MARKET UPDATE

JUNE 2007

Rating Environment Remains Attractive

The aim of the EU Transparency Directive, implemented in January 2007, is to enhance transparency on EU capital markets by establishing rules for the disclosure of periodic financial reports for companies whose securities are admitted to trading on a regulated market in the EU. One of the consequences is increased disclosure of periodic financial information through a mix of quarterly financial reporting for the first and third quarters of the financial year, and a more detailed half-yearly financial report.

In response to the new requirements, many of the listed Lloyd's vehicles have recently issued trading updates covering the first four months of the year. These vary in detail but the overall picture is of a rating environment that remains attractive, although the overall trend is towards a softening market. The development of 2007 is satisfactory with no significant catastrophe losses. First quarter investment returns show an improvement over the same period last year.

All are aware that, with predictions of above average Atlantic hurricane activity in 2007, it is what happens in the second half of the year that really matters. Hardy Underwriting Group makes a bolder statement than others: "Hardy is satisfied that the combination of low loss incidence to date and acceptable margins provide a healthy buffer to withstand adverse catastrophe losses in the second part of the year and so provide the potential for a good result to be achieved for 2007."

Amlin provides the most detailed commentary on the various classes.

In its **reinsurance** book "…US catastrophe reinsurance pricing is still strong, although it is off the peaks achieved in the run-up to the 2006 US hurricane season. Early indications for forthcoming Florida renewals are encouraging and the effect of the decision by the State of Florida to increase its hurricane protection fund is anticipated to be less than initially expected." On the other hand "…International catastrophe reinsurance rates have come under greater pressure as more reinsurers have sought to increase the diversity of their portfolios. For example, prices for the recent Japanese catastrophe excess of loss renewals were down approximately 6% on average relative to last year."

On direct property Amlin reports: "For US exposed **direct property** insurance, pricing is still acceptable, although increased competition from some US domestic carriers offering materially increased lines and recent new entrants is placing greater downward pressure on rates."

Meanwhile "Gulf of Mexico **energy** rates remain strong and international **hull** rates remain firmer following a series of market losses in the first quarter."

UK commercial and **aviation** "remain competitive". Airline rates continue to decline, by 25% in the first quarter according to Aon, but other aviation classes such as general aviation and corporate jets are more stable. Brit, whose UK division covers employers' liability, public liability, professional indemnity, directors & officers, motor and property confirms that in the UK conditions are "competitive and challenging".

The anticipated recovery in the **UK motor** private car market appears to be faltering.

Produced by Argenta Research Team
130 Fenchurch Street
London EC3M 5DJ
E-mail: research@argentaplc.com

Although rate increases held in the first quarter, recent reports suggest that these have been given up in the second quarter. It now seems less likely that the hoped-for gathering momentum, for an overall improvement in the second half of 2007, will materialise.

Premium rating indices support the assertion that the rating environment remains attractive overall. Kiln's index shows overall prices for Composite Syndicate 510, which writes a broad book across accident & health, property, reinsurance, marine and aviation, at 99% of those at the same time last year on renewal business. In addition, "The current rates on average across the Kiln portfolio are comfortably ahead of those of 2002, acknowledged as a year of good underwriting rates." Kiln continues, "In this rating environment, Kiln is writing fewer new risks than it did at this stage last year, accounting for 18% (Q1 2006: 21%) of the total premiums written. At the same time, the company has been successful in renewing business in those areas where pricing remains most attractive; retention rates in the accident & health and reinsurance divisions - parts of the business that generally have high retention rates - are 90% (2006: 90%) and 82% (2006: 70%) respectively. "

Catlin's rate monitoring experience and conclusions are very similar to Kiln's: "Average weighted premium rates for catastrophe-exposed business increased by 3% during the period ended 30 April 2007, whilst average weighted premium rates for non-catastrophe exposed business decreased by 4%. Overall, average weighted premium rates for all classes of business decreased by 1% during the period ended 30 April 2007, which is in line with the Group's expectations. Rate adequacy continues to be good."

Catlin also reports that **prior year reserves** have developed "according to expectations", whereas Amlin's experience has been better than expected with a release of £19.5 million.

In **summing up,** some are more cautious than others. Kiln concludes: "It is our expectation that, if the year continues as it has begun, rates will show a marginal decline for the rest of this year. With the backdrop of the weak dollar and strengthening competition in the market, we will focus on maintaining underwriting discipline in line with our commitment to underwrite for profit, which may be at the expense of volume."

Amlin is upbeat: "Overall, the outlook for 2007 financial performance remains very healthy, with income at similar levels to 2006 and reduced exposures to major catastrophes."

Catlin, like Hardy, is prepared for what the hurricane season may offer: "Whilst we expect continued downward pressure on rates for more classes of business throughout the remainder of 2007, we believe that underwriting margins are still robust. We are prepared for the onset of the Atlantic hurricane season, having substantially reduced our exposure to catastrophic events over the past 18 months."

View from Throgmorton Street

(The following comments are general observations only and should not be construed as being any form of investment advice).

Our continued round-up of share price movements of the listed Lloyd's vehicles shows the group performing well against the two main UK indices. For the sake of completeness, we have added AIM-listed Advent and Heritage, along with LSE-listed Catlin and Novae, to our table.

When comparing share price performance against the stock market indices it is important to remember that the stock market indices are calculated on the basis of total returns (i.e. including reinvestment of dividends), while the individual share price movements do not include dividends. In fact, the Integrated Lloyd's Vehicle (ILV) stocks are some of the higher yielding stocks in the market (average yield from the group is 3.86% against an average of 2.93% for FTSE100 and of 1.93% for FTSE250).

Atrium has led the way over the past two months, largely on a pledge to return a significant amount of capital to shareholders in the second half of 2007. Kiln, in the midst of relocating to Bermuda, has seen the largest reverse. Over the past seven months, the two largest companies by capitalisation, Amlin and Catlin, have been amongst the under-performers. Amlin saw an increase of over 30% in 2006, perhaps due a breather, while the market is waiting to see how Catlin digests Wellington before re-rating.

	Share price (p)			Change (%)	
	Oct 06	Mar 07	May 07	Oct – May	Mar – May
Advent	33	31	29	-13.0	-6.6
Amlin	296	315	308	4.1	-2.2
Atrium	221	238	317	43.4	33.2
Beazley	120	155	148	23.5	-4.4
Brit	331	330	348	5.1	5.5
Catlin	509	513	502	-1.2	-2.1
Chaucer	77	97	105	36.4	8.2
Hardy	242	286	297	22.5	3.7
Heritage	88	101	99	12.6	-2.5
Hiscox	258	273	280	8.5	2.6
Kiln	94	121	110	16.8	-9.3
Omega	146	156	164	12.3	5.1
Novae	30	40	39	30.5	-3.8
FTSE100	6,166	6,320	6,571	6.6	4.0
FTSE250	10,361	11,754	12,057	16.4	2.6

Surging levels of merger and acquisition activity have been widely forecast to spread to Lime Street. Firstly, Catlin's acquisition of Wellington has been cited as presaging consolidation amongst the established London market players. Secondly, Bermudian property catastrophe reinsurers have been expected to seek diversification through acquisition of Lloyd's Managing Agents. Although there is no activity of the first type to report, May saw Bermudian reinsurer, Validus, agree terms for the acquisition of Lloyd's Managing Agent Talbot Underwriting in a deal reportedly worth £200m. Talbot owns and operates Syndicate 1183. Validus was established in 2005 and is backed by the private equity firm, Aquiline Capital Partners. Aquiline is also one of the principal backers of the recent Lloyd's start-up, Ark Syndicate Management, under David Foreman.

In Europe, French reinsurer SCOR has agreed takeover terms with Swiss rival Converium in a £1.4 billion deal. In acrimonious opening exchanges, Converium argued that a link up would result in a loss of $800m of business as well as an exodus of senior management and staff. However, by the time SCOR upped its offer (from SwFr4 plus half a SCOR share for each Converium share held to SwFr5.5 plus half a SCOR share), Converium managers were promising "a smooth combination of the two businesses".

Syndicate Forecasts

Managing Agents have now reported their updated forecasts for 2005. A summary is reproduced on the following page. Generally forecasts at the first quarter 2007 are the same or better than those published last quarter.

In our April 2007 Market News, we detailed those syndicates which had made early forecasts for the 2006 year of account. These remain unchanged at the 1st quarter with the exception of three of the Kiln syndicates where improved forecasts have been published. These are: Syndicate 510: +11.0% to +21.0%, Syndicate 557: +15.6% to +25.6% and Syndicate 308: +0.4% to +10.4%.

Produced by Argenta Research Team
130 Fenchurch Street
London EC3M 5DJ
E-mail: research@argentaplc.com

2005 forecasts for third party syndicates and Argenta MAPAs

Syndicate /MAPA	Previous Forecast at 31/12/06 Worst Case %	Best Case %	Mid-Point %	Latest Forecast at 31/03/07 Worst Case %	Best Case %	Mid-Point %	Change %
33	-7.50	2.50	-2.50	-7.50	2.50	-2.50	
44	3.46	8.46	5.96	2.75	7.75	5.25	-0.71
218	10.00	15.00	12.50	9.55	14.55	12.05	-0.45
260	7.67	12.67	10.17	7.91	12.91	10.41	+0.24
308	8.60	13.60	11.10	9.39	14.39	11.89	+0.79
318	-5.11	-0.15	-2.63	-3.90	1.10	-1.40	+1.23
382	6.00	11.00	8.50	7.50	12.50	10.00	+1.50
386	27.35	32.35	29.85	28.45	33.45	30.95	+1.10
510	-9.10	-4.10	-6.60	-9.09	-4.09	-6.59	+0.01
557	-23.20	-18.20	-20.70	-18.70	-13.70	-16.20	+4.50
570	2.50	10.00	6.25	2.50	10.00	6.25	
609	-7.50	0.00	-3.75	-7.50	0.00	-3.75	
623	-1.07	4.07	1.50	2.41	7.41	4.91	+3.41
727	1.00	11.00	6.00	1.00	11.00	6.00	
779	2.29	7.29	4.79	3.53	8.53	6.03	+1.24
780	-80.00	-70.00	-75.00	-80.00	-70.00	-75.00	
807	-11.00	-6.00	-8.50	-10.62	-5.62	-8.12	+0.38
958	5.00	10.00	7.50	5.00	10.00	7.50	
1007	10.00	15.00	12.50	10.00	15.00	12.50	
1084	0.00	5.00	2.50	1.00	6.00	3.50	+1.00
1176	20.00	30.00	25.00	20.00	30.00	25.00	
1200	-10.01	0.00	-5.00	-10.00	0.00	-5.00	
1221	-2.69	2.31	-0.19	-1.62	3.38	0.88	+1.07
2010	-2.00	3.00	0.50	-2.00	3.00	0.50	
2020	-16.00	-8.00	-12.00	-16.00	-8.00	-12.00	
2121	-67.50	-62.50	-65.00	-67.50	-62.50	-65.00	
2525	5.02	12.56	8.79	5.02	12.56	8.79	
2526	7.52	15.03	11.28	7.52	15.03	11.28	
2791	-2.00	3.00	0.50	-1.00	4.00	1.50	+1.00
3245	7.50	12.50	10.00	7.50	12.50	10.00	
4040	-0.40	4.60	2.10	-0.40	4.60	2.10	
MAPA7006	-9.16	-2.85	-6.01	-8.68	-2.38	-5.53	+0.48
MAPA7049	-3.42	2.64	-0.39	-2.80	3.24	0.22	+0.61
MAPA7102	-4.91	1.62	-1.65	-4.28	2.24	-1.02	+0.63

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