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## From the Editor

The forecasts for the 2007 year of account, based on the figures at the end of the third quarter of 2009, showed a profit for the Lloyd's market of just under 15% of capacity. The actual result is a profit of 16.95%, or, assuming a Funds at Lloyd's (FAL) ratio of 40%, a return on FAL of 42.3%, making 2007 a good year, surpassed only by 2003 at 18.6% (on capacity) and the exceptional 2006 at 27.0%.

On an annually accounted basis, which is essentially the result of trading during the 2009 calendar year, the news is also good. Lloyd's has declared a record profit of £3,868m, narrowly beating the previous record of £3,846m for the 2007 year.

The Lloyd's quoted companies have been reporting some very good results, largely due to the absence of catastrophic events causing insured losses. Investment returns were also generally good. Hiscox, with a return of 7.2% on invested assets, told its shareholders with characteristic enthusiasm: "The investments yielded a cracking result".

In spite of Hurricane Ike and a series of large single losses in the first part of the year, the 2008 account is set to make a profit in the region of 5% of capacity. Preliminary estimates for 2009, although necessarily in a broad range, currently indicate a better result, perhaps double digit.

Although it is right to celebrate achievements, this should not obscure immediate challenges. As if to remind us that the business we are in is all about the unpredictable, claims experience in the first quarter of 2010 has been very different from the benign 2009 year. According to Swiss Re, total catastrophe claims in 2009 were \$26bn, half the previous year. Estimates for the insured cost of the Chilean earthquake are now as high as \$10bn and Windstorm Xynthia \$4bn. With a series of US storms also set to cost \$1.35bn and Australian hailstorms costing nearly \$460mn, according to Allianz, total first quarter claims will be around \$16bn.

So, if claims experience carries on like this, with above average hurricane activity forecast in the North Atlantic, 2010 could be a challenging year.

In this edition we comment in more detail on the results, including more good news on progress with run-off accounts. We also look at recent loss events and their possible impact, as well as threats that you may have heard about, such as pleural plaques, and the implications for Lloyd's.

The message from our review of the various class of business sectors is that catastrophe exposed business remains comparatively well rated and that where we go from here depends largely on loss experience in the forthcoming hurricane season and the availability of capital and its appetite for risk.

***Catastrophe exposed business remains well rated but the Market is softening.***

But it has to be recognised that overall the Market is softening. The position is very similar to 2008, prior to Hurricanes Gustav and Ike and the onset of the financial crisis. As has been observed by many market commentators already, the market is softening but not soft. However, in so far as Lloyd's is concerned, there is plenty of evidence that the Performance Management Directorate (PMD), headed by Tom Bolt, is already addressing the challenges posed and we expect the forthcoming Lloyd's Global Accounts to both recognise the good results and be realistic about what lies ahead.

*Jeremy Bray - Editor*

## Lloyd's Annual Results 2009

Lloyd's released its global results for the year ended 31 December 2009 on 24 March. Benign catastrophe experience, strong releases from reserves and good investment returns combined to produce a record profit (on an annual accounting basis) of £3,868m, beating 2007, the previous best, by £22m. Gross premium income, at almost £22 billion, was also a highest ever figure.

***Record profits achieved for 2009.***

Business written during the period 2002 to 2006 continues to show very favourable characteristics and was responsible for the bulk of a release from reserves of £934m. This is equivalent to 3.4% of claims reserves held at 1 January 2009. The release is smaller by quantum than that made at the end of 2008. This is the fifth successive year of reserve releases, although Lloyd's believes that the scope for these will be reduced in future years.

Chart I shows Lloyd's global premium income and combined ratios since the first publication of the annual accounts in 2003. For clarity, the combined ratio axis has been reversed as a lower combined ratio corresponds to higher profitability.

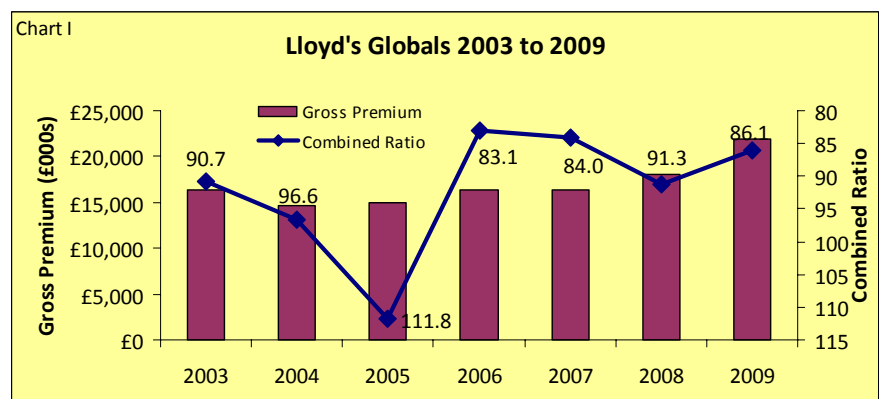
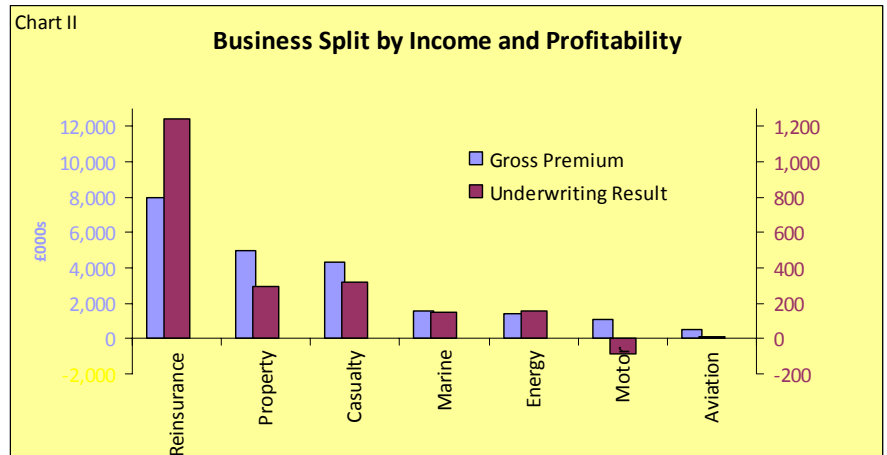


Chart II shows Lloyd's dependency in 2009 on higher risk business. Although 36% of premium income was reinsurance business, almost 60% of the profit emanated from this class. Motor business produced an £83m loss, exacerbated by adverse old year movements, while Aviation was only able to deliver a very modest profit after a release from old years.



#### Traditional (Three Year) Results

On a three year underwriting account basis, the 2007 account produced a profit of £2.78 billion, or 16.95% on allocated capacity, which placed the year third in terms of overall profitability behind the 2003 and 2006 accounts where returns on capacity were 18.6% and 27.0% respectively. The result for 2007 is approximately 8 percentage points better than the forecast made after 24 months as releases from reserves for 2006 and prior years have increased the final result by almost £1 billion (6% of capacity) and investment income was stronger than many expected. 2008 has improved slightly to a mid-point of 4%. A schedule of underwriting year results and forecasts is included on pages 18 and 19.

**16.95% profit for the 2007 underwriting year of account.**

#### Number of Run-Off Years Reduced

All syndicates supported by Argenta members were able to close their 2007 accounts at 31 December 2009, although there were three other syndicates that were not able to do so. 18 syndicate/years in run-off closed their accounts by reinsurance to close (RITC), so there was a net reduction in run-off years of 15. There are now 22 years of account in run-off, a reduction from 102 in 2006. Of these, just five run-off years involve members underwriting via Argenta Private Capital. The results for run-off syndicates where Argenta members are involved are discussed further on page 17.

**More run-offs close. Only five run-off years remain for Argenta members.**

## Sector Reviews

***Focus in better rated catastrophe business has the potential to increase volatility.***

Early indications are that 2009 will prove to be one of Lloyd's better underwriting years. A short lived upturn in rating levels in many of Lloyd's core classes has coincided with lower incidences of catastrophe losses. However, it is evident that the trend in rating levels has been downward for some time, especially in non-catastrophe areas, where rates have been reduced successively for five years or more. The upshot is that business exposed to catastrophic loss, whatever its broader class (marine, property, energy etc), is much more attractively rated than is non-catastrophe business or casualty. Additionally, reinsurance underwriters appear to have been able to exercise more discipline than the direct insurance peers. This means Lloyd's underwriters' focus on better rated catastrophe business is increasing the potential for volatility in results.

***Lloyd's capacity a record £23 billion for 2010.***

There is an upturn in UK motor and an argument to suggest that the UK liability market must be close to the bottom of the cycle, but otherwise market rating levels are driven by the return of capacity to the market after the surprisingly rapid restoration of balance sheet strength in the industry. At this early stage of the year, we anticipate that syndicates will be likely to undershoot their premium projections for the year (which were largely predicated in June 2009 on an improving rating environment during 2010) and that they will seek to shrink their premium volumes further into 2011. This may result in an overall de-emption of capacity for Members in 2011. Lloyd's began 2010 with a record £23 billion of capacity, up from £18 billion in 2009. While 2010 capacity could go up if new syndicates start up or if (wholly aligned) existing ones pre-empt mid year, our current expectation, leaving aside rate of exchange movements, is that the premium volumes will shrink in 2010 over 2009.

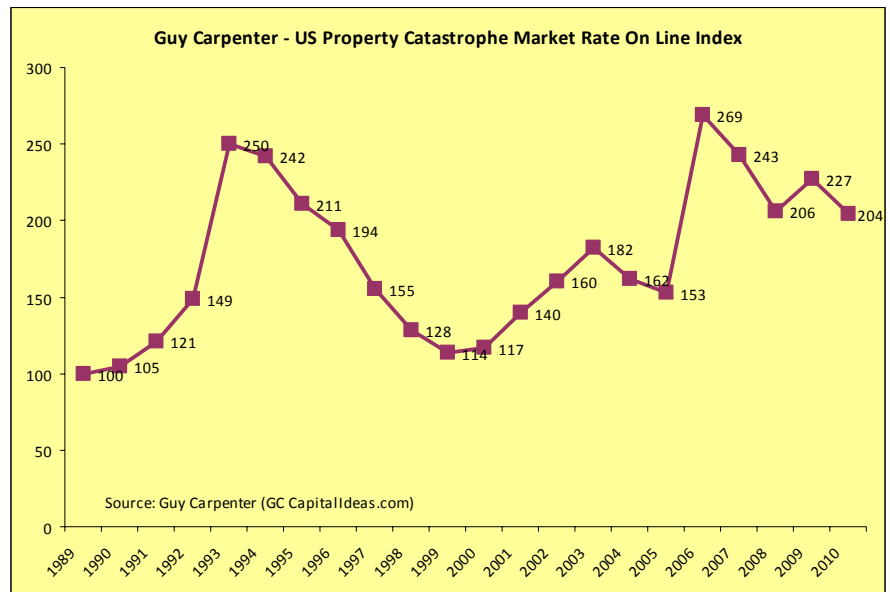
## Property Reinsurance

In the USA, the January renewals saw reductions in overall rating levels. Brokers, including Marsh and Willis, pointed to an average reduction of 6% or 7%, whereas underwriters have claimed that their own rates have reduced by rather less, with Munich Re stating that their average rates fell by 2% and Hannover claiming only a 0.5% reduction in pricing. While this obviously seems implausible, an underwriter explained that both can simultaneously be true. Brokers are looking at the totality of their book, including business that they find new (cheaper) markets for, whereas the underwriter will be withdrawing from business he sees as insufficiently priced and retaining or increasing his share where rates are better.

***Rate on line analysis shows property catastrophe business remains relatively well rated.***

The broker Guy Carpenter has produced the following chart of average aggregate Rates on Lines. Rate on Line is a crude but effective measure of reinsurance pricing. A policy with a limit of £1,000,000 and a premium of £100,000 is said to have a Rate on Line of 10%. Many other factors will go into the actual rating of a reinsurance programme, including experience, change in the underlying exposures and wording issues such as the definition of an event, but the movement in the Rate on Line gives a clue as to the relative rating of the

Market. Guy Carpenter has tracked the aggregate Rate on Line (total Excess of Loss premium income divided by aggregate Excess of Loss limit accepted) since 1989.



***Non-US catastrophe reinsurance remains competitive.***

Continental European reinsurance pricing fell by up to 5% for loss free contracts, but there were a number of areas where losses in 2009 caused upward price movements. These include lower layers of French programmes hit by Windstorm Klaus, and Austrian programmes with hailstorm losses. UK business followed suit, being generally down in pricing. Losses during 2009 largely did not reach reinsurance programmes in the UK, so insurers were able to take advantage of recent good experience for reinsurers.

The major Japanese renewal season is at 1 April. Last year, despite largely clean renewals, rates increased by 5% or so as the increase in value of the Yen against the US Dollar and Sterling meant Japanese aggregates consumed more of reinsurers' capital. This year, despite further appreciation in the value of the Yen, indications are that the pricing gains of 2009 are likely to be given up. The market is dominated by the big European reinsurers, with Lloyd's underwriters largely price takers.

It is becoming apparent that the Chilean earthquake will be a sizeable event for some reinsurers, albeit one that takes time to crystallise and have an impact on pricing levels.

#### **Hurricane Forecasts for 2010**

***Above average hurricane activity forecast for North Atlantic for 2010.***

The first forecasts for Atlantic hurricane activity for the period 1<sup>st</sup> June to 30<sup>th</sup> November are usually made in the December of the preceding year. In December 2009 both Tropical Storm Risk (TSR) and Colorado State University predicted an active Atlantic hurricane season for 2010, with TSR specifying about 35% above the 1950 to 2009 norm. The probability of a hurricane making landfall is therefore above average. TSR bases its prediction on forecast July

to September trade wind speed over the Caribbean and tropical North Atlantic and on the forecast sea surface temperature from August to September. Trade winds are forecast to be weaker than normal and sea surface temperatures higher than normal, which combined are predicted to have a “moderate enhancing effect” on hurricane activity. Forecasts to date are summarised below:

	Tropical Storm Risk	Colorado State University	AccuWeather
Named Storms	13.9	11 – 16	15
Hurricanes	7.4	6 – 8	5
Major Hurricanes	3.4	3 – 5	2 – 3

Interestingly, in December 2008 the same forecasters made the same forecast of 35% above the average for 2009. However, by June the forecasts reduced to below average due to stronger trade winds and cooler sea surface temperatures and the 2009 hurricane season was indeed a quiet year for hurricanes. The forecasts are updated monthly from April onwards.

### Energy

Many insurers, including most Lloyd’s syndicates, elected to reduce their available capacity for Gulf of Mexico (**GoM**) windstorm risks, with available aggregate for this type of business reducing by about half. Rates for GoM wind exposures hardened significantly during 2009. However, rates for “Risk only”, (i.e. excluding wind cover) moved up at the beginning of 2009, only for the rate of increase to fall away to just about nil by the end of last year. There have been a number of substantial losses; the West Atlas rig in the Timor Sea is expected to cost insurers around \$1 billion for the various insured interests and the collision of a service vehicle into a platform in the North Sea at Ekofisk could cost the insurance industry \$1.4 billion. In both cases, much will fall on the oil industry mutual Oil Insurance Limited (**OIL**), but some of these losses will be borne by the commercial market. Early this year, Berkshire Hathaway announced that it will be accepting 10 per cent of all energy business placed through the London office of broker Marsh. Although terms have not been made public, it is understood that multi-year policies will be issued. While Berkshire Hathaway can hardly be considered naïve capacity and its willingness to enter into such a blanket contract gives an indication of the overall attractiveness of the rating environment, new capital entering the energy market is going to test underwriters’ resolve on renewals.

*Shortage of capacity and high rates has attracted new capacity.*

*New capacity may lead to a sudden fall in rates.*

### Marine

Rates for Hull business improved at a modest rate throughout 2009, although this upward momentum seems to have been lost in the early 2010 renewals. Whilst the absolute size of the world’s tonnage has been reduced by the laying-up of ships in consequence of lower trading activity, this has partially

been offset by a lower appetite for the class from Scandinavian markets, which typically compete with Lloyd's and in recent years have experienced worse loss ratios. Piracy in the Gulf of Aden continues to be a problem, although the business is now written as part of the War risks product at a significant premium, rather than in the Hull market.

***Marine becalmed.***

Losses in Specie and Jewellers' Block markets accelerated in 2008, with underwriters responding by imposing 5% to 10% rate increases. Momentum has been lost during 2009 and at the start of 2010.

Given the severe deterioration on the 2006 and 2007 accounts of the International Group of Protection and Indemnity clubs, the most important marine liability contract written by Lloyd's syndicates, the rating movements were disappointing. The contract has been consistently profitable for many years, but the lower layers of the 2006 and 2007 contracts are now in loss. The rates on the loss making layers were increased by around 5%, with broadly flat renewals on higher layers.

The spate of credit and political risk losses covered under the Major Loss section of this report on page 11 has prompted an increase in pricing on better terms for new business (albeit that new business volumes are down due to reduced volumes of trade). Underwriters have been reluctant to commit capacity for some of the longer term business. A fundamental dichotomy of this type of business is that rates of default are lower on longer term business - like individuals, corporate entities are less likely to default on their long term mortgage than their shorter term car loan or HP contract. However, longer term business poses different risks to insurers, who do not have the chance to improve terms if conditions deteriorate.

***Political Risk premiums rising.***

## **Direct Property**

This market can be segmented in a number of different ways: risk size, occupancy, method of acceptance and territory being just some. The US falls into catastrophe exposed areas of the Gulf of Mexico, California, Florida and the Eastern seaboard, and those areas less catastrophe prone. Competition for non-catastrophe business has been most intense, for most property lines, albeit little of this business usually makes its way to London, being written generally by the "admitted" market ("admitted" means licensed by the state insurance commissioner, with Lloyd's trading as a non-admitted or "surplus lines" insurer in all states except Illinois and Kentucky). Marketscout, an information exchange for independent insurance brokers based in Dallas Texas, has calculated that rates have fallen in every month over the last five years. In the catastrophe prone states, admitted insurers are unable to increase rates due to the regulations and much business flows into the surplus lines markets. Rate increases were the order of the day here during 2009 and, while the rate of increase has now moderated, the catastrophe exposed lines remain much more attractively rated, having been subject to rate hikes in 2006 (after Hurricane Katrina) and 2009 (after Hurricanes Ike and Gustav and in the wake of the banking crisis and the near collapse of the AIG).

***As with property reinsurance, catastrophe exposed business continues to be more attractively rated...***

*...and non-US business is likewise more competitive.*

Whilst international business has been more competitive than the US market, UK business is barely above burning costs, even with catastrophe and recession related claims. It seems that the perceived benefits of a diversified book of business are, in some underwriters' minds, at times overcoming the obvious need to make profits.

A series of mining losses during 2008 prompted a contraction of capacity and upward pressure on pricing during 2009. Good results in 2009 seem to have allowed underwriters to forget the past and capacity is returning to the sector with the pressure on pricing now reversed.

### **Non-Marine Liability (including USA)**

*The non-marine liability market is unlikely to improve until claims materialise and/or there are reserve shortfalls.*

Although there is widespread acknowledgement of the need for rates to increase, major US competitors continue to be driven by premium volumes rather than profit. The feared "tsunami" of claims arising out of the financial crisis has not yet materialised, although claims frequency continues to increase. While Lloyd's syndicates and vehicles trading at Lloyd's have been reporting reserve surpluses, which have bolstered their 2009 profits, the same is not true in the wider market. AIG strengthened old year reserves by \$2.3 billion at year end, and rating agencies such as AM Best and Moody's see the US Property & Casualty industry as no better than adequately reserved at present. An increase in claims activity and reserving shortfalls is likely to increase calls for increased rating levels, although it may still be some time before the market begins to respond. Rating levels for financial risks continue to outpace those for non-financial business.

### **Non-Marine Liability (excluding USA)**

*Non-marine liability underwriters are hoping that rates have reached the bottom of the cycle and will now increase.*

Rates for UK liability business, including Employers' and Public liability, have flattened in recent months, albeit there have been a number of years of successive rate reductions since the peak of the market five or six years ago and an acceptance that few are actually making any money, with the prospect of poor investment returns. Companies, feeling recessionary pressure, are seeking amelioration on their insurance terms, which for many can be one of their largest overheads. This may come in the form of increased retentions or instalment premium plans. There have been some very poorly performing Medical Malpractice contracts, especially in Southern Europe. This appears to relate mostly to non-third party syndicates, but claims seem to relate back to policies written in 2001 and 2002, giving another reminder of the potential for deterioration in old years, especially when business is written on an "occurrence" form.

*UK motor rates are going up but claims culture has changed.*

### **UK Motor**

Results for the private car market have been very poor, bolstered in recent years by releases from reserves. There is evidence that the scope for these releases is now beginning to run out. Credit hire (the practice of accident victims being provided with hire cars following a loss, often aided by a specialist company) and multi-claimant fraud (whereby a driver with a full complement of passengers engineers an accident with a seemingly 'at fault' party and each of the passengers claims whiplash injuries) are two major problems for the industry. Deloitte, the actuary, estimated a pure combined ratio of 116% in 2009 for the UK motor insurance market, moderated to 113% when releases from reserves are factored in. Although rates are going up, increases may not yet be sufficient to return the market to profit. Some of the better performers will be content to keep their rates low in the short term, hoping that some competitors will go to the wall and that the consequent upturn in rating will be delayed but stronger and more sustained.

*The Accident & Health market is steady but competitive pressures are mounting.*

### **Accident & Health**

This business has been a consistent performer in recent years, with good profit margins slowly being eroded by over-capacity. Although most of the book is prone to attritional losses, there is catastrophe exposure here from both man-made and natural events. There has not been a substantial personal accident catastrophe since the World Trade Center loss. Clients have been seeking additional cover for Nuclear, Chemical, Biological and Radioactive (NCBR) events. Aggregate exposure to this type of risk is difficult to calculate and so it is generally being resisted, or given only in restricted form by underwriters. In most cases, reinsurance excludes NCBR causes. Competitive pressures arise as most underwriters are trying to get new business on the books, meaning rates can be down by 10% and more if the insured elects to renew with a different market. Recessionary claims are likely in travel and creditor books and medical expenses policies are prone to medical inflation.

*Airline rates up, but not enough.*

### **Aviation**

Although there continues to be upward pressure on rates, absolute levels remain weak. The airline market sustained one of its worst ever years in 2009, with losses from Colgan Air, Air France and Yemenia Airways giving a global claims figure of around \$2.5 billion against premium income of \$1.9 billion. This is the third successive year that airline claims have exceeded premium income, and has resulted in premium increases of around 10%. Unfortunately, however, this is insufficient to return the account to profit, especially as continued economic uncertainty is reducing passenger numbers and prompting consolidation amongst airlines. This in turn reduces airline insurers' client base and reduces the "miss factor". Aviation reinsurance has responded to losses on original business, with rate increases of up to 15%, as well as increasing the attachment point for programmes. This increasing cost base is further increasing a squeeze on primary insurers.

Away from the airline sector, rates for general aviation (smaller aircraft, specialist craft and helicopters) are marginal at best, although there have been some increases in liability rates for products and airport operators.

## 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.*

### **Better investment returns boost 2009 results.**

All of the quoted Lloyd's vehicles have produced their 2009 year-end figures. In general, these show improvements on 2008, reflecting slightly better rating environment and a benign catastrophe experience. Despite this, combined ratios (claims and expenses divided by net premiums) are only slightly lower than 2008, with the bulk of the improvement arising out of better investment returns. While premium volumes are up in 2009 over 2008, this is due largely to the movement in sterling. Catlin, which reports in US dollars, reported the smallest increase at 8%. Of these companies, Amlin, BRIT, Catlin, Hiscox and Omega all write business through subsidiaries outside Lloyd's, so their results are not necessarily indicative of the Lloyd's operations on which third party capital participates. Lloyd's released its global results on 24 March (visit <http://www.lloyds.com/2009annualreport> for full details).

	2009 Full Year			2008 Full Year			Change		
	GWP	CR	Result	GWP	CR	Result	GWP	CR	Result
Amlin	£1,544	72	£509	£1,034	76	£122	49%	4	319%
Beazley	£1,116	90	£101	£876	90	£87	27%	0	15%
Brit	£1,696	94	£116	£1,395	96	£89	22%	2	30%
Catlin	\$3,715	89	\$603	\$3,437	95	(\$13)	8%	6	n/m
Chaucer	£796	93	£42	£690	94	(£26)	15%	1	n/m
Hardy	£242	78	£20	£173	91	£23	40%	13	13%
Hiscox	£1,435	86	£321	£1,147	76	£105	25%	-10	205%
Novae	£389	105	£4	£346	109	£40	13%	4	-90%
Omega	\$266	81	\$47	\$265	101	\$28	0%	20	67%
Totals*	£9,690	87	£1,517	£7,960	90	£450	22%	3	237%

GWP: Gross Written Premiums in millions. CR: Combined Ratio (%). Result: Pre-Tax Profit/(Loss) in millions.

\* US\$ converted at \$1.61:£1

## Corporate Developments

### **Omega Holdings – Special General Meeting**

### **All change at Omega Holdings after shareholder revolt.**

After three months of often acrimonious exchanges between Omega Insurance Holdings and a group of shareholders led by Invesco, a Special General Meeting took place on 12<sup>th</sup> March. In spite of the Board's recommendation to vote against the resolutions to remove a number of directors and to appoint others, over 95% voted in favour. Shareholders' discontent appears to be driven by disappointment over the use of the £124m of capital raised in January 2009,

but no clear statements have been made. The new chairman is John Coldman, who was chairman of the Benfield Group until it was acquired by Aon Corporation in November 2008. Prior to that, he was chairman of Brit Insurance Holdings plc and has served as deputy chairman and member of the Council of Lloyd's. Details of the new Board's plans for the Omega Group are eagerly awaited, in particular with regard to Omega's Syndicate 958. As a first move, Omega Holdings announced on 19<sup>th</sup> March that CEO Richard Tolliday had been replaced by Richard Pexton, former CEO of Heritage Underwriting Agency plc (since acquired by Argo) which manages Syndicate 1200.

### **AIG Results**

*AIG insurance division reports an increased loss.*

AIG reported a \$10.9 billion loss for the 2009 year. This followed the widely reported \$99.3 billion loss reported for the 2008 year. While much of the loss still emanates from the activities of AIG Financial Products and the company's efforts to unwind the position taken, the insurance division produced an underwriting loss (premiums less claims) of \$2.6 billion (up from \$1.8 billion in 2008) and a combined ratio of 132% (up from 121%). Past under-reserving meant that a strengthening of reserves of \$2.3 billion was required. Premium volumes fell 14% during 2009. The insurance division has been rebranded Chartis as the group seeks to repay government borrowing.

### **Max Capital and Harbor Point – Claiming the High Ground**

*Max Capital and Harbor Point merge.*

Max Capital and Harbor Point, two Bermudian reinsurers, have agreed a merger to form a new company with \$3 billion of assets and with trading platforms in Bermuda, Ireland, Lloyd's, the USA and Latin America. The new company will be called Alterra, which translates (more or less) as "High Ground". There continues to be an expectation of further consolidation in the Bermudian market, with this deal moving the two companies from the lower reaches of the Bermudian market top twenty companies (by capital) to just into the top ten. Max currently trades at Lloyd's via Syndicates 1400, 2525 and 2526.

## **Major Losses**

Last year was a quiet one for catastrophe losses affecting international insurers and reinsurers, but 2010 has started as if it intends to make up for that respite. Just two months in, the Market faces potentially large loss bills from several natural disasters around the world.

### **Haiti Earthquake**

The magnitude 7.0 earthquake that struck Haiti on 12<sup>th</sup> January 2010, causing devastation and an estimated 230,000 deaths, has put into sharp focus how the world's poorest regions are exposed to catastrophic events. When disaster strikes in developed economies insurance plays a key part in helping the

affected countries recover. In Haiti, insurance penetration amounts to only 0.3% of GDP, ranking it amongst the lowest in the world (with most of the insured risks being situated in Port-au-Prince) and motor insurance accounts for over 50% of non-life premiums.



Economic damage from the quake will amount to billions of dollars, but insurers and reinsurers are not expecting a large bill. One small part of the assistance that Haiti will receive will come in the form of an \$8m payment under the country's insurance policy with the Caribbean Catastrophe Risk Insurance Facility (CCIRF), a venture promoted by the World Bank that combines traditional and securitised risk protection for various perils, notably hurricanes and earthquakes. Protection is parametric, related to the intensity of an event, and claims are paid within a matter of days.

In our enquires of Lloyd's syndicates as to possible losses from the event, most report no or minimal exposure.

### Chilean Earthquake

The 8.8 magnitude earthquake that struck Chile on 27th February looks as if it will be the most expensive insured event ever to hit Latin America.

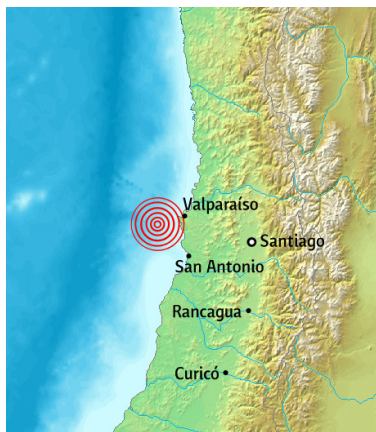
Catastrophe risk modelling firm Eqecat was the first to produce estimates of the economic cost at between \$15bn and \$30bn, or between 10% and 20% of gross domestic product. Rival firm RMS has since estimated \$30bn to \$40bn.

Estimates of the insured cost have been, and continue to be, provided regularly by market participants. Most are in the \$4bn to \$7bn range, but the upper end is now moving out to \$10bn.

Eqecat estimates that most of the damage, some 55% to 65%, is to residential structures, with commercial damage estimated at 20% to 30% and industrial damage at 15% to 20%. Eqecat notes that "widespread adoption and enforcement of modern, seismic-resistant building practices (in Chile) has mitigated the potential for devastation."

Damage has been particularly severe in Chile's second largest city, Concepcion, around 70 miles south-southwest of the epicentre. The capital Santiago has also been significantly affected. Some of the largest individual losses are expected to be from large industrial facilities. Copper mining is Chile's largest export activity and production was interrupted by power shortages, but there has been no structural damage to the facilities reported so far. Several oil refineries have been affected. Aconcagua oil refinery, located close to Santiago, has halted operations. Bio Bio oil refinery, close to Concepcion, has the largest output in the country. Although the extent of damage to this facility is not known, statements from the government indicate that the repairs are expected to take longer than at Aconcagua.

Chile is the third largest insurance market in Latin America, as measured in premium income volume. Earthquake coverage is widespread, with 90% of property insurance policies covering quake.



***Most expensive insured loss ever to hit Latin America.***

The established insurance companies in Chile include subsidiaries of global operators such as RSA (the largest), Liberty, Mapfre and Chartis. Since competition for business in this market has been strong recently, the amount of risk retained by insurers may be relatively low, meaning that much of the catastrophe risk is passed on to the reinsurers.

As is stressed by reinsurers publishing estimates of the potential cost, the whole process is at an early stage. Generally, it takes longer to assess earthquake damage than it does with windstorms, since structural damage to buildings may not always be visible. Reinsurers rely on insurers to tell them what losses they have suffered. Insurers very often do not have that information as it has not yet been possible to assess damage. The estimates therefore include a significant element of guesswork and are likely to change (probably upwards) as the months go by.

Lloyd's did not give initial estimates of the Market's involvement when it published its global results on 24<sup>th</sup> March. However, individual companies have included comments in their recently published results and we expect further trading statements of the sort published by Hiscox on 16 March. Based on an insured Market loss of US\$8 billion for the Chilean earthquake, and US\$3 billion for windstorm Xynthia, Hiscox estimates a combined net loss of approximately £100 million for these two events. Hiscox adds: "This estimate is within budgeted losses for such events and the Group has reinsurance cover remaining for other catastrophes. Hiscox believes these losses will result in the firming of some reinsurance rates."

How this event has affected individual syndicates will become apparent over the next few months. We expect the losses among Lloyd's syndicates to be unevenly spread, dependent in part upon which individual 'facultative' risks were insured – for example, there are reports of damage to pulp and paper facilities, which could give rise to large business interruption claims. We also expect that part of the loss will fall on the 2009 year of account, although the distribution between 2009 and 2010 will vary according to the book, including renewal date, of business written by the individual syndicate. So far the range reported to us varies from 90/10 to 40/60 between 2009/2010.

***Scale of insured damage remains uncertain as meaningful claims information has been limited.***



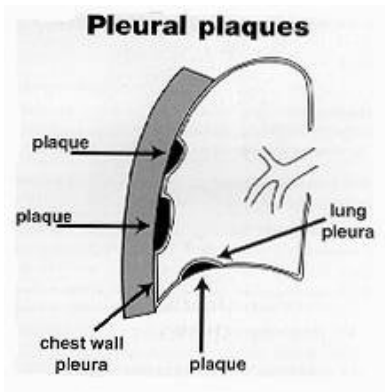
### **Windstorm Xynthia**

Windstorm Xynthia swept across northern France, Belgium and Northern Germany on 27<sup>th</sup> / 28<sup>th</sup> February. The storm has caused damage from extremely strong winds and has resulted in flooding – most noticeable in the Vendee region of France where strong winds combined with high spring tides caused a breach of coastal flood defences.

Windstorm Xynthia is expected to be the second catastrophe of 2010 to exceed \$1bn following winter storms in the eastern US. Initial reports have suggested that the cost of Xynthia could reach \$4bn. The intensity of Windstorm Xynthia is thought to have been about the same as Winter Storm Klaus, which was the most costly natural disaster of 2009, causing \$5.1bn in damage. Klaus hit northern Spain and southwest France in January 2009.



***Pleural plaques and exposure to asbestos.***



***UK Government decides not to reverse the House of Lords decision on compensation.***

### **Pleural Plaques**

Pleural plaques are small areas of thickening on the lung membrane caused by the inhalation of asbestos fibres. They are benign and in most cases harmless, but indicate exposure to asbestos.

A bill is currently making its way through the UK legal system that proposes reintroducing compensation for those diagnosed with the condition. A 2008 Ministry of Justice consultation paper estimates that this could cost UK insurers anything between £3.7bn and £28.6bn.

The wide range reflects uncertainty surrounding the potential number of claims.

In *Rothwell v Chemical & Insulating Co Ltd* in October 2007, the House of Lords found that a person who developed pleural plaques from being exposed to asbestos could not sue his employers for negligence.

The legal precedent set by this case is threatened by the Damages (Asbestos-related Conditions) Bill [HL] 2009-10, which received its second reading on 5th February 2010, and was recently overturned by a mirror-image version that came into force in Scotland.

The Scottish Act received royal assent on 17th April 2009, and is currently being appealed by insurers Aviva, Axa, Zurich and RSA.

On the one hand it is argued that pleural plaques itself does not cause harm or lead to other asbestos-related conditions and that that much of the fear and distress caused to those with pleural plaques is instilled by claimant solicitors – for whom they are big business.

On the other hand it is contended that pleural plaques is a clear indication of asbestos exposure, and although it is in itself benign, the condition means the claimant's employer has breached its duty of care by negligently exposing them to high levels of asbestos.

However, on 25<sup>th</sup> February 2010 Justice Secretary Jack Straw made a statement on the government's decision on the question of compensation for pleural plaques as follows:

"...On the basis of medical evidence received during the course of this review, including authoritative reports from the Chief Medical Officer and the Industrial Injuries Advisory Council, we are unable to conclude that the Law Lords' decision should be overturned at this time or that an open-ended no-fault compensation scheme should be set up."

The ministry did, however, "acknowledge that a particular grievance is felt by individuals who had already begun a legal claim for compensation for pleural plaques at the time of the House of Lords' decision" and "had an understandable expectation that their claim would result in compensation. The government has therefore decided to make extra-statutory payments of £5,000 to individuals in this limited category."

The Association of British Insurers (**ABI**) was pleased with the plan. Its director of general insurance and health said in a statement: "Insurers remain determined to ensure that all those entitled to compensation receive it." "The

### *ABI welcomes the decision.*

government's decision not to reverse the House of Lords ruling is the right one," he added. The ruling "reflects medical evidence that plaques are symptomless, have no impact on health and do not develop into asbestos-related diseases. It also upholds the fundamental legal principle that compensation is payable when someone suffers symptoms following negligence, but not for exposure alone."

How might this affect Lloyd's? Claims could arise principally under Employers' Liability policies. If so, as happened with asbestos claims, the date of exposure, rather than the date of discovery of the symptoms, is more likely to determine liability. If the appeal against the Scottish Act is unsuccessful and claims are made, our view is that this would be more of a problem for Equitas than for current syndicates, whose 1992 and prior year liabilities were reinsured by Equitas. QBE Syndicate 386, which has underwritten a book of UK Employers' Liability business for many years, does not at present anticipate any material losses arising from the latest developments.

### **Chinese Drywall**

Over the past year, there has been increasing attention on defective Chinese drywall, used extensively in the building or repairing on houses in the USA. Drywall, usually known as plasterboard in the UK, was in short supply during the boom years for housing construction, prior to the credit crunch. Repairs following the active 2004 and 2005 hurricane seasons also contributed to that shortage, part of which was met by imports from China.

It has now been discovered that the imported drywall contains strontium sulphide and pure sulphur which, when exposed to high levels of heat and humidity, produce corrosive gases. Problems with corroding metal components in the home, damage to wiring, as well as health problems have been reported, particularly in the hot and humid south eastern states. The US Consumer Product Safety Commission had, by January 2010, received 2,775 reports from residents in 36 States linking metal corrosion or health symptoms to Chinese drywall, almost 60% of which were in Florida.

Financial services company Keefe Bruyette & Woods (**KBW**) has researched the potential exposure of the insurance industry to claims arising from Chinese drywall. Current estimates are that it costs up to \$100,000 to 'repair' each property with defective drywall and that there are 100,000 affected homes. Cost of repairs is therefore up to \$10bn. However, on top of that there would be legal fees at \$5bn to \$10bn, 'indirect costs' of another \$2bn to \$5bn and unquantifiable health costs. Estimates of the total potential cost are therefore in the range of \$15bn to \$25bn.

KBW stresses that it does not expect insurers to bear all of this cost; it will be distributed among insurers, manufacturers, homebuilders/contractors, the government and insureds. It says that, although insurers will have to spend money defending claims, it "ultimately will not be held responsible for bearing the brunt of the Chinese drywall problem".

In answer to the question as to who will be responsible for covering the losses, KBW believes that, given the complexities, the claims will be settled on a case-



### *Toxic plasterboard.*

*A 'lingering cloud' over the insurance industry.*

by-case basis, depending upon the individual contract wording, court decisions relating to pollution and other exclusions, and the ultimate level of governmental involvement. Potential claims could come under various types of coverage, including manufacturers' or products liability, builders risk or contractors' liability, homeowners insurance and professional liability policies.

KBW believes that Chinese drywall will be a 'lingering cloud' over the insurance industry for the next few years, but adds that it is not in its view the "next asbestos". As yet, we have heard nothing about it from any syndicate with which we have an involvement. If there are claims that eventually reach Lloyd's, we would expect them to be in the professional liability area and we will update you in future editions of Market News.

### **Political Risks**

Losses arising from the political risks account have featured in results reporting by insurers and reinsurers for the last 18 months. Political risks are divided broadly into: on the one hand, the insurance of investments and assets against confiscation, nationalization and expropriation by governments; and on the other, the insurance of contracts, whether for the sale, purchase, lease of goods and services or the financing of such contracts in emerging markets.

It is in the latter category, specifically trade credit, that the losses have arisen. In reporting its results for the year ended 31 December 2009, Beazley plc said that the negative impact on profit of increasing its reserves for trade credit risks "...particularly those supporting bank letters of credit in emerging markets..." was £33m. Likewise, Catlin reported trade credit losses, whilst Chaucer referred to a "challenging year" for trade credit as "...heavy losses were experienced following the near collapse of Ukraine's banking sector and similar issues surfacing in Kazakhstan." After many years of highly profitable underwriting, with loss ratios consistently below 50%, the combination of commodity price volatility and a banking and liquidity crisis has caused significant losses.

The balance of the accounts written by Lloyd's underwriters has shifted from the confiscation/nationalisation risks to payment and performance risks, including trade credit, and in consequence these losses are impacting the 2007 and 2008 years of account. Some market participants have withdrawn or severely cut back their accounts, thereby creating opportunities for others. From the recent round of company year-end results reporting, it seems that the position has stabilised with no further actual deteriorations or strengthening of reserves in anticipation of worse to come. The caveat here is that the fortunes of the trade credit account depend heavily on the state of the global economy and should the current fragile recovery falter or if there is another dip into recession, then further trade credit losses will surely emerge.



*Withdrawal of some market participants is creating opportunities.*

## Run-Offs

In our last *Market News* (December 2009) we reported the “good news” that 14 run-off years of account could close at 31<sup>st</sup> December 2009. We now know that 11 of these will indeed be closed. Six syndicates (10 years of account) will remain open for at least a further 12 months. Two (389 and 1171) are life syndicates and therefore may remain open for a while yet as there is currently no RITC market for life syndicates. The only option available to them at the moment is a so-called “Part VII transfer”, which, it seems, is not currently a viable option for either syndicate. The four non-life syndicates (340, 529, 1007, and 1241) all have, we believe, good prospects for closing in 12 months time.

The following table gives an updated summary of the run-off syndicates that Argenta members still have an involvement with. It details the average balance brought forward from last year, the movement in result during 2009 and the amounts due in May this year or carried forward.



*11 years of account closed*

Syndicate	Year	Brought Forward	Movement in 2009	Due in May 2010	Carried Forward
53	1998	-15.3%	5.1%	-10.2%	Closed
53	1999	-1.0%	5.1%	4.0%	Closed
340	2000	-2.8%	-0.5%	nil	-3.3%
340	2001	-15.0%	1.4%	nil	-13.6%
529	1998	13.7%	1.0%	nil	14.7%
529	1999	9.7%	-6.5%	nil	3.2%
957	1997	21.2%	3.2%	24.4%	Closed
957	1998	11.5%	1.0%	12.5%	Closed
957	1999	13.9%	3.0%	16.9%	Closed
991	1998	21.2%	-5.0%	16.2%	Closed
991	1999	-6.4%	1.3%	-5.1%	Closed
991	2000	-5.4%	0.0%	-5.4%	Closed
1007	2002	-1.9%	-2.1%	nil	-4.0%
1101	1997	11.3%	1.8%	13.1%	Closed
1101	1998	2.5%	-0.8%	1.7%	Closed
1101	1999	-6.0%	2.9%	-3.1%	Closed

## Syndicate Results and Forecasts

The following tables show the final results for the 2007 year of account and latest forecasts for 2008. Whilst managing agents are not required to give forecasts for the 2009 year of account until the first quarter this year, a number have provided early estimates and those that we have received are shown on page 20.

**2007 results for third party syndicates and Argenta MAPAs as at 31<sup>st</sup> December 2009 (% of capacity)**

Syndicate/ MAPA	Previous Forecast @ 30/09/09			Reported Result @ 31/12/09	Change in Result %
	Worst Case %	Best Case %	Mid-Point %		
<b>33</b>	22.50	30.00	26.25	31.74	+5.49
<b>218</b>	1.50	6.50	4.00	0.06	-3.94
<b>260</b>	-18.47	-13.47	-15.97	-20.89	-4.92
<b>308</b>	4.88	9.88	7.38	5.19	-2.19
<b>318</b>	-6.25	-1.24	-3.74	-2.76	+0.98
<b>386</b>	55.83	60.83	58.33	66.50	+8.17
<b>510</b>	10.70	15.70	13.20	13.21	+0.01
<b>557</b>	13.77	18.77	16.27	16.62	+0.35
<b>570</b>	15.03	20.04	17.54	17.57	+0.03
<b>609</b>	0.00	5.00	2.50	6.49	+3.99
<b>623</b>	11.52	16.53	14.02	14.55	+0.53
<b>727</b>	13.00	18.00	15.50	17.14	+1.64
<b>779</b>	3.58	8.59	6.09	11.40	+5.31
<b>780</b>	13.50	18.50	16.00	17.48	+1.48
<b>807</b>	7.69	12.69	10.19	10.59	+0.40
<b>958</b>	12.50	17.50	15.00	16.40	+1.40
<b>1176</b>	45.00	55.00	50.00	54.39	+4.39
<b>1200</b>	4.00	9.00	6.50	14.67	+8.17
<b>2007</b>	5.00	10.00	7.50	10.26	+2.76
<b>2010</b>	10.00	15.00	12.50	11.37	-1.13
<b>2121</b>	8.50	13.50	11.00	11.91	+0.91
<b>2525</b>	21.39	26.39	23.89	40.94	+17.05
<b>2526</b>	16.61	21.61	19.11	24.18	+5.07
<b>2791</b>	20.00	25.00	22.50	27.81	+5.31
<b>3245</b>	7.50	12.50	10.00	8.39	-1.61
<b>3334</b>	3.00	8.00	5.50	3.69	-1.81
<b>4040</b>	-6.63	-1.63	-4.13	-1.75	+2.38
<b>6101</b>	5.50	10.50	8.00	8.59	+0.59
<b>6102</b>	5.50	10.50	8.00	8.10	+0.10
<b>6103</b>	36.00	41.00	38.50	40.80	+2.30
<b>MAPA 7006</b>	12.99	18.28	15.63	17.23	+1.60
<b>MAPA 7049</b>	11.90	17.20	14.55	15.97	+1.42
<b>Lloyd's Ave</b>	11.90	17.28	14.59	16.95	+2.36

Source: Managing Agents' Results as at 31<sup>st</sup> December 2009 submitted to Lloyd's.

**2008 forecasts for third party syndicates and Argenta MAPAs as at 31<sup>st</sup> December 2009 (% of capacity)**

Syndicate /MAPA	Previous Forecast at 30/09/09			Latest Forecast at 31/12/09			Change %
	Worst Case %	Best Case %	Mid-Point %	Worst Case %	Best Case %	Mid-Point %	
<b>33</b>	0.00	7.50	3.75	2.50	10.00	6.25	+2.50
<b>218</b>	2.35	7.36	4.86	-0.50	4.50	2.00	-2.86
<b>260</b>	-21.32	-16.32	-18.82	-26.24	-21.24	-23.74	-4.92
<b>308</b>	9.82	14.82	12.32	8.48	13.48	10.98	-1.34
<b>318</b>	-14.92	-9.92	-12.42	-14.11	-9.11	-11.61	+0.81
<b>386</b>	15.92	20.92	18.42	18.72	23.72	21.22	+2.80
<b>510</b>	4.90	9.90	7.40	5.14	10.14	7.64	+0.24
<b>557</b>	8.07	13.07	10.57	9.49	14.49	11.99	+1.42
<b>570</b>	0.00	9.97	4.99	2.99	7.98	5.48	+0.49
<b>609</b>	2.50	12.48	7.49	9.98	14.98	12.48	+4.99
<b>623</b>	5.50	10.50	8.00	7.50	12.50	10.00	+2.00
<b>727</b>	4.51	14.53	9.52	4.50	14.50	9.50	-0.02
<b>779</b>	2.12	7.12	4.62	1.64	6.64	4.14	-0.48
<b>807</b>	2.98	7.98	5.48	3.00	8.00	5.50	+0.02
<b>958</b>	0.00	5.02	2.51	0.00	5.02	2.51	
<b>1176</b>	30.00	45.00	37.50	35.00	45.00	40.00	+2.50
<b>1200</b>	-8.00	2.00	-3.00	-8.00	2.00	-3.00	
<b>2007</b>	-7.50	-2.50	-5.00	-7.50	-2.50	-5.00	
<b>2010</b>	2.50	7.50	5.00	5.00	10.00	7.50	+2.50
<b>2121</b>	1.00	6.00	3.50	1.00	6.00	3.50	
<b>2525</b>	0.00	7.50	3.75	0.00	7.50	3.75	
<b>2526</b>	6.86	14.36	10.61	9.70	17.20	13.45	+2.84
<b>2791</b>	7.00	12.00	9.50	8.00	13.00	10.50	+1.00
<b>3334</b>	10.01	20.02	15.01	9.01	14.00	11.50	-3.51
<b>4040</b>	0.51	5.51	3.01	-2.50	2.50	0.00	-3.01
<b>6101</b>	-1.00	4.00	1.50	1.00	6.00	3.50	+2.00
<b>6102</b>	-1.00	4.00	1.50	1.00	6.00	3.50	+2.00
<b>6103</b>	7.50	12.50	10.00	7.50	12.50	10.00	
<b>6104</b>	25.00	32.50	28.75	25.00	32.50	28.75	
<b>6105</b>	3.11	8.17	5.64	2.81	7.72	5.26	-0.38
<b>MAPA 7006</b>	2.48	8.29	5.38	4.06	9.31	6.69	+1.31
<b>MAPA 7007</b>	2.08	7.98	5.03	3.28	8.67	5.97	+0.94
<b>MAPA 7049</b>	2.09	7.90	5.00	3.61	8.86	6.24	+1.24
<b>Lloyd's Ave</b>	0.02	6.23	3.12	1.02	7.00	4.01	+0.89

Source: Managing Agents' Forecasts as at 31<sup>st</sup> December 2009 submitted to Lloyd's

**Currently available 2009 initial forecasts as at 31<sup>st</sup> December 2009 (% of capacity)**

Syndicate	Initial Forecast @ 31/12/09		
	Worst Case %	Best Case %	Mid-Point %
<b>33</b>	2.50	10.00	6.25
<b>260</b>	-15.60	-10.60	-13.10
<b>308</b>	-4.00	6.00	1.00
<b>510</b>	9.30	19.30	14.30
<b>557</b>	9.90	19.90	14.90
<b>570</b>	0.00	10.00	5.00
<b>609</b>	7.50	17.50	12.50
<b>623</b>	9.50	14.50	12.00
<b>779</b>	-10.40	-5.40	-7.90
<b>807</b>	2.10	12.10	7.10
<b>958</b>	5.00	15.00	10.00
<b>6104</b>	<b>35.00</b>	<b>50.00</b>	<b>42.50</b>

Source: Forecasts provided by Managing Agents as at 31<sup>st</sup> December 2009.

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