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

(m) 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 changed its accounting policy on the recognition of claims other than for negligence, which has resulted in the estimated future costs of these claims being included within provisions

This change in accounting policy has resulted in a prior year adjustment and comparatives have been restated Set out below is the impact on the consolidated income and expenditure account and the Group balance sheet for both the prior and current year

2005	As previously stated £'000	Adjustment £'000	As restated £'000
Income and expenditure account			
Excess of income over expenditure	46,804	(3,468)	43,336
Net contribution for the year to meet future liabilities and charges	64,014	(3,468)	60,546
Balance Sheet			
Net assets	526,698	(21,100)	505,598

2006	As previously stated £'000	Adjustment £'000	As restated £'000
Income and expenditure account			
Excess of income over expenditure	47,238	2,063	49,301
Net contribution for the year to meet future liabilities and charges	59,925	2,063	61,988
Balance Sheet			
Net assets	615,267	(19,037)	596,230

The resulting net adjustment from this change in 2006 of £19 million, for both the group and company, has been credited to provisions, further details of which are included in note 15

4a *Administration expenses*

		2006 £'000	2005 £'000
Included under this classification are			
Operating lease rentals	– Land and buildings	908	880
	– Motor vehicles	82	83
Loss on disposal of tangible fixed assets		2	139
Depreciation of fixed assets		721	788
Auditors' remuneration			
Services to the company and its subsidiaries			
Fees payable to the company's auditor for the audit of the annual financial statements		57	55
Fees payable to the company's auditor and its associates for other services			
Audit of the financial statements of the company's subsidiaries pursuant to legislation		11	12
Other services relating to taxation – compliance and advice		40	43
Services related to corporate finance transactions		32	26
Other services – accounting advice		–	5
Services to the company's associated pension scheme			
Audit of the financial statements of the Scheme pursuant to legislation		4	4

4b *Exchange movements*

The majority of the losses on exchange movements relate to the restatement of international bonds and cash assets held to match international liabilities These losses are substantially offset by a corresponding decrease in international liabilities, which is included in costs through a decrease in the overall claims provisions (note 15)

5 *Net income from investments*

	2006 £'000	2005 £'000
Dividends listed investments	–	1,432
Bond and gilt interest	16,068	15,210
Bank interest	4,268	3,477
Other investment expense	(57)	(183)
	20,279	19,936

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 12 to 24

Notes to the accounts: continued

6a *Tax on income and gains from investments*

Tax on income and gains included in the income and expenditure account for the year	2006 £'000	2005 £'000
UK corporation tax		
Current tax on income and gains for the year at 30% (2005 30%)	21	4,781
Adjustment in respect of prior years	(28)	(1)
Double taxation relief	(21)	(18)
	(28)	4,762
Foreign tax		
Current tax on income for the year	21	18
Tax on investment income and gains in the income and expenditure account	(7)	4,780
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% (2005 30%)	–	2,499
Tax on other gains included in the statement of total recognised gains and losses for the year	–	2,499

6b *Factors affecting tax charge for the year*

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	2006 £'000	2005 £'000 Restated
Contribution before tax per accounts	61,981	65,326
Less non-taxable contribution (see below)	(62,294)	(44,842)
Income and net losses from investments included in the income and expenditure account for the year	(313)	20,484
Income and net losses from investments multiplied by the standard rate of corporation tax in the UK (30%)	(94)	6,145
Effects of		
Income from UK equities not subject to taxation	–	(430)
Realised gains on disposal of investments	(37)	(889)
Losses allowed on pre-trading expenditure	–	(151)
Expenses not deductible for tax purposes	49	2
Unrealised gains in MPS Risk Solutions	9	104
Surplus tax losses	94	–
Current tax charge for the year	21	4,781

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 £14 6 million (2005 £11 7 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*

		2006 £'000	2005 £'000
Aggregate amount of emoluments paid to members of the Council (including executive members)		808	812
Chairman		41	39
Highest paid member of the Council			
Chief Executive	– emoluments and taxable benefits	208	214
	– accrued annual pension rights	99	91

For 2005 the Chief Executive's emoluments and taxable benefits included a long service award

There are 3 (2005 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 £17,250 (2005 £16,600) An increase of £650 per annum was implemented on 1 March 2006 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	12,441
Mark Dinwoodie	1,153
Kathryn Harley	11,860
Leela Kapila	2,083
Ravinder Maini	2,083

Council Member	Additional Remuneration (£)
Brian Mouatt	6,990
Elizabeth Vallance	2,083
John Leighton Williams	5,392
Richard Youell	2,083

In addition, and as stated in the Report of Council on pages 12 to 24, two members of the Council received fees for acting as expert witnesses on behalf of MPS members, one received fees for providing risk management services to members and six had personal membership with MPS

8 *Employees*

The average number of people employed by the group during the year was 279 (2005 262) Costs in respect of these employees were

	2006 £'000	2005 £'000
Wages and salaries	11,977	10,817
Social security costs	1,202	1,114
Pension costs	1,525	2,024
	14,704	13,955

Pension costs included above relate to the FRS17 value of the benefits earned by active members during 2006 less employee contributions and past service gains These gains have arisen as a result of changes made during 2006 to future benefits payable by the pension scheme and are the main reason for the reduction in pension costs between 2005 and 2006

Notes to the accounts: continued

9 *Pensions*

MPS operates a defined benefit pension scheme, The MPS Pension 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 Schedule of Contributions agreed between the Trustees and MPS

The full actuarial valuation as at 31 December 2005 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 2006 % per annum	At 31 December 2005 % per annum	At 31 December 2004 % per annum
Price inflation	3 1	2 9	2 9
Discount rate	5 1	4 7	5 3
Pension increases (LPI 5%)	3 1	2 9	2 7
Pension increases (LPI 3%)	2 5	N/A	N/A
Salary growth	4 6	4 4	4 4

On the basis of the assumptions used for life expectancy, a male pensioner currently aged 60 would be expected to live for a further 26 5 years (2005 24 4 years) Allowance is made for future improvements in life expectancy

Asset distribution and expected returns	At 31 December 2006 Expected return (%pa)	Fair value £'000	At 31 December 2005 Expected return (%pa)	Fair value £'000	At 31 December 2004 Expected return (%pa)	Fair value £'000
Equities	7 5	26,362	7 3	23,243	7 5	19,041
Bonds	4 5	15,784	4 1	14,002	4 6	6,634
Property	6 3	936	5 7	797	6 0	662
Cash	5 2	273	4 2	259	4 5	204
Total		43,355		38,301		26,541

Balance sheet	At 31 December 2006 £'000	At 31 December 2005 £'000	At 31 December 2004 £'000
Total fair value of assets	43,355	38,301	26,541
FRS17 value of scheme liabilities	(43,654)	(39,451)	(30,945)
Pension liability	(299)	(1,150)	(4,404)

Under FRS17, the scheme is represented on the balance sheet at 31 December 2006 as a liability of £299,000 (2005 £1,150,000)

Over the year to 31 December 2006, MPS made contributions of £1,987,952 (2005 £6,763,447) to the Scheme It has been agreed that future employer contributions will continue at a rate of 20% of pensionable salaries

9 *Pensions continued*

The post retirement deficit under FRS17 moved over the year as follows	2006 £'000	2005 £'000
Post retirement deficit at start of year	(1,150)	(4,404)
Current service cost	(2,825)	(2,398)
Contributions (employer and employee)	2,386	7,138
Past service gain	921	–
Other net finance income	470	144
Actuarial loss	(101)	(1,630)
Post retirement deficit at end of year	(299)	(1,150)

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	2006 £'000	2005 £'000
Amount charged to operating surplus		
Current service cost	2,427	2,024
Past service gain	(921)	–
Total operating charge	1,506	2,024
Amount credited to other financial income		
Expected return on pension scheme assets	2,359	1,828
Interest on post retirement liabilities	(1,889)	(1,684)
Net return to credit to other financial income	470	144

The following amounts are recognised in the statement of total recognised gains and losses	2006 £'000	2005 £'000
Actual return less expected return on scheme assets	1,621	3,554
Experience losses arising on scheme liabilities	(814)	–
Loss due to changes in assumptions underlying the FRS17 value of scheme liabilities	(908)	(5,184)
Actuarial loss	(101)	(1,630)

History of experience gains and losses	2006	2005	2004	2003
Actual return less expected return on scheme assets (£'000)	1,621	3,554	1,272	2,078
Percentage of scheme assets	4%	9%	5%	9%
Experience (losses)/gains arising on scheme liabilities (£'000)	(814)	–	–	135
Percentage of the FRS17 value of the scheme liabilities	(2%)	–	–	1%
Amount recognised in the statement of total recognised gains and losses (£'000)	(101)	(1,630)	(167)	(494)
Percentage of the FRS17 value of the scheme liabilities	(0%)	(4%)	(1%)	(2%)

Notes to the accounts: continued

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 2006	6,506	405	5,718	12,629
Additions	43	1	592	636
Disposals	–	–	(204)	(204)
At 31 December 2006	6,549	406	6,106	13,061
Depreciation				
At 1 January 2006	149	405	3,941	4,495
Provided in year	138	–	583	721
Released on disposals	–	–	(202)	(202)
At 31 December 2006	287	405	4,322	5,014
Net book value				
At 31 December 2006	6,262	1	1,784	8,047
At 31 December 2005	6,357	–	1,777	8,134
Company				
Cost or valuation				
At 1 January 2006	6,506	405	5,657	12,568
Additions	43	1	530	574
Disposals	–	–	(204)	(204)
At 31 December 2006	6,549	406	5,983	12,938
Depreciation				
At 1 January 2006	149	405	3,905	4,459
Provided in year	138	–	562	700
Released on disposals	–	–	(202)	(202)
At 31 December 2006	287	405	4,265	4,957
Net book value				
At 31 December 2006	6,262	1	1,718	7,981
At 31 December 2005	6,357	–	1,752	8,109

All the leasehold properties held at 31 December 2006 are short leaseholds

10 *Tangible fixed asset 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 FRS15, 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	4,186
Depreciation	(880)
At 31 December 2006	3,306
At 31 December 2005	3,332

Capital commitments

Capital expenditure approved and contracted for amounted to £ nil (2005 £ nil)

11 *Investments*

	2006 Group £'000	2005 Group £'000	2006 Company £'000	2005 Company £'000
Valuation or cost at 1 January	737,516	575,749	31,001	31,001
Additions	331,433	278,521	–	–
Disposals at carrying value	(259,821)	(143,052)	–	–
Movement in cash	5,328	(29,660)	–	–
Foreign exchange (losses)/gains on listed investments	(9,085)	2,523	–	–
Surplus on revaluation of listed investments	28,745	53,435	–	–
At 31 December	834,116	737,516	31,001	31,001

Investments comprise

	2006 Group £'000	2005 Group £'000	2006 Company £'000	2005 Company £'000
Listed on UK Stock Exchange				
– Equities	101,034	86,670	–	–
– Government and other bonds	417,523	354,396	–	–
Listed on overseas Stock Exchanges				
– Equities	179,639	150,289	–	–
– Government and other bonds	122,778	138,347	–	–
Shares in group undertakings	–	–	31,001	31,001
Cash	13,142	7,814	–	–
	834,116	737,516	31,001	31,001
Historical cost of investments	754,061	657,669	31,001	31,001

Notes to the accounts: continued

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

After the end of 2006 MPS Risk Consulting Limited established MPS Risk Consulting Australia Pty Limited (MPSRCA), a company registered in Australia On 10 January 2007, MPSRCA acquired 100% of the share capital of Cognitive Consulting Group Pty Limited trading as Cognitive Institute, also registered in Australia, as set out in the Report of the Council on pages 12 to 24

13 *Debtors*

	2006 Group £'000	2005 Group £'000	2006 Company £'000	2005 Company £'000
Receivable within one year				
Trade debtors	1,136	1,208	892	883
Recoverable insurance claims	2,500	2,572	2,500	2,572
Amounts owed by subsidiary undertakings	–	–	616,533	518,405
Other debtors	1,949	794	617	684
Prepayments	2,875	2,642	2,788	2,606
	8,460	7,216	623,330	525,150
Receivable after one year				
Recoverable insurance claims	9,902	9,832	9,902	9,832
Total debtors	18,362	17,048	633,232	534,982

14 Creditors: amounts falling due within one year

	2006 Group £'000	2005 Group £'000	2006 Company £'000	2005 Company £'000
Bank overdraft	–	643	–	792
Corporation tax	–	5,060	–	95
Other taxes and social security	524	536	509	488
Other creditors and accruals	16,570	16,459	16,128	16,121
Deferred subscription income	31,757	28,357	31,358	28,091
	48,851	51,055	47,995	45,587

15 Provision for liabilities and charges

	Reported negligence claims £000	Claims handling £'000	Reported other claims £'000	Total £'000
Group				
At 1 January 2006 as previously stated	262,808	9,063	–	271,871
Prior year adjustment	–	–	21,100	21,100
At 1 January 2006 restated	262,808	9,063	21,100	292,971
Movements in the year				
Charged to the income and expenditure account				
– Reported negligence claims	105,293	10,059	–	115,352
– Reported other claims	–	–	22,800	22,800
Paid	(71,018)	(5,940)	(24,863)	(101,821)
At 31 December 2006	297,083	13,182	19,037	329,302
Company				
At 1 January 2006 as previously stated	262,585	9,063	–	271,648
Prior year adjustment	–	–	21,100	21,100
At 1 January 2006 restated	262,585	9,063	21,100	292,748
Movements in the year				
Charged to the income and expenditure account				
– Reported negligence claims	104,719	10,059	–	114,778
– Reported other claims	–	–	22,800	22,800
Paid	(70,986)	(5,940)	(24,863)	(101,789)
At 31 December 2006	296,318	13,182	19,037	328,537

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

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

The reported negligence claims provision is stated before insurance recoveries of £12 4 million (2005 £12 3 million) that are estimated to be recoverable from MPS's insurers

Although FRS12 requires that the unwinding of the discount within a provision be shown separately, it is not considered practical for these provisions, due to the complexities of the many actuarial calculations involved

Notes to the accounts: continued

16 *Movement on reserves*

	Revaluation £'000	Income and expenditure £'000	Accumulated £'000
Group			
At 1 January 2006 as previously stated	79,408	447,290	526,698
Prior year adjustment	–	(21,100)	(21,100)
At 1 January 2006 restated	79,408	426,190	505,598
Surplus on revaluation of listed investments	28,745	-	28,745
Realised on disposal of investments	(19,452)	19,452	-
Actuarial loss recognised in pension scheme	-	(101)	(101)
Release of depreciation on revalued property	(69)	69	–
Net contribution for the year after tax	–	61,988	61,988
At 31 December 2006	88,632	507,598	596,230
Company			
At 1 January 2006 as previously stated	3,025	283,435	286,460
Prior year adjustment	–	(21,100)	(21,100)
At 1 January 2006 restated	3,025	262,335	265,360
Actuarial loss recognised in pension scheme	–	(101)	(101)
Release of depreciation on revalued property	(69)	69	–
Net contribution for the year after taxation	–	62,340	62,340
At 31 December 2006	2,956	324,643	327,599

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

	2006 £'000	2005 £'000 Restated
Net contribution for the financial year	61,988	60,546
Other recognised gains relating to the year	28,644	51,805
Tax charge on investment gains	–	(2,499)
Total recognised gains	90,632	109,852
Opening funds available to meet future liabilities and charges	505,598	395,746
Closing funds available to meet future liabilities and charges (see note 22)	596,230	505,598

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

	2006 £'000	2005 £'000 Restated
Excess of income over expenditure	49,301	43,336
Depreciation charges	721	788
Loss on disposal of tangible fixed assets	2	139
Increase in provisions	36,331	39,846
(Increase)/decrease in debtors	(1,314)	1,194
Increase in creditors	3,499	9,984
Foreign exchange losses/(gains) on listed investments	9,085	(2,523)
Cash pension contributions in excess of current service cost and past service gain	(482)	(4,740)
Net cash inflow from operating activities	97,143	88,024

19 *Returns on investment and servicing of finance*

	2006 £'000	2005 £'000
Interest received	4,268	3,477
Dividends received	–	1,432
Bond and gilt interest received	16,068	15,210
Other interest	(57)	(183)
Net cash inflow from returns on investments and servicing of finance	20,279	19,936

20 *Capital expenditure and financial investment*

	2006 £'000	2005 £'000
Purchase of tangible fixed assets	(636)	(617)
Purchase of investments	(331,433)	(278,521)
Proceeds from sale of tangible fixed assets	–	13
Proceeds from sale of investments	251,752	144,962
Net cash outflow from capital expenditure and financial investment	(80,317)	(134,163)

21 *Commitments*

		2006 Group £'000	2005 Group £'000	2006 Company £'000	2005 Company £'000
Operating lease commitments					
Land and buildings, leases expiring	– Greater than five years	902	897	902	897
Motor vehicles, leases expiring	– Within one year	–	4	–	4
	– Two to five years	13	7	12	6
		13	11	12	10

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

MPS has issued a letter of credit to MPS Risk Solutions Limited in the sum of £20 million

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 2006 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

MPS information

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

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1 Churchill Place
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Investment Managers
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21 St James's Square
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EC2V 7QP

AllianceBernstein Institutional Investments
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W1J 8HA

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MPS is the world's leading indemnifier of health professionals As a not-for-profit mutual organisation, MPS offers support to members with legal and ethical problems that arise from their professional practice

MPS membership offers peace of mind to more than 245,000 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

The MPS group of companies

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