Argenta

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From the Editor

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25% Pre-emption for 2010?

The 2010 Syndicate Business Forecasts will shortly be published and these will include planned pre-emption offers for next year. Of course much depends on what happens during the forthcoming hurricane season, which may as in past years result in late revisions to business plans.

Nevertheless widespread pre-emptions are anticipated, perhaps 20% to 25% across the average portfolio. Of that increase, approximately 15% will be due to the change in the US Dollar / Sterling premium income reporting rate from $1.99:£1 for 2009 to $1.50:£1 for 2010. The rest will be anticipated growth.

Reports on the 1 June renewals of the Florida catastrophe programmes note that the process was easier than expected. Capacity was not as tight as some had predicted, which will result in a tempering of expectations for the 1 July renewals of the nationwide and regional US catastrophe programmes.

Lloyd's in particular has been keen to dampen the 'hype' surrounding the predicted improvements in market conditions, stating that it is not seeing the widespread upward movement across all classes to the degree forecast in 2009 Syndicate Business Plans. On the contrary, many classes remain flat and some continue to decline.

So is our anticipated 5% to 10% pre-emption for growth on top of the 15% for the dollar/sterling exchange rate movement too optimistic?

We think not for two principal reasons.

First, that even if catastrophe rates are not reaching the 20%+ increases predicted, they are still increasing. As we report in our sector reviews, there are other areas where rates are moving up. The prerequisites for a steadily improving market are still in place. Insurers and reinsurers are mindful of the need to preserve capital and that it will be difficult to replace if impaired by losses. They know that investment income will be minimal in the short term and they are wary of the impact of economic recession – the claims environment is undoubtedly worsening.

Revival of the subscription market benefits Lloyd's

Second, that the problems at AIG and others have resulted in buyers and brokers seeking to spread risks more widely. AIG remains active and competitive, but in many classes is not retaining such a large percentage of each risk. The subscription market has seen a revival and Lloyd's has benefited. Lloyd's syndicates therefore have greater choice in the business they underwrite and will seek to build their books accordingly, subject always to the moderating influence of the Franchise Performance Directorate.

Conditions right for steady improvement to continue into 2010

Although the improvement in the market is hesitant in places, we are nevertheless seeing gradual and sustained improvement - the much quoted 'slow burn' - rather than the sudden upturns that have taken place in the past, and we believe that this will continue into 2010 and beyond, whatever the experience in the forthcoming hurricane season.

We will provide further comment on syndicates' pre-emptions in our forthcoming Syndicate Profiles publication in August, in particular as regards the rate of exchange and the real growth elements. Meanwhile we hope that you enjoy this quarter's survey of market conditions and Lloyd's developments.

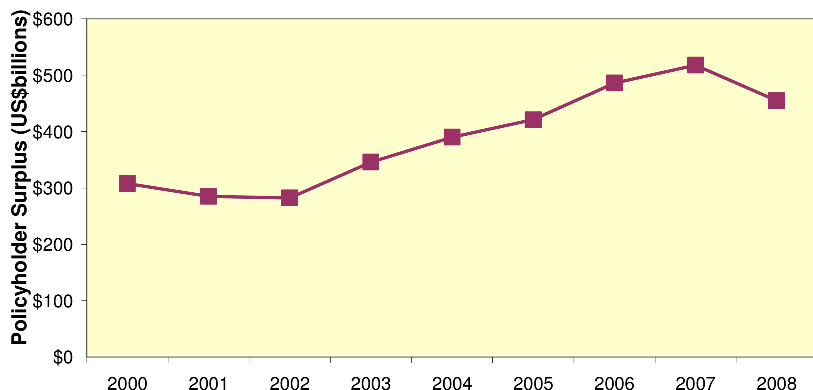
Jeremy Bray - Editor

Sector Reviews

US insurance capital fell in 2008

In 2008, US insurance industry capital fell for the first time since 2002 with the combined impact of a poorer underwriting environment, catastrophe losses and realised and unrealised investment losses. Capital had risen by over 80% in the profitable underwriting years 2002 to 2007 and many companies had been seeking to repatriate capital to shareholders by way of share re-purchase and special dividends. With the reduction in capital, there is an argument that the industry is now adequately rather than under-capitalised, with capital shortfalls pronounced only in areas of peak aggregate underwriting exposure (for example Florida windstorm).

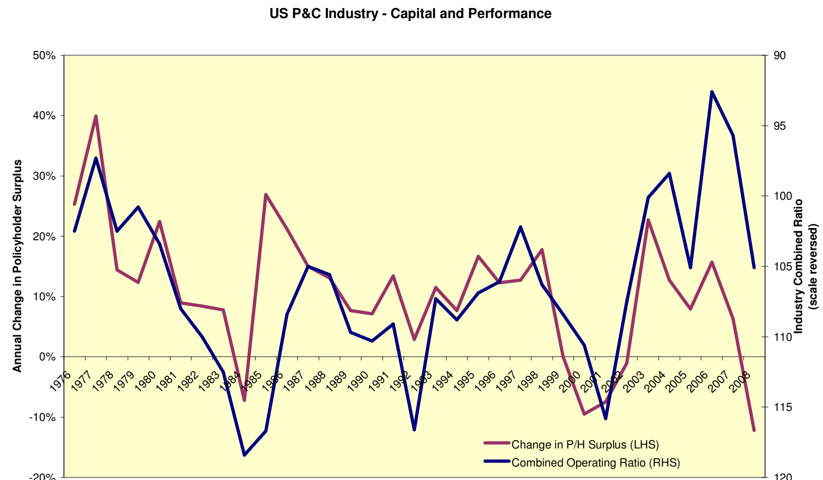
US Insurance Industry Capital



Source: AM Best, ISO, Insurance Information Institute

With low investment returns, insurers must focus on underwriting profit

A recent analysis by US research company Dowling & Partners said that, at current levels of capital, insurers need to target a combined operating ratio (**COR**) in the range of 85% to 89% in order to achieve a 12% return on equity. Higher average income-to-capital ratios and higher interest rates meant that the COR to achieve this benchmark performance was much higher (i.e. less onerous) in the past. The 12% return on equity could have been achieved at a COR of 96% in 2001 and at 103% in 1985. The US industry has only recorded a COR of less than 95% once in the past forty years. The relationship between policyholder surplus (defined as the difference between an insurance company's assets and its legal obligations to policyholders) and operating ratio is a strong one. Strong operating performance (low combined ratio) simultaneously forms new capital via retained profits and attracts new capital into the business, while weak performance destroys capital but eventually forces up prices and leads to better future performance. The following chart shows the relationship between the two. The scale on the right hand axis has been reversed as a lower combined ratio indicates a larger profit margin.



Property Reinsurance

Japanese renewals at 1 April set trend for increases in catastrophe exposed areas

April renewals are dominated by the Japanese treaty market. The strength of the Yen against both the US Dollar (up 10% on the year) and Sterling (up 30% on the year) means that Japanese aggregate consumes more of foreign insurers' capital than it did twelve months ago and despite the good record, overseas reinsurers were seeking price increases. Pricing for Japanese catastrophe programmes increased in general by 5% to 10%.

Renewals in May, June and July centre on the regional US market. Given the importance of the Florida sub-sector on this market, it is the focus of this issue's "Spotlight On" on page 8. Rates increased by an average of 15% at the 1 June renewals, almost returning rating to 2007 levels as they

reduced by an average of 15% last year. Arithmeticians will spot that a 15% reduction one year followed by a 15% increase the next still leaves rates some 2.25% below their start point. In general, brokers report that there was adequate capacity to complete almost all programmes, despite the reduction in the Florida state's temporary increase in limit (**TICL**) layer (described in more detail on page 9).

Energy

Most Gulf of Mexico risks renew during the second and third quarters, with the vast majority on one of three key dates, being 1 May, 1 June and 1 July. A number of brokers and their clients have extended programmes for up to 6 weeks in the hope that the market imbalance will begin to correct itself. Wind aggregate for Gulf risks has reduced radically, some commentators suggest by up to a half, and consequently programmes are having to be restructured, with clients buying as much wind cover as can be placed and buying a separate policy excluding wind to cover the balance of their assets. Clients are being forced to retain far more of the original risk, and coverage for Operators' Extra Expense and Control of Well (which cover the costs of capping off a damaged well head and, where necessary, re-drilling a well) is far more restrictive and expensive. A large part of insured damage arising out of Hurricane Ike fell to Operators' Extra Expense.

Complete overhaul of the underwriting of wind exposed risks in the Gulf of Mexico

Although there has been some publicity attached to the launch of alternative products, these have not really brought any meaningful new solutions to the market. The Marsh-Berkshire Hathaway Triple-C programme (Cost Certainty and Coverage) has failed to attract buyers as, despite the five year coverage and guaranteed minimum capacity, policyholders faced scaling down of policy limits as the wind capacity was aggregated across all buyers and could easily be exhausted. The class has attracted the attention of Rolf Tolle (Lloyd's Franchise Performance Director) because overall underwriters have lost money over the past decade despite some bumper profit years.

Lloyd's Franchise Board targets the energy sector

Marine

Underwriters are reporting rate increases on almost all lines of marine insurance. Contraction in the capacity of the Norwegian market is prompting rate increases for Hull business. However, values for hulls are falling rapidly as world trade slows and freight rates fall owing to the sudden change from under-capacity to over-capacity. The net effect is that overall premium volumes may continue to reduce. Many owners are opting to lay-up at least part of their fleets, a risk that most mariners are prepared to underwrite, although one that tends to give characteristics akin to a non-marine book (exposed to catastrophe perils and an aggregation of risk). Piracy in the Gulf of Aden continues to be an issue, albeit one that it is generally seen as an opportunity for many marine

Marine hull, liability, cargo and specie all improving

insurers. Piracy coverage has been deleted from hull policies and written in the hull war market at substantial premiums and with restricted cover, with discounts given to those ships able to defend themselves against the risks. Cargo prices are broadly up 5%, although commodity values have fallen by more than this and premium volumes are likely to be adversely impacted.

Hull war underwriters charging significant additional premiums for piracy cover

Specie business has been hit by some large losses. Jewellers' block and cash in transit are particularly difficult classes in an economic downturn and insurers need to be very careful as to the clients and the terms and conditions that they are prepared to entertain. Rates have risen by up to 15%.

Direct Property

Rates hardening in catastrophe exposed areas. Elsewhere rates still soft

Direct insurers are being squeezed by firm or increasing reinsurance costs

Rates have been coming down in catastrophe exposed zones since 2007 and in non-catastrophe areas since at least 2005. Although the rate of reduction had begun to increase during 2008, the combination of some very large individual risk losses, catastrophe losses arising out of the 2008 hurricane season and the global economic downturn saw the rate of decrease slow. In some classes, most notably heavy industry and mining, rates have begun to increase and terms and conditions become more restrictive. Catastrophe exposed business has also carried rate increases, but rate reductions have continued for business not prone to natural catastrophes. Falling levels of business activity reduce values at risk (for example, business interruption values) as well as potential premium volumes. Direct underwriters are also being squeezed as their cost of reinsurance is increasing more rapidly than the rate they are charging their clients.

UK remains competitive

Optimism that price rises will stick in the UK has begun to wane. The broker Aon surveyed UK Underwriters' sentiment at the beginning of the year and again in April, with the proportion expecting rate rises on property business falling from 89% to 50%, largely as policyholders are under pressure to keep costs to a minimum and because competition for UK business continues to be plentiful.

Recession brings insurance issues

Commercial businesses are trying to resist premium increases at a time of flagging business confidence. A business in distress represents new risks to insurers and causes underwriters to consider the legal implications of a client entering administration in the UK or Chapter 11 in the US. Some underwriters have started to issue their equivalent of the supermarkets' 'value range', with policy coverage stripped to a bare minimum in order to offer clients affordable cover.

Non-marine Liability

In the wake of the Madoff/Stanford scandals, rates in the US financial D&O and PI sectors are up, elsewhere in USA rates are flat

Lloyd's continues to state that its exposure to the Madoff and Stanford scandals is limited. The fact that much of the cost of these losses will fall on two of the insurers most damaged by the banking crisis, AIG and XL, is presenting opportunities to Lloyd's syndicates in the financial Directors' and Officers' (**D&O**) and Professional Indemnity (**PI**) arenas. However, to date, appetite for this type of business has remained limited from those syndicates supported by third party capital.

While rates in the financial D&O and PI sectors have been increasing by up to 150%, rates for non-financial US business have not increased, and in some areas are still under pressure. Most underwriters expect that rate increases will accelerate throughout the year, although evidence is scant at present.

The reinsurance market has firmed, again more substantially for financial risks, but even non-financial business is seeing a firming of pricing and terms and conditions. Lloyd's stable rating and subscription market has resulted in an increased showing of casualty reinsurance business during the first part of 2009.

Non-US liability rates are flat or down

Away from the US, rates in both PI and general third party markets continue to be under pressure. Results have been good for a number of years and rates have been continually cut for six years. Underwriters have become accustomed to receiving additional premiums at expiry based on the measures of exposure for the various liability classes, typically payroll, professional fees or sales turnover. It is quite probable that there will be no adjustment this year. Together with releases from reserves and investment income, these adjustments have formed the underwriters' profit margin for the past couple of years. Primary insurers are also being squeezed by their current inability to pass the increase in reinsurance costs on to their clients. Without rate increases, the UK liability sector faces great danger of falling into loss, especially if there is an increase in loss frequency from recession related claims.

Motor

UK motor rate increases may not be sufficient to cover claims inflation and recession related claims

Rate increases continue to be the norm and are estimated to average more than 5% during the year. Personal lines have seen better improvements in rating levels than have commercial fleets, although fleet prices have begun to improve in the first quarter this year. It is far from certain that rate increases imposed will be sufficient to keep pace with claims inflation (of which a major component is the cost of long term medical care to an accident victim). The UK motor insurance industry is heavily exposed to recessionary claims, as additional losses may arise from increased crime, an increasing proportion of fraudulent claims and the costs of more motorists electing to drive without insurance. Recent years at Lloyd's look marginal, with profits on the 2006 account largely arising from releases of reserves established for 2005 and prior and forecasts for 2007 and 2008 far from promising.

Accident and Health

A&H remains disciplined and stable

Results continue to be generally stable. The market suffers from over-capacity but Lloyd's syndicates have nonetheless been able to preserve a respectable profit margin. Clients and brokers have been pressing insurers to include nuclear, chemical, biological and radioactive events, although reinsurers are continuing to resist, so any exposure is assumed net by direct insurers who consequently are keeping exposures to a minimum. UK travel underwriters accepting premiums in Sterling face claims typically in Euros and Dollars and there is no evidence as yet of premiums increasing to cover the lower value of Sterling. Travel policies will also extend to the cancellation of travel following outbreaks of Swine Flu or any other epidemic.

Life

Number of Life syndicates increases from two to five

The number of life syndicates has now increased to five with the relaunch of Syndicate 44 by Sagicor and the formation of two new syndicates by Beazley and Catlin. Although this increases intra-Lloyd's competition, it also helps to raise the credibility of the market for producers and enables larger risks and broker facilities to be placed using the subscription approach. While business volumes are under-pressure for credit related business and will remain so until banks resume lending, they have not suffered noticeably for other lines of business. In general, this is not an area where fraudulent claims are expected to be a problem.

Aviation

The Air France loss will have a significant influence on the forthcoming November / December airline renewal season

There is little renewal activity in the second quarter of the year. The recent loss of the Air France Airbus 330-200 over the Southern Atlantic (see page 18) is almost certain to push the global market into loss for 2009, adding further impetus to the upward momentum on aviation pricing. It remains to be seen whether the 25% rate increases widely agreed as necessary to return the market to profit can be achieved in a market seen as non-correlating with other exposures. Premium volumes will be adversely impacted as fewer people fly in a recession. Other areas of the aviation market continue to suffer from over-capacity and consequent competition. Reinsurance rates have been under pressure, although costs may be driven up by the combination of the cost of the Airbus loss and withdrawals of capacity.

Spotlight on Florida

Florida is a sandbank with a population of 18 million

Florida's hurricane exposure is perhaps the most intractable reinsurance problem of today. Florida is larger in area than England (Florida is 58,560 square miles compared with England's 50,346 square miles). It has experienced phenomenal population growth, with an estimated 1,000 people moving to the State every day and consequently population doubling every twenty years since the Second World War. The current population is 18 million, 95% of whom live in coastal regions. Florida is essentially a sandbank, with a high point only 345 feet above sea level. Hurricanes such as Wilma in 2005 and Charley in 2004 can pass right across the peninsula without loss of power, before strengthening again over warm waters.

Annual Hurricane Strike Probabilities

Florida Hurricane Catastrophe Fund (FHCF) set up in 1992 following Hurricane Andrew

In the aftermath of Hurricane Andrew in 1992, at the time the most expensive insured event ever ($15 billion, equivalent to $25 billion today), the State of Florida established the Florida Hurricane Catastrophe Fund (**FHCF**) to provide reinsurance to companies writing homeowners' business in the state. Homeowners business in Florida is highly

regulated, with admitted insurers being required to submit policy wordings and rating schedules the Office of Insurance Regulation. Insurers were required to make contributions to the FHCF based upon their underwriting exposure in the various counties of Florida. Between 1993 and 2003, hurricane experience in the state was light. Hurricane Opal caused a total insured loss of $3 billion in 1995; there were also some near misses and smaller losses where the main impact was on adjoining states. In 2004, Florida was struck by Hurricanes Charley, Frances, Ivan and Jeanne. In 2005, while the majority of the impact of Hurricane Katrina fell on Louisiana and Alabama, there was structural damage in the Panhandle area (Pensacola) of Florida. Hurricane Wilma doubled back in the Gulf of Mexico, passing across the Yucatan peninsula in Mexico before crossing Florida from near Naples on the Gulf coast to Palm Beach on the Atlantic.

In 2004 Florida was struck by Hurricanes Charley, Frances, Ivan and Jeanne

In addition to the state reinsurance back-up for admitted insurers, there have been numerous state attempts to alleviate the shortage of insurance. All US states run some form of assigned risks' pool for citizens unable to get insurance cover. In most cases, all admitted insurers are required to participate in the pool, which will cover most types of insurance, including for example workmens' compensation, automotive liability and liquor law liability as well as property insurances. Naturally, the requirement for windstorm coverage in Florida outstrips demand for all other products. Florida established the Florida Windstorm Underwriting Association in 1970 and there have been many other market and state-led solutions since then, culminating in the launch of the Citizens' Property Insurance Corporation (**Citizens**) in 2002.

Citizens Property Insurance Corporation established by the State of Florida in 2002

Citizens now has a 14% market share of the Florida homeowners' market and a 29% share of the commercial property market. Although the state fund has built up a sizeable surplus (c $8 billion), it is estimated that a major hurricane could cost the FHCF and Citizens a combined $28 billion. Historically, the state had planned to issue post-event bonds to finance the calls on the funds. Dislocation in credit markets since September 2008 has reduced the amount that it is expected could be raised from such a bond issue to a maximum of $3 billion. The shortfall could be as high as $15 billion. Of this, much falls on the Temporary Increase in Limit ((**TICL**) but commonly referred to as "tickle") layer, which provides $12 billion of cover in excess of the base FHCF pool. Florida's legislators have decided to reduce TICL by $2 billion for 2009 and by a further $2 billion a year until it is withdrawn completely by 2014.

State-backed funds may not be enough in the event of a major hurricane

Structurally, a typical Floridian programme will look something like this:

<table>
<tr><td rowspan="6">Gross
Incurred
Loss</td><td colspan="2">Commercial Reinsurance</td></tr>
<tr><td>Commercial Reinsurance (10%)</td><td>TICL
(90%)</td></tr>
<tr><td>Commercial Reinsurance (10%)</td><td>FHCF
(90% cover)</td></tr>
<tr><td colspan="2">Commercial Reinsurance</td></tr>
<tr><td colspan="2">Self Insured Retention</td></tr>
</table>

Reduction in FHCF has potential benefits for the private reinsurance market

Given the way that the state plans to fund a catastrophe, many insurers have sought to reduce their exposure to the TICL layers, as failure to raise funds could leave them with a sizeable shortfall in the amount they can recover. Many insurers have withdrawn from the state (although state legislation now attempts to prevent further withdrawals) and many of the remaining insurers are companies with only limited resources. This uncertainty has increased demand from Florida companies for reinsurance from the private (i.e. reinsurance) market.

The importance of Florida is that changes in the way the state plans to fund any catastrophe loss impact the volume of business written in the private market. When volumes are increasing (as they will do under the latest revisions to FHCF), prices are driven up, not just for Florida business, but elsewhere along the Gulf Coast as reinsurers elect to deploy their aggregate in Florida rather than in contiguous states. Renewals for the majority of this business are at 1 June and 1 July.

Lloyd's Developments

Chaucer

Chaucer still in play

In the March *Market News* we reported that Chaucer and Novae had entered due diligence in a process that could lead to an all paper merger. Chaucer announced that it had been approached by a number of other parties interested in acquiring the business. Novae withdrew from the race but a private equity bidder, Pamplona Capital Management, has made a formal offer to acquire up to 29.9% of Chaucer's share capital. Brit has also confirmed that it remains interested.

Amlin

Amlin buys Fortis

Amlin has purchased Fortis Commercial Insurance (**FCI**) from the Belgian bancassurer, Fortis. FCI writes approximately €760m of Gross Premium, the vast majority being in Holland and Belgium. Business lines include marine (49%), property (21%), liability (15%) and motor fleet (8%). Amlin will pay €350 million in cash, with the acquisition in part being funded by a placement of new shares raising £76m.

Omega

Omega makes surprise capacity offer

Omega has announced a formal Capacity Offer for capacity on Syndicate 958. The share offer would give accepting Members of the syndicate shares worth 45p (using the Friday 29 May closing price of 135.5p) for every £1 of capacity surrendered. There is a cash alternative of 40p per £1 of capacity surrendered. Of the listed Lloyd's vehicles, Omega has been the laggard in terms of capacity ownership, preferring to build up its non-Lloyd's operations in Bermuda and the USA rather than acquire capacity from third party members of Syndicate 958. The offer is limited to 50% of the syndicate's capacity (although the maximum that can be accepted for cash is 20%). Omega currently only supplies some 14% of Syndicate 958's capacity. Simultaneously, Omega announced that it proposes to transfer its listing from AIM to the full Stock Exchange. We have written separately to Members of Syndicate 958.

W R Berkley

WR Berkley launches new syndicate at Lloyd's

WR Berkley, a property and casualty insurer based in Connecticut, USA, has launched Syndicate 1967 at Lloyd's. Until March last year, it held a 20% stake in Kiln Limited, although this holding was sold when Kiln was acquired by Tokio Marine & Nichido Fire. Berkley already operates in the UK an FSA registered insurance company which focuses largely on liability business. The Active Underwriter of Syndicate 1967 will be Mike Sibthorpe, formerly of Brit. Alistair Blades, formerly of Beazley, has been appointed Head of Underwriting Operations. The initial capacity for the

1 June 2009 launch has been set at £55 million. Whittington Capital Management will provide outsourced managing agency services under a "turnkey" arrangement.

Renaissance Re

Renaissance Re launches new syndicate and buys Managing Agent

Renaissance Re has become the latest overseas reinsurer to establish a syndicate at Lloyd's. It will form Syndicate 1458 to commence underwriting on 1 June with Jamie Lewis, a Casualty Reinsurance and Medical Malpractice underwriter, the named Syndicate Underwriter. Spectrum Syndicate Management will provide managing agency services to the syndicate under a "turnkey" arrangement. Renaissance Re was formed in Bermuda in 1993 and currently underwrites $1.8 billion of premium against a capital base in excess of $4 billion. It was subsequently announced that Renaissance Re has agreed to purchase the Spectrum business.

Lloyd's buys back debt

"…a prudent move..." says Lloyd's FD

Lloyd's has bought back £102m of its subordinated debt from bondholders. The debt was issued in 2005 and 2007, with recent dislocation in the capital markets reducing the values of many corporate bonds and Lloyd's debt being no different, enabling the Market to repurchase some debt at a substantial discount to the issue price. Luke Savage, Lloyd's Finance Director, said: "The decision to buy back some of our debt was a prudent move, which took advantage of our strong capital position, favourable market conditions, and perceived interest from holders of our debt."

Lloyd's Annual Report 2008

Investment income and reserve releases contribute to good result

Lloyd's published its annual results for the year to 31 December 2008 at the end of March. While certain elements of the press chose to focus on the 50% fall in profits from 2007, we consider the result to be extremely encouraging against a backdrop of increasing rating pressure, vanishing investment returns and an active US windstorm season. Gross premium grew by 10% to £18 billion. Lloyd's combined ratio increased from 84.0% to 91.3% and the profit for the year fell from £3.8 billion to £1.9 billion. The combined ratio is a measure of an insurer's profitability and is calculated as: claims costs plus operating expenses (including acquisition costs) all divided by gross premiums. An operating ratio of 100% means the company is entirely dependent on investment income for any profit, while a ratio over 100% means the business is making an underwriting loss.

Lloyd's states that the result is equivalent to a pre-tax return on capital of 13.7% (the five year average return on capital is now 17.2%). The results are flattered by the fall in the value of Sterling against the US Dollar as

operating costs are reduced, but the conservatism of the investment strategy was seen as a positive contribution. Releases from reserves held for prior years have followed an increasing trend, improving the combined ratio by 9.2% (2007 improvement: 6.5%). While Lloyd's publicly doubts that there is scope for many more such good releases from reserves, our analysis shows that syndicates supported by our clients continue to hold robust reserves.

Record result for 2006 at over 25% on capacity and 60% on capital employed

On a three year underwriting basis, the 2006 account has closed with a record profit of over £4 billion. Individual members have enjoyed results in excess of 25% of capacity (which exceeds 60% return on capital employed, assuming a 40% capital to capacity ratio). The 2006 account is the best return on capacity in at least 60 years. The year benefited from a fall in the value of Sterling from $1.99 at the beginning of the year to $1.44 at close (which itself accounted for foreign exchange gains equivalent to almost 10% of capacity) and from a release from reserves held for the 2005 and prior years of account of 6% of capacity.

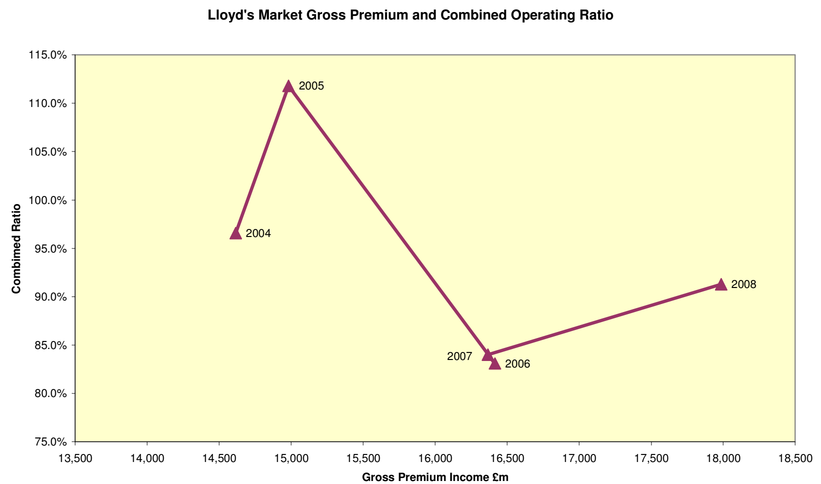
2007 profit currently forecast at around 10% of capacity

The forecast result for 2007 has improved marginally to a mid-point forecast profit of just under 10% of capacity. After third party members' results fell slightly below those of corporate syndicates for the first time in 2006, third party members' forecasts exceed the Lloyd's average by two percentage points for 2007.

First indications for 2008 show profit of approximately 3% of capacity

The first indications for 2008 are for a modest profit, with Lloyd's overall figure currently forecasting a mid-point 3% return on capacity. Again, forecasts for third party members are better than the Lloyd's aggregate. Much business remains on risk for the 2008 account and underwriters are traditionally cautious in making a forecast as early as the fifth quarter. Many managing agents have released forecast results in a 10 or even 15 percentage point range. Aside from the uncertainty as to the final underwriting result, the continuing volatility in investment markets makes any estimate of returns that will be earned during 2010 speculative. A full list of the most recent open year forecasts has been included on pages 19 and 20.

The following chart presents Lloyd's results since they were first reported on a GAAP (i.e. annually accounted) basis. Ideally, insurers should progress down and to the right over time, indicating increasing premium volumes and reducing the combined ratio (which increases the profit margin). While Lloyd's has increased premium volumes year on year (albeit that exchange rate differences played a large part in 2008), the progress on the combined ratio has not been so steady, with 2008 being the third consecutive increase in combined ratio, reflecting an increasingly competitive market environment over the period.



Source: Lloyd's Annual Reports 2005 - 2008

Tom Bolt appointed Lloyd's Underwriting Performance Director

"He has a great reputation and track record, and the perfect mix of technical knowledge and commercial experience that will enable him to work in partnership with the market..," Richard Ward, Lloyd's CEO (Press release 23 March 2009)

Tom Bolt has agreed to join Lloyd's as Underwriting Performance Director with effect from 1 September 2009. He will work with Rolf Tolle on the approval of 2010 Syndicate Business Plans. Tom joins from Marlborough Underwriting Agency. He has spent most of his career with Berkshire Hathaway, initially joining in 1985 and becoming manager of the New York reinsurance division in 1988. He left the group in 1991 to join Bankers Trust as Managing Director of the Insurance Derivatives Business before rejoining in 1993 to head up Berkshire's European Division. Berkshire bought Marlborough from CGNU (now called Aviva) in 2000, installing Tom as Managing Director. He stayed with Marlborough when the managing agency was sold to Flagstone Re in 2008.

Rolf Tolle, Lloyd's first Franchise Performance Director, appointed in early 2003, arrived as something of an unknown quantity, having spent much of his career in Europe prior to becoming Active Underwriter of Syndicate 435 in November 2001 (succeeding David Mann). The success Rolf has made of the Lloyd's role has been reflected in the strength of the candidates considered to become his successor. Lloyd's is to be congratulated on appointing someone of Tom's calibre. Argenta understands that Rolf, Franchise Performance Director since 2003, will have final say of approval of the Syndicate Business Plans for 2010.

View from Throgmorton Street

Our regular review of Stock Exchange listed Lloyd's vehicles. This is for general information and must not be construed as being any form of investment advice.

Lloyd's listed vehicles miss out on stock market rally

The recent rally in stockmarkets has not extended to Lloyd's listed vehicles which have generally stood still over the past three months. While most of the Lloyd's vehicles report in Sterling, their principal income is in Dollars and the recent recovery in the value of Sterling will adversely impact results, just as the fall in Sterling caused one-off increases in profit at the 2008 year end.

	Share price			Change since	
	31-Dec-08	*03-Mar-09*	*03-Jun-09*	*31-Dec-08*	*03-Mar-09*
Advent	170	118	138	-19.1%	16.5%
Amlin	358	365	336	-6.1%	-7.9%
Beazley	130	107	106	-18.8%	-1.4%
Brit	220	180	183	-16.7%	1.8%
Catlin	341	403	323	-5.3%	-19.9%
Chaucer	50	42	42	-16.0%	0.0%
Hardy	262	262	274	4.4%	4.4%
Hiscox	340	288	317	-6.8%	10.1%
Omega	150	149	128	-14.7%	-14.1%
Novae	312	298	377	20.8%	26.5%
Lloyd's*	96	92	89	-7.9%	-3.4%
FTSE100	*4,434*	*3,512*	*4,383*	*-1.2%*	*24.8%*
FTSE250	*6,361*	*5,850*	*7,689*	*20.9%*	*31.4%*

** AIRL's Index of Lloyd's quoted companies*

Other Developments

Max Re, IPC and Validus

Validus derails proposed MAX and IPC merger.

In our March issue, we reported on Max Capital and IPC Re's plans for an all paper merger of the two Bermudian based businesses. Shortly after these proposals were made public, fellow Bermudian Validus made a counter, and in its opinion, superior, offer for IPC. The Boards of both Max and IPC recommended the all paper merger to their respective shareholders. However, on 18 May, Validus revised the terms of its offer to include a cash element, which was put to IPC shareholders. Exchanges continued throughout May and early June, with both Max and Validus accusing each other of issuing misleading statements and inaccurate valuations. However, on 12 June, Max withdrew its merger proposals when IPC did not approve the required proposals at its AGM. This leaves the way open for Validus to pursue its hostile bid.

AIG

AIG's insurance income drops in Q1, negative publicity blamed

AIG's quarterly loss to 31 March 2009 fell to $4.3 billion (first quarter 2008 loss: $7.8 billion, full year 2008 loss: $99.3 billion). Most of this quarter's loss was attributed to realised capital losses on investments and the costs of winding down AIG Financial Products. Premiums to the insurance group fell markedly in the quarter, with commercial premiums down 18% to $4.2 billion. The Group reported essentially flat rates in the quarter, with the retention of business lower and limited new business, against a backdrop of an economy in downturn and limited opportunities for growth. Edward Liddy, AIG Chairman and Chief Executive, blamed negative publicity surrounding the Group for the drop in income in the quarter. The insurance business is placed at the centre of plans for a slimmed down AIG, the Group having now positioned AIU Holdings as a distinct brand, and the business has been transferred to a special purpose vehicle, with a minority share in the group expected to be sold.

"The Left Side of the Balance Sheet Has Nothing Right And The Right Side Of The Balance Sheet Has Nothing Left. But They Are Equal To Each Other. So Accounting-Wise, We Are Fine."

AIG Vice Chairman, Jacob Frenkel, about AIG

Asset disposals continue

AIG has completed a number of disposals in the quarter, the most significant of which is the sale of 21st Century Insurance Group to Farmers Group Inc for a reported US$1.9 billion. 21st Century is AIG's wholly owned US auto insurer. Farmers Group is a subsidiary of Zurich Financial Services. In another significant move, AIG has recently (12 June) reduced its 59% share in reinsurer, Transatlantic Re, to 13.9% in a deal worth $1.14 billion

Berkshire Hathaway

Warren Buffet has less appetite for insurance risk this year

Warren Buffet announced a reduction in the appetite of his Berkshire Hathaway for catastrophe business in his annual address to shareholders saying "We have plenty of capital but we don't have as much excess capital as we had a couple years ago, so we cut back somewhat on the insurance risk". The company and its National Indemnity Company subsidiary has withdrawn from a number of programmes in consequence, although commentators point out that the business is still heavily exposed to the reinsurance sector following a $3 billion injection to Swiss Re in February.

2009 Hurricane Season

Above average activity forecast for 2009 North Atlantic hurricane season

The Atlantic storm season is generally accepted as running from 1 June until 30 November each year. 2008 was the third year in a row when climate experts predicted an active season, with hurricane activity above long term trends. Unlike 2006 and 2007, this time the forecasters were correct; three hurricanes (Dolly, Ike and Gustav) made landfall on the US mainland. This year, four major environmental forecasting organisations are predicting above average activity, with a consensus forecast of tropical storm and hurricane activity 35% higher than the average over the period 1950 to 2008.

2009 Hurricane Season Forecasts

	Forecasting Agency				
	Tropical Storm Risk	*WSI Corp.*	*Colorado State University*	*Accu-Weather*	*Long Term Average*
Named Storms	15.0	13.0	15.0	13.0	10.0
Hurricanes	7.8	7.0	8.0	8.0	6.0
Major Hurricanes	3.6	3.0	4.0	2.0	6.0

Source: Fitch Ratings

Stop Press: TSR has just revised its forecast and now anticipates a season with activity 'below-average to moderate probability'

The Colorado State University team (Dr Philip Klotzbach and Dr Bill Gray), while citing the potential for a re-emergence of El Niño conditions reducing storm activity, have made the following estimates of landfall probabilities for the various categories of storms. In each case, the probabilities are slightly in excess of the long term averages (which are given in parenthesis). Although these numbers are interesting, from an insurance and reinsurance perspective, it is the location of the storm's landfall, allied to the strength of storm, that are critical in evaluating the potential costs.

Probability of at least one storm making landfall in 2009

	Tropical Storm	Category 1 to 2 Hurricane	Category 3 to 5 Hurricane	Any Hurricane	Any Named Storm
Entire USA	81 (79)	69 (68)	54 (52)	86 (84)	97 (97)
Gulf Coast	60 (59)	44 (42)	31 (30)	62 (60)	85 (83)
Florida/East Coast	52 (50)	46 (44)	32 (31)	63 (61)	82 (81)

Those interested in monitoring storm activity in the Atlantic may find the following two websites of interest; www.nhc.noaa.gov (the US National Hurricane Center) and www.stormpulse.com, a private site.

Storm Names for 2009

A storm called Wanda?

Ana	Bill	Claudette	Danny	Erika
Fred	Grace	Henri	Ida	Joaquin
Kate	Larry	Mindy	Nicholas	Odette
Peter	Rose	Sam	Teresa	Victor
Wanda				

Major Losses

The very few significant losses occurring in the first quarter, namely Windstorm Klaus, the Australian wildfires and US Airways Flight 1549, were reported on in our March 2009 *Market News*. The second quarter

started quietly with no major losses of note during the first two months, with only the earthquake in L'Aquila, Italy being particularly news-worthy. Then, on 1st June, Air France Flight 447 disappeared over the Atlantic Ocean. Very little is still known about what actually happened.

L'Aquila Earthquake

In the early hours of Monday 6th April, an earthquake of 6.3 magnitude struck L'Aquila, a Medieval fortress town in the mountainous Abruzzo region of Italy, East of Rome. The geographic extent of the earthquake was fairly limited. However, the damage to L'Aquila and nearby towns was high. Causing 300 deaths and extensive damage to buildings, this is the worst earthquake in Italy since a 6.9 magnitude earthquake struck Eboli, South of Naples, in 1980, killing more than 2,700 people.

Catastrophe risk modelling firm AIR Worldwide estimates that insured losses from this earthquake are likely to range between €200m and €400m. These estimates include losses to residential, commercial and industrial buildings and contents. They do not include business interruption losses. Total damage for this earthquake is estimated at between €2bn and €3bn.

"While damage from this event will likely be between two and three billion Euros given the scale of destruction, insured losses will be limited due to the low penetration of earthquake insurance in the region," said Dr. Guillermo Franco, senior engineer at AIR Worldwide. *"Damage to commercial properties will likely drive the insured losses, since a higher proportion of businesses tend to purchase earthquake insurance."*

Air France Flight 447

At 7.30pm on 31 May, Air France flight AF447 took off from Rio de Janeiro heading for Paris. The first few hours of the flight appeared to be uneventful. However, at 11.10pm a barrage of 24 automated messages were sent back from the plane's computer system to Air France headquarters that signalled the catastrophic failures of computer and electrical systems. Four minutes later came the signal of complete electrical failure and "vertical speed" alert as all cabin pressure was lost – a strong indication for investigators that the plane split apart before spiralling down 35,000 feet in pieces through a storm. Shortly afterwards, the Airbus A300-200 and all 228 passengers and crew were lost.

Although it is believed that the aircraft encountered severe weather conditions, combined with multiple system failures, the exact cause of this disaster is still not known and indeed may never be known. As a result, the implications for insurers are not clear. Will the loss fall to Air France or in part, or in full, to the manufacturers? What we do know is that the insured value of the aircraft hull is $100m (led by Axa). The current best

estimate for passenger liabilities stands at a little over $400m. We anticipate being able to provide more detail by the time we publish the next edition of our *Market News*. What does seem to be clear, however, is that this loss will fuel further pressure on insurers to increase airline premiums.

Syndicate Forecasts at 31 March 2009

2007 forecasts for third party syndicates and Argenta MAPAs as at 31 March 2009 (% of capacity)

Syndicate /MAPA	Previous Forecast at 31/12/08			Latest Forecast at 31/03/09			Change
	Worst Case %	Best Case %	Mid-Point %	Worst Case %	Best Case %	Mid-Point %	%
33	10.00	17.50	13.75	10.00	17.50	13.75	
218	3.50	8.50	6.00	3.50	8.50	6.00	
260	-9.09	-4.09	-6.59	-9.09	-4.09	-6.59	
308	7.51	12.50	10.00	2.88	7.88	5.38	-4.62
318	-5.00	0.00	-2.50	-5.56	-0.55	-3.06	-0.56
386	19.09	14.09	21.59	23.27	28.27	25.77	+4.18
510	6.82	11.82	9.32	7.36	12.36	9.86	+0.54
557	13.89	18.89	16.39	14.33	19.33	16.83	+0.44
570	10.02	15.03	12.53	10.02	15.03	12.53	
609	0.00	5.00	2.50	0.00	5.00	2.50	
623	9.52	14.52	12.02	11.52	16.52	14.02	+2.00
727	8.50	18.50	13.50	8.50	18.50	13.50	
779	0.25	5.25	2.75	3.58	8.59	6.09	+3.34
780	13.50	18.50	16.00	13.50	18.50	16.00	
807	7.16	12.16	9.66	6.64	11.64	9.14	-0.52
958	12.50	17.50	15.00	12.50	17.50	15.00	
1176	35.00	50.00	42.50	40.00	50.00	45.00	+2.50
1200	4.00	9.00	6.50	5.00	9.00	7.00	+0.50
2007	2.50	7.50	5.00	2.50	7.50	5.00	
2010	7.50	12.50	10.00	10.00	15.00	12.50	+2.50
2121	6.00	11.00	8.50	7.00	12.00	9.50	+1.00
2525	4.05	11.55	7.80	10.63	15.63	13.13	+5.33
2526	9.17	16.67	12.92	10.42	15.42	12.92	
2791	19.00	24.00	21.50	19.00	24.00	21.50	
3245	7.50	12.50	10.00	7.50	12.50	10.00	
3334	5.00	10.00	7.50	5.00	10.00	7.50	
4040	-8.31	-3.31	-5.81	-8.31	-3.31	-5.81	
6101	6.50	11.50	9.00	5.00	10.00	7.50	-1.50
6102	6.50	11.50	9.00	5.00	10.00	7.50	-1.50
6103	39.00	44.00	41.50	39.00	44.00	41.50	
MAPA 7006	7.16	12.98	10.06	8.78	14.07	11.42	+1.36
MAPA 7049	6.92	12.75	9.84	8.59	13.88	11.24	+1.40
Lloyd's Ave	6.25	11.65	8.95	7.08	12.47	9.77	+0.82

Source: Managing Agents' Forecasts as at 31 March 2009 submitted to Lloyd's

2008 forecasts for third party syndicates and Argenta MAPAs as at 31 March 2009 (% of capacity)

Syndicate /MAPA	Previous Forecast at 31/12/08			Latest Forecast at 31/03/09			Change
	Worst Case %	Best Case %	Mid-Point %	Worst Case %	Best Case %	Mid-Point %	%
33	0.00	7.50	3.75	0.00	7.50	3.75	
218				2.35	7.36	4.86	
260				-3.85	1.15	-1.35	
308	2.90	12.90	7.90	7.60	12.60	10.10	+2.20
318				-15.28	-10.28	-12.78	
386	10.00	15.00	12.50	9.91	14.91	12.41	-0.09
510	1.90	11.90	6.90	3.86	8.86	6.36	-0.54
557	3.90	13.90	8.90	7.08	12.08	9.58	+0.68
570	0.00	10.00	5.00	0.00	9.97	4.99	-0.01
609	0.00	10.00	5.00	0.00	9.98	4.99	-0.01
623	5.50	10.50	8.00	5.51	10.52	8.02	+0.02
727				3.51	13.53	8.52	
779	1.30	6.30	3.80	1.31	6.31	3.81	+0.01
807	2.30	12.30	7.30	3.59	8.59	6.09	-1.21
958	0.00	10.00	5.00	0.00	10.04	5.02	+0.02
1176				20.00	40.00	30.00	
1200				-8.00	2.00	-3.00	
2007				-5.00	5.00	0.00	
2010				2.50	7.50	5.00	
2121				1.00	8.50	4.75	
2525				-3.75	3.75	0.00	
2526				2.50	10.00	6.25	
2791				0.00	10.00	5.00	
3334				12.50	22.50	17.50	
4040				0.51	5.50	3.01	
6101				-3.50	4.00	0.25	
6102				-3.50	4.00	0.25	
6103				5.00	15.00	10.00	
6104	10.00	25.00	17.50	10.00	25.00	17.50	
6105				8.41	13.61	11.01	
MAPA 7006				1.06	7.89	4.48	
MAPA 7007				1.08	8.16	4.62	
MAPA 7049				0.78	7.57	4.17	
Lloyd's Ave				-0.32	6.28	2.98	

Source: Managing Agents' Forecasts as at 31 March 2009 submitted to Lloyd's

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