

Market News

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Rolf Tolle, Lloyd's Franchise Performance Director.

Argenta secures exclusive deal with Ark. - See page 14.

Stand Firm

With another year of low natural catastrophe activity and the listed Lloyd's companies reporting excellent underwriting loss ratios at the third quarter, profitability is expected to be good. Attention however is focused on where the market is heading in 2008. In a new departure, Lloyd's has issued a podcast of a short interview with Rolf Tolle, Franchise Performance Director, which may be accessed at www.lloyds.com.

In the interview, Tolle says that he expects Lloyd's syndicates to take more drastic cycle management steps next year in response to softening market conditions. "We will follow up through 2008 and we will encourage those agents who may not be so committed as others to proper cycle management to get up to speed with their efforts," he warns.

In our September Market News, we noted that a number of syndicates, whilst not de-emptying, plan to underwrite less premium income for 2008. Asked whether more Lloyd's syndicates should reduce capacity for the 2008 underwriting year, Tolle says that the emphasis should be on premium reduction, as opposed to capacity reduction. "I've told those syndicates that... have unaligned capacity that they should keep that capacity as high as possible in case something happens and they need to react very quickly," he says in the podcast.

The challenge that Lloyd's companies face over the next two years, according to Mr Tolle, is to solidify their strong reputation by showing the world that they can manage their underwriting through a downturn and be ready to take advantage of improved conditions when the market turns.

A Softening Market

Insurers and commentators are attempting to draw a distinction between soft markets and softening ones. Markets are softening in almost every business area.

Trading statements speak of the need to be “resolutely disciplined” and of being prepared to walk away from under priced business. In practice, two distinct skills are required; firstly that the underwriter has an appreciation of the pricing levels at which his account becomes unable to deliver an acceptable level of profit, and secondly that he has the strength of character to see a book of business built up over a number of years disappear to competitors. As Robert Hiscox pointed out in his interim results statement in August “...every senior executive of every insurer and reinsurer is preaching discipline and yet many rates are still magically reducing”. On the one hand, an insurer’s management is telling the world that it is maintaining discipline, but on the other its underwriters are being encouraged to maintain volume.

It is always difficult to argue the case that “this time it is different”. However, it is possible to argue that analytic capability of insurers to identify the technical price of risk has improved since the last soft market. Also that Lloyd’s syndicates have a more robust peer review system in the Franchise Performance Directorate than was the case in the last soft cycle. Investment income is unlikely to cushion the blow of underwriting losses and, given continuing uncertainty in capital markets, there seems little incentive for cashflow underwriting. That some of the Lloyd’s syndicates which successfully negotiated the last soft market are not yet shedding significant amounts of business gives credence to assertions that they are trading in a satisfactory pricing environment which offer good prospective margins.

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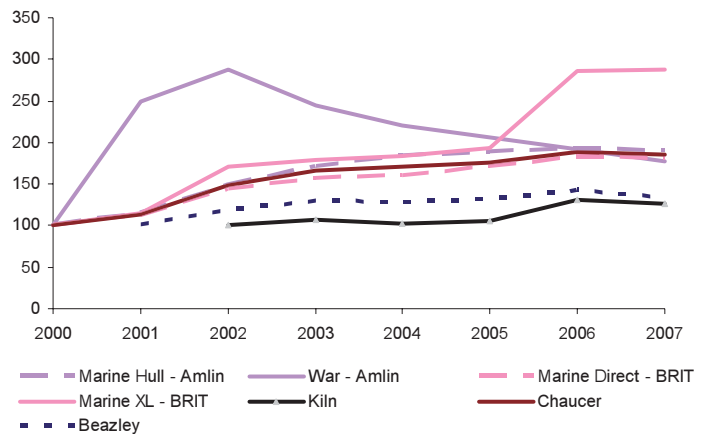
Sector Reviews

With our review of each sector, we have again included rating indices from various sources to illustrate pricing movements. Insurers recognise that rating indices are to be treated with caution. They are usually based on underwriters’ estimates of rate changes, including adjustments to terms and conditions, and often relate to renewal business only, since this represents the business on which the best year-on-year data is available. That this is an inexact science can be seen where two companies are reporting on ostensibly the same markets, but the lines on the graph are far apart. Unlike the stock market, where investors are making money if the index is going up,

profitability in insurance is determined by the absolute level of pricing so what matters most is whether pricing is adequate for the risk including a margin for profit.

The rating charts provided by Kiln, BRIT and Chaucer are updated to 11 November, 30 September and 30 October respectively. Indices for Amlin and Beazley are reported as at 30 June.

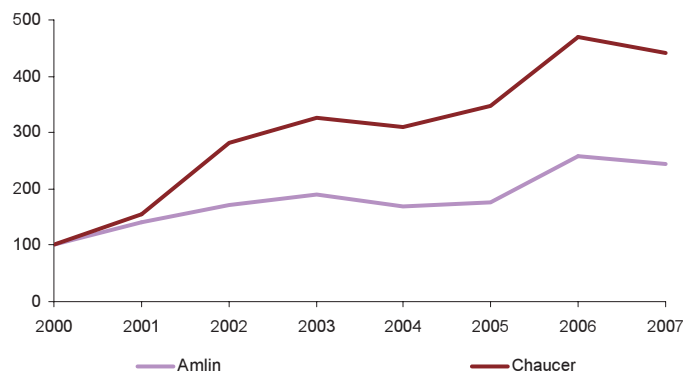
Marine



Despite losses, hull rates under pressure. Specie and cargo more robust.

The hull market has continued to soften despite losses totaling more than \$800m in the first nine months of the year. Competition from Scandinavian markets and the Far East plus renewed appetite from some London markets is keeping rates under pressure. Specie and Cargo have been more robust, although again new entrants are introducing competitive pressures. Where catastrophe exposures prompted rate increases in 2006, there has been some easing of pricing in 2007.

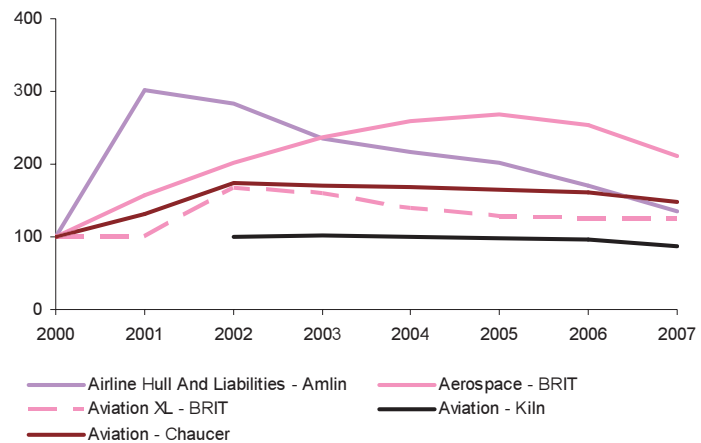
Energy



Rates under pressure but increasing insured values serve to maintain premium base.

Insurers have been under pressure to reduce rates following the benign 2006 year; this can only be expected to increase, as 2007 is equally benign. Improved terms have generally been offered to clients via incentives to renew, such as no claims bonuses or by profit commissions, rather than reductions from the original rates, although the latter certainly has happened. The value of reductions and incentives to risk buyers has been steadily increasing over the year. Insurers have also relaxed the windstorm limits imposed on Gulf of Mexico accounts. Given the continually increasing costs of raw materials, owners have been increasing the insured values of their assets, which has served to maintain the premium base.

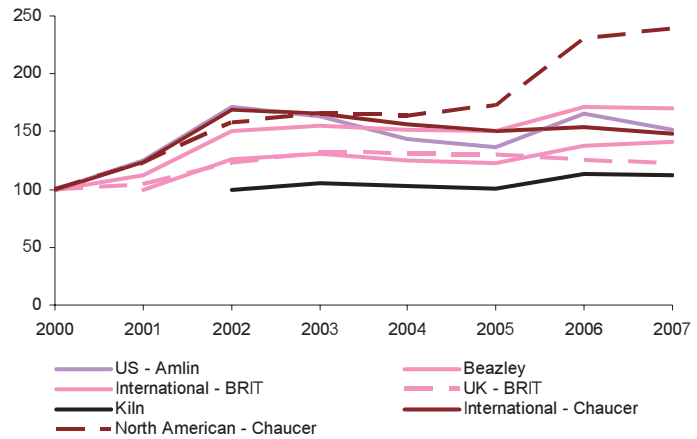
Aviation



Difficult underwriting conditions, especially for major airlines.

Surplus capacity and low incidence of loss continue to drive down rating levels across the aviation market. In the airline sector, the most competitive, it seems likely that the new rating levels, on average 15% down according to Aon, will be insufficient to cover the claims activity even without major loss. Aon believes that "...the evidence of a change in market direction is mounting" but there seems to be a strong element of 'clutching at straws' here, rather than hard evidence. Difficult conditions are also reported in the airport liability and general aviation classes, albeit that the rating environment has proved slightly more robust. Orders for new satellites reflect increasing demand for communications and entertainment technology. Despite the Sea Launch loss at the beginning of the year, there has been a continuing weakening of terms and conditions.

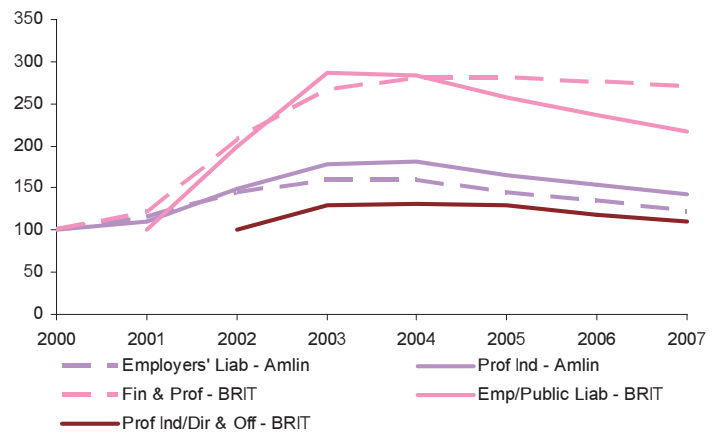
Direct Property



US Catastrophe rates off slightly from all-time highs. Margins also remain acceptable in other catastrophe exposed areas.

Rates for US Catastrophe exposed business have fallen from the all-time highs recorded during the latter half of 2006, but many underwriters report that the margins remain more than acceptable. Binding authorities are also holding up. Away from the US, the cycle is more advanced, with severe over-capacity impacting most territories without notable natural catastrophe exposure. Where the catastrophe exposure exists, most underwriters are still reporting good rates.

UK Liability

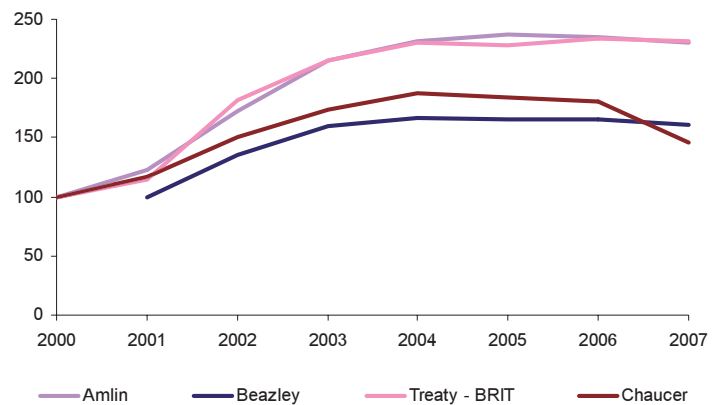


Declining rates but better risk management and minimum premiums has improved claims record.

Rates for UK liability continue to decline. Composite insurers have rediscovered their appetite for Small and Medium sized Enterprises (SMEs) and tend to package liability risks with property coverages at

rather less than many underwriters would want for a stand alone policy. Claims records for liability classes have been good in recent years; better than would be expected from simply inflating historic premiums charged to the present day levels. This is due to both better risk management and to the imposition of minimum premiums. There is a danger, particularly if the economy turns down, that claims levels will return to their long term averages, pushing insurers into loss. On the Professional Indemnity side, the recent round of solicitors' renewals recorded an average reduction of 15%. If the economy stalls loss activity will likewise probably accelerate on the professional indemnity side.

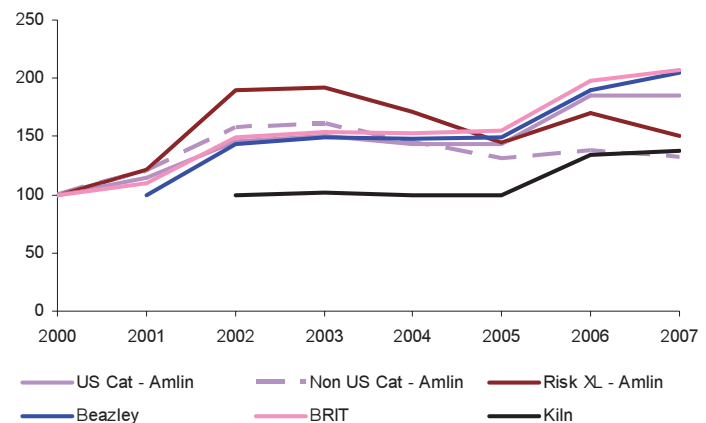
US Casualty



Rates holding better than expected. "premiums achieved in 2007 were 61% higher on a like for like basis for business written in 2001."

Rates in the US have proved more resilient than expected throughout the first half year. Beazley stated that premiums achieved in 2007 were 61% higher than on a like for like basis for business written in 2001. In the second half of 2007, there have been increasing signs of competition. In particular, it seems that US insurers have fallen some way short of their annual premium income targets and are aggressively seeking to make up for this in the final quarter. Chaucer's premium rate index shows a rate decrease of 4.4% over the 2007 year to the end of October.

Property Reinsurance

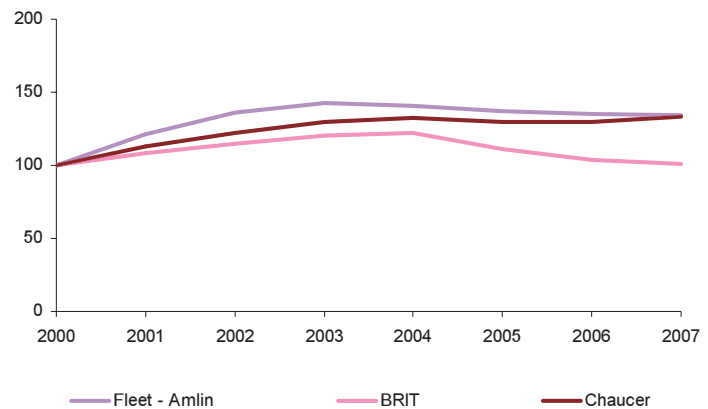


“Pricing is under some pressure but terms for US Catastrophe exposed business remain particularly attractive.”

Pricing is under some pressure but terms for US Catastrophe exposed business remain particularly attractive. The increased coverage afforded by the Florida Hurricane Catastrophe Fund has had little impact as cedants have sought additional coverage alongside and above the protection afforded by the Florida State. Recent releases of loss modeling software have inbuilt assumptions of larger original losses and more frequent catastrophic events. Insurers have made good profits in the past two years and, to an extent, are using these profits to support larger reinsurance retentions and to buy larger limits of cover (i.e. dropping lower tiers and using the savings to buy new top layers). This should reduce attritional loss for reinsurers but makes the product they offer more volatile. This applies in particular to catastrophe specialist syndicates such as Kiln 557, MAP 6103 and Hiscox 6104.

At the time of writing, one underwriter described the market as in the midst of a “phoney war”. While demand and supply are both up, supply has increased by more and the effect on pricing will be downward pressure. Reinsurers generally are comfortable to give a little on the rates, and while their adjustable premiums are impacted by reducing rates on direct business, it seems that primary insurers will be squeezed if they elect to reduce their rates by more than the reduction in reinsurance terms. The underwriter also noted that in one or two cases, his syndicate had declined to support a programme as he felt the leader had been overly generous in offering renewal terms. These programmes had not been supported by following markets and the leader has had to increase his original terms in order to get following market support.

Motor



“Average premiums for Comprehensive cover up by 8% on the year to 30 September”. Rate of increase expected to accelerate during 2008.

Premium rate increases for Private Car have been pushed through by most insurers since April. The AA premium rate index shows average premiums for Comprehensive cover up by 8% on the year to 30 September. Third party, fire and theft prices are up by 4.4% over the same period. In both categories, motorists are able to obtain better renewal prices by shopping around. However, Admiral, Chaucer and Highway all expect the rate of increase to accelerate during the last quarter of 2007 and into 2008.

Rates increases for commercial vehicles have lagged the private car market in the first half of 2007, although again there is increasing momentum for increases into the second half of the year. In general, insurers have done better in recent years out of commercial business, out-performing the private car by more than 6 percentage points in combined ratio terms according to Deloitte.

Claims inflation is lower than in previous years, especially for first party claims for crashed and stolen cars, where it is almost negligible. Claims inflation for third party claims is higher, with larger claims (£80,000+) accelerating at an annual rate of 10%. Claims inflation for lower valued claims is reported to be closer to 6%, producing an aggregate claims inflation figure closer to 4.5%. During 2007, judicious releases from reserves have again allowed insurers to turn poor underwriting results into acceptable profits, although the ability to continue to do this is in doubt. Insurers have also used the UK floods of June and July as a lever to force up rating levels.

“Rate adequacy will remain good....”

Outlook for 2008

Chaucer also published its rate movement expectations for 2008. They expect an overall decrease of 4.9% in premium rates in 2008, with a projected upturn of 6.4% in UK motor rates dampening the effect of a 6.6% reduction in non-marine and marine rates. Catlin (28 November) expects that weighted average premium rates may decrease by as much as 10% during 2008, although rate movements will vary considerably across more than 30 classes of business that Catlin underwrites. “However, we believe that rate adequacy will remain good across most of these business classes”.

Insurance and the Law

Terrorism and TRIA

In the aftermath of 9/11, coverage for terrorism damage almost completely dried up. Congress passed the Terrorism Risk Insurance Act (TRIA) in 2002, obliging all insurers to “make available” insurance coverage for large foreign-inspired acts of terrorism, as well as providing a federal backstop for insurers exposed to terrorism losses. The initial provisions ran until 2005 but were subsequently extended to expire on 31 December 2007.

The US Senate is likely to extend TRIA for another seven years.

The House of Representatives has passed a bill to extend TRIA until 2022. This bill has now passed to the Senate. It incorporates a number of positive features for insurers including capping losses to the insurance industry at \$100 billion per year and removing the distinction between foreign and domestic terrorist acts.

However, critically for insurers, the bill includes provisions requiring them to extend coverage for terrorism to include Nuclear, Biological, Chemical and Radiological events (NCBR). The American Academy of Actuaries has estimated the potential cost of an NCBR attack at three quarters of a trillion dollars (\$778,000,000,000). In particular, insurers point to the lack of any meaningful claims history and the inability to assess potential values at risk as two of the main dangers if they are forced to make available NCBR coverage.

It seems likely that Senate will pass a restricted form of the Representatives’ bill, reducing the period of the extension to seven years, excluding NCBR and accelerating the time over which the state recoups payments made under the scheme from policyholders.

The EU and the Subscription Market

Much of Lloyd's business is placed via the subscription market. Market convention dictates that all insurers on the same policy trade on the same terms and price. The broker approaches a number of possible leaders, each of whom will indicate terms and a lead line (a percentage of the placement). It is the broker's job to know the market and how to manipulate it such that he can obtain 100% support for the leader's terms at best advantage to his client.

The EU has asked the insurance industry to justify the convention on market pricing.

Not all insurance markets follow this convention, for example the aviation hull market is prone to differentiated pricing or "verticalisation". This is the practice of each insurer quoting his own terms for his share of the risk and accepting that price irrespective of the price charged by others insuring the same risk

While not concluding that competition law is infringed, a report by European Competition Commissioner Neelie Kroes, suggests that undifferentiated pricing is not intrinsic to the operation of the subscription market. The insurance industry has been asked to justify the convention on market pricing, as it could be argued that the practice prevents following insurers from offering lower prices or more favourable terms. The insurance industry enjoys an exemption lasting until 2010, but a decision will be taken by the EU in 2009.

The State of Connecticut sues Marsh

The Attorney General of the State of Connecticut, Richard Blumenthal, has issued a writ against Guy Carpenter, the reinsurance brokerage unit of Marsh & MacLennan, alleging it conspired with reinsurers to fix prices, eliminate competition and to increase profits in the reinsurance markets. Blumenthal commissioned an enquiry into the cost of homeowners insurance in 2006, following a dramatic rise in insurance costs for coastal properties. The enquiry found that the price rises were largely driven by the cost of reinsurance. The suit names nine alleged co-conspirators (no Lloyd's entities were named) but Blumenthal said his investigation is continuing and that there might ultimately be more than 20 co-conspirators. Marsh has dismissed the action as a "fundamental misunderstanding of reinsurance facilities that have been in operation for the benefit of small and mid-sized clients for as long as fifty years".

The Connecticut Attorney General is alleging that Guy Carpenter conspired with reinsurers to fix prices and increase profits.

US Collateral Requirements

Skirmishes over the collateral that foreign reinsurers are required to deposit in the USA have been played out on the letters page of the Financial Times over recent weeks. Prompted by a review of the regulation of US insurers and a potential move from individual state control to a single federal regulator, Lord Levene sounded the opening shot on 16 October. He denounced the lack of a level playing field, citing discrimination against reinsurers on the basis of domicile and not of financial strength and claimed that failure to reform would damage US interests as the country's need for reinsurance capacity grows with the increase in risks associated with man-made and natural catastrophes.

Lloyd's Chairman, Lord Levene, joins the "debate" to level the playing field for Lloyd's and other non-US (alien) reinsurers and end discrimination. The US currently requires alien reinsurers to fund reinsurance losses 100%. There are positive noises coming from the New York Insurance Commissioner. However, infighting between states is likely to make reform a long and drawn out process.

Two days later, the New York Insurance Commissioner tacitly agreed with these sentiments when he announced a unilateral change in collateral requirements, stating "There is a growing need for reinsurance in New York to deal with risks from terrorism and from natural catastrophes such as hurricanes. We cannot afford to maintain outdated and unnecessary standards for the international market for reinsurance. This new regulation recognises the reality of the global market and frees up capital, which will increase capacity in the reinsurance market. It will help attract more capital to the New York reinsurance market, which should help lower costs and benefit consumers and businesses purchasing insurance." Under the revised New York requirements, Lloyd's syndicates, as single A rated reinsurers, would see their funding requirement fall from 100% to 20% of gross outstanding claims.

New York's move was dismissed by John Oxedine, Insurance Commissioner for Georgia and Chairman of the National Association of Insurance Commissioners Reinsurance Taskforce, as having negligible impact on the reinsurance market and warning "Lloyd's or anyone else" that New York's scheme remains unapproved outside New York and that any reinsurer using the proposed New York scheme may "subject itself to retaliation from 49 other states". He went on to criticise what are seen as barriers faced by US reinsurers in Europe, including the more liberal accounting standards and discrimination against US reinsurers in European courts.

In another letter to the FT published on 9 November, two UK MEPs, Peter Skinner (Labour) and Jonathan Evans (Conservative), dismissed Commissioner Oxedine's claims on accounting treatment as "untrue", on discrimination as "ridiculous" and accused the NAIC of "parochial obstinacy".

Lloyd's Director and General Counsel, Sean McGovern, joined the fray, praising the opponents of reform for their ingenuity in prolonging debate for over eight years in order to maintain the discriminatory status quo. He dismissed Commissioner Oxedine's concerns over the lack of openness in the EU as just another red herring.

Commissioner Oxedine and the President of the NAIC, Walter Bell, Insurance Commissioner for Alabama, wrote to clarify the deliberations of reinsurance taskforce of the NAIC. This is working on a risk-based evaluation process, based on risk and credit criteria, and not solely on US licensure status, in establishing collateral requirement. It goes on to state that the New York proposals incorporate several features in the taskforce's proposal.

US situs funding could become an increasing issue for Lloyd's as rating levels soften and we strongly support the Chairman's endeavours to bring the collateral regime for domiciled and non-domiciled reinsurers into line.

In a further letter published on 19 November, Lloyd's Chairman Lord Levene pronounced himself "baffled" by the difference in tone between Commissioner Oxedine's warning of "retaliation" against those using the New York regime and his letter praising the New York Commissioner's "contribution to the proficiency of the state based system of insurance regulation". He then accused the NAIC of giving the impression that great progress has been made, when in fact current proposals do not deliver on an earlier promise.

Funding for US situs risks has been less of an issue for Lloyd's syndicates over the past few years. Many, although far from all, syndicates traded through the loss impact of Katrina, Wilma and Rita in 2005 without the need to call cash from their Members. This was in part due to the strong cash balances the syndicates enjoyed at the time. Funding for US casualty reinsurance has not presented a problem for a while. With the softening of rating levels and reducing syndicate liquidity (as cash balances are paid out in profits), there will be more of a strain on syndicates' funds, particularly in the event of catastrophic losses. Lloyd's currently has more than \$9 billion in US collateral funding, administratively burdensome and, with interest rates about a third lower in the US, expensive. This is clearly a live issue and we can expect further developments soon. The issue of situs funding is close to the Chairman's heart and we strongly support his endeavours to bring the collateral regime for non-domiciled reinsurers into line with that of US domiciled reinsurers

View from Throgmorton Street

The commentary in this section is for general information purposes only and should not be construed as being any form of investment advice.

New Entrants

Lightyear Capital/Antares: Antares Holdings, a newly established Bermudian holding company, has acquired the renewal rights of the London market business previously written by Württembergische Versicherung AG. The business will be transferred to the new Syndicate 1274, backed by Antares and managed by Chaucer Syndicates Limited. Antares is founded by the New York private equity house Lightyear Capital LLC. Chaucer has itself committed £15m to the venture. The Württ book is specialty business, including property, casualty, marine and aviation risks, with a worldwide geographical spread, and will be underwritten by the current Württ team, lead by Stephen Redmond, a former Chairman of the Institute of London Underwriters, as Active Underwriter and Chief Executive Officer. Initial capacity will be £135m and the syndicate will begin underwriting on 1 January 2008.

Goldman Sachs: Arrow Re, a Bermudian based reinsurer and a wholly owned subsidiary of Goldman Sachs, has announced that it has formed Syndicate 1910 to commence underwriting at 1 January 2008. Arrow Re was formed in 1998 and has acted to facilitate insurance risk securitisations (i.e. take on traditional insurance and reinsurance risks but backed by selling catastrophe linked securities) and provide insurers and reinsurers with access to capital markets, although the syndicate's expected book of business is described as traditional property catastrophe and other reinsurance accounts. Its entry into Lloyd's, with a modest capacity of £65m, has caught commentators by surprise. It seems unlikely that the scale of the business will remain modest for long.

Beaufort: Munich Re acquired its second Lloyd's managing agent with the purchase of MSP Underwriting, the parent of Beaufort Syndicate Management (managing agent of Mike Pritchard's Syndicate 318) as well as dedicated capital providers and Evergreen Underwriting Services. With unusual Teutonic imprecision, the purchase price was given as the "mid double-digit million euro range". Munich Re also owns Munich Re Underwriting, managing agent of Syndicate 457.

Syndicate 457 is a marine and space specialist, while Syndicate 318 writes short tail non-marine and aviation lines, so there is minimal cross over between the two business lines. Syndicate 457 is wholly aligned, Munich Re having bought out the last non-aligned members in 1999, whereas more than half of Syndicate 318's capacity rests with spread capital providers. Earlier this year, Munich Re acquired the Lloyd's broker, Bell and Clements, a specialist dealing with US binding authority business, a large proportion of which is placed with Lloyd's syndicates.

Barbican: Former QBE underwriter Mark Harrington has returned to the Lloyd's market with a new composite syndicate with capacity of £75m for the 2008 year. Syndicate 1955 will write casualty reinsurance, international property and treaty business. It is backed by two US private investment funds, Steel Partners II, L.P. and funds managed by Carlson Capital L.P. The Syndicate will be managed under a turnkey arrangement by insurance services provider Whittington.

Ark: Also making the news this month has been Argenta Private Capital. Within 10 days of asking, its members provided £20m of capacity to the April 2007 start-up Ark Underwriting. Capacity is provided to a Special Purpose Syndicate (6105) writing a Quota Share reinsurance of Syndicate 4020's 2008 account. Although other similar arrangements have been put in place for Catlin Syndicate 2003 and catastrophe reinsurance accounts of Syndicates 33 (Hiscox) and 2791 (MAP), this transaction is the first time that the mechanisms introduced in the Annual Venture Review of 2006 have been utilized for spread capital to support a previously 100% aligned syndicate.

This is the first time that third party capital has been able to access a wholly dedicated syndicate.

Share buy-backs

A number of insurers and reinsurers have elected to return capital to their shareholders. The following list is the most significant:

Insurer	Date	Buy-back (€bn)
ING	July 2007	5.0
Swiss Re	April 2007	2.6
Munich Re	May 2007	2.0
Generali	August 2007	1.5
Legal and General	July 2007	1.5
AEGON	August 2007	1.0

During November, three Lloyd's insurers have announced an intention to follow suit. Cynics have long believed that insurers have such difficulty in returning capital to shareholders that it is simpler for them to distribute it to policyholders by under-pricing their product. It is encouraging that insurers and reinsurers are now trying to do the right thing. While companies speak of capital returns being part of a process of active cycle and capital management, we are aware that in many cases the capital returns are prompted by activist shareholders. Most also cite the lack of profitable opportunities.

Kiln announced on 6 November that it planned to return £60m to shareholders. Kiln invested £16 million in 2003 to take a 20% share of a joint venture with WR Berkley. WR Berkley is a US based commercial lines insurer which owns 20.1% of Kiln. This new business, WR Berkley (Europe), writes largely UK and European casualty business, but also took a share of the Kiln Reinsurance Consortium, established for the 2005 year of account. The Kiln Reinsurance Consortium between Syndicates 510 and 557 and WR Berkley (Europe) ends this December, with the business reverting to Syndicate 510 (with quota share support from Syndicate 557). Kiln will now be selling its 20% stake in WR Berkley (Europe) to WR Berkley (the majority shareholder). The return of capital was announced almost two years to the day after Kiln announced a rights issue to raise an additional £72.8m from shareholders.

Kiln, Amlin, Beazley and Hiscox are returning capital to shareholders as part of their cycle and capital management.

Amlin joined Kiln in promising a £120m return of capital in an announcement made on 14 November. While expressing overall satisfaction at the levels of premiums for marine and non-marine risks, Amlin states that it does not “expect a material increase in the level of required capital in the medium term”.

Catlin's CEO, Paul Jardine, dampened expectations of a capital return from the Catlin group in a speech on pricing and cycle management, saying insurers should be “very wary” of repatriating capital to shareholders in the current market environment, as the sub-prime debacle may hamper future attempts at capital raising. He also warned of the dangers of seeking growth via merger and acquisition at the bottom of the cycle, which despite being exactly the wrong time to buy was often seen as a valid way to deploy capital. It seems that Catlin will neither be returning capital nor making further acquisitions in the medium term.

Both Beazley and Hiscox are undertaking open market purchases of their own share capital as a way of returning capital to shareholders.

The Index of Lloyd's quoted companies gave up all of its 2007 gains during November.

	Share price				Price movement		
	Oct-06	Jan-07	Oct-07	Nov07	Since Oct 06	Since Jan 07	Since Oct -07
Advent	33	34	24	24	-25.8%	-29.0%	0.0%
Amlin	296	332	324	295	-6.3%	-11.0%	-8.2%
Beazley	120	139	174	161	38.5%	15.6%	-7.4%
Brit	331	316	330	258	2.5%	-18.4%	-21.7%
Catlin	509	510	480	402	-11.9%	-21.1%	-16.2%
Chaucer	77	98	107	96	17.2%	-2.0%	-9.8%
Hardy	242	259	307	281	29.2%	8.7%	-8.5%
Heritage	88	102	117	116	11.9%	13.8%	-0.9%
Hiscox	258	284	275	260	8.5%	-8.3%	-5.5%
Kiln	94	123	99	100	14.9%	-18.7%	0.3%
Omega	146	161	163	149	-0.2%	-7.8%	-8.6%
Novae	29	35	38	34	20.0%	-1.4%	-9.2%
Lloyd's*	100	108	108	96	2.2%	-10.9%	-10.7%
FTSE100	6,166	6,221	6,514	6,155	-1.3%	-1.1%	-5.5%
FTSE250	10,361	11,178	11,375	10,366	2.7%	-7.3%	-8.9%

* Argenta's Index of Lloyd's quoted companies

Fears over the rating environment saw the ILV sector record its worst month since we began monitoring its movements a little over a year ago. All of the gains of 2007 have been given up. Swiss Re's disclosure of a substantial loss on credit swaps coincided with a large fall for many of the followed shares. Falling dollar exchanges rates, in which currency syndicates earn up to 75% of their income, have also prompted marking down of share values. Even Amlin's announcement of better than current market forecast profits for the year and a return of capital could not prevent a 2.5% fall on the day of announcement.

Lloyd's combined ratio is once again notably better than its peer competitors.

Lloyd's Interim Results

Lloyd's announced its interim results for the half year to 30 June 2007 at the end of September. The press releases were deliberately shorn of superlatives and the general response was muted. Members may recall the 2005 interims, when a half year profit of £1.4 billion was turned into a full year loss of £103m following Hurricanes Katrina, Rita and Wilma. This year, the half year result on an annually accounted basis (i.e. not a forecast for the 2007 underwriting year) is a profit of £1.8 billion.

The combined ratio was 82.9%, down from 86% for the same period in 2006, and once again notably better than the peer competitors of the US Property & Casualty industry, the Bermudian reinsurers, US

reinsurers and European insurers and reinsurers. The combined ratio can be broken down into constituent parts as follows:

	Half year to 30 June 2007	Half year to 30 June 2006
Accident year excluding Catastrophes	85.6%	86.3%
Catastrophes	3.6%	0.0%
Prior Year Movement	(6.3%)	(0.3%)
Combined Ratio	82.9%	86.0%

Lloyd's is sanguine that reserves are sufficiently robust for the releases to be more commonplace than shortfalls. For the 2005 year of account, releases from reserves contributed a surplus of slightly under 2% of capacity to the bottom line result of Argenta members. There is nothing to suggest that these surpluses should not strengthen by the year end.

Recent Loss Activity

Subprime

As outlined in Argenta's September Market Update, losses may arise on the asset side, where syndicates have invested in Mortgage backed securities, or on the liability side, where claims may be made against Directors & Officers of Lending Institutions, Investment Banks, Retail Banks, hedge funds managers and asset managers. Claims could also emanate from actions against the professional indemnity insurers of lawyers, mortgage brokers, rating agencies or any other party potentially at fault.

One underwriter said that trying to estimate the impact is like trying to guess how much insured damage will be caused by a hurricane when it is still out at sea. An analyst at Bear Sterns has placed the potential cost to insurers at up to \$3 billion. This seems very small, especially when considered variously as only 20% of premiums to the class, adding less than 1% to industry combined ratios, or as equivalent to the cost of the June flooding in the UK. Lloyd's syndicates continue to expect minimal claims activity, as appetite for this type of risk dried up



after the Enron and Worldcom scandals. In general, those syndicates supported by third party capacity have shown an even lesser appetite than has the market as a whole. Although Lloyd's has allocated a catastrophe code to any claims attributable to this source, this is standard for any event with the potential to produce a number of different claims. We are aware of some claims against rating agents and expect that more will be made over the coming months, but underwriters continue to be exceptionally sanguine about the likelihood of avoiding claims and optimistic over prospects of successfully defending those claims that do materialise.

The world's largest reinsurer, Swiss Re, announced a loss of SwFr1.2billion (£525 million) through credit swaps providing insurance against default on two books protected clients' asset portfolios against a reduction in value. The underlying portfolios comprised largely mortgage-backed securities, including residential and commercial mortgage-backed paper. "While the majority of the exposure is to prime and mid-prime securities, there is exposure to subprime and, more importantly, to asset-backed securities in the form of collateralised debt obligations (CDOs)," it said. AM Best reacted by placing the reinsurer's A+ rating under review. Swiss Re's share price fell by more than 10% on the day of the announcement, with further falls thereafter. Although other reinsurers' share prices also fell, including listed Lloyd's vehicles, it was not until 28 November that Catlin announced that, after a comprehensive review of all individual subprime-related securities, it expects to take a total charge during 2007 of US\$75m against the value of these securities. Catlin added that, based on information currently available, it did not believe that its insurance and reinsurance portfolio is materially exposed to potential claims arising from subprime-related issues. Catlin's share price had already been marked down by 10% following Swiss Re's announcement, so the revelation of the \$75m charge must have been in line with expectations. Separately, two Japanese insurers have owned up to exposures to CDOs. Sompo Japan has announced a ¥30 billion (£132m) exposure via financial guarantees of CDOs and Aioi said it had unrealised sub-prime exposures of ¥25 billion (£110 million) through asset backed securities and CDOs held as investments.

Lloyd's underwriters continue to expect little or no claims activity arising out of Subprime.

Black Sea Marine Losses – 11/12 November

Sources are claiming that none of the ships damaged in the storms of 11 and 12 November were insured in the London market. Seven ships, the largest being the oil tanker Volgoneft-139, were damaged in fierce storms in the Black Sea and the Ukrainian inland Sea of Azov. All are

understood to be insured by the Russian insurer, Ingosstrakh, and the impact on the wider marine market is thought to be minimal.

Californian Bushfires – October 2007

Estimated losses from the Californian bushfires of late October 2007 has been put between \$1.2 billion and \$1.6 billion with more than 2,300 dwellings and other structures destroyed. These losses, as devastating as they must be for residents and as spectacular as they appear on screen, are relatively routine in California. Fires in Oakland Hills in October 1991 destroyed 2,900 structures and cost insurers \$1.7 billion and the Cedar fire of October 2003 claimed 2,200 buildings at a cost of \$1.0 billion to insurers. Insurance rates are at a high level, such that insurers are well recompensed for assuming these exposures, with reinsurance attachment points in the state at a level to reflect potential earthquake and fire following earthquake exposures. Occasionally high valued contents, such as fine arts, are destroyed by bushfires, giving syndicates an occasional spike loss, but in general, we do not expect much Lloyd's exposure to these events.

Cosco Busan – 14 November

The 810 foot South Korean container ship Cosco Busan crashed into the San Francisco Bay Bridge on 14 November. Although the bridge itself was not damaged, the crash caused the loss of 58,000 gallons of bunker (a viscous form of crude oil) which has killed wildlife and polluted beaches in the area. By oil tanker standards, this is a relatively small leak (Exxon Valdez spilled 11 million gallons of crude) but it is in a politically and environmentally sensitive and populous area. While the ship was under pilotage and the master and the pilot are blaming one-another for the accident, the costs of clean-up fall on the owners who are insured by a mutual Protection and Indemnity Club and reinsured via the International Group. Some of this exposure will fall on Lloyd's. Experts have placed the initial estimate of costs at US\$100m.



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