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34TH ANNUAL GIRO CONVENTION

Workshop A10 – Lloyd's Issues

Henry Johnson
Veekash Badal
Jerome Kirk

Agenda

- Introduction – Henry
- Capital - Veekash
- Results, Reserving, Claims and Run Off - Jerome
- Discussion and Q&A

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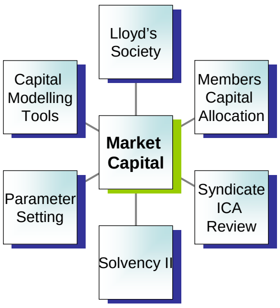
Market Capital Core Activities



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Central Capital

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Lloyd's Central Capital

- Two main areas of focus for 2007 YoA:
  - The increase in insurance risk arising from the softening market
  - Offset by recognising the reinsurance by National Indemnity Corporation (NICL) of Equitas
- Central assets for solvency at end of 2006 were £1,794m
- Additional £500m raised, with syndicate loans being paid off

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Syndicate ICAs

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Syndicate ICA review

- Final submissions for non aligned received 20th September
- Aligned expected 18th October
- Feedback over the next 6 weeks
- 3rd submission:
  - Process very similar to last year
  - Improvements in submissions continue
  - Review still as much work as ever
  - Unreasonable submissions not expected but…

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ICAs – What have we learnt?

✓ Technical standards have improved
✓ Essential to engage other departments in discussions on capital
✓ Risk Management has improved
  - Risk register now commonplace and used to complement capital modelling

? Link between the business plan and capital assessment essential
  - Can help to be more realistic in business planning
  - Should help to manage the cycle
  - Added pressure on underwriting and pricing

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Syndicate ICA review

- Areas focused on this year
  - Reserve Margins
  - Discounting
  - Subprime issues
  - Recognising cycle uncertainty
- Price Monitoring can help….

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Price Monitoring

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Price Monitoring

- Wide range of underwriting systems in use to capture rate changes
- On a risk by risk basis in the underwriting system
- Most managing agents
  - Capture three or four components for rate movements
  - Review rate movements on a monthly basis
  - Calculate a benchmark price for at least some of their lines of business
- General agreement on the components to be captured
- Implementation differs
- Further consultation with the Market needed
- FPD will lead

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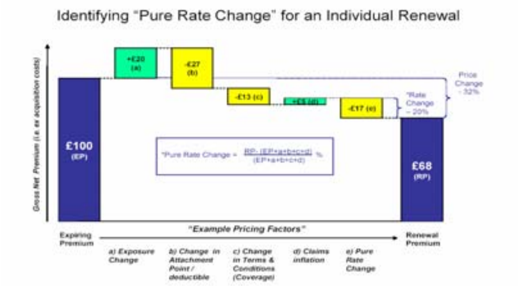
Price Monitoring



Solvency II

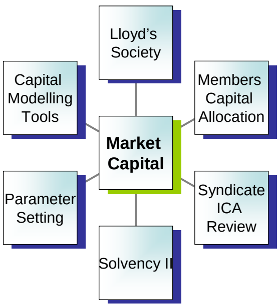
Solvency II

- 23 syndicates submitted to Lloyd's on best effort basis
- Feedback on submissions towards the end of the year
- Main practical difficulties encountered in exercise:
  - Accident year data required
  - Difficulty calculating historical loss ratios on prescribed basis
  - Lack of clarity in instructions
- General Feedback from Market
  - Failure to capture non-proportional reinsurance benefits (pillar 2)
  - Catastrophe risk component needs further development
  - Removal of size factor
  - Granularity of classes could be improved
  - Insurance cycle has not been explicitly considered
- Can't wait for QIS 4

QIS-3 versus internal model

- Generally, the SCR calculated was significantly higher than syndicate's internal model results
- Standard approach would increase capital by 75% on a weighted average basis
- The differences range from a 32% reduction to 125% increase
- Reasons standard model so onerous?
  - Most discrepancy came from underwriting risk component
  - No allowance for expected profits
  - Correlation matrices and standard deviations appear high for underwriting risk module

Market Capital Core Activities



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Interim Results

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A Strong First Half Performance

	6 months to June 2007	6 months to June 2006
Gross written premiums[1]	**£9,864m**	£9,966m
Combined ratio[1]	**82.9%**	86.0%
Profit[1]	**£1,807m**	£1,351m
Central assets[2]	**£2,165m**	£1,401m

1) Lloyd's pro forma financial statements
2) Net assets per Society of Lloyd's consolidated financial statements (under IFRS) excluding the callable layer and the liability in respect of the subordinated debt, and is prior to the repayment of £333m of syndicate loans in July 2007.

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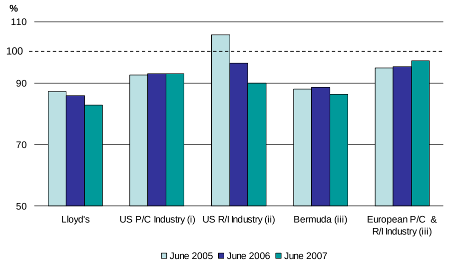
Strong Comparative Performance



Source: *Sources: i) Insurance Information Institute estimate, ii) Reinsurance Association of America iii) Company data (8 European companies: 15 Bermudian companies)*

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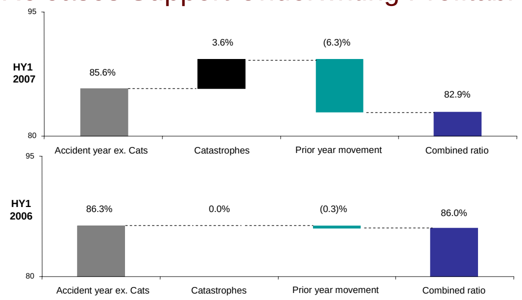
Limited Catastrophes and Reserve Releases Support Underwriting Profitability



Source: Lloyd's proforma financial statements

Reserving

Market Reserving – Usual Activities

- Reserve Benchmarking Packs
  - Sent July 2007
  - Introduced Quartile ranking of syndicate reserves
- Monitor IBNR utilisation
- Monitor 2005 Hurricanes
  - Small deterioration in ultimate with stable incurred development
  - No new issues
- Conduct independent reserve projections
  - Market projections at low level class of business
- Lloyd's regards aggregate reserves to be adequate as at year-end 2006

Year-end Update

- Standard of SAO reports received by Lloyd’s remains very high
  - Currently feeding back to individual producers of reports
  - Seen a variety of approaches to communicating uncertainty
- Year-end 2007 Valuation of Liability Rules to be issued soon
  - No significant changes
  - Basis for SAO sign-off remains the same
- Lloyd’s may additionally issue SAO Report Guidance / Best Practice Document

Mindful of a Softening Market

- Reserving and pricing are naturally linked
- Reserving in a softening market has its own issues. For example:
  - Weakening of terms and conditions
  - Change in deductibles
  - Inclusion of new perils
- Have seen that historically bad years do get worse (and vice versa)
- Look at Lloyd’s Casualty account during last soft cycle

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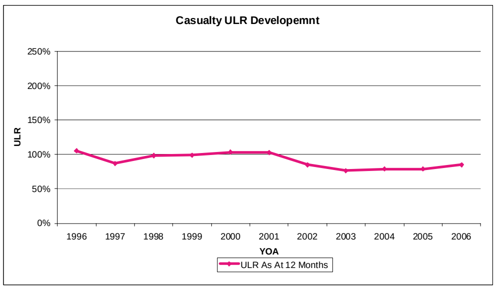
Reserving – Bad Years Get Worse



Source SRD 2006

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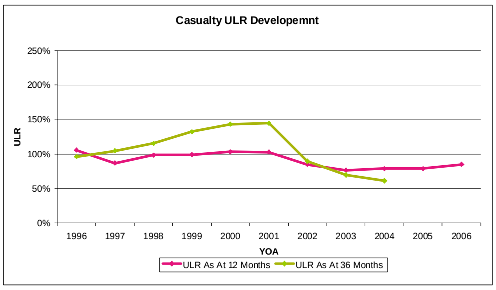
Reserving – Bad Years Get Worse



Source SRD 2006

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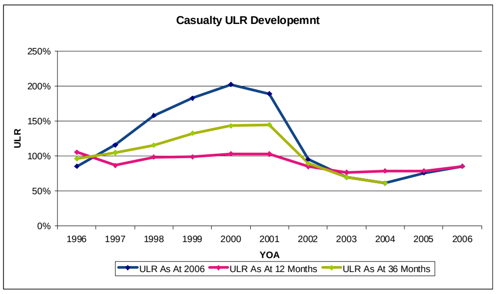
Reserving – Bad Years Get Worse



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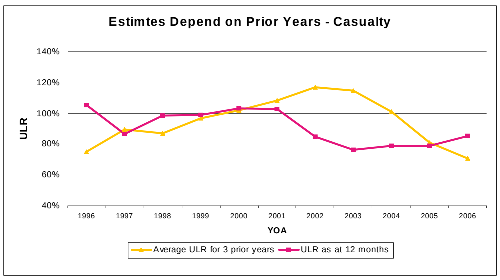
Current Estimates are Driven by Prior Years



Source SRD 2006

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Claims

Current Claims Environment

- General continuation of benign claims environment
- Some large losses this year but nothing that seriously impacts Lloyd's
- Subprime issues / Credit crunch
- Need to consider general impact on US economy that can drive casualty claims
- Process improvements through Lloyd's Claims Minimum Standards
- Electronic Claim Filing (ECF)

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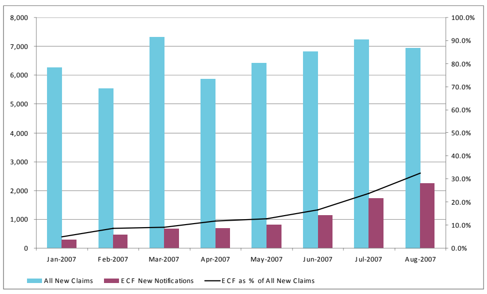
Claims – ECF Progress



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Run Offs

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Run Off Syndicates - Background

- What is a "run off" syndicate / Year of Account?
  - Defined as a unnaturally open year of account
  - That is, not closed after 36 months
- Syndicates remain open because:
  - There is no ongoing year to close in to
  - The year is too uncertain
  - The syndicate members are financially impaired
- "Run off" does not mean the members on the syndicate are insolvent…but a number of run off members are supported by New Central Fund undertakings

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Run Off Syndicates – Why Worry?

- Run off syndicates are key to Lloyd's financial stability and reputation as they:
  - Can be a drain on the NCF
  - Normally occur for a "reason"
  - Can attract negative press
- A syndicate being unnaturally open goes against the Lloyd's operating model as it can:
  - Lock in member capital
  - Incur high on-going costs
  - Hinder the release of profits

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Run Off Syndicates – What is Lloyd's doing?

- Has a dedicated team of experts – Open Year Management (OYM) – whose function is to:
- Actively supervise run off syndicates
- Encourage closure by:
  - Reduced uncertainty. For example, dispute resolution
  - Seeking new closure solutions
- Review and agree run off plans
- Assess and where appropriate support 3rd party RITC quotations for NCF dependent syndicates
- Pre-1993 liabilities are reinsured into Equitas
- Oldest open YoA is 1997

Run Off Syndicates – Some Figures

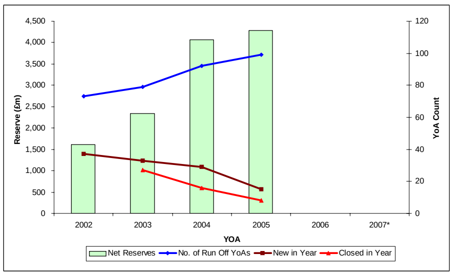
Can use the SAOs to extract numbers and associated reserved for non-life run off syndicates. For this presentation, the definition of run off is "a year of account that has a SAO provided and is over 36 months old".

As at Year-End	2002	2003	2004	2005	2006	2007*
Number SAOs "run off" years	73	79	92	99	94	75
Net SAO value for these (£bn)	1.6	2.3	4.1	4.3	3.3	2.9*
Number New in Year	37	33	29	15	3	2
Number Closed in Year		27	16	8	8	21

*** 2007 based on closure activity to date and year-end 2006 SAO provisions (not June 2007 provisions)**
Run off defined as SAO signed for year of account over 36 months old – excludes life syndicates

Source: Lloyd's Annual Returns

Run Off Syndicates – Development to 2005



Source: Lloyd's Annual Returns

Run Off Syndicates – The Rise

- **The main reasons for the increase in run off syndicates during the early 2000s was:**
  - Soft market of the late 1990s
  - PA spiral / WCA carve out business
  - World Trade Centre
  - Enron / Laddering / Worldcom (ELW)
  - Some unusual risks
- **The result was a number of syndicates that were either:**
  - Too uncertain to close
  - Financially impaired

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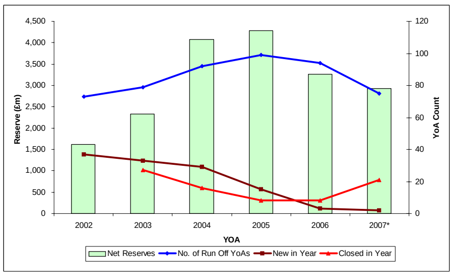
Run Off Syndicates – Development to Date



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Run Off Syndicates – The Fall

The recent favourable development in run off syndicates is driven by:

- Benign casualty claims activity
- Market resilience with no new failures – despite 2 bad hurricane seasons
- Favourable developments for ELW
- More closure options:
  - Reduced Uncertainty
  - Part VII Transfers
  - New 3rd Party RITC Providers

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Run Off Syndicates – What Next?

- Continue with OYMs active management of run offs
- Lloyd's expects continued success in closure of current run off syndicates
- Explore further RITC solutions
- Be mindful of softening market but...
- …FPD controls will lead to limited new run offs which are more likely to be tactical withdraw rather than failure

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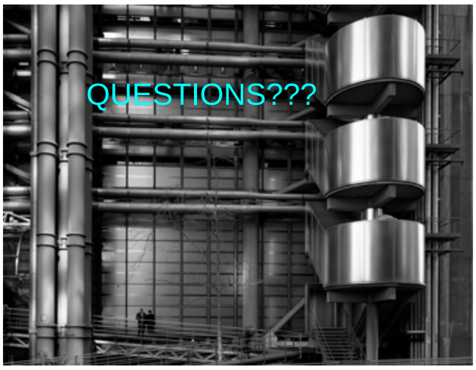

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