The Actuarial Profession
making financial sense of the future

Capital Setting at Lloyd’s

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Agenda

- Overview – Capital Advantages at Lloyd’s
- Member capital
- Central capital
- Conclusion

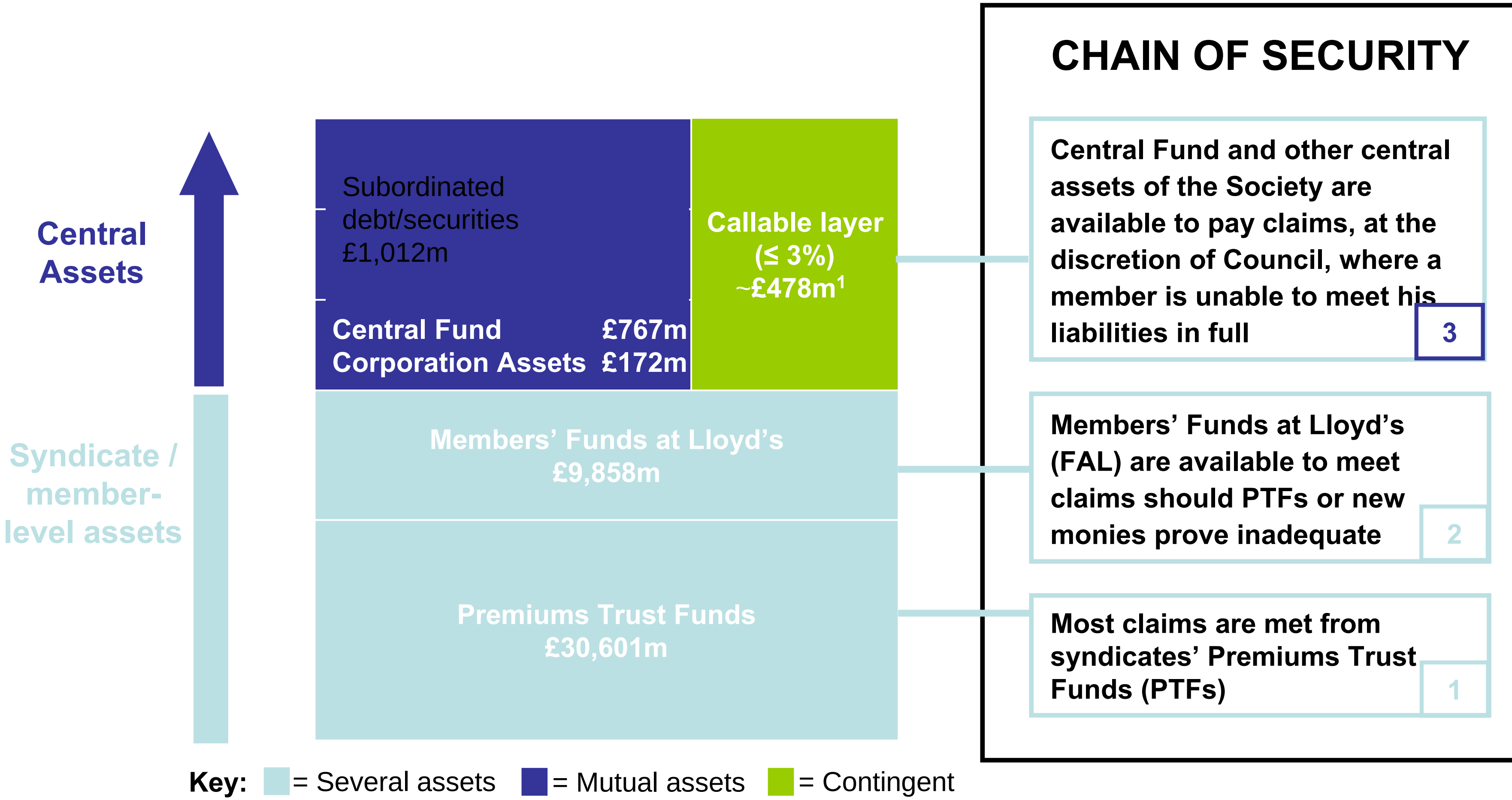
OVERVIEW

Capital advantages at Lloyd's

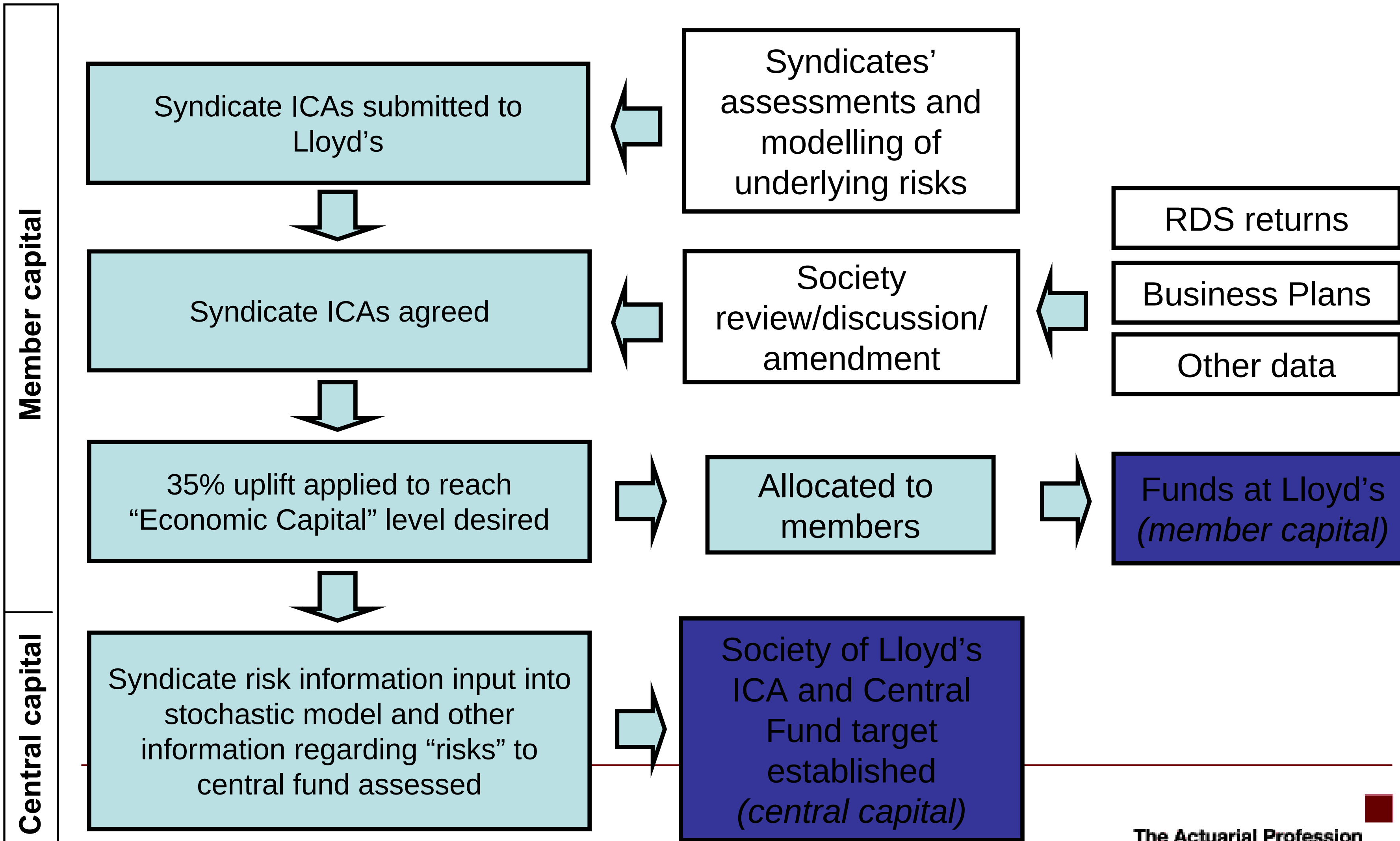
- A risk-adjusted capital-setting process
- Capital structures that can be tailored and benefit from strong ratings
- Cost of maintaining Lloyd's mutual assets targeted to be on average less than 1% of GWP across the insurance cycle
- A capital framework that actively assists managing agents in accessing flexible sources of capital at a competitive cost and allows them to take advantage of business opportunities

"A capital framework in which the benefits of mutuality demonstrably outweigh the costs and which cannot readily be duplicated outside Lloyd's"
Lloyd's three-year plan 2008-2010

Strong and flexible capital structure



Capital setting process

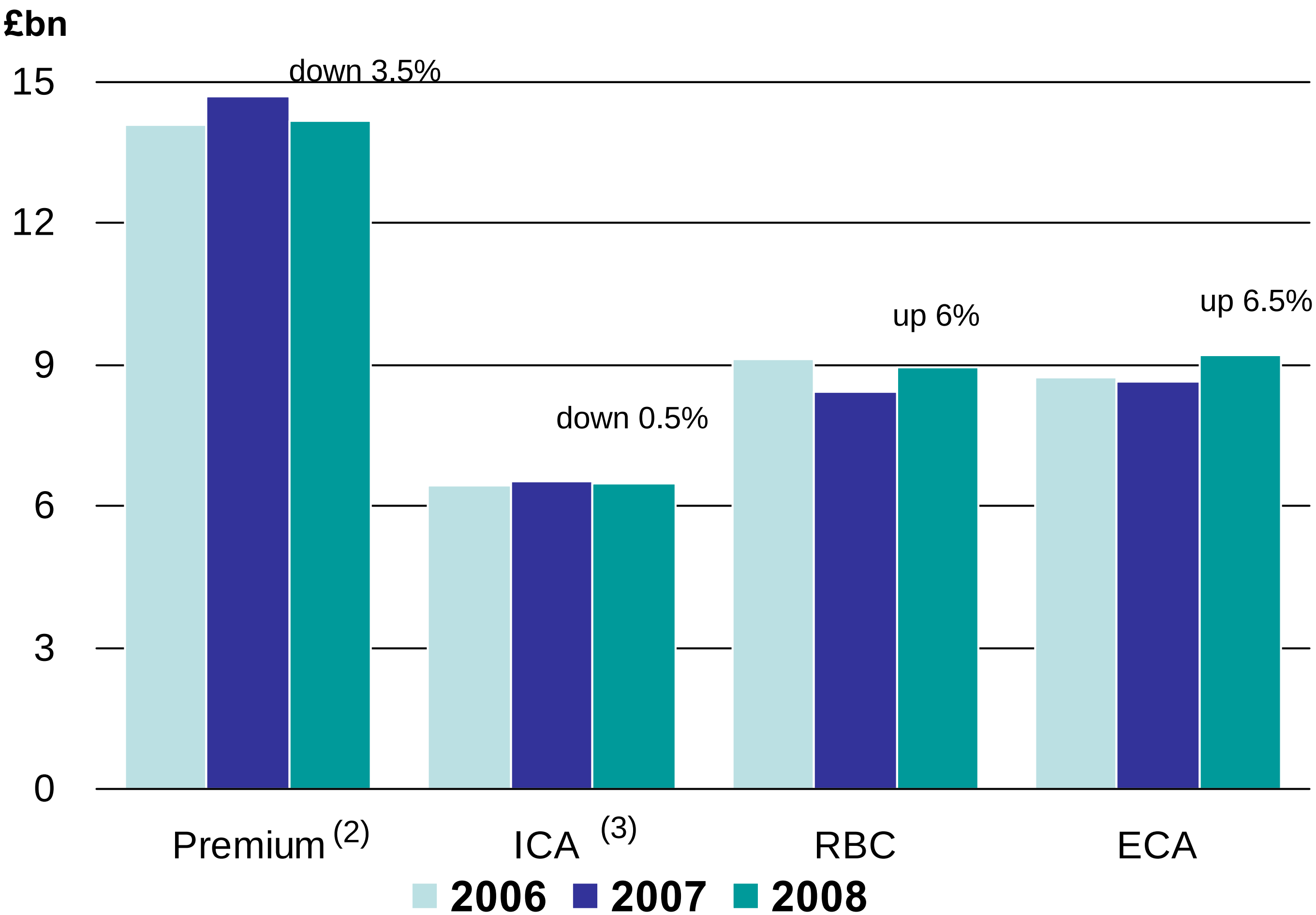


MEMBER CAPITAL

Syndicate ICA reviews

- Guidance updated
- Multi-disciplinary teams (Actuarial, FPD, Risk Management, other Finance)
  - Information feeds from all departments including Exposure Management
  - Steering Group
- Consultative approach – pre-meetings, early clarity regarding issues
- Link to business planning process
- Continued reliance by FSA on Lloyd’s ICA review process
- Similar but separate process for run-off syndicates

Aggregate capital increased to 65% of gross premium

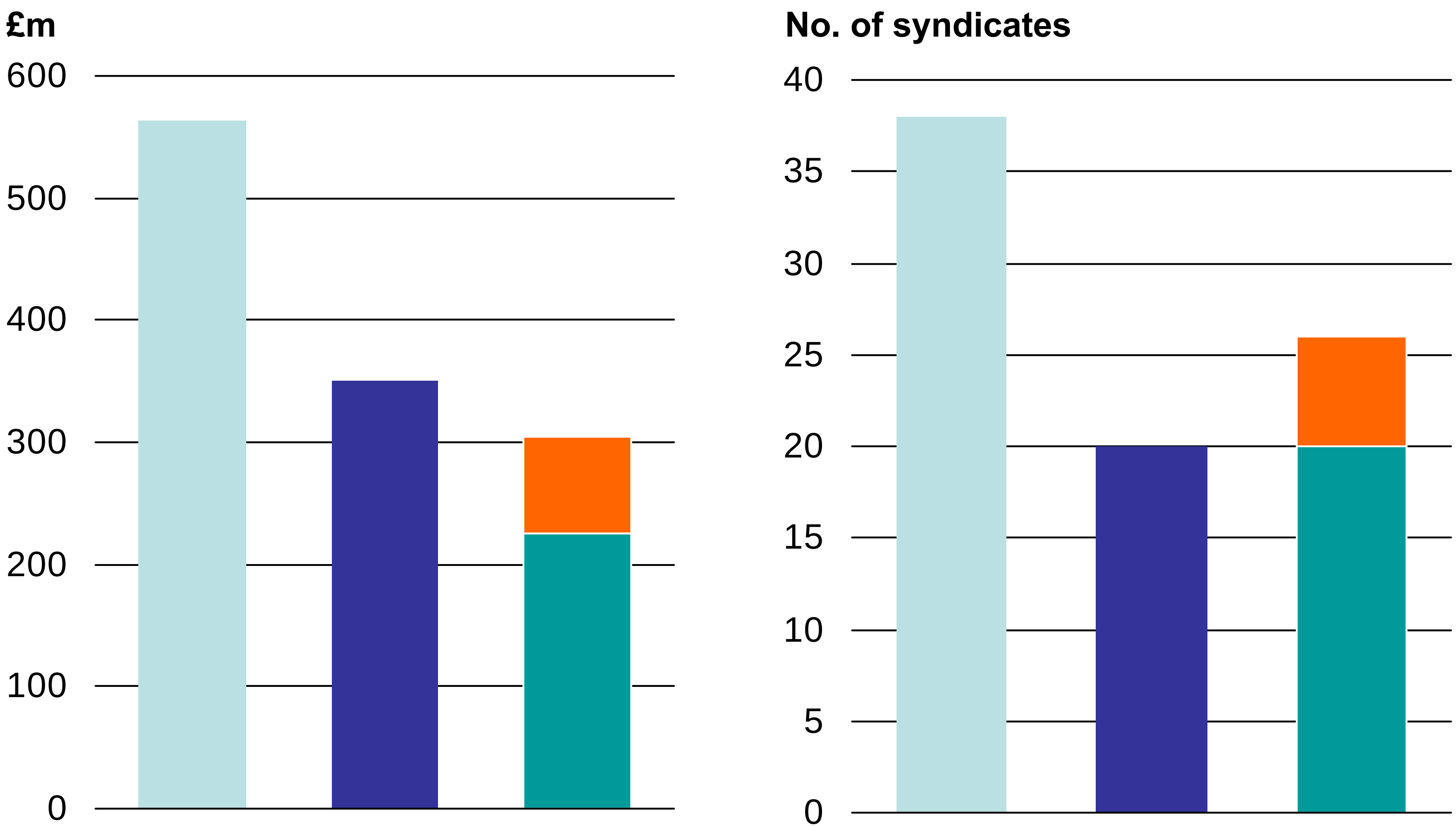


(1) All figures based on 1 January for each year of account
(2) Gross premium net of acquisition costs
(3) Excludes new syndicates

Key issues were addressed during 2008 YoA review

- Consideration of **market softening** conditions both in assumptions and methodology
- **reserve margin** credit restricted to 50%
- **Compliance** with guidance:
  - o loss ratios consistent with SBF
  - o discounting FAL not permitted
- **Dependency structures** and correlation factors within and between risk components
- **Operational risk**, including group risk
  - particular focus for new syndicates and recent agent mergers

Into third year of ICAs, similar level of capital increases required



2006 2008 2008

Increases included within re-submitted ICA following Lloyd's review

Policy for new syndicates reflects additional risk

- 8 new syndicates/SPS's approved and initial capital set at RBC plus 20%
  - o includes two notional prior years for calculation of reserve risk
- Encourage agent to prepare ICA at earliest opportunity
  - uplifted ICA benchmarked against RBC plus 20%
  - higher operational risk
  - full feedback on all points to ensure ICA captures all issues going forward irrespective of quantum
- New syndicate capital averages 110% of premium (62% for all others)

“Light” submissions can reduce workload

- Recognised improvement in overall quality of submissions during 2007 and 2008 YoA
- ICA “light” is
  - a summary of change document which should provide a commentary per risk group as well as an overview of the change in total ICA number and key sensitivities
  - a completed pro-forma
  - requirement that previous ICA has been accepted and is fully compliant
- FSA have approved this approach
- A full submission required if there are major changes

CENTRAL CAPITAL

Optimum Size of Central Assets

- Two years ago Lloyd’s made a tactical decision to increase the central assets so that it can further improve its financial strength
- ..and also in preparation for potential strains on assets:
  - Deterioration in KRW claims
  - Downturn in the insurance cycle
  - Expected losses from viatical business
- Underwriting and reserving losses better than expected
- Investment return high
- Subordinated Debt issued successfully
- The size of the central assets is now very healthy compared with the LSICA
- This will be reviewed over the next two months

Conclusion

- Strong capital base
- Approach now in fourth year - “evolutionary” to “stable” approach
- Greater focus on consultation and transparency
- Capital will flex with market conditions, contributions to be low and stable
- New tools