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From the Editor

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“The Tide has Turned”

The words used by Robert Hiscox in reporting interim results in November illustrate the change in sentiment that has taken place across the insurance and reinsurance markets in recent weeks. In this edition of Market News we include a selection of statements made by senior figures in the industry, some of them bordering on hyperbole, to reinforce the point that the soft market mentality has been replaced by a determination that, even if the market is not actually hardening yet, it soon will do.

This is an important point. The reversals of de-emptions and late pre-emptions have come about because soft market business plans for 2009 have been replaced by plans that anticipate a steadying of rates in many sectors and a possible improvement in others. As yet there is little evidence that rates have actually improved, but the process has started and there are good reasons why it should continue, which are clearly recognised by market participants.

Elsewhere we look at the potential drivers for improvement, including reduced investment returns, the higher cost of capital, increased demand for traditional reinsurance to protect weakened balance sheets and the particular benefits for Lloyd's from the problems experienced by AIG and XL. However, enthusiasm needs to be reined in because it will take time for this change of direction to work through to the bottom line.

An essential ingredient for a turn in the market is of course loss experience. 2008 has suffered an above average frequency of catastrophe and large risk losses and attritional claims are increasing. Once again industry catastrophe models have proved to be inadequate, in particular in the Gulf of Mexico, and loss estimates continue to be revised upwards. Even if it is assumed that no further major losses will affect the 2008 year of account, we should not expect better than a marginal profit.

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Conditions right for steady improvement during 2009

As 2009 progresses and we move through the 1 January, 1 April, 1 June and 1 July major renewal anniversary dates, we expect to see a continued hardening of the market, in particular in US catastrophe exposed property reinsurance and direct property insurance and offshore energy. On top of this, the weakening of sterling against the US dollar will result in increased capacity requirements. We therefore foresee widespread pre-emptions for 2010, with the possibility of requests for mid-year increases in capacity during 2009.

These encouraging developments in the insurance and reinsurance markets are against a background of dramatic events elsewhere in the world, of which we are all aware, including financial market volatility, near meltdown of the global banking system, a change of government in the US, the rescue of AIG by the US Government and a world economy in recession. Although these events have had, and will have, both positive and negative implications for Lloyd's and the insurance market, it is instructive to consider how the credit crisis has impacted insurance.

We recommend a paper on this subject – Credit Crisis and Insurance - published by the Geneva Association, which can be viewed on their website at www.genevaassociation.org. The Geneva Association describes itself as 'a unique world organisation formed by 80 chief executive officers (CEOs) from the most important insurance companies in the world.' Its main goal is to research the growing importance of worldwide insurance activities in all sectors of the economy.

Traditional insurance business model resilient through Credit Crisis

The report distinguishes between three kinds of financial institutions: banks on the one hand and traditional insurance and reinsurance companies on the other, with a third group, large complex financial institutions, falling in between. Whilst insurers operating in traditional ways have escaped the adverse effects of the credit crisis, such as liquidity problems and credit losses arising from subprime mortgages, this cannot be said of all large complex financial institutions that conduct insurance business. This is most obvious in the case of AIG, where the insurance operations are reported to be sound, and the real damage has come from financial products.

The insurance companies that have suffered are those that have entered into some sort of financial guarantee. The notion that companies operating as financial guarantors may be described as 'credit insurers' is misleading, as they are not traditional insurers. The conclusion is that the insurance business model is resilient in the face of the credit crisis, and we may add that Lloyd's is firmly at the traditional insurance and reinsurance end of the spectrum.

As we go to press, the deadline for applications for capacity on Amlin Special Purpose Syndicate (SPS) 6106 has been reached and demand for capacity is such that it will exceed the £50m sought, with allocations being scaled down accordingly. We are very pleased firstly, that this opportunity has been made available to third party capital and secondly, that the response has been so strong. Third party capital has

Widespread pre-emptions anticipated for 2010

demonstrated once again that it can respond rapidly to demands for additional capacity and this augurs well for the future, both as regards further proposals that might come in our direction as well as the possibility of being able to negotiate better terms for the provision of our capacity as the market gets tighter. We foresee significant opportunities for 2010 but, like the Franchise Performance Directorate (**FPD**), we have advocated restraint at this stage. The market is only beginning to improve, the recession will create challenges and conditions change rapidly.

We will keep you informed through our quarterly Market News of developments as they unfold through 2009, beginning with comment in our February edition on the 1 January renewals.

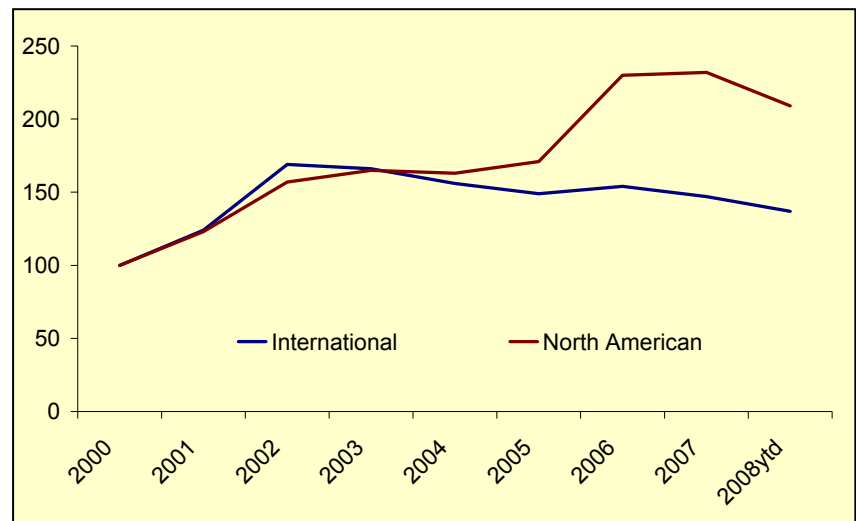
We hope you enjoy this edition of Market News. In particular we draw your attention to the article "Planning for 2010" on page 14. As always, we encourage you to contact any member of the Argenta Insurance Research team if you have any question or comments on any syndicate related matter. Meanwhile we send Seasons Greetings to all our readers.

Jeremy Bray - Editor

Sector Reviews

For clarity, we have chosen the Chaucer rating index for all but the Reinsurance classes. Chaucer does not publish a reinsurance specific rating index, so we have used the Amlin index. The base point for each is the 2000 year of account at 100.

Property



Rates have continued to be under pressure with limited evidence of the predicted improvement. The fourth quarter tends to be one of relatively

Direct Property market set to harden with January renewals

few renewals and, as we have seen in the past prior to a market turn, there has been evidence of a 'fourth quarter factor'. Against the background of falling rates across the market, underwriters find themselves some way behind their annual budget. With only a handful of risks to renew and the US hurricane season safely out of the way for another year, underwriters seem happy to compete for new business, especially where the record has been clean. Meanwhile, every underwriter to whom we speak expects a hardening of resolve in the New Year as the impact of the poor underwriting year, coupled with increased reinsurance costs, begin to sink in.

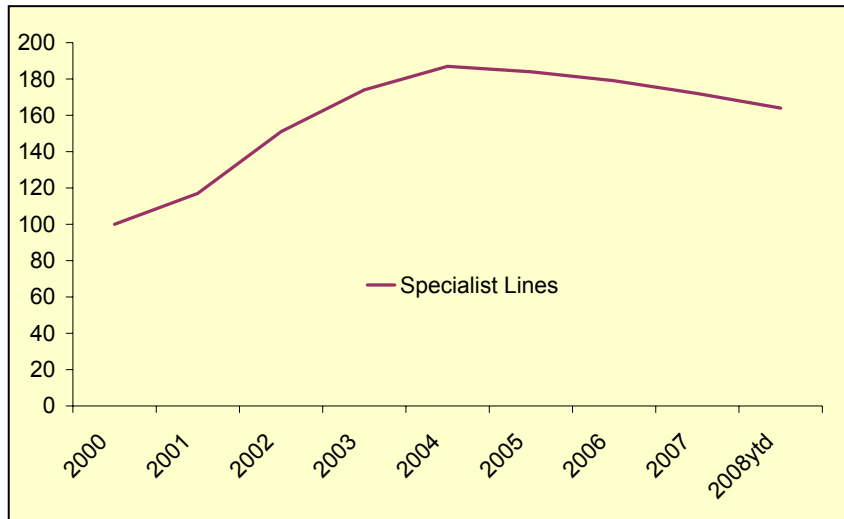
Lloyd's likely to benefit from firmer US surplus lines market

Of particular interest will be the US surplus lines market. This is business that falls outside the admitted market, where insurers are obliged to file rates and policy wordings with the state insurance regulators. Lloyd's syndicates trade as admitted insurers only in the states of Illinois and Kentucky. Business qualifies as surplus lines (sometimes referred to as Excess and Surplus lines or "E&S") when there is no insurer prepared to write it in the admitted market. As the insurance market moves from hard to soft cycles, admitted markets relax their underwriting criteria, taking previously surplus line business back into the admitted market. Premium volumes therefore exaggerate the market cycles. Lloyd's position, with only the stricken AIG ahead of it, gives good cause for optimism as the market firms in 2009 and clients and brokers turn to the surplus lines market for cover. While AIG is widely reported as cutting rates to preserve market share, many brokers and underwriters report clients expressing a preference for subscription markets (such as Lloyd's), which reduces the impact of AIG's activities on Lloyd's syndicates.

Top 10 Surplus Line Writers 2007

Insurance Group	Direct Written Premium	Market Share
AIG	\$8.3bn	22.2%
Lloyd's (70 Syndicates)	\$6.4bn	17.0%
Zurich Financial	\$1.6bn	4.4%
Nationwide	\$1.4bn	3.9%
ACE	\$1.2bn	3.3%
WR Berkley	\$1.2bn	3.1%
Markel	\$1.1bn	3.0%
Allegheny	\$1.0bn	2.6%
Berkshire Hathaway	\$900m	2.5%
CNA	\$800m	2.0%

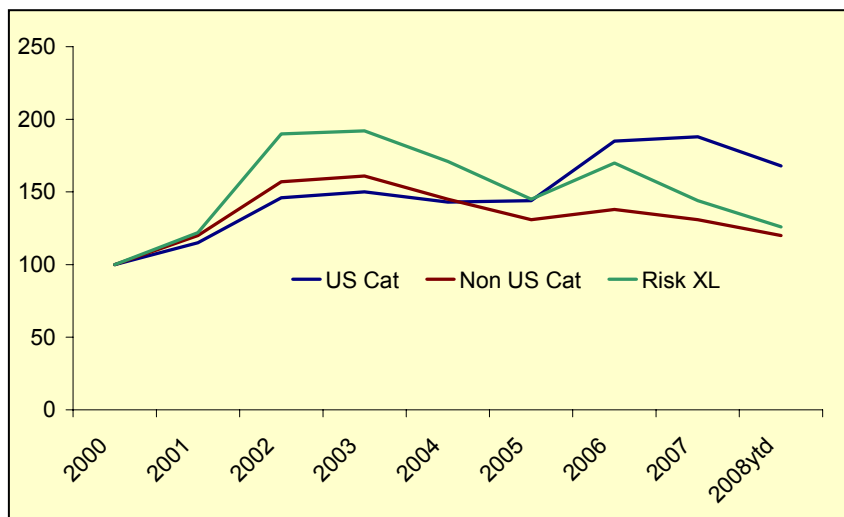
Casualty



Recession will bring additional challenges

It is anticipated that there will be an increase in claims activity arising out of the credit crisis, especially in financial lines and professional indemnity. Recessionary impact could also increase claims in areas such as Employment Practices Liability. Turnover and payroll, the two most commonly used bases for premium rating, are both likely to reduce in a recession, hampering insurers' ability to increase premium volumes. Rates continue to be under pressure and at this stage there is little evidence of any hardening in terms, either for US business or for UK and International, although rating levels have held up better for the former.

Property Reinsurance



Hurricane Ike insufficient in itself to cause the market to turn

Although Ike now looks likely to be the second or third most expensive hurricane ever (from an insurer's perspective), it is a widely held view that this event would have been insufficient alone to change the market. Most observers were forecasting a year of increased hurricane activity. It is the combination of events that may yet become market changing. Opinions are divided on the strength of a recovery; we can certainly report that the market is no longer softening and in some areas there have been improvements in terms and conditions. There are many competing trends and it is entirely possible to read into them the message that you want to hear.

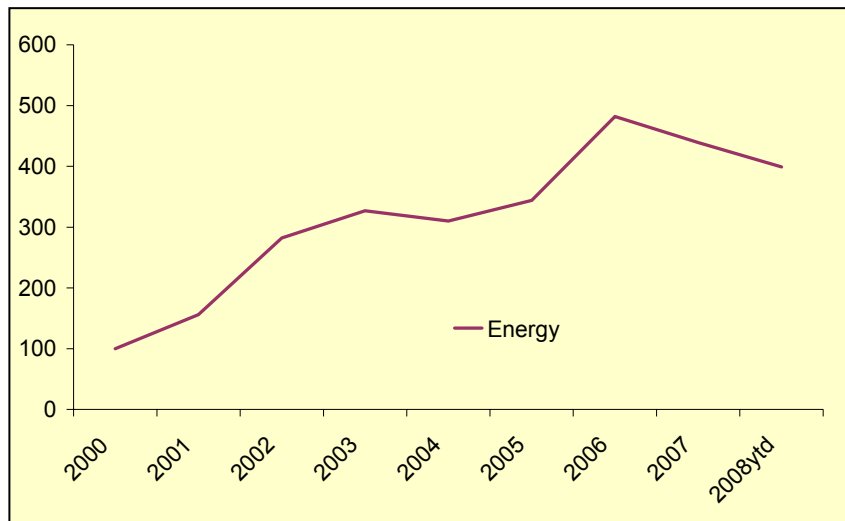
Talk of an improving market becomes action

The final quarter of the year is the least active in terms of renewal dates. Instead it is marked by a number of talking shops, the reinsurance conferences in Monte Carlo in September and in Baden Baden in October. The mood has intensified in the weeks between the two conferences, with underwriters increasingly talking of a higher price for risk. It of course remains to be seen whether the tough talk becomes tough action at renewal, especially as insurance losses have been incurred during 2008, they may not be paid until 2009 and investment losses are not realised. Market cycles usually require consecutive quarters, if not years, of negative cashflow to bring a sustained improvement. Cashflow is not yet negative even if the results are likely to be so.

Damaged balance sheets + increased need to buy reinsurance + reduced supply of reinsurance = improving market

Cedant insurers' balance sheets are being reduced, both by claims activity for those hit by catastrophes and by investment losses. This increases cedants' need to buy reinsurance when there is a contraction in supply, with the withdrawal of some of the collateralised hedge fund capacity and of some of the catastrophe bonds. We expect these two dynamics to tighten the market considerably during 2009 to the extent that even loss free contracts are paying far more. In particular, Florida's Hurricane Catastrophe Fund must decide whether it can continue with the limits it currently offers, with a dependency on the issue of state bonds after a major loss, or whether it will reduce the limits and place more cover in the private markets. The former may have huge fiscal consequences for the state, the latter is difficult politically.

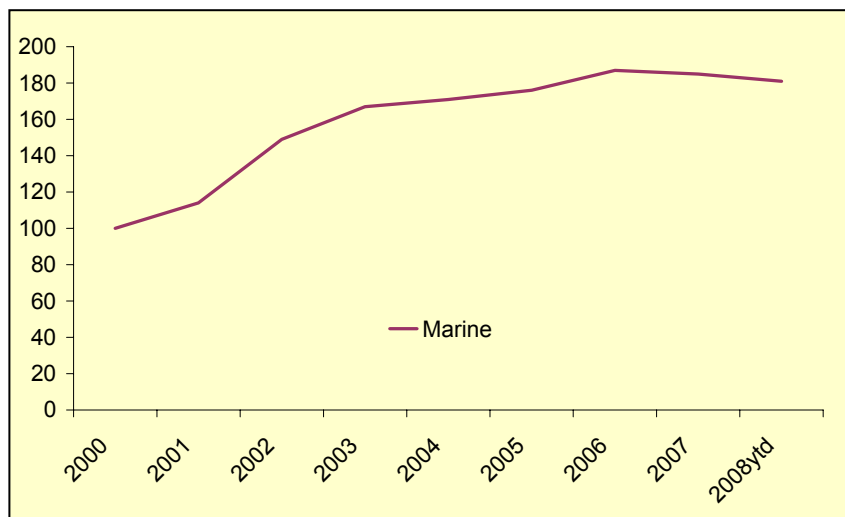
Energy



Lessons to be learned from Hurricane Ike

Losses arising out of Hurricane Ike have been severe, and while very little business interruption (loss of profits) is now written in Lloyd's, some of the claims for 're-drill' and 'control of well' have exceeded underwriters' expectations following the changes to the policy wordings made in the wake of Hurricanes Ivan, Katrina and Rita. Underwriters are working to develop a product that offers real risk transfer to those companies that need it. Insurance is often a requirement of banks lending to oil companies and given the extreme risk aversion currently in the banking sector, is unlikely to cease to be so. The new product will seek to sub limit exposures across a company's interests. The major renewal season for these risks is during the spring and we will not know until then the extent of success that underwriters have achieved in redesigning this product.

Marine

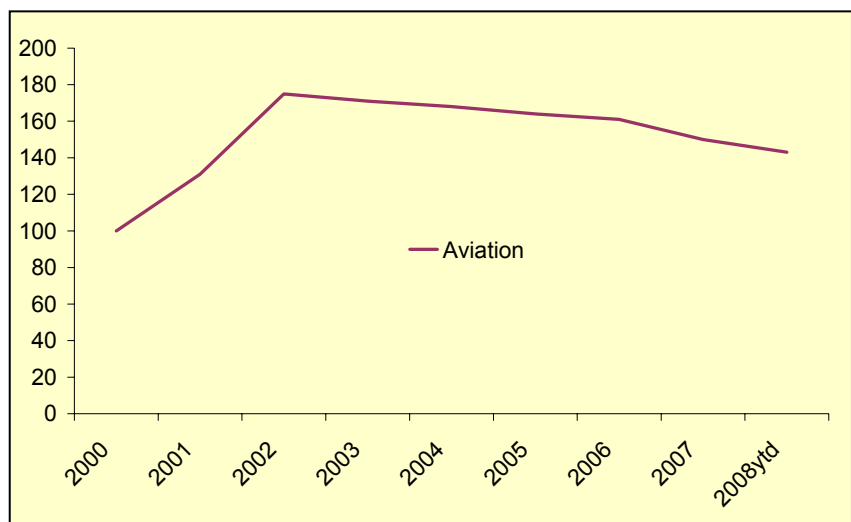


**Challenging conditions but
Lloyd's doing better than
competitors**

Freight rates have fallen markedly since September. Vessels had been over-worked for a number of years but as world trade reduces, ships will be brought into dry dock and it is certain that some owners will seek to push mechanical repair and service costs onto insurers. A particular moral hazard for the mariners is that falling freight levels mean that mortgagees' interests can exceed the market value of vessels (ships are insured for more than they are worth). Recently, Lloyd's has written hull business much more successfully than have many competitors (the global market has lost money in eight of the last twelve years). Poor results have helped to bring about the withdrawal and downgrading of a number of competitors, including parts of the Scandinavian market. This is expected to lead to improved rating conditions.

Despite falling rates, increases in commodity values had helped to maintain cargo premium volumes. This is no longer the case, and reduced premium income to cargo accounts can be anticipated.

Aviation



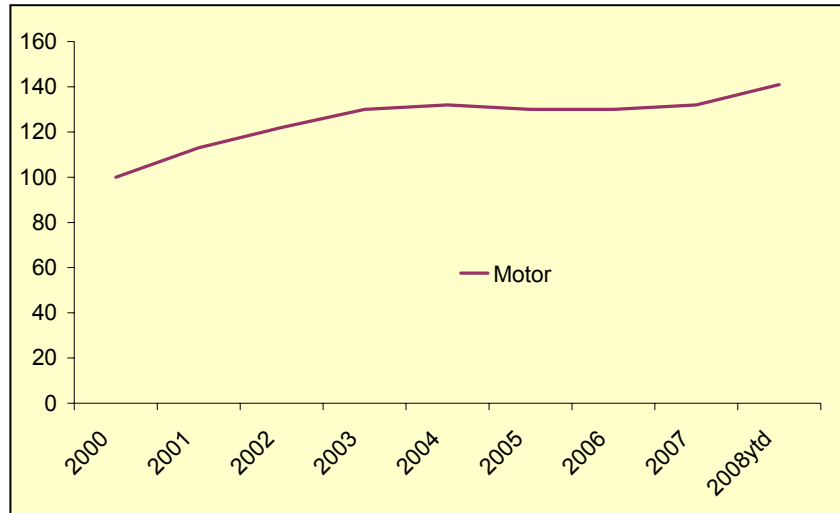
**Airline rates improving at
last**

Aon reports that airline renewal terms have firmed by some 8% so far this year, with November renewals being at a higher level of 12%. Of the 137 hull and liability renewals placed by Aon, 62% have been at higher premium terms. There is some expectation that airline passenger numbers will fall over the next year and if so this will reduce exposures, but simultaneously reduce the premium base to insurers. Despite the airline claims so far this year, it seems that premiums will exceed claims, although probably not by a sufficient margin to account for cost of capital and reinsurance expense. We expect continuing upward pressure in this sector.

In the satellite sphere, losses look set to be almost twice net premiums and rates are beginning to increase for launch exposures. They have been flat for in-orbit cover, although these too seem set to increase.

Aviation Excess of Loss has produced some good results since 2001 and has been disciplined despite the good claims record.

UK Motor



Rating levels for UK Motor have continued to improve throughout the year. Those for Commercial risks have been slightly less responsive, although it can be argued that these rates have not fallen to the same extent as there is rather less competition in this area. Claims inflation continues to be an issue and at 4%, eats up 80% of the benefit of a 5% rate rise. Recessionary impact and the high price of fuel has caused vehicle owners, both private and commercial, to review the costs of operating and attempt to reduce their annual mileage, which may reduce loss activity.

Quote / Unquote

We have collated some of the more interesting quotations on the third quarter reporting season. The consensus of opinion is that the market is hardening.

“...now no question that the market has turned....”

Lancashire Holdings Limited’s Group CEO **Richard Brindle** (Third Quarter results statement 27 October 2008): *“There is now no question that the [re/insurance] market has turned. In many areas of our portfolio, conditions could be similar, or even better, than what would have been in place in 2002 due in part to large improvements in terms and condition since that time.”*

Evan G. Greenberg, Chairman and CEO ACE Limited (Third quarter results statement 28 October 2008): *“In my judgment, given both the rapid*

destruction and increased cost of capital, combined with the damage inflicted on a number of companies in our industry, the soft market for P&C insurance is essentially over, and rates will begin to firm."

Chris O'Kane, CEO of Aspen Insurance Holdings (third quarter results statement 29 October 2008): *"Our strong balance sheet leaves us well positioned to benefit from the improved pricing environment which we expect to result from the hurricanes and financial markets crisis."*

"We expect an improved rating environment created by the removal of significant capital from the marketplace."

Stephen Catlin, chief executive of Catlin Group Limited (Interim Management Statement 17 October 2008): *"The unprecedented events of this year, including the instability in international financial markets, have presented the Group with both challenges and opportunities. We believe that these are market turning events. We expect an improved rating environment created by the removal of significant capital from the marketplace."*

Ewen Gilmour, CEO of Chaucer Holdings PLC (Hurricane Claims and Investment Update 21 October 2008): *"Hurricane Ike is likely to have caused one of the largest hurricane losses in US history. We expect the impact on Chaucer, though commensurate with a major market loss, to reflect recent reductions in our energy exposures in the Gulf of Mexico. Additionally, these events, combined with the instability of financial markets, are likely to have a beneficial effect on premium rates in energy and US property classes."*

"...the significance of reinsurance as a direct capital substitute is growing."

Ludger Arnoldussen, a member of Munich Re's Board of Management (Press Release – Munich Re sees turnaround in the cycle 27 October 2008): *"Given the erosion of many insurers' capital, the significance of reinsurance as a direct capital substitute is growing. With our capacities, we are able to give primary insurers more headroom, thus also playing a part in counteracting the financial crisis and stabilising the economy. "The release stated that Munich Re writes risks only at adequate prices and conditions and Arnoldussen commented "Quality and security have their price in reinsurance. In view of the increased cost of capital, the growing demand and the changed risk environment, we expect significantly higher prices, with percentage increases definitely going into the double-digit range. Where Munich Re is unable to obtain the requisite prices, we will not write the business".*

"...business opportunities abound for Hiscox."

Robert Hiscox, Chairman Hiscox Limited (Interim Management Statement 10 November 2008): *"The tide has turned. Whereas we were depending on retail growth in UK and Europe to offset the fall in income from internationally traded business and reinsurance, rates have now switched from softening to hardening in some major areas such as Reinsurance, Offshore Energy and Large Property. Most importantly, market conditions and sentiment have changed and business opportunities abound for Hiscox. We have already announced an increase in capacity for our Lloyd's Syndicate and the formation of a new one. We have added new teams and senior individuals, mainly from AIG,*

who will strengthen various parts of our business in the USA. Meanwhile the UK and Europe continue to make good progress”.

John Charman, President and Chief Executive, Axis Capital Holdings (comments made in Axis’ third quarter earnings conference call 28 October 2008): *“We believe a hard market in 2009 is a near certainty and we are amply prepared to maximize shareholder value throughout this important next cycle. I think this is a broader and I’d say sustainable opportunity than 9/11. The outlook for the reinsurance market is more positive than I have seen for many, many years. I think the reality of the capital markets substantially withdrawing from providing capacity will lead to a re-energisation of the reinsurance market place and a better understanding of what the reinsurance market provides to the insurance marketplace. And I believe that that will be witnessed over the next two or three years. As far as AIG are concerned, I shed no tears for them. I have been in the business for 37 years and I believe that any normalisation of AIG will be very beneficial to the marketplace because it will release huge volumes of the business throughout the insurance portfolios both by product and by geography. So I don’t want to jump on their grave but I do believe it’s a very, very important and significant event, so I think it’s very positive in the marketplace.”*

“As far as AIG is concerned, I shed no tears for them... I don’t want to jump on their grave...”

Stephen Catlin, Chief Executive Catlin Group (*Interim Management Statement 13 November 2008*): *“events affecting some of our major competitors have removed significant amounts of capital from the marketplace and are causing the market to turn. Rates for some types of reinsurance are already rising as a result, and we expect significantly improved conditions for most classes of reinsurance and some classes of insurance by year-end renewals. We believe rates for many other classes of insurance will begin to rise later in 2009.”*

Recession

Towers Perrin, a US professional consulting firm, has recently published a review of the US Property Casualty insurance industry (“Property & Casualty (P&C) Insurers Brace for Dramatic Drop in Third Quarter Surplus”). It predicts that catastrophe losses, directors’ and officers’ (D&O) claims and poor underwriting results could produce a third quarter combined ratio of 116.6%, which would mean an underwriting loss of \$18.5 billion. Coupled with realised and unrealised losses on investments, the full year decline in capitalisation of US P&C insurers could be as much as 15% or \$80 billion. In insurance and reinsurance, capital surplus can be equated to supply and restricted supply points to increased prices.

Restricted supply of capital...

On the demand side, primary insurers and reinsurers have rather less flexibility as to how they protect their balance sheets. The capital markets are to a large extent closed. Many of the hedge funds that were offering collateralised capacity to the reinsurance sector have now withdrawn.

...increased demand for reinsurance

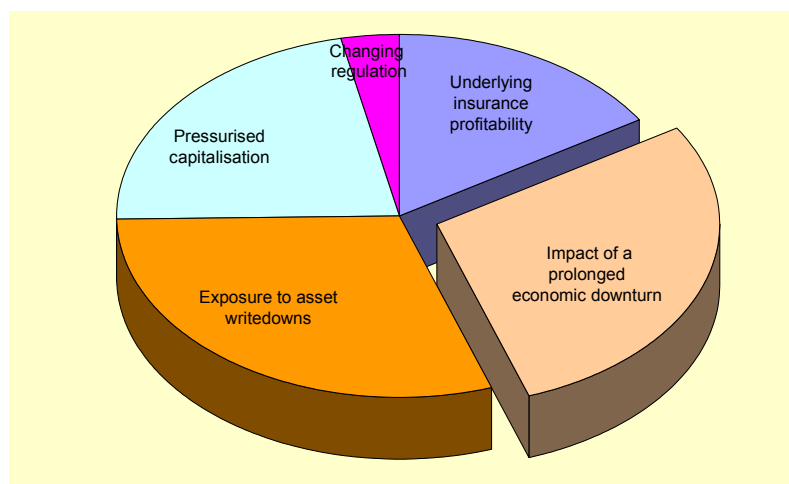
That an AAA rated insurer fell into such difficulties that it needed \$150 billion of government money to stay afloat has increased the value that insurance buyers place on diversification. One of the first hallmarks of this cycle turn is the resurgence of the subscription market.

Robert Hiscox has observed that Lloyd's flourishes to the sound of gunfire but struggles to the sound of violins. Gunfire may be muted at present, but the world economy is far from hearing violins. The chart overleaf looks at the performance of the Lloyd's market plotted against the US recessions over the past thirty-eight years.

Although Lloyd's performance has been highly volatile over this period, there is no correlation between recessionary forces and underwriting performance. Undoubtedly, there will be an increase in attritional loss activity, as even the most eagle eyed claims handler will not be able to weed out every fraudulent claim, and there will be a number of crime related classes (e.g. employee fidelity, jewellers' block), where there is an increase in legitimate claims' activity.

A recent conference of insurers and investors posed the question of the most significant challenge facing the industry; giving five potential answers. Twelve months ago, (under-)pricing of risk was viewed as the most serious threat and recessionary pressure was not mentioned at all. It is apparent that the risks of recession and development of strategies to combat these risks are becoming an important part of insurers' planning for the next few years.

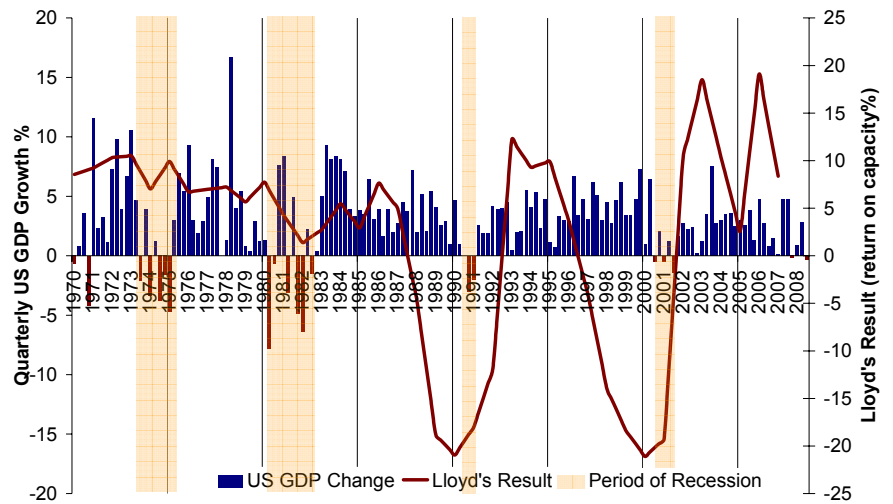
Marked change in perception of challenges facing insurers



Historically Lloyd's has fared relatively well in recessions

Lloyd's has actually fared relatively well in the most recent recessions, recording profits in the recessions of 1973-5, 1981-3 and 2002-3, although the losses in the 1990-2 period were some of the worst ever recorded by the market. Prior to the poor years in the late 1980s, Lloyd's recorded profits every year from at least 1948 until 1986, save for the Hurricane Betsy years 1965 and 1966. Anecdotally, those that were around recall modest profits in the depression years of the early

1930s, although we have little reliable data for this period and the nature of risks covered by the market has also changed out of all recognition.



Hurricane Barack?

During his campaign, US President Elect Barack Obama was noticeably more critical of offshore tax domiciles, including the Bermudian reinsurance market, than was Jon McCain, who had pledged to preserve the status quo. A 14-strong lobby group, the Coalition for a Domestic Insurance Industry (including WR Berkley, Chubb, Hartford, Liberty Mutual and Berkshire Hathaway) is seeking support for a Democrat introduced bill HR6969, that would seek to close the loophole that allows foreign based insurers a competitive advantage over domestic insurers in underwriting US risks. The group that this coalition has in its sights is the Bermudian reinsurers, as overseas insurers and reinsurers are generally subject to double taxation treaties. Some press comment speculates that President Elect Obama would be unlikely to weaken the insurance industry at a time of a hardening market as this would potentially exacerbate the situation. The alternative view is that offshore reinsurers paying little or no US tax will be seen as ripe for punitive treatment as the US budget deficit increases in the wake of additional spending and borrowing to ward off the recession.

Bermuda's special status under threat?

The fall in the value of Sterling

Sterling has fallen dramatically against the US dollar in recent months. At the time of writing it is down to \$1.55, up from a low for the year of \$1.48, representing a 26% fall from the year end rate. This will have profound implications for Lloyd's members, especially those providing Funds at Lloyd's (**FAL**) in sterling.

Dollar profits worth more but bear in mind that early releases in dollars also worth more

Capital requirements will increase, which may restrict distribution of profits in May/June 2009

Large pre-emptions expected for 2010

Possibility of 25% pre-emptions and more SPSs for 2010

Firstly, and perhaps most satisfyingly, profits for 2006 will be substantially more than forecast. To a lesser extent, so will profits on the 2007 account. However, early releases of profit in dollars made on the 2006 account at 30 June 2007 and 30 June 2008 will be accounted for at the year end conversion rate. The estimates based on 30 June 2008 data from managing agents showed that early releases of profit equivalent to 8.5% and 7.8% of capacity in respect of MAPAs 7006 and 7049 respectively had been distributed to members. These releases were calculated at the prevailing exchange rate of \$1.99:£1. Recalculating these releases at the rate of \$1.78:£1 used for the 30 September 2008 estimates, that are included on page 29 of this document, increases the value in converted sterling terms of the early releases to 11.3% of capacity for MAPA 7006 and 10.5% for MAPA 7049. If the pound is to end the year at \$1.50, the value of the early releases increases the value of funds already released to 12.8% and 12.0% respectively for the MAPAs. In other words, while we expect 2006 to be an even better result than currently indicated, some of the improvement will be accounted for in the releases already made.

Secondly, will be the impact on capital requirements. Syndicate business plans and their associated capital requirements were set by reference to the 31 March 2008 rate of exchange. The FPD monitors the performance of syndicates against their overall plans rather than against their capacity, so there is no issue that syndicates may overwrite their capacity when dollars are translated at the more recent rates of exchange. However, the syndicate capital requirements (**ICAs**) will be recalculated using the 1 January 2009 exchange rate. This is likely to provide a significant uplift in the overall level of capital required and could impact members' eligibility for release of profit on distribution of the 2006 account results next June.

Third will be the impact on capacity requirements for 2010. These will be set using the rate of exchange in March next year. Assuming this will be closer to the current level of roughly \$1.50:£1, rather than the rates at 31 March 2008 (\$1.99:£1), syndicates writing US dollar business will require an increase in capacity. If the market continues to improve, we think that the pre-emption level for 2010 could be very substantial indeed.

Planning for 2010

Our current expectation is for the rating environment to continue to improve throughout 2009 as capital write-downs impact insurers' solvency and in turn their appetite and ability to underwrite new and renewal business. Pressure from increased reinsurance costs will feed through into insurers' pricing. Lloyd's attraction as a subscription market place will continue, with an increased showing of business. These factors will combine to increase expected premium volumes, with syndicates requiring more capacity next year. We argue above that the

change in exchange rate alone could prompt a pre-emption, which could be to the order of 15%. If, on top of this, there is an average increase of 10% in premium rating levels, syndicates could be looking to increase capacity by at least 25%. The recent launch of SPS 6106 by Amlin is further evidence that the SPS structure is highly attractive to Managing Agents, suggesting that there could be more of these on offer to Members.

Marginal results for 2008 means negative solvency at 12 months

While we are relatively sanguine that surpluses on reserves established at the close of the 2007 account will provide sufficient cushion to prevent the 2008 account falling into overall loss, the attritional loss ratios are much higher than in preceding years, and with the hurricane losses, 2008 looks to be a marginal year at best. We certainly expect that the twelve month solvency position for the 2008 year of account will be a deficiency.

Equities in FAL were valued at 30 June 2008 for the general Coming-into-Line (CIL) exercise. Assuming that there is no recovery in stock market values, Members with a high proportion of equities will have their valuations heavily marked down at 31 December 2008. It is also probable that the extreme volatility in the market over the past months has changed the position with regard to concentrations of asset disallowances.

Be prepared!

The implications regarding the devaluation of sterling on capital requirements are dealt with above. Taking a very broad-brush approach, bearing in mind that all members' circumstances will vary, the combination of the stronger dollar against sterling and the substantial pre-emptions we project, there could be very large increase in capital requirements for 2010. At this distance, given our expectations as to what 2010 may look like, we would recommend that Members should be taking up as much of the pre-emption as possible and that they should start planning with their Client Directors as to how they will meet their 2010 funding requirements. We will be writing to all clients with an indicative CIL calculation, based upon the 31 December 2008 FAL valuation and an estimate of the uplift in capital requirements and solvency position on the 2007/08 years of account, at the end of January 2009.

Corporate Developments

View from Throgmorton Steet

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.

Insurers in strong rally

Listed Lloyd's insurers have been one of the few bright sectors amid the gloom of the banking crisis and an economy tottering into recession. Although shares were marked down in the early part of the banking crisis, the optimism emerging from the sector in more recent weeks has seen a strong rally. Amlin, the largest in the sector with a market capitalisation of £1.55 billion, is believed to be close to admission to the FTSE 100 on the

next rebasing of the index. The sector's three largest players, Amlin, Catlin and Hiscox, are all ahead on the year and have made substantial gains in the past three months.

	Share price			Change since	
	31-Dec-07	21-Aug-08	08-Dec-08	31-Dec-07	21-Aug-08
Advent	245	200	170	-30.6%	-15.0%
Amlin	302	271	371	22.8%	36.9%
Beazley	179	110	121	-32.4%	10.3%
Brit	229	178	222	-3.1%	24.9%
Catlin	385	315	435	13.1%	38.1%
Chaucer	102	75.5	65	-36.3%	-13.9%
Hardy	295	229	283	-4.1%	23.3%
Hiscox	287	238	329	14.8%	38.2%
Omega	157	142	148	-5.7%	4.2%
Novae	335	307	308	-8.1%	0.4%
Lloyd's*	97.2	79.4	101.1	4.0%	27.3%
FTSE100	6,457	5,370	4,300	-33.4%	-19.9%
FTSE250	10,651	8,938	5,948	-44.2%	-33.5%

* AIRL's Index of Lloyd's quoted companies

Flagstone Re acquires Marlborough

Bermudian reinsurer Flagstone Reinsurance Holdings has announced that it intends to acquire Lloyd's managing agent Marlborough Underwriting Agency from the Berkshire Hathaway group. Berkshire acquired Marlborough from CGNU (now called Aviva) in 2000, at the same time as it acquired the run-off of CGNU's London market exposures. Berkshire continues to have a presence at Lloyd's via Faraday Syndicate Management which is owned by Berkshire subsidiary General Re Corp.

Another Berkshire subsidiary, National Indemnity Company, has written the reinsurance of Equitas and will ultimately transfer the liabilities of reinsured Members to National Indemnity.

Flagstone was established in the wake of Hurricanes Katrina, Rita and Wilma in 2005 and is headquartered in Bermuda with thirteen offices around the world. It has over \$1billion in capital and is rated A- (excellent) by AM Best.

Flagstone continues the trend of Bermudian reinsurers seeking a Lloyd's platform to access the global wholesale business marketed here. No fewer than six managing agents have been acquired by Bermudians since the start of 2007. It seems that there is a preference for acquiring established businesses as only two (Montpelier Re and Aspen) have established their own start-up syndicates (5151 and 4711 respectively).

Speaking recently at an insurance and reinsurance conference organised by AM Best, Ian Clark, a partner of Deloitte & Touche LLP's corporate finance insurance practice, suggested that more deals for London

**Flagstone of Bermuda
acquiring Marlborough from
Warren Buffet**

platforms were likely. Although the share price of both London vehicles and Bermudian companies have fallen, the differential has reduced, with the movement in the value of the dollar to the advantage of would-be buyers of London business.

Montpelier

Bermudian reinsurer Montpelier has formed a new managing agency to assume the management of its existing Syndicate 5151 for the 2009 underwriting year onwards. Syndicate 5151 was formed in 2007 to underwrite US and European non-marine property and engineering business and was originally managed under a turnkey agreement by Spectrum Syndicate Management. Syndicate 5151 has a capacity of £143m in 2008.

Montpelier forms new Managing Agency

Kiln

Lloyd's managing agent, RJ Kiln & Co Limited, has announced the launch of a new Syndicate 1880 with an initial capacity of £200m. This will underwrite reinsurances of the Tokio Marine group (Kiln was acquired by Tokio Marine in March 2008) including shares of the Kiln managed syndicates at Lloyd's. It is Kiln's intention to place with Syndicate 1880 the same proportion of the total outward reinsurance programme as is supplied by the Tokio Marine corporate member to the main Kiln syndicate. For example, Tokio Marine owns 53% of Syndicate 510's capacity for 2009 and Kiln will place 53% of all Syndicate 510's reinsurance programmes with Syndicate 1880. In each case the terms will be the same as those set by the balance of the placement. The effect of this will be for the non-aligned members of Kiln syndicates to continue to benefit from the long standing reinsurance arrangements of the syndicates, while the corporate member is able to adopt a higher risk profile, in effect writing its share of the Kiln managed syndicates without the benefit of reinsurance.

Kiln launches Syndicate 1880 to underwrite Tokio Marine group reinsurances, including Kiln Syndicates 510 and 807

Stephen Mathers, who has recently retired after 17 years as Active Underwriter of Syndicate 807, will become the Active Underwriter of Syndicate 1880. Stephen will be assisted by Eddie Doi, who brings 18 years' experience of a broad range of commercial lines insurance and reinsurance at Tokio Marine, both in Japan and the US.

Argenta Comment: Kiln argues that Tokio Marine, having limited access to non-Japanese business, has a higher risk appetite than do the bulk of the non-aligned Members of the syndicate. Given the size of the gross Realistic Disaster Scenario (**RDS**) exposures of Syndicates 510 and 807 we tend to agree. Tokio Marine does not currently provide any capacity to Syndicate 557, so Syndicate 1880 will not write any part of that syndicate's reinsurances. Syndicate 557 also adopts a higher risk profile than do any of the other main syndicates. Non-aligned members can thus adjust their risk profile within the Kiln group by varying the proportions of the various Kiln syndicates. This arrangement allows both categories of member to achieve their risk aims. The benefits to the non-aligned

Argenta believes this will not disadvantage participants in Syndicates 510 and 807

members include a reduction in the cost of reinsurance brokerage and also an improvement in the overall security of the reinsurance programme, as Syndicate 1880 will increase the proportion placed with Lloyd's security.

Omega

Lloyd's insurer Omega Insurance Holdings announced plans on 8 December for a £130m share placement with institutional investors. This will increase the group's capitalisation by over 60% to around £337m. Funds will be used to grow the firm's Bermudian and US surplus lines businesses. Omega foresees a positive trading outlook in its core lines of business as financial market illiquidity and investment losses will impact the balance sheets of insurers and reinsurers, compounded by the recent losses arising out of US hurricanes Gustav and Ike. Omega considers itself very well placed, as it has no exposure to equities or asset backed securities and is an established player within the subscription markets. Omega also plans to switch its listing from AIM to the full London Stock Exchange during the first half of 2009.

Walter Fiederowicz, Chairman of Omega, said "As a result of this fundraising, the Group is now able to seize a significant market opportunity to grow the underwriting book in our existing business areas over the next 12 to 18 months. During this time we foresee a hardening of rates and an improvement in terms and conditions in the Group's core lines of business. Our conservative investment policy and short-tail account mean we will be focused on the future and its opportunities and not dealing with legacy issues from 2008 and prior years that will be preoccupying so many in the industry".

Richard Tolliday, Chief Executive of Omega, said "We expect to see a progressive and significant improvement in market conditions over the next 12 to 18 months. The insurance industry environment is very different today from the conditions seen following Hurricane Andrew, 9/11 and the 2005 hurricane season, because of the number and nature of the factors which are profoundly affecting the industry. This creates exciting opportunities for a group as well positioned as Omega is. The severity of capital constraints being felt in the industry means we are confident we can utilise our enlarged balance sheet to grow our Bermudian operations and our surplus lines carrier in the US, essentially by writing more of the same type of business we have written so successfully for the past 29 years".

AIG

AIG's \$85 billion rescue by the US government was renegotiated over the weekend of 8 and 9 November. The government's objective continues to be to prevent the collapse of the business leading to a devastating domino effect on capital markets around the world. It had become apparent that the initial loan was both too small and too expensive. The initial bail-out was a loan of \$85 billion at a rate of 8.5% over LIBOR. This

Omega foresees significant growth opportunities over the next 12 to 18 months

was followed by an additional \$38 billion. The company remained in trouble and reported a \$24.5 billion (\$24,500,000,000!) net loss for the third quarter. The initial measures were passed before the approval of the Troubled Asset Relief Plan, the US government's banks' rescue package.

The trading picture with AIG remains complicated. There have been a number of high level departures. Onshore and offshore energy teams left at the end of October and are believed to be headed for WR Berkley. Many employees were on short notice periods by industry standards and are able to start underwriting in their new operations in relatively short order.

Evan Greenberg, CEO of ACE Group (and son of former AIG CEO Hank) reported in his third quarter earnings conference that new business enquiries were up by 31% on 2007 in the period late September to early October, with large account enquiries up more than 80%. He accused AIG of cutting prices in order to maintain premium volumes, a charge AIG has denied, albeit one that we often hear repeated in our meetings with brokers and underwriters.

It seems that AIG is acting to defend its book, largely by aggressively cutting prices. The insurance operations remain sound and well capitalised. The problems lie with the holding company and the Financial Products division. The company has always been a heavy buyer of reinsurance and ran some very large aggregate positions against a very large balance sheet. Brokers are routinely offering clients alternative quotes to AIG renewals. In many cases, the order placed with the AIG is being reduced. The combined impact of a shrinking premium base, increasing reinsurance costs and much reduced company balance sheet will mean that the company, even if it does survive in anything like its current form, will be unable to buck the emerging market trends.

Ironshore

On 30 October it was reported that Les Rock had resigned from Bermudian reinsurer Ironshore. Ironshore was established in Bermuda in late 2005 with former Lloyd's Underwriter, Rock, as Chief Underwriting Officer. Rock's CV includes Murray Lawrence Syndicate 362, DP Mann Syndicate 435 and he was the founder underwriter of Heritage Syndicate 1200. Ironshore recently acquired the Pembroke Managing Agency. We understand that his termination agreement precludes an immediate return to the market.

XL

XL's share price fell 54% to \$4.01 on 9 October on market rumours of capital inadequacy and investments losses. It has since recovered slightly, and on 8 December shares closed at \$5.96, but remain volatile. The high for the year to 24 November was \$63. XL's problems relate to a former subsidiary, Syncora Holdings Limited (formerly known as Security Capital Assurance or SCA). Syncora operated in the financial guarantee market, guaranteeing payment of principal and interest in the event of

Uncertainty over the future of AIG insurance and reinsurance divisions create opportunities for others

Les Rock resigns (again)

XL share price volatile

***Rumours of QBE acquiring
Equity Red Star Syndicate
218***

default by a debt issuer. Although XL's stake in Syncora was reduced to 46% following an IPO in August 2006, XL continued to offer guarantees on pre-IPO exposures. XL's share price fell back below \$4 on 11 December following news of another investment loss in quarter four. Goldman Sachs has been appointed to explore "value enhancing opportunities".

QBE/IAG

IAG of Australia announced plans in June to reduce their overseas operations with the sale of UK mass market motor operations Advantage, Hastings Direct, People's Choice and Equity Insurance Brokers, as well as a Lloyd's syndicate based in Singapore. Equity Red Star, which includes Syndicate 218, and writes a more specialist (and profitable) motor account, was not included in their sale plans. Over the past couple of weeks there have been a number of press reports linking QBE (which owns the managing agent of Syndicate 386) to a purchase of Equity Red Star. A bid from QBE for the entire IAG business was rebuffed by IAG earlier this year.

Amlin

Amlin plc recently approached Members' Agents with a view to capitalising a new SPS to support the reinsurance writings of Syndicate 2001. Amlin is one of the most successful independent businesses in the Lloyd's market. In 2002, it acquired the ownership rights to 100% of its managed capacity in a capacity offer to third party capital providers. The offer included a share alternative and many former members became shareholders in the business and, as noted elsewhere in this Market News, its share performance this year has been exceptional. The new syndicate writes a quota share protection of Syndicate 2001's reinsurance account, including US and International Catastrophe business, and Excess of Loss for non-marine per risk business, as well as Aviation, Marine and Terrorism. Members' Agents have been able to raise the full £50m of new capacity sought for SPS 6106, once again highlighting the risk appetite and flexibility of third party capital at a time when many other capital markets are all but closed.

***Successful launch of SPS
6106***

Major Losses

Gustav

For some time, Gustav looked likely to follow a path to New Orleans similar to that of 2005's Hurricane Katrina. New Orleans was evacuated over the weekend of 30 and 31 August, with citizens remaining subject to a curfew. Gustav weakened slightly as it approached Louisiana and made landfall to the South and East of New Orleans as a Category Two windstorm. Wind speeds weakened rapidly on reaching land, although



several inches of rain fell across Louisiana. The levees were not breached and, although water did splash over the tops in some areas, improved foundations of the flood defences were not weakened. Industry estimates of loss are around \$5 billion.

Ike

Hurricane Ike was the most intense storm of this year's Atlantic storm season. At one point in the Gulf of Mexico it achieved sustained wind speeds in excess of 140mph and was a Category Four storm. It eased slightly by the time it made landfall at Galveston, Texas in the early hours of 13 September as a Category Two storm, with wind speeds closer to 110mph. The storm was one of the largest ever in terms of wind field, (the diameter of hurricane strength winds), which stretched 120 miles from the eye. Tropical storm strength winds were felt some 275 miles from the eye. Ike, which was quickly downgraded to a tropical storm, then travelled North through Texas and Arkansas. It caused damage through an extensive swathe of the US as far North as Ohio.

The modelling agencies made initial estimates of the expected levels of insured damage in a range approximately \$7 billion to \$12 billion. These have been shown to be substantially understated. RMS has subsequently amended its range for onshore and offshore insured losses to \$13 billion to \$21 billion, a range so broad (\$8 billion) as to be of little help to anybody. More recently most insurers, Lloyd's included, have been regarding Ike as a loss costing the industry at least \$20 billion and likely to rank third or fourth on the all time list of largest insured losses. Including Ike, seven of the top ten losses have now occurred in the past seven years.

Initial insured loss estimates revised upwards to \$20+ billion and still moving



Top Ten Major Losses 1970-2007

Event	Date	Country	Insured Loss (2007 US\$)
Hurricane Katrina	25/08/2005	USA, Caribbean	\$68.5bn
Hurricane Andrew	23/08/1992	USA, Caribbean	\$23.7bn
Al Qaeda attack on US	11/09/2001	USA	\$22.0bn
Northridge Earthquake	17/01/1994	USA	\$19.6bn
Hurricane Ivan	02/09/2004	USA, Caribbean	\$14.1bn
Hurricane Wilma	19/10/2005	USA, Mexico, Caribbean	\$13.3bn
Hurricane Rita	20/09/2005	USA, Caribbean,	\$10.7bn
Hurricane Charley	11/08/2004	USA, Caribbean,	\$8.8bn
Typhoon Mireille	27/09/1991	Japan	\$8.6bn
Hurricane Hugo	15/09/1989	USA, Caribbean	\$7.6bn

Source: Sigma Research, Swiss Re January 2008

Notes Excludes life and liability insurances

Insured losses inflated to 2007 values at US consumer price index

Sirius Star

The supertanker *Sirius Star*, travelling from Saudi Arabia to the US laden with 20 million barrels of crude oil, worth \$100 million, became the highest profile in a series of hijackings by Somalian pirates. The crew of 26 were taken hostage on 16 November. At the time of writing, the ship has been placed at anchor pending a ransom payable by the owners. Coverage for hijacking by pirates falls under hull policies written under London institute wordings, but under war policies for business written with American Institute wordings. Lloyd's syndicates tend to write direct business on London Institute clauses but often write reinsurance on the American form. The distinction is important as hull policies are typically annual contracts, whereas war policies are specific to the voyage and thus pricing is much better able to respond to sudden changes in the nature of the risks. A possible outcome of these recent events will be the treatment of piracy as a war risk on the London policy form. It is normal for the pirates to seek a ransom for safe return of the vessel. To date all hostages have been well treated. Specialist negotiation companies deal with the pirates. Ransoms have been paid and, although payment of ransoms is obviously counter-productive as proceeds are reinvested in more and better equipment, we understand that these are a fraction of the total sum insured. We understand that the cargo risk is placed in Lloyd's, although not with syndicates supported by third party capacity.



California Wildfires

Damage of up to \$800 million has been inflicted in Southern California in a series of wildfires that raged for a week in mid November. Three main fires destroyed crops, homes and property across over 40,000 acres. Fires such as these are a relatively commonplace event. October 2007 witnessed one of the more severe series of losses with \$1.7 billion of insured damage.



XL Airlines

On 27 November 2008 an Airbus 320 owned by Air New Zealand crashed on approach to Perpignan, France into the Mediterranean Sea. The aircraft – leased by XL Airways – was believed to be carrying seven crew members, all of whom were killed in the accident. XL Airways' hull cover was provided by Global Aerospace Underwriting Managers (**GAUM**) and placed by Jardine Lloyd Thompson (**JLT**). GAUM manages the Global Aerospace Pool and is owned by Berkshire Hathaway and Munich Re following their acquisition of Converium's shareholding in July 2008. The pool has four participants, National Indemnity (40.89%), Munich Re (37.46%), Tokio Marine (12.37%) and Mitsui Sumitomo (9.28%). Industry experts estimate the value of the aircraft's hull at around \$43 million and XL Airways hull insurance policy is expected to bear the loss.



This is the second incident involving XL Airways in a matter of weeks following an engine fire and subsequent emergency landing at Belgrade, Serbia in October. XL Airways is a former subsidiary of XL Leisure Group which went into administration in September 2008.

***Mumbai terrorist attacks
may be reinsured in Lloyd's***



***New Lloyd's risk code to
cover power and utilities***

***Deregulation has radically
changed the industry over
the past 20 years***

Mumbai Terrorism

On 29 November 2008 a group of terrorists attacked several locations in Mumbai, India killing 188 people. Among the affected sites were the Oberoi-Trident and Taj Mahal Hotels, the latter of which is expected to be a total loss for insurance purposes. Both hotels are believed to have purchased cover from the Indian terrorism reinsurance pool, which includes participations from local insurers Tata AIG, ICCI Lombard and Iffco Tokio. The pool itself is reinsured at Lloyd's. Given that material property losses alone are estimated at \$600m and the pool has funding of \$150m, claims are expected to make their way through to some Lloyd's syndicates.

Terrorism cover in India has historically been under-priced due to soaring competition; in anecdotal cases premiums are said to have been lower than equivalents in Scandinavia. Many London Market insurers are not prepared to write terrorism business in the country, which means any loss could be spread heavily among a small number of companies.

Spotlight on Power and Utilities

We are grateful to Derek Harding for providing an overview of the Power and Utilities sector. Derek is a recognised lead underwriter specialising in Power and Utility risks at Argenta Syndicate 2121.

The power and utilities market has been long established in the London market. This however is the first year that Lloyd's has created a risk classification code (PG) specifically for this class. In previous years the risks had been coded together with general property risks as diverse in profile as oil refining and beachfront condominiums. This will be the first year that the performance of this industry can be monitored at market level which will create competition amongst the underwriters as we all strive to outperform the market.

The power and utility industry has changed radically over the past twenty years as it has moved from a state owned and regulated environment towards a corporately dominated, deregulated market place.

The industry started to change when large swathes of assets were sold off by governments around the world in a bid to inject some competition into the market and of course generate a significant public cash windfall. Inevitably once corporate interests were involved, there was a move towards deregulation. This allowed the corporate interests to set pricing rather than have pricing forced upon them by a government regulator.

There are intrinsic differences in the way market prices are set in different territories. In general each company or power station sets a price for its output and when the projected price reaches this set level they are called upon to generate.

Nuclear energy cheapest to produce

In the UK nuclear power is the cheapest form of generation so these stations are required to operate every day in what is known as a base load (always operating) configuration. The next cheapest generators tend to be the hydro powered stations as obviously the fuel source is relatively cheap. Fossil generators are the next cheapest and in conjunction with nuclear, form the majority of the UK's generating capacity. The renewable or so called green energy sector tends to be one of the most expensive producers of electricity so on a pure price basis would be one of the last generators called upon. There are, however, emissions constraints that artificially move them up the pecking order.

Green energy most expensive to produce

The movement in electricity prices is dependant on many factors but in common with most markets the key driver is supply and demand. High demand coupled with low supply creates high prices and vice versa. It was only a relatively few years ago that the price for a megawatt hour of electricity was under £25 in the UK. A few of weeks ago the price reached £133 due to several of the cheapest producers being unavailable. This is a volatility issue that has helped to generate large profits for many corporate investors and created an extremely complex risk assessment issue for the insurance industry.

The power and utility industry dynamics have caused both short and long term issues for the insurance market. High electricity pricing cycles tend to be relatively short lived as they are mostly caused by territorial factors such as weather or temporary shortages of capacity but they have had enough impact on insurers to lead to a capping of exposure by the insurance market in order to reduce volatility.

Economic slowdown has benefits for insurers

The issues of equipment reliability and availability are unsurprisingly linked to global and territorial economic conditions. The economic cycle has a complex relationship with the insurance cycle in this sector. From a generation standpoint an economic slowdown is helpful for insurers whilst the boom years of hard running equipment and high electricity prices can be impossible to manage without accurate risk selection.

The current expected economic downturn will cause a general tightening of belts among the public and consequently reduce factory gate output. If consumers have less money to spend, the demand for goods reduces. Importantly this will lead to a reduction in demand for electricity. The reduction in the cost of fuel sources such as coal will only have an impact in the longer term as most generators have multi year fuel supply contracts.

The wholesale pricing of electricity is, therefore, likely to closely resemble that of a regulated market where peak demand is a relatively short period and mostly driven by the weather.

There are still some short term areas of supply constraint such as the one we are currently experiencing in the UK, but, once a few of the stations currently undergoing repair come back on line the wholesale price of electricity will fall.

The same cannot be said in all areas. Parts of Australia are gripped by the hottest and driest spell on record which has reduced the availability of cheap hydro power. This will keep electricity demand and prices exceedingly high until the drought breaks.

The commodity price boom of recent years has also affected insurers' results. The price of steel had, until recently, greatly increased the replacement costs of components as raw steel costs had moved up from \$200 per ton to over \$1,000 per ton this year. We have seen client valuations of their assets increase by twenty percent in just two years which has obviously had an impact on the cost of claims.

The longer term outlook is a complicated picture. In previous years the decision to build a new power station was a relatively simple one. There was a demand, so a suitable site was found and a new plant was built. The future is much more complex. With emissions targets being a key driver in the planning and permitting process, there are several technology solutions currently in a fledgling state of commercial development. The method of carbon capture where emissions from a power station are pumped underground is being touted as making the burning of fossil fuel a lower level emitter of pollution.

The anticipated large growth in wind generation is seen as a way of reducing emissions. In the UK we simply do not have enough areas of consistent wind to supply the country's needs. This means that every megawatt of electricity produced by wind power needs to have a conventional fossil fuel burning station as backup. In effect we have to build two stations instead of one to meet the emissions targets. This is potentially good news for insurers as it would mean more stations with lighter load but less so from the environmental stand point.

The outlook for insurers in this area is starting to look more positive, there have been several key events arising during the past twelve months which, cumulatively, will turn the market. There has been a run of large machinery breakdown losses, including a very complex Italian plant which looks likely to produce the largest machinery breakdown loss to the industry in over ten years.

There has been a withdrawal of capacity in the sector, especially the non specialist property underwriters who have picked up many of the large losses. Lastly the problems AIG and several other large insurers have experienced with their financial risks exposures have impacted the purchasing strategies of many major clients. Many risk managers are looking at how much exposure they should have with any one insurer which is likely to see some new accounts moving to London as well as increased orders on existing business. We are likely to see a move back to subscription market placements which will greatly benefit the London market.

Emissions targets will be a key driver in future power generation projects

Losses and the AIG factor are creating opportunities for the London market

The insurance industry has had many challenges thrown at it by the power and utility industry. Change is a constant factor in setting the terms and conditions we are able to offer our clients. As an industry we have to make certain we can deal with the changes in risk profile the coming economic downturn will produce.

We have to make sure we are aware of future territorial risks and of technology issues; machines are being enhanced to drag the last few percentage points of efficiency out of equipment to assist profits.

Most importantly, we need to be aware of how government intervention with emission targets will shape how the industry operates for the next twenty years.

Derek Harding – Argenta Syndicate Management Limited (24/11/08)

Lloyd's News

Lloyd's Welcomes NAIC Reform

On 7 December, it was announced that the National Association of Insurance Commissioners (**NAIC**) had adopted its Reinsurance Regulatory Modernization Framework Proposal as a conceptual framework.

The proposal aims to modernise the US state-based regulation of reinsurance, including modifying the hotly debated collateral requirement for foreign reinsurers and creating two new classes of reinsurers in the US: US domiciled national reinsurers and non-US based port of entry reinsurers (**PoE reinsurers**).

Lloyd's, along with other international industry bodies, has long campaigned against existing rules that require non-US reinsurers to post collateral of 100% of gross liabilities assumed for American cedants, which result in an estimated \$50bn+ tied up in letters of credit, trust funds and other financial instruments. Although the details of the new system are to be worked through, it is likely that Lloyd's would apply to be a PoE reinsurer. Assuming that the NAIC is happy with Lloyd's home state regulation by the FSA, and based on Lloyd's current rating, the collateral requirement would drop from 100% to 20% for new business written once approved as a PoE reinsurer.

Sean McGovern, Director and General Counsel at Lloyd's, said: "We are pleased that the NAIC has adopted a new policy framework for the regulation of reinsurers. This has been a long time coming and is a major step forward. However, the focus must now switch to ensuring speedy and consistent implementation across all States. This is likely to require some form of federal legislation."

US situs funding requirements for non-US reinsurers likely to reduce once proposals implemented

Lloyd's Claims Equalisation Reserves

Following over two and a half years of lobbying by Lloyd's, the Government announced in the November Pre-Budget report that it will align the tax treatment of Lloyd's corporate members' reserves with that of other general insurers. Lloyd's has welcomed this measure that will contribute to its ability to compete globally.

Commenting on the announcement, Lord Levene said: "We welcome this decision that finally brings the tax treatment of Lloyd's reserves into line with other UK insurers and will contribute to Lloyd's ability to compete globally. We are grateful to the Treasury and HMRC for their support in introducing this change."

Since 1996, general insurers have had to put up Claims Equalisation Reserves (**CERs**) for solvency purposes, which requires them to set aside premiums on certain types of volatile classes of business in profitable years to provide a cushion against periods with worse than average claims.

Tax relief is available for amounts transferred into the CER with the effect that some volatility of the tax result is removed. Lloyd's is not required to set up CERs for solvency purposes, as when they were introduced for general insurers in 1996 Lloyd's was deemed to be adequately capitalised. As a result, Lloyd's has not historically been able to take advantage of this tax relief.

The new legislation means that Lloyd's Corporate Members will in future benefit from a tax relief for CERs. Unlike general insurers, however, Lloyd's will not be required to create a CER for solvency purposes, recognising that the Lloyd's capital regime ensures members are already adequately capitalised.

The legislation will apply to profits treated as arising in the year ended 31 December 2008 and, as far as possible, will mirror the tax regime as it applies to general insurers with adaptations to take account of Lloyd's unique structure.

Little detail is available at present as to how the CERs for Lloyd's Corporate Members will operate, but this will be explored further with the Treasury over the coming months. In particular, it is presently unclear whether partners of LLPs and SLPs will be able to establish a claims equalisation reserve for tax purposes. The relief will not apply to individual members who already benefit from the Special Reserve Fund, which has a similar effect.

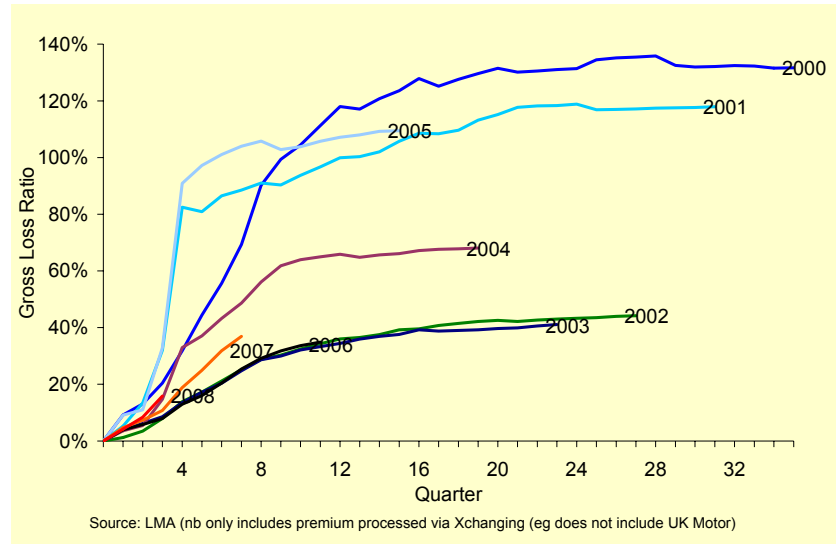
Looking forward to Solvency II, general insurers will no longer be required to put up CERs for solvency purposes. However, Lloyd's has been lobbying for the extension of tax relief on CERs beyond the introduction of Solvency II and the Government has also announced that it will review the case for such an extension.

Lloyd's will continue to work with HM Treasury and HMRC on this.

New legislation means that Lloyd's Corporate Members will in future benefit from a tax relief for Claims Equalisation Reserves

Syndicate Forecasts at 30 September 2008

Lloyd's Market Gross Loss Ratio Development



These are gross loss ratios (paid and outstanding losses divided by gross premiums after deduction of brokerage and commissions). As they do not take account of outward reinsurance premiums nor of any reinsurance recoveries, they give only an indication of the relative performance of the different years of account and are not indicators of profitability. Of note here, firstly, is how consistent the three bumper years, 2002, 2003 and 2006 are. Second is that, although 2007 will have sustained an element of the 2008 catastrophe losses in Quarter 7, the difference between 2006 and 2007 is due principally to lower original rates and an increase in attritional loss activity. Although 2007 is tracking better than 2004, which produced a good final result, it is currently forecast to make a smaller profit as original terms and conditions were worse on much of the non-catastrophe book, suggesting attritional losses will continue to materialise. Investment performance for the year is also likely to be lower. As for 2008, the impact of hurricanes Ike and Gustav is not fully reflected in the numbers although the account is noticeably worse than 2007 at this stage and a marginal results looks likely. The first formal estimates of the outcome of the 2008 account are made at the 15 month stage, although many agents release provisional estimates after twelve months.

2006 forecasts for third party syndicates and Argenta MAPAs as at 30 September 2008 (% of capacity)

Syndicate /MAPA	Previous Forecast at 30/06/08			Latest Forecast at 30/09/08			Change %
	Worst Case %	Best Case %	Mid- Point %	Worst Case %	Best Case %	Mid- Point %	
33	22.50	30.00	26.25	22.50	30.00	26.25	
44	4.15	5.89	5.02	4.51	6.25	5.38	+0.36
218	3.50	8.50	6.00	3.50	8.50	6.00	
260	2.58	7.58	5.08	-1.70	3.30	0.80	-4.28
308	2.17	7.17	4.67	0.99	5.99	3.49	-1.18
318	5.02	10.03	7.53	5.47	10.48	7.98	+0.45
382	11.00	16.00	13.50	12.00	17.00	14.50	+1.00
386	34.85	39.85	37.35	40.33	45.33	42.83	+5.48
510	12.75	17.75	15.25	15.21	20.21	17.71	+2.46
557	25.08	30.08	27.58	29.10	34.10	31.60	+4.02
570	11.50	16.50	14.00	11.50	16.50	14.00	
609	12.04	17.05	14.54	12.04	17.05	14.54	
623	12.49	17.49	14.99	12.50	17.47	14.99	
727	11.50	18.50	15.00	11.50	18.50	15.00	
779	4.35	9.35	6.85	4.35	9.35	6.85	
780	17.50	22.50	20.00	20.00	25.00	22.50	+2.50
807	10.18	15.18	12.68	11.69	16.69	14.19	+1.51
958	14.00	19.01	16.51	14.00	19.00	16.50	-0.01
1007	12.50	17.50	15.00	17.50	22.50	20.00	+5.00
1176	50.00	65.00	57.50	57.50	67.50	62.50	+5.00
1200	17.50	22.50	20.00	17.50	22.50	20.00	
1221	12.81	17.78	15.30	15.02	20.07	17.55	+2.25
2010	15.00	20.00	17.50	15.00	20.00	17.50	
2020	23.94	28.94	26.44	14.86	19.86	17.36	-9.08
2121	17.50	22.50	20.00	17.50	22.50	20.00	
2525	16.82	21.82	19.32	21.41	26.41	23.91	+4.59
2526	20.39	25.39	22.89	20.39	25.39	22.89	
2791	31.00	36.00	33.50	32.50	37.50	35.00	+1.50
3245	10.00	15.00	12.50	10.00	15.00	12.50	
4040	0.04	7.54	3.79	1.37	6.37	3.87	+0.08
MAPA 7006	17.45	22.75	20.10	17.18	22.47	19.83	-0.27
MAPA 7049	16.54	21.84	19.19	16.34	21.63	18.98	-0.21

Source: Managing Agents' Forecasts as at 30 September 2008 submitted to Lloyd's

2007 forecasts for third party syndicates and Argenta MAPAs as at 30 September 2008 (% of capacity)

Syndicate /MAPA	Previous Forecast at 30/06/08			Latest Forecast at 30/09/08			Change %
	Worst Case %	Best Case %	Mid-Point %	Worst Case %	Best Case %	Mid-Point %	
33	7.50	15.00	11.25	7.50	15.00	11.25	
218	5.00	10.00	7.50	4.00	9.00	6.50	-1.00
260	-3.57	1.43	-1.07	-6.35	-1.35	-3.85	-2.78
308	4.90	9.90	7.40	7.14	12.14	9.64	+2.24
318	-0.70	4.31	1.81	-5.34	-0.33	-2.84	-4.65
386	19.50	24.50	22.00	20.77	25.77	23.27	+1.27
510	3.92	8.92	6.42	3.98	8.98	6.48	+0.06
557	8.42	13.42	10.92	10.48	15.48	12.98	+2.06
570	5.51	15.54	10.52	5.51	15.54	10.52	
609	0.00	10.01	5.00	0.00	10.01	5.00	
623	9.52	14.53	12.02	9.48	14.57	12.02	
727	5.00	15.00	10.00	5.00	15.00	10.00	
779	0.48	5.48	2.98	0.48	5.48	2.98	
780	10.00	15.00	12.50	10.00	15.00	12.50	
807	8.85	13.85	11.35	8.18	13.18	10.68	-0.67
958	12.50	17.50	15.00	12.50	17.50	15.00	
1176	30.00	50.00	40.00	30.00	50.00	40.00	
1200	12.50	17.50	15.00	12.50	17.50	15.00	
2007	4.00	9.00	6.50	1.00	6.00	3.50	-3.00
2010	2.50	10.00	6.25	5.00	10.00	7.50	+1.25
2121	7.50	12.50	10.00	7.50	12.50	10.00	
2525	4.00	11.50	7.75	4.00	11.50	7.75	
2526	10.82	18.32	14.57	10.82	18.32	14.57	
2791	16.00	21.00	18.50	16.00	21.00	18.50	
3245	7.50	12.50	10.00	7.50	12.50	10.00	
3334	10.00	20.00	15.00	10.00	20.00	15.00	
4040	-4.18	0.82	-1.68	-8.77	-3.77	-6.27	-4.59
6101	6.50	11.50	9.00	6.50	11.50	9.00	
6102	6.50	11.50	9.00	6.50	11.50	9.00	
6103	30.00	35.00	32.50	32.50	37.50	35.00	+2.50
MAPA 7006	7.10	13.11	10.11	7.15	12.98	10.06	-0.05
MAPA 7049	6.96	12.97	9.97	6.92	12.75	9.84	-0.13

Source: Managing Agents' Forecasts as at 30 September 2008 submitted to Lloyd's

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