GIRO Convention
7-9 October 2009
Edinburgh

Workshop A11 – Lloyd’s Issues
Jerome Kirk
Henry Johnson

Agenda

- First Half Update
- Capital
- Solvency II
- Reserves and Year-end
- Performance Management Data (PMD)
- CSU Benchmark
- Questions
Solid half year results

<table>
<thead>
<tr>
<th></th>
<th>6 months to June 2009</th>
<th>6 months to June 2008</th>
<th>12 months to Dec 2008</th>
</tr>
</thead>
<tbody>
<tr>
<td>Gross written premiums</td>
<td>£13,462m</td>
<td>£9,983m</td>
<td>£17,985m</td>
</tr>
<tr>
<td>Combined ratio</td>
<td>91.6%</td>
<td>89.0%</td>
<td>91.3%</td>
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<tr>
<td>Investment return</td>
<td>£708m</td>
<td>£346m</td>
<td>£957m</td>
</tr>
<tr>
<td>Profit before tax</td>
<td>£1,322m</td>
<td>£949m</td>
<td>£1,899m</td>
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<tr>
<td>Return on capital (annualised)</td>
<td>17.5%</td>
<td>14.7%</td>
<td>13.7%</td>
</tr>
</tbody>
</table>

Source: Lloyd's pro forma financial statements, June 2009

Premium increase driven by currency movements and partly by new business

[Graph showing premium increase driven by currency movements and partly by new business]

Few natural catastrophes and continued prior year releases

[Graph showing combined ratios with major losses, prior year reserve movements, and calendar year]

Notes:
- Attribution to foreign exchange movements and increase in local currency stated on a compound basis.
- Source: Lloyd's

FX on NMI (5%)
Investments remain geared towards higher security

LLOYD'S MARKET INVESTED ASSETS

- Corporate bonds 20%
- Below A 8%
- A 20%
- AA 22%
- AAA 50%
- Cash & LOCs 35%

Includes supra nationals and government agencies
Source: Lloyd’s pro forma financial statements, June 2009

CORPORATE BONDS

Claim frequencies continue to increase..

- Non Cat claim count by YoA
- Non-precautionary only so ECF not a driving factor

Source: Xchanging Data (as at Q2 2009)

...in all classes of business

Graphs exclude Cat Claims and Precautionary Notifications
Source: Xchanging Data (as at Q2 2009)
...but the trend in incurred claim amounts has stabilised

Gross Incurred claims in first 6 months of YoA relative to 2002

- Current levels are high versus 2002
- Only an indication – not the best predictor

Source: Lloyd’s MRRQ database

Lloyd’s Early Warning - Casualty
Actual v Expected for H1 2009

- No issues – appears to be tracking well

Source: Lloyd’s Early Warning System

Lloyd’s Early Warning – Energy
Actual v Expected for H1 2009

- No issues – appears to be tracking well

Source: Lloyd’s Early Warning System
...and 2008 hurricanes continue to develop within estimates

![2008 Hurricane Development Graph](image)

Source: Lloyd's QMR and Xchanging data

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**Have seen aggregate capital increase over recent years**

![Capital Increase Graph](image)

- All figures based on 1 January for each year of account
- Excludes new syndicates for 2007
Aggregate ICAs higher than ECR in softening market

Key considerations for 2010 ICA review

- Guidance/process substantially unchanged
  - treatment of reserve margins has changed
    - bottom line credit against ECA
    - more in line with FSA approach
- Anticipated review focus
  - catastrophe exposure
  - rate changes & exposure
  - recession / impact on claims environment
  - historical performance against plans
  - discounting / market risk
- New benchmark tool

Already a long way through 2010 process

<table>
<thead>
<tr>
<th>Date</th>
<th>Non-Aligned</th>
<th>Aligned</th>
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<tbody>
<tr>
<td>Initial SBF submission</td>
<td>19 June</td>
<td>24 July</td>
</tr>
<tr>
<td>Initial ICA pro-forma</td>
<td>10 July</td>
<td>24 July</td>
</tr>
<tr>
<td>Full ICA documentation</td>
<td>10 July</td>
<td>28 August</td>
</tr>
<tr>
<td>Final SBF</td>
<td>18 September</td>
<td>16 October</td>
</tr>
<tr>
<td>Final ICA pro-forma</td>
<td>18 September</td>
<td>16 October</td>
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</tbody>
</table>
Emerging issues so far

- Catastrophe exposure
- Rate changes & exposure
- Recession / impact on claims environment
- Historical performance against plans
- Discounting / market risk

plus

- Sense checking of results and/or over reliance on model outputs

Linked to validation under S2

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Solvency II - where is Lloyd’s at?

- Application of SII at Lloyd’s
  - “Association of Underwriters known as Lloyd’s”
  - agreement in principle with FSA on approach
  - will be looking for internal model approval
- Society level
  - programme governance
  - CSU / ERM developments key
  - close liaison with LMA
- Syndicate level
  - guidance / support from centre
  - completed QIS4 / gap analysis
  - Lloyd’s account managers
SCR increase depends on size but decrease in TPs does not

Comparison of QIS4 SCR and TPs to current basis

Solvency II – what is coming next?

- Consultations / lobbying
  - continue lobbying on level 2 proposals
  - removal of geographical diversification
  - treatment of non-life cat risk
  - prudence

- Society level
  - ongoing CSU / ERM projects
  - develop further guidance
  - gap analyses/implementation plans/technical provisions/QIS5 dry run
  - consider timings and resource implications

- Syndicate level
  - gap analysis feedback → implementation plans

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Reserve Cycles and Surplus

Source: Lloyd's SRD and Annual Report

Relative ULR movement post 24 months

- 20%
- 15%
- 10%
- 5%
0%
5%
10%
15%
20%


Prior Year Movement

Reserving cycle

Reserve Cycles and Surplus

Source: Lloyd's SRD and Annual Report

Relative ULR movement post 24 months

- 20%
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Prior Year Movement

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0%
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10%
15%
20%


Prior Year Movement

Reserving cycle
Reserve Cycles and Surplus

- Reserve cycle
  - 2008 year of account “on the line”
  - casualty reserve cycle is more severe
    - may have already crossed the line
  - need to consider implications for pricing
- Lloyd’s estimate reserves surplus exists
  - but is diminishing
  - expect reducing prior year surplus over coming years
- Look forward 2-3 years
  - Lloyd’s will actively review and investigate areas of reserving concerns

Year-end 2009

- Valuation of Liabilities rules issued 30 September 2009
  - additions to incorporate GN20/33
  - changes relating to winding up of LATF
  - discounting only on basis consistent with GENPRU 2.2.107 (2) R
- Dates for submission of SAOs and reports equivalent to last year
- Reports comply with GN12 not TAS R this year-end
- Will hold signing actuaries forum in December
  - open to actuaries from managing agents
  - ideas for discussion topics welcome
SAO report quality continues to improve - something to be proud of

Overall performance for all producers by year-end

- 60%
- 61%
- 65%
- 69%

2005 2006 2007 2008

Unacceptable
Poor
Meets Requirements
Good
Excellent

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Performance Management Data

- Collect robust and accurate risk level information
  - link to use test for underwriting information under Solvency II
- Monitor the performance of syndicates relative to their business plans
  - information to take decisive action where there are prudential concerns
- Enhance the performance framework that has been in place since 2003
- Reduce the risk of a call on the central fund
  - which in turn adds protection to policyholders

PMD project successfully delivered

- Project successfully delivered ahead of schedule
  - First returns received 15 April 2009
- PMD provides more information on
  - Geographical split, broker information, distribution channels, linesizes
- First Management Information (MI) Packs played back to the market in August
  - Current focus is to improve data quality and to provide more guidance to the market

PMD Rate Changes

- Syndicates report on premium changes for all renewal business written at Lloyd’s
- Information is reported to Lloyd’s on a policy level

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<th>170</th>
<th>180</th>
<th>190</th>
<th>200</th>
<th>210</th>
<th>220</th>
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<tbody>
<tr>
<td>Expiring 100% Prem</td>
<td>Deductible Change</td>
<td>Breadth of Cover Change</td>
<td>Other Change</td>
<td>Pure Rate Change</td>
<td>Current 100% Prem</td>
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Look at some worked examples

Key principles

- All values captured in PMD are in monetary amounts
- Changes due to deductible, and due to breadth of cover are on expiring terms
- Changes due to breadth of cover focus on changes on the coverage for perils.
- Changes in deductible and changes in breadth of cover have to be treated independently
- When changes of exposure of the same kind are added (e.g. changes in the indemnity size) these have to be priced on last year’s pricing basis adjusted for this year’s changes in policy terms
PMD – Example 1

- Expiring Terms - 1 hotel, Fire and flood cover @ £100 per hotel
- Change of Terms – None
- Current Terms - Same 1 hotel, Fire and flood cover @ £105
- Risk Adjusted Rate change = 5%

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<td>+105</td>
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PMD – Example 2

- Expiring Terms - 1 hotel, Fire and flood cover @ £100 per hotel
- Change of Terms – Flood cover change of -£40, deductible change of +£50 on expiring terms
- Current Terms - Same 1 hotel, Fire cover only and adjusted deductible @ £90 per hotel
- Risk adjusted rate change equals X%

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<tr>
<td>100</td>
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<td>+90</td>
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PMD – Example 3

- Expiring Terms - 2 hotels, Fire and flood cover @ £100 per hotel
- Change of Terms – 1 new hotel added. Deductible change worth +£95 per hotel, Fire cover removed worth -£90 per hotel (on expiring risk).
- Current Terms - 3 hotels, modified flood cover @ £80 per hotel
- Risk adjusted rate change equals Y%

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PMD – Example 4

- Expiring Terms - One ship, sum insured £10m, rate 2%
- Change of Terms – One ship added with sum insured £12m. Piracy cover added @ rate 0.08%.
- Current Terms - Two ships, sum insured £22m, rate 2.1%
- Risk adjusted rate change equals 2%

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<tr>
<td>Expanding Prem</td>
<td>Deductible Change</td>
<td>Breadth of Cover Change</td>
<td>Other Change</td>
<td>Pure Rate Change</td>
<td>Current 100% Prem</td>
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<tr>
<td>200,000</td>
<td>Completed during talk</td>
<td>462,000</td>
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The new CSU Benchmark system is now in use in the 2010 ICA review

- Based on the Capital System Upgrade (CSU) platform
- Replaces RBC as a benchmark
- System works like a typical ICA stochastic model
  - allows reviewer to drill down into the calculation to look for differences
  - simulation based
- Insurance risk is core element
  - but results are presented for total including all risk types
- ICA (not ECA) level – i.e. pre economic uplift
Other risk types are incorporated

- Other risk types and diversification have been included by means of a market average loading
  - alternative approaches would be syndicate specific
- Separate benchmark for market risk
  - differentials between syndicates
  - not used in overall benchmark, only reviews
- Overall figures are directly comparable to total ICA as presented
  - will look at “insurance risk only” as well

Drill down is possible

- The insurance risk component can be shown in underwriting and reserving components
  - pre and post diversification
- A range of drill down is available including:
  - 2010 underwriting profit
  - year end net reserves
  - 1:200 ULR
  - 1:200 reserve deterioration
  - probability of breakeven
- Assumptions (e.g. ULRs) can be flexed away from market average benchmarks

CSU benchmark - next steps

- Actively use in ICAs
- Continue to refine
  - only first iteration
  - but now a working model
- Present / discuss workings with CALM
  - make an outline technical specification available
- Fully replace RBC as benchmark
Summary

First Half Update
• strong results / claim frequencies up but not amounts

Capital
• similar ICA process / few changes / as expected

Solvency II
• great progress / focus turns to dry run & implementation plans

Reserves and Year-end
• reserve cycle turned / reducing reserves surplus / year-end 2009 process similar to 2008

Performance Management Data (PMD)
• live project / feedback to agents / focus on data

CSU Benchmark
• in use / working model now / will replace RBC

Questions