Current Issues in General Insurance
Jerome Kirk – Lloyd’s

Lloyd’s Update
12 May 2011

Agenda

- Year-end 2010
  - Results
  - Findings
- 2011 to date
- 2012 Capital Setting
- Quick Solvency II update
  - Dry run
  - Lobbying
- Summary & Questions
2010 saw solid result in challenging circumstances…

<table>
<thead>
<tr>
<th>£m</th>
<th>2009</th>
<th>2010</th>
</tr>
</thead>
<tbody>
<tr>
<td>Gross written premiums</td>
<td>21,973</td>
<td>22,592</td>
</tr>
<tr>
<td>Combined ratio</td>
<td>86.1%</td>
<td>93.3%</td>
</tr>
<tr>
<td>Investment return</td>
<td>1,769</td>
<td>1,258</td>
</tr>
<tr>
<td>Profit before tax</td>
<td>3,868</td>
<td>2,195</td>
</tr>
<tr>
<td>Return on capital (pre-tax)</td>
<td>23.9%</td>
<td>12.1%</td>
</tr>
</tbody>
</table>

Source: Lloyd’s pro forma financial statements, 31 Dec 2010

…and our performance compares well against our peers

Sources: i) Insurance Information Institute (estimate-2010), ii) Reinsurance Association of America, iii) Company data (17 European companies: 17 Bermudian companies)
Solvency coverage is now at record levels

BALANCE SHEET
£m

2005 2006 2007 2008 2009 2010
1,368 1,801 2,206 2,490 2,756 2,923
10,992 13,333 14,461 15,264 19,121 19,121

SOLVENCY
£m

Note: * Solvency surplus net of solvency deficits
Source: Lloyd’s pro forma financial statements, 31 Dec 2010

The full year underwriting remains in profit despite significant catastrophe losses...

Combined ratios

2010
AY excl. major losses and FX on NMI Impact of FX on NMI Major losses Prior year reserve movements Calendar year
86.5% 0.0% 12.7% (5.9%) 93.3%

2009
AY excl. Major losses and FX on NMI Impact of FX on NMI Major losses Prior year reserve movements Calendar year
87.3% 2.3% 2.1% (5.6%) 86.1%

Source: Lloyd’s pro forma financial statements, 31 Dec 2010
...with resilient profits in major classes but UK motor did face a hostile claims environment

![Calendar Year Combined Ratio Graph]

Source: Lloyd’s pro forma financial statements, 31 Dec 2010; GWP: Gross Written Premium

2010 saw insured industry cat losses of $43bn

![Industry Cat Losses Graph]

Source: Industry - Swiss Re, Sigma No 1/2011; Lloyd’s – Net ultimate claims for major losses per syndicate QMRs; Source: Lloyd’s pro forma financial statements, 31 Dec 2010
The 2009 SAO Large Loss Wordings were dominated by a small number of losses....

- Year-end 2009 saw:
  - only 1 “high” severity wording
  - 2008 windstorms were the largest by number (42%)

Source: Lloyd's 2009 SAO analysis

…but year-end 2010 has seen a different picture

- Year-end 2010 saw:
  - 3 “high” severity wordings
  - Wordings relating to a number of new losses – as expected

Source: Lloyd's 2010 SAO analysis
The results are bolstered by further reserve releases

- Fourth year in a row of significant reserve releases
- Releases have been seen over
  - most “back” years of account…
  - ...but with more pressure on more recent years
  - and most classes
  - especially property and reinsurance
- Surpluses have been generated by favourable experience
  - Consistent with Lloyd’s “Early Warning” results….

The 2010 experience on back years was, in general, favourable....

Actual and Expected Development
Whole Account - Claims

Source: MRC Early Warning exercise. MRC projections vs MRRQ incurred data converted at ye 2009 exchange rates. Figures are gross of reinsurance.
...with casualty following a similar pattern to the whole account....

Actual and Expected Development
Casualty Account - Claims

Source: MRC Early Warning exercise. MRC projections vs MRRQ incurred data converted at y/e 2009 exchange rates. Figures are gross of reinsurance

...and property treaty was constantly lower than expected

Actual and Expected Development
Property Treaty Account - Claims

Source: MRC Early Warning exercise. MRC projections vs MRRQ incurred data converted at y/e 2009 exchange rates. Figures are gross of reinsurance
During 2010 Lloyd’s maintained the focus on reserving cycles…..

...including writing to CFOs on Reserving in Dec 2010

- Looking to Managing Agents to ensure standards of governance are met
  - includes telling Boards that Lloyd’s level of concern exists
  - Signing Actuaries must also play a part
- Further benchmarking analysis extends central best estimate from market total to syndicate
  - allocations of market level best estimate by 50 class line of business – not allocating a deliberately conservative number
- Portfolios differ, but needs an explanation that goes beyond just saying “portfolio differs”
- Expecting CFOs to discuss with Boards
- FSA wrote a similar letter to CEOs in March 2011
Casualty has seen a significant movement – a positive response to Lloyd’s concerns?

The movement is marked when only focusing on the later years of account.
Finish the results section with the good news that the level of Open Years continue to decline.

<table>
<thead>
<tr>
<th>NO. OF YEARS OF ACCOUNT IN RUN OFF</th>
<th>Gross Reserves (£bn)</th>
</tr>
</thead>
<tbody>
<tr>
<td>2005</td>
<td>7.0</td>
</tr>
<tr>
<td>2006</td>
<td>4.7</td>
</tr>
<tr>
<td>2007</td>
<td>2.7</td>
</tr>
<tr>
<td>2008</td>
<td>2.5</td>
</tr>
<tr>
<td>2009</td>
<td>1.8</td>
</tr>
<tr>
<td>2010</td>
<td>1.0</td>
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</table>

Source: Lloyd's pro forma financial statements, 31 Dec 2010

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But not a great start to 2010….

But not a great start to 2011…..
....already been several significant Catastrophes

- There are already estimates of industry losses
  - with many insurers publishing own impact
- Lloyd’s issued a Major Loss Return on 14th March
  - return received on 20th April
  - trade off between speed of reporting and accuracy
  - return now received and results are being analysed
- There will be an impact on the profit release process
- Will be issuing a statement soon with estimated loss amounts…
  - uncertainty will remain in estimates
  - and even more SAO large loss wordings?

And what about the rest of 2011?

“Based on current and projected climate signals, Atlantic basin and US landfalling tropical cyclone activity are forecast to be about 25% above the 1950-2010 norm in 2011. There is a moderate (55%) likelihood that activity will be in the top one-third of years historically.”

TSR April Update
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2011 YoA saw capital moving in line with changes in market conditions

-2%  +8%

- Premium (1) - ICA
  - 2008  2009  2010  2011

- ECA to Premium (2)
  - 2008  2009  2010  2011

(1) Gross premium, net of acquisition costs
(2) Excludes reserve margin credit
2012 will once again see a streamlined ICA process

Approach

- Similar streamlined approach as seen for 2011 capital setting
  - intended to free up market resources for Solvency II dry run
  - no full ICA documentation required
- Heavily dependent on Lloyd’s ICP benchmark movement
  - worked well for 2011
- Tier 1 syndicates (ICA < £125m)
  - full pro-forma unless electing benchmark
- Tier 2 syndicates (ICA > £125m)
  - full pro-forma
  - analysis of change (in September)
  - more detail for “big” syndicates

With no change in underlying basis...

- 2010 ICA guidance still holds
- 35% uplift remains
- Treatment of reserve margins
  - discretionary 75% maximum credit
  - reliance on both SAO and Lloyd’s reserve reviews
- Statutory requirement to keep ICA under continuous review remains
- Reminder that the pro-forma information is key to process
  - ensure it makes sense
  - last year time was lost by both market and Lloyd’s due to issues here
...and with the following timetable

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<tr>
<th>Date</th>
<th>Non-Aligned</th>
<th>Aligned</th>
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<tbody>
<tr>
<td>Initial ICA</td>
<td>8 July</td>
<td>8 July*</td>
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<tr>
<td>Final SBF</td>
<td>9 September</td>
<td>9 September</td>
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<tr>
<td>Final ICA</td>
<td>9 September</td>
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<tr>
<td>Coming into Line</td>
<td>28 November</td>
<td>28 November</td>
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</table>

- * may be based on rollover of 2011 or initial 2012 plan if submitted
- Tier 1 syndicates have option to elect the benchmark movement at times during process

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2011 is based on 7 “new” workstreams...

<table>
<thead>
<tr>
<th>2010 Dry run</th>
<th>2011 Workstream</th>
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<tr>
<td>New for 2011</td>
<td>Internal Model SCR</td>
</tr>
<tr>
<td>QIS5 and new for 2011</td>
<td>Valuation &amp; Balance Sheet</td>
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<td>TP and QIS5</td>
<td>Technical Provisions &amp; Standard Formula</td>
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<tr>
<td>SQS, CVP &amp; EMD</td>
<td>Model Validation</td>
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<tr>
<td>SOG, MSG &amp; ORSA</td>
<td>Governance, Risk Management &amp; Use</td>
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<tr>
<td>SREP</td>
<td>Reporting &amp; Disclosure</td>
</tr>
<tr>
<td>DOC and new for 2011</td>
<td>Documentation &amp; Final Application</td>
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</table>

...with three key deliverables

- Article 101 – the model must be able to calculate a Solvency Capital Requirement (SCR)
  - Action – deliver SCR by October 2011
- Article 112(5) – there are adequate systems in place for identifying, measuring, managing and reporting risk
  - Action – deliver ORSA by 16 December 2011
- Articles 120-126 – the model meets the tests and standards on use, statistical quality, profit & loss attribution, calibration, validation, documentation and external models & data
  - Action – evidence that standards are being met throughout process and deliver ‘application pack’ by 16 December 2011
With guidance and support from Lloyd’s

<table>
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<th>Workstream</th>
<th>Format</th>
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<tr>
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</table>

**SAOs under Solvency II**

- Solvency II introduces the concept of an Actuarial Function
- Syndicates (or Managing Agents) will require an Actuarial Function
- Duties of Actuarial Function are **close to** providing an opinion on Technical Provisions for Solvency
- Current SAOs provide an opinion of Technical Provisions for Solvency
  - but is relied upon by auditors for accounts...
  - …given the similarity between financial reporting and solvency bases
- However not the same similarity under Solvency II
- What does this mean for the provision of SAOs?
  - many possible solutions
- Currently considering options and are consulting with stakeholders
**QIS5 results**
- “too big and unbalanced”

- The results have led to lobbying activities that aim
  - to focus on large issues
  - to avoid complexity

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**Non-Life Cat Risk**
– recognition of geographical diversification

- Geographic diversification (GD) of risks is an important feature for any insurer writing in multiple regions
  - e.g. no reason to expect event in Central Asia given one in Western US
  - GD in premium/reserve risk – just as important for cat risks
- Proposal through reinstated European NL Cat Task Force:
  - recognition of diversification across 18 regions, by peril
  - independence for some perils/regions, small link for others
- Rather than SCR calculated using sum of premiums across all regions, SCR for a peril would become:

\[
SCR_{\text{peril } i} := \sqrt{\sum_{a,b} Correlation_{\text{region } a, \text{region } b} SCR_{i,a} SCR_{i,b}}
\]
Market Risk
– introduction of matching for capital

- QIS5 calculates currency risk charge based on difference between total assets and total liabilities in each currency (non-domestic/EUR)
  - liabilities are pure obligations only – no allowance for capital requirement
- Where solo insurers hold excess assets (i.e. capital buffer) in a currency, standard formula penalises severely
  - effectively introduces an incentive to poorly match currency
- Lloyd’s proposal for solo entities taken into a CEA proposal
  - consider proportion of assets and liabilities in particular currencies
  - only charge based on extent to which these proportions are mis-matched
  - makes allowance for holding excess capital in the currency of obligations

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Summary

Year-end 2010 Results
• Strong results with catastrophe losses offset by continued reserve releases

2011
• Already seen significant catastrophe losses
• Focus will remain on reserving
• 2012 capital will be set on a streamlined basis again

Solvency II
• Key priority for 2011 with dry run in full swing
• Continue to lobby including technical items in standard formula

Questions or comments?

The views expressed in this presentation are those of the presenter.