Lloyd's: A Review by U.S. State Insurance Regulators

**Report of the Examination Team
to the Surplus Lines (E) Task Force on**

September 14, 1998

Lloyd's: A Review by U.S. State Insurance Regulators

EXECUTIVE SUMMARY

Lloyd's management has maintained that the requirement to collateralize 100% of the gross US Surplus Lines liabilities of its Members in US Situs trusts was onerous. Lloyd's argued that the requirement put it at a competitive disadvantage relative to other alien companies, placed unreasonable strains on its liquidity, and interfered with the smooth operation of the Reinsurance to Close mechanism.

Lloyd's requested the collateral required for US Situs surplus lines business be reduced from the 100% level. In December 1997, New York determined that Lloyd's should be allowed to reduce the Lloyd's US Situs Surplus Lines Trust Deed requirement to a 50% level for business incepting from August 1, 1995, subject to certain conditions.

The NAIC voted in December to also allow the US Situs Surplus Lines Trusts to be reduced to a 50% level on surplus lines business incepting on or after January 1, 1998, subject to similar conditions to those established by New York. However, a decision regarding the request for application of a 50% standard to surplus lines business incepting between August 1, 1995 and December 31, 1997 was held in abeyance pending a legal opinion on legality and liability issues.

Additionally, the NAIC voted to form a Review Team under the direction of the NAIC's Surplus Lines (E) Task Force and charged it to:

> "Perform an in-depth and on-site investigation of the structure and workings of Lloyd's. Provide a written report and explanatory brochure for use by state insurance regulators. Complete field work and make recommendations regarding appropriate levels for Lloyd's U.S. Situs Trust Funds – Surplus Lines by March 1998 meeting. Complete report and explanatory brochure for use by state insurance regulators by June 1998 meeting."

The review of Lloyd's organization and operations undertaken by state regulators is described in this report. The review was performed in two phases. Phase one consisted of a one-week planning conference in January 1998. Phase two consisted of two weeks of fieldwork in February 1998. The fieldwork consisted of an in-depth review of the processes at Lloyd's together with limited testing of internal controls and reporting. Time and resources limited the review and the reader is urged to review the "Scope and Limitations" section on page 56.

This report is written in two parts. Each responds to a different aspect of the charge given to the Review Team. Part 1 is a descriptive brochure intended to assist US regulators to better understand the structure and operations of Lloyd's. Part 2 describes the scope and findings relative to the fieldwork performed by the NAIC Review Team.

Part 1: Highlights

Part 1 contains historical background and tracks the evolution of the current state of the market, including regulation, and a brief description of the market participants. The business cycles at Lloyd's are described, as is the financial underpinning known as the "Lloyd's Chain of Security".

Noteworthy points include:

- Lloyd's insurance activities account for:
  - approximately 18% of the US Surplus Lines premium writings, totaling $1.6 billion for 1997;
  - participation in the US Reinsurance market, with credits for reinsurance taken by US cedants of nearly $6 billion at year end 1997;
  - an important part of the US "exempt" market, including Marine, Aircraft, Transportation, and Industrial Insured placements; and
  - direct writings as an admitted insurer in Illinois, Kentucky, and the U.S. Virgin Islands.
- Lloyd's 1997 worldwide gross premiums approximated $12.8 billion. The US accounts for 32% of this amount or $4.1 billion. The 1998 premium capacity is approximately $16.8 billion; however, Lloyd's estimates its market will only write about 70% of capacity (or approximately $11.8 billion).
- As of January 1, 1998, the Lloyd's market participants included:
  - 7,260 individual and corporate Members, who bring the capital into the market to underwrite risks;
  - 19 Member agents, who provide guidance to Members on the selection of syndicates;
  - 66 Managing Agents, who hire the underwriters and administer the syndicate operations;
  - 155 main syndicates, whose capacity is based upon allocated capacity of participating Members;
  - approximately 200 registered brokers, combined into approximately 120 groups, that are the sole means by which insurance business can be brought into the Lloyd's market;
  - the Corporation of Lloyd's, which provides the facilities, authorization, and administrative infrastructure, together with certain accounting rules, for the syndicates to operate; and
  - the Council of Lloyd's, which provides the regulatory structure and the market rules of operation.
- Lloyd's is a market, not an insurer. As a result, Lloyd's has certain unique operating characteristics worth noting:
  - Many syndicates, rather than any single syndicate, participate in the substantial majority of all insurance or reinsurance policies. Lloyd's, coupled with insurance companies located in London, make up the "London Market". The other insurers, often referred to as the company market, also participate in many of the policies and treaties. This approach to insurance underwriting is known as a "subscription market". Insurers "subscribing" to a risk do so on a several, not joint, basis.

- Because of the many participants, all premium collections and claim payments for Lloyd’s syndicates go through central processing facilities provided by Lloyd’s.
- All premiums and reinsurance recoveries are collected into working trust funds used to pay claims and expenses. These same premium working trust funds are used to transfer dollars to the US Situs Credit for Reinsurance and the US Situs Surplus Lines Trust Funds.
- Lloyd's utilizes a three-year accounting cycle that typically ends through a Reinsurance To Close (RITC) mechanism. In an RITC scenario, one or more new underwriting syndicates, formed by Members of Lloyd's in a succeeding year, reinsure the outstanding liabilities of the original syndicate three years after inception. Thus, each syndicate underwriting-year is a separate annual venture.

• Currently, many initiatives are underway, both inside Lloyd’s and externally at the newly formed regulatory unit under HM Treasury, to strengthen the chain of security for policyholders. These include:

- A freshly revitalized regulatory group, reporting directly to the Lloyd’s Regulatory Board, that performs the functions of authorization, monitoring, and enforcement;
- The establishment of the Market Risk Unit, under the Finance Division. This Unit is enhancing Lloyd’s risk-based capitalization approach that indexes the Members' required Funds at Lloyds (FAL) to the risks being underwritten;
- New equivalents of the NAIC Schedule P and Schedule F implemented by the Market Reporting and Solvency Unit to track reserves and reinsurance for US Surplus Lines and Reinsurance business;
- The requirement for syndicates to obtain actuarial opinions on their reserves.

Part 2: Highlights

Part 2 of the report describes the testing performed on internal controls and financial reporting and summarizes the recommendations on appropriate levels of funding for Lloyd’s US Situs Surplus Lines Trust Funds. This objective was accomplished through extensive interviewing of key persons in the Lloyd’s market, and through observation and limited sampling of Lloyd’s processes. The Team's interviews included all levels of management, from the Chairman and the Chief Executive Officer, to pertinent department heads and intermediate managers, to rank and file employees. In addition, market participants were interviewed, including Lloyd’s brokers, underwriters, Managing Agents, actuaries and independent accountants, as well as insurance regulatory officials, whose job it will be to effect the transition of UK regulation of financial services.

The Review Team concluded that:

• no evidence was found that the internal controls and financial reporting processes were not adequate.

• no inconsistencies were noted during the interviews regarding the descriptions of both the financial controls and reporting processes.

• while several areas were identified as needing improvement, the continuing developments in capitalization standards and the regulatory structures were encouraging to the Review Team.

As a result of their work, the Review Team recommended that state insurance commissioners formally consider relief from the 100% gross liability funding level to a lesser level. The recommendation for maintaining a lower funding requirement was contingent on continued progress in the areas of capitalization, reserving, market regulation, and financial reporting. The Review Team also recommended that additional reviews, to monitor progress of the new initiatives, be performed in future reporting periods. Based on these additional reviews, US insurance regulators should reevaluate the appropriate level of funding requirements for Lloyd's US Situs Surplus Lines Trust Funds.

The Review Team expresses appreciation to the leadership and many people at Lloyd's, at Equitas, at HM Treasury, and in the London Market. The Team received a remarkable degree of cooperation, candor in response to our questions, and access to the entire Lloyd's infrastructure throughout our review efforts. In addition, we appreciate the direction from the NAIC leadership and the personal participation by several state commissioners.

Associate Commissioner José Montemayor
Team Chief, NAIC Review Team
September 14, 1998

PART 1 – THE OPERATIONS AND STRUCTURE OF LLOYD'S

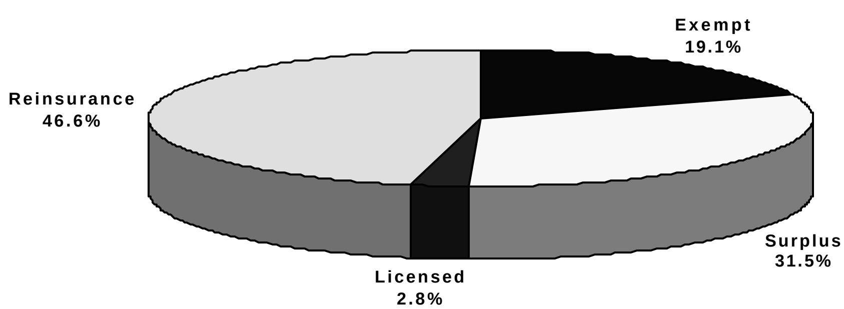
Overview of Operations

The Lloyd’s market has been a significant participant in the US insurance industry dating back to colonial days. Lloyd’s has enjoyed a 300-year reputation and mystique as a direct writer and also as a reinsurer. Lloyd’s itself is not an insurer. Lloyd’s is a market where individuals (sometimes referred to as “Names”) and corporate Members write insurance. Hereafter, throughout this report, the term "Members" will refer to the combination of individual and corporate Members. Insurance is written "on their own accord and not one for another", which means business is accepted by the Members on a strictly several, not joint basis. Members write insurance by joining syndicates who underwrite the insurance or reinsurance of all types of risks on behalf of their subscribing Members. It is estimated that in 1997, Lloyd's syndicates accounted for approximately 18% of the surplus lines business in the United States as well as an important presence in the reinsurance market. They are also a major participant in the “exempt” marketplace, consisting primarily of, marine, aircraft, and transportation. Finally, Lloyd’s is an admitted insurer in the states of Illinois ($75.2 million), Kentucky ($25.8 million) and the US Virgin Islands ($31.9 million).

Lloyd's is the 5th largest global reinsurer and 2nd largest global commercial lines insurer operating in over 100 countries. The 1997 worldwide gross premiums are estimated at $12.8 billion. For 1998, they have the “capacity” to accept premiums of approximately $16.8 billion. However, the expectation is that only about 70% of capacity will be utilized. In the world insurance market, the syndicates at Lloyd’s have historically been a significant provider of reinsurance and surplus line capacity. Indications are that the US Dollar premiums in both reinsurance and surplus lines markets have been decreasing. This is consistent with the decreases in the proportion of US Dollar premiums in the global insurance market that have occurred since the late 1980’s.

As of December 31, 1997, 32% of Lloyd's business emanated from the US. Lloyd's US business is categorized into the four groups as shown in the following chart:

Source of Lloyd’s US Net Premiums 1997



Overview of Structure

Lloyd's has a 350-year history. Its structure is statutorily based in the Lloyd's Act (last revised in 1982). Over time a unique structure has evolved that has many noteworthy operating characteristics.

The primary players in the market are the Members (individual Names and corporate Members), Member's Agents, syndicates, Managing Agents, brokers, and the Corporation of Lloyd's. At the beginning of 1998, there were 6,825 individual and 435 corporate Members that provide the capital used to underwrite risks. Nineteen Member's Agents provide guidance to the Members on their selection of syndicates and also perform administrative functions on their behalf. Currently, Members participate in 155 main syndicates. The Corporation of Lloyd's provides the facilities, global authorization, financial reporting and administrative and finance infrastructure for the market participants to operate. Importantly, the Corporation of Lloyd's also provides the regulatory structure and the market's rules of operation.

Insurance business can only be brought into the Lloyd's market through insurance brokers registered with Lloyd's as being permitted to place business in the market (Lloyd's brokers). There are 187 Lloyd's brokers operating worldwide who bring individual risks to the 155 syndicates managed by 66 Managing Agents.

While the Members are the risk bearing entities in the market, the market operates by way of syndicates. Each syndicate is formed annually by a group of Members. Both individual and corporate Members pledge unlimited liability (although the total net worth of the corporation limits a corporate Member's liability). In addition both individual and corporate Members must also deposit capital with Lloyd's in the form of assets held in trust instruments. These assets are not used as working capital in the day to day operations of the syndicates.

The majority of all insurance policies are placed with many syndicates, rather than with a single syndicate. Many policies have participation from insurers outside of Lloyd's at the "company market". The company market is made up of insurance companies, some of which are members of trade associations. This multiple participant approach to insurance underwriting is known as a "subscription market".

Historically, there have been significant tax advantages associated with Lloyd's. High United Kingdom (UK) taxes in the 1960's and 1970's were a strong inducement to membership by UK residents.

Unlike other UK insurance concerns, the business of Lloyd's is largely self-regulated. This jurisdiction is provided by a separate Act of Parliament, the Lloyd's Act 1982.

Historical Perspective

Prior to the Mid-1980's

The genesis of the modern entity that is now Lloyd's can be traced back to a coffee shop owned by Edward Lloyd in the seventeenth century. Wealthy merchants would mutualize the risk of loss of ship voyages by indicating the amount of risk that they would accept on a line and writing their names underneath – hence, the source of the terms "line" and "underwriter" in insurance parlance. Over time, this insurance activity became more structured, and ultimately the modern Lloyd's evolved. Although originally Lloyd's was a marine market insuring ships, cargoes, etc., at the end of the 19th century, Cuthbert E. Heath – the founder of broker C. E. Heath – introduced non-marine policies to Lloyd's. C. E. Heath was also responsible for a master-stroke of public relations: immediately after the devastating San Francisco earthquake in 1906, he sent a cable to the Lloyd's loss adjusters telling them to pay all of his Lloyd's policyholders in full as opposed to debating the exact terms of the policy. His cable, which received wide publicity, popularized the mystique of Lloyd's in the United States.

Up until the late 1960's, Lloyd's was the exclusive domain of the wealthiest men in Britain. Following Hurricane Betsy in 1966, and in response to a need for further capital, it was decided to allow foreigners and women to become Members of Lloyd's. The amount of wealth required to become a Member at Lloyd's has remained high. However, the period of rapid inflation in the UK in the 1970's, reduced the overall wealth levels required to join Lloyd's as the capital requirement decreased substantially in real terms.

The decrease in real capital coincided with an unprecedented chain of events that included natural disasters, low premium rates, and an increasing recognition of the problems associated with US asbestos and pollution liabilities.

Several problems caused great strain on the market including:

- **London Market Excess of Loss Spiral (LMX Spiral) -** This problem was created as layers of various large risks were underwritten and subsequently reinsured and retroceded within a few syndicates. Lloyd's internal controls failed to recognize that the risk was not being dispersed but instead was being concentrated. As a large claim materialized, it hit the few syndicates who had essentially reinsured the risk between one another. As one syndicate tried to collect its reinsurance from another syndicate, it became apparent that the premium trust funds and the Members Funds at Lloyd's would be inadequate. The liquidity of the working capital of the relevant syndicates was put under unprecedented pressure by the concentration of the risk. Appendix 2 provides a more detailed historical narrative of the LMX Spiral.

- **Catastrophes** - All insurers face the probability of catastrophes but expect that these incidents are dispersed over time. Such was not the case for Lloyd's and other international insurers and reinsurers during the five-year period between 1988 and 1992. In a relatively short span of time the Lloyd's market and other insurers were hit by very large claims from catastrophes including the Exxon Valdez, Piper Alpha, and Hurricane Hugo.

- **Environmental** - The emergence of US long-tailed liability claims for asbestos, pollution, and health related exposures on contracts dating back several decades compounded the situation. The US tort system, coupled with federal Superfund legislation that included retroactive liability provisions, resulted in a flood of primary and reinsurance claims.

- **Inappropriate Capital Requirements** - The conflict between self-regulation and market forces and the lack of effective external oversight was especially evident from the fact that the Lloyd's market did not ensure that certain Members had adequate liquid assets or other personal wealth (OPW). In other words, there were Members, either knowingly or unknowingly, who did not have the means to take on the extraordinary level of risk that they did.

- **The Disaster Years**

For the 5 years from 1988 to 1992, Lloyd's as a whole incurred underwriting losses as follows:

Lloyd's Global Results: 1988 to 1992

Account yr. **(reported)**	***1988 ('91)***	***1989 ('92)***	***1990 ('93)***	***1991 ('94)***	***1992 ('95)***
Loss £/million	(£510)	(£1,863)	(£2,319)	(£2,048)	(£1,193)
Exchange rate	1.93	1.87	1.51	1.48	1.56
Loss $/million	($984)	($3,484)	($3,502)	($3,031)	($1,861)
Cumulative $/million	($984)	($4,468)	($7,970)	($11,001)	($12,862)

These losses were not uniformly distributed and therefore hit certain syndicates particularly hard. To give a better perspective, losses from 1988 to 1992 averaged £287,000 or about $461,000 per existing Member. As a result, some Members' losses exceeded their capacity to pay them. A number of the hardest hit Members believed that some of the underwriting practices had been negligent and resorted to legal action against their agents and others involved in risk placement and evaluation.

Reconstruction & Renewal (R & R)

By 1995, Lloyd's was in a serious crisis. Lloyd's management acknowledged in 1995 that by 1996 Lloyd's would be under extreme pressure resulting from the depletion of the Central Fund, with the concomitant and unprecedented risk that the market would be unable to pay all its claims. If Lloyd's were to continue as a marketplace, a drastic solution to its problems was required. After thorough internal and external evaluations, Lloyd's solution, the Reconstruction and Renewal (R&R) program, was to reinsure all pre-1992 liabilities under a single reinsurance contract and cede them to a new venture named Equitas Reinsurance Limited (ERL). ERL in turn, retroceded all these liabilities to its wholly owned subsidiary Equitas Limited (EL). As used subsequently in this review the term Equitas is meant to consist of ERL and EL.

The first major objective of the R&R program was to determine the appropriate level of reserves for all Lloyd's liabilities for the 1992 and prior years of account. An integral part of this determination was an immense reserving project Lloyd's began in 1993, and that was to last three years. On September 4, 1996, the UK Government approved Lloyd's reserving proposals and authorized the largest ever run-off reinsurance companies, Equitas. Shortly thereafter, Equitas compulsorily reinsured the non-life liabilities of all Members of Lloyd's syndicates for account years 1992 and prior.

A second major objective of the R&R program was to formulate a market settlement that would enable Lloyd's to settle outstanding litigation with its Members. The settlement fund was established and distribution proposals determined after extensive negotiations with Members' action groups and market participants. Individual offers were made to each Member in the summer of 1996. In September 1996, 95% of Members agreed to accept the settlement.

A third major objective of R&R was to reform Lloyd's internal operations, governance, and regulation.

The R&R process was successfully completed in the fall of 1996. As a result, Equitas assumed reinsurance to close for all the Members' participations in syndicate years 1992 and prior. In return, Equitas received a $21 billion reinsurance premium funded from:

- Members' reserves held in premium trust assets and elsewhere;
- Members' settlement awards;
- Additional payments made form Members' own funds;
- Contribution from Member's Agents and Lloyds's brokers; and
- Lloyd's Central Fund.

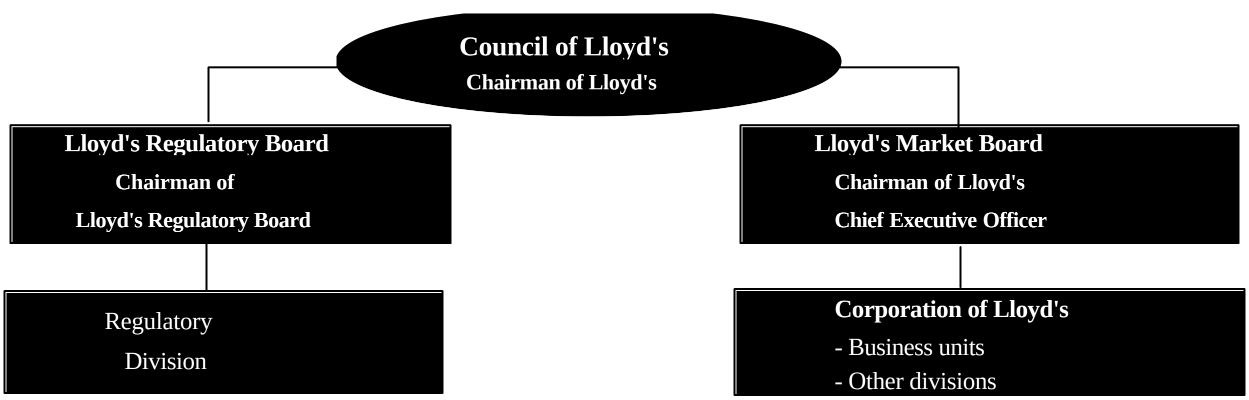
Equitas was created by the Council of Lloyd's, with the approval of the UK Department of Trade and Industry (DTI). The new companies were subject to certain restrictions such as no new business, no new outward reinsurance, no payment of dividends, no return premium, and no amendment to the companies memorandum and articles of association without the approval of DTI.

With the creation of Equitas, the syndicates writing in the market for 1993 and forward were freed from the problems of the past; they were writing on a "clean slate". However, Members on syndicates in years 1992 and prior still retained contingent liability if Equitas' funds ever prove inadequate.

Organization and Governance Structure

The governance structure is as follows:

Lloyd's Governance Structure



The Council of Lloyd's

Lloyd's has its own Acts of Parliament, known as the Lloyd's Acts 1871 to 1982. Under theses Acts, the governance of Lloyd's resides with the Council of Lloyd's. Nineteen members currently make up the Council. Thirteen are elected members as shown in the chart below, and six are "nominated" or non-executives approved by the Governor of the Bank of England. One of the nominated members of the Council serves as the Chief Executive Officer of the Corporation. Under Lloyd's Act 1982, the Council of

Lloyd's has control over the management and regulation of the affairs of the Society with power to make bylaws for this purpose.

The Boards: Lloyd's Regulatory Board and Lloyd's Market Board

The Lloyd's Regulatory Board (LRB) and the Lloyd's Market Board (LMB) were established in January 1993 in order to:

- create an expert and impartial body, the LRB, chaired by a nominated member of the Council of Lloyd's, to establish and operate an effective regulatory structure for the market's business
- create a body with an appropriate range of Lloyd's and outside expertise, the LMB, chaired by the Chairman of Lloyd's, to provide a focus for business leadership; and
- focus the Council of Lloyd's on its overall supervisory function as provided in the Act of 1982, and to carry out the statutory provisions of legislation and confirmation of disciplinary decisions.

Members of the LRB and LMB are appointed annually by the Council of Lloyd's, as shown on the following chart.

Lloyd's Governing Bodies

Regulatory Board 14 Members	Council of Lloyd's 19 Members	Market Board 18 Members
One working member of the Council	Six working members of the Council	Three working members of the Council
Two external members of the Council	Five individual external members of the Council	Three external members of the Council
Two appointed external members	Two corporate external members of the Council	One appointed external member
Four nominated members of the Council	Six nominated members of the Council	Eight additional market practitioners
Four appointed working members		Three Corporation executives
Director, Regulatory Division		

The Corporation of Lloyd's

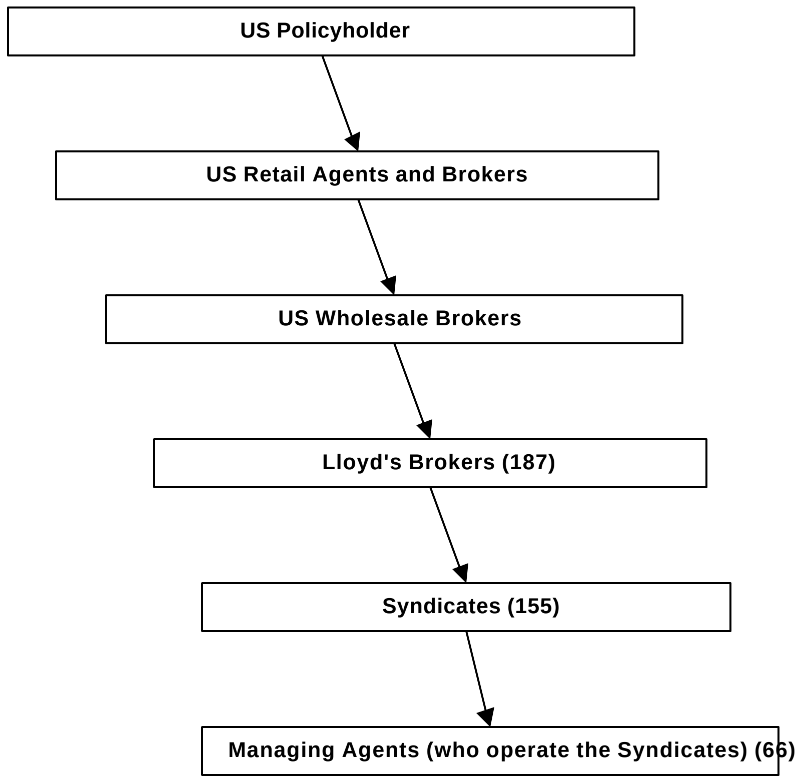
The Corporation of Lloyd's is the corporate body that provides certain strategic, business process, finance, general administrative, and property services to the market participants. It recovers the cost of these services by fees, levies, and re-charges. The Corporation is not an underwriting entity. Directed by Lloyd's Chief Executive Officer, it employs about 2,000 management and staff.

In 1997, Lloyd's established five unit boards (Business Development, North America, Members' Services, Insurance Services, and Property Services) to oversee the work of the Corporation's business units responsible for the core business of Lloyd's. The boards are appointed from among recognized market figures and are mostly chaired by the CEO.

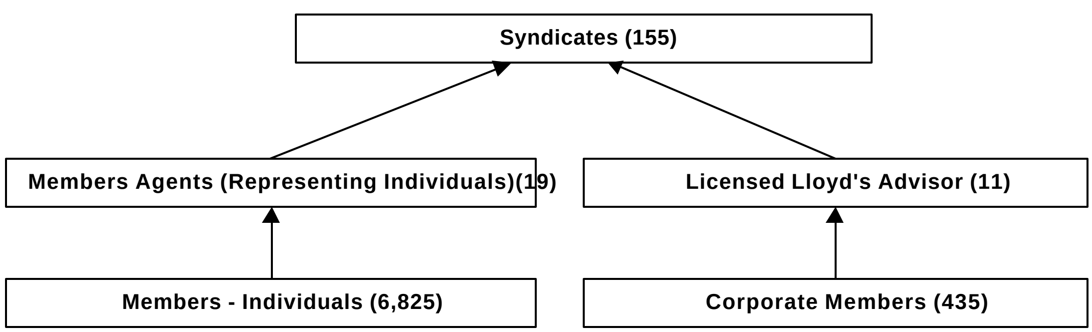
An organizational chart is attached as Appendix 3.

The Market Participants

The key components of the Lloyd's market are Members, Members' Agents, syndicates, Managing Agents, and brokers. The basic flow of US business into the marketplace is (Numbers as of January 1, 1998):



The capital flow to support the business flow is:



As discussed below, each participant in the Lloyd's Market has a unique role and responsibility.

Lloyd's Brokers

Lloyd's brokers are the intermediaries between clients (the insureds and/or cedants, either directly or through non-Lloyd's brokers) and the Lloyd's Market for almost all insurance business placed with Lloyd's syndicates. Lloyd's brokers range from subsidiaries of the major global brokerage groups to specialist brokers who focus on particular lines of business and clients.

Some Managing Agents (described below) have service companies to market their syndicates' business (mainly UK motor and other personal lines) direct to policyholders. In this instance, the role for the Lloyd's broker is to guarantee (in return for a fee) amounts due from non-Lloyd's brokers.

Managing Agents

Managing Agents (MAs) are the companies that provide management and other services to Lloyd's syndicates. The MA appoints and employs an Active Underwriter (and other management and staff) who underwrites on behalf of the Members of the syndicate. The MA determines the underwriting policy of the syndicate in conjunction with the Underwriter. The MA provides the syndicate's business infrastructure (staff, accommodation, computer systems, etc.). The associated costs are normally charged directly to the syndicate. The MA charges capacity-based fees and profit commissions to Members in order to cover costs, which are not syndicate-specific and to make a profit. The decline in the number of MAs has mirrored the decline in the number of other market participants. As of January 1, 1998, there were 66 MAs, which is a drop from a peak of 196 MAs in January 1985.

Syndicates

Syndicates are groups of Members. Syndicates are not insurance companies although sometimes they are mistakenly described or treated as if they were. A syndicate is an annual venture, with each Member separately liable for its own losses. Syndicate Members share severally in the income, expenses and losses of the syndicate in their pre-determined proportion. Frequently syndicates have more than a thousand Members.

Historically, a syndicate would predominantly specialize in one market sector, although it's underwriting is not restricted to that sector unless specified by the Regulatory Division. The introduction of corporate capital and increased consolidation in the market has created composite syndicates underwriting across multiple sectors.

The number of main operating syndicates has declined from 401 in 1990 to 155 in 1998. Virtually all of these syndicates are authorized to accept US Situs Surplus Lines business and are qualified as accredited reinsurers to accept US Situs Reinsurance business. While some predicted that the number of syndicates would continue to decline, recent developments have shown that the number of syndicates in 1998 has remained relatively constant.

Members' Agents

Member's agents represent the Member's interests and manage the supply of capital to syndicates on each Member's behalf. They advise Members on choosing their syndicate portfolio and on the auction process (see below); they negotiate with Managing Agents to place capacity in syndicates; and they manage Members' administrative affairs. The number of Member's Agents has declined significantly in recent years. In 1998, there are 19 Member's Agents, one of which is a combined Member Agent and Managing Agent.

Members

Members, sometimes termed "Names", are the actual insurers in the Lloyd's Market. Each accepts risks by means of participation in Lloyd's underwriting syndicates. Participation on a Lloyd's syndicate by a Member is on a several, not joint, basis. A Member typically spreads underwriting capacity to a number of syndicates. A typical Member will underwrite in 40 to 100 syndicates.

Prior to the 1994 underwriting year, all Lloyd's Members were individuals who underwrote business on a bespoke (see page 18) and unlimited liability basis, i.e. individually, each placed at risk the whole of its personal wealth. Effective January 1, 1994, Lloyd's expanded its underwriting membership to include corporations. Corporate Members can lose no more than the corporate Member's total net worth. From 1994 to 1998, the percentage of market capacity provided by corporate Members has steadily increased from approximately 15% to 60%.

The number of individual Members has declined substantially in recent years, from over 34,000 in 1988 to 6,825 in 1998. As individual Members are generally expected to take advantage of the increasing opportunities to convert their unlimited liability participation into limited liability participation by way of various corporate conversion vehicles. Many observers expect this decline to continue. However, perhaps because of UK tax advantages to individual membership, seven individuals pledged unlimited liability and were admitted to membership in 1998.

The decline in the total value of capacity contributed by individual Members and the concurrent increase capacity provided by corporate Members to the Market is demonstrated in the following table:

PREMIUM / CAPACITY HISTORY			All figures in £m		
	1994	**1995**	**1996**	**1997**	**1998**
Individual	9,289	7,835	6,985	5,824	4,105
	85.24%	*76.90%*	*69.89%*	*56.41%*	*40.37%*
Corporate	1,609	2,360	3,009	4,500	6,064
	14.76%	*23.10%*	*30.11%*	*43.59%*	*59.63%*
Total capacity	10,898	10,195	9,994	10,324	10,169
Capacity Utilization	*70.27%*	*78.72%*	*69.80%*	*65.80%*	
Resulting premium	**7,658**	**8,025**	**6,976e**	**6,793e**	**7,419e**
Note: 1996-1998 figures are Lloyd's forecasts					

Individual Bespoke Members

Individual “bespoke” Members select their own portfolio of syndicates on which they wish to participate, with the assistance of their Member's agent. It has been a number of years since individuals have become Members of Lloyd's in large numbers. Since 1994, U.S. residents and citizens have no longer been eligible to join as individual Members.

An individual wishing to become a Member of Lloyd's selects a Member's agent. If the Member's agent advises that membership is appropriate for the individual, during the spring and summer months, the agent will guide the prospective Member through the procedures that precede election to membership. These procedures include proof of the prospective Member’s unencumbered assets and culminate in a Rota Committee, a meeting in London between the prospective Member and representatives of the Council of Lloyd’s, during which the individual is questioned on its understanding of the responsibilities that membership entails. The Member's agent will then assemble the agreed syndicate portfolio for the Member to underwrite the following year and the Member will provide the necessary Member’s capital, known as Funds at Lloyd’s, before the Member is allowed to underwrite any risks.

Members' Agent Pooling Arrangements (MAPAs)

Diversification is one way of minimizing the risk carried by a Member of Lloyd’s. However, for Members underwriting on only a modest scale, the expense of spreading their participation widely and the time involved to keep in touch with the activities of a large number of syndicates makes this difficult on a bespoke basis.

MAPAs are administrative arrangements run by Members' Agents who place all the Members involved on a common underwriting plan. This way, Members are able to achieve economies of scale making a widespread underwriting portfolio cost effective. A member of a MAPA does not have to remain in the MAPA. If the Member does elect to remain in the MAPA, the Member's Agent will determine the underwriting program without direct input from the Member.

Individual Members can place some or all of their underwriting capacity via MAPAs. Individual Members can (and often do) underwrite on a bespoke basis as well as on a MAPA basis in the same underwriting year. Currently, there are 43 MAPAs with a combined capacity of approximately £2.19 Billion.

Corporate Members

Corporate Members are corporations held by one or more shareholders for the exclusive purpose of becoming a corporate Member of Lloyd's. Corporate Members are either "spread vehicles", which typically participate on approximately 50 syndicates or "dedicated" which support only those syndicates managed by one Managing Agent or which support only one syndicate.

The Annual Venture

As previously discussed, syndicates are an annual venture. The Lloyd's Agency Agreement governs the relationship between the manager of a syndicate and Members providing capital. The agreement forms the basis of the annual venture structure and allows a Member to terminate participation on a given syndicate after one year, as long as the Member gives three months notice.

Each Lloyd's syndicate is reconstituted each year as a new entity. Members must indicate their willingness to continue underwriting on each syndicate in advance of each underwriting year. If the Managing Agent makes additional capacity available, Members may increase their participation. Members can also decrease their participation.

The right to participate on a syndicate in the following year has value. Effective from the 1995 year of account forward, the Council of Lloyd's precluded Managing Agents from giving notice, without prior Council consent, to their Members that they cannot participate in the following year. Members acquire 'security of tenure' which creates value in their syndicate participation.

Members now have the right to continue to participate on a syndicate for the following year or to nominate another Member to participate in their place. A Managing Agent wishing to increase the size of a syndicate must first offer the new capacity to Members already on the syndicate in proportion to their current participation. A Managing Agent proposing to decrease the size of the syndicate must do so evenly across the entire syndicate stamp, or membership.

The Auction Process

Since 1995, Members wishing to leave a syndicate or reduce their participation may access the auction as one method to realize the value inherent in the right to participate. The auction process also enables Members to join syndicates of their choice. If capacity on any syndicate is placed in the auction, a Member prepared to pay the highest price may secure the right to underwrite on that syndicate the following year. In 1997, eight auctions were held between the middle of July and the end of September to coincide with the period of the year when Members review their underwriting plans for the following year. Each auction lasts for two days with reports published after the first day and after the final results are known. The auction is an electronic process managed by the Corporation of Lloyd's. The system deals in £1 units of capacity on a particular syndicate.

Those seeking capacity on a particular syndicate bid for the number of units of capacity they would like to acquire at the price they are prepared to pay per desired unit. These bids are then matched to the number of units of capacity available from existing Members of that syndicate wishing to dispose of the capacity. The highest bid is matched to the number of offered units included in that bid, the second highest bid is matched to the number of offered units included in that bid and so on until all offered units are matched by a bid. Each successful bidder pays the price offered for the number of units bid and thereby acquires that number of units of capacity. The price per unit of the successful bids are then averaged so that each existing Member disposing of the capacity receives the same payment per unit of capacity.

Business Processes

Lloyd's Underwriting

Lloyd's is part of the London market. Insurance is placed with Lloyd's and other insurers in the London Market on a subscription basis. Thus, a risk is typically placed with several different insurers, including Lloyd's syndicates, each of which is liable on a several basis. On large commercial risks, 30 or more insurers may subscribe to a policy and the London market may be approached to write only a "part-order" or certain "layers" of the risk.

Because there are multiple syndicate participants in a typical insurance policy or reinsurance treaty placed at Lloyd's, all premium fund collections and claim payments go through central processing facilities provided by Lloyd's to facilitate policy signing, netting, settlement, and accounting services for the syndicates. The central facilities also collect basic statistical data.

Because of the diversity of the Lloyd's Market, an intricate system has evolved at Lloyd's by which all premiums and reinsurance recoveries are collected into working trust funds used to pay claims and expenses. These same premium working trust funds are used to fund US Situs Trust Funds to allow US insurers to take credit for reinsurance and to protect US surplus lines policyholders. A more complete discussion of the Lloyd's trust funds supporting US business can be found under the section "Chain of Security".

The business processes supporting all interactions between Lloyd's brokers and the syndicates are carried out centrally in the Lloyd's Policy Signing Office (LPSO) and the Lloyd's Claims Office (LCO). The LPSO is responsible for preparing, checking, and signing/embossing all Lloyd's policies, although the preparation of non-standard and complex wordings is carried out in the first instance by Lloyd's brokers. The LCO is responsible for reviewing, adjusting and settling claims against Lloyd's underwriters in conjunction with the leading underwriter. The signing off of premiums and claims for settlement by LPSO and LCO triggers Lloyd's Central Accounting systems (LCA), which is run by LPSO's Settlement and Trust Fund Operations, and acts as a clearing process. That function nets the millions of premiums and claims transactions between syndicates and Lloyd's brokers to form balance totals for settlement on a daily basis.

The Placing of a Risk

The customer approaches a Lloyd's broker with details of the risk to be insured. The customer (either an individual, a company or, in the case of reinsurance, an insurance company) may either approach the Lloyd's broker directly or more frequently the approach may be made on the customers behalf by an intermediary broker or series of brokers. Only Lloyd's registered brokers are permitted to transact business with Lloyd's syndicates.

The Lloyd's broker approaches an underwriter known to specialize in the class of business involved. The Lloyd's broker establishes whether the underwriter is prepared to accept such a risk on behalf of the Members of their syndicate, and, if so, negotiates the premium terms and the policy conditions with the underwriter.

With this information, the Lloyd's broker consults the customer via the broking chain. If the customer is satisfied with the terms and conditions, the broker may place a firm order.

The Lloyd's broker then prepares an underwriting "slip", which is the document used for placing a risk in the London market. The slip sets out the nature of the risk, the premium, and the terms and conditions in a standard format recognized in the London market. The Lloyd's broker then presents the slip to the underwriter who will confirm his acceptance of the proposed terms and conditions and will "put down his line" on the bottom of the slip. It is at this point that a contract exists between the customer and the Members of the particular syndicate. The underwriter accepting the risk becomes the "leading underwriter".

The Lloyd's broker then approaches other underwriters on other syndicates with a view to obtaining written lines totaling 100% of the risk or more. The other underwriters, known as "following underwriters", review the risk and decide whether to accept a portion of it on behalf of the Members of their syndicate. Following underwriters do not negotiate terms and conditions. Instead, they rely on the decision and expertise of the leading underwriter.

If the written lines on the slip exceed 100%, the Lloyd's broker "signs down" these lines on a pro-rata basis to determine the final "signed line" per syndicate. Once the slip is finalized, the Lloyd's broker presents it to the LPSO for checking and processing.

The LPSO prepares, signs, and embosses the Lloyd's policy before it is sent to the client via the broking chain. The broker retains the slip for his files. In cases where the policy insures a complex risk or does not contain standard wording – as is the case in 55% of risks placed at Lloyd's – the LPSO checks the policy wording as prepared by the Lloyd's broker and then signs and embosses that wording as a Lloyd's policy. In either case, it is the function of the LPSO to ensure that the policy meets the exact requirements of the risk as specified in the slip terms and conditions, and that the wording is in accordance with all Lloyd's and regulatory requirements. This same procedure operates to provide an insurance contract giving binding authority to US Surplus Lines brokers, which must be specially authorized to be "Lloyd's cover-holders".

Daily electronic messages are sent to each syndicate and Lloyd's broker confirming the risks signed by LPSO for the preparation of a policy or for the payment of premiums (see below).

In circumstances where the Lloyd's broker has placed the risk with both the Lloyd's and company markets, the broker must approach the company market separately to facilitate the placement, the issuance of a separate policy, and the settlement of premiums for the company proportion.

Premium Processes

The settlement of premiums and claims at Lloyd's is carried out by Lloyd's Central Accounting (LCA) system at the Lloyd's Chatham location. This settlement process occurs daily for each of Lloyd's three settlement currencies, US Dollar, Sterling, and Canadian Dollar. Lloyd's anticipates adding additional settlement currencies to the system in the future as needed, including the Euro currency. This settlement process involves a netting procedure. Syndicates will be making claim payments to insureds through broker accounts and insureds will be making premium payments to syndicates through broker accounts. These amounts are netted by the LCA system before making a single payment to each broker and each syndicate.

Once the underwriter has established the premium for the risk, the broker is responsible for collecting the premium from the insured. The customer or the intermediary broker(s) deducts any brokerage due and pays the premium to the Lloyd's broker. The Lloyd's broker submits a Premium Advice Note (PAN) to the LPSO, which records the details of the premiums due and the terms of trade governing the settlement date of those premiums. The premium is settled to the Lloyd's syndicate within three working days of the date of LPSO signing.

Once the premium amounts have been entered into the LPSO database, the Central Accounting system processes premiums, along with claims and adjustment amounts, as a daily bulk settlement process. The premium is allocated to the syndicates involved based on the signed lines and is included in a daily net payment to the underwriters. An electronic message is sent by the Central Accounting system to all syndicates and brokers involved detailing the breakdown of their net payments.

The system employed by the LPSO and the Central Accounting system to transfer premiums to the correct trust funds is based on a series of codes. These codes are utilized to identify a risk as being US Situs, and if so, to classify it as licensed, Surplus Lines, US reinsurance or exempt business. These codes are designed to deposit the premiums into the proper trust accounts, for the year of account and syndicate number. The accuracy of the information entered into Lloyd's Insurance Data System (LIDS) depends on how accurate the broker is in preparing the information supplied to the LPSO and the LCO.

LIDS also is designed to verify that the syndicates have the necessary trust funds in place for the proposed business before LIDS permits it to be processed.

The LPSO supports and facilitates insurance transactions in the Lloyd's market by providing services which include:

- Document checking, preparation and any associated functions carried out for underwriters;
- Data capture and storage on the LPSO system, known as LIDS;
- Data transfer to the mainframe Central Settlement System. (Transfer of monies between brokers and syndicates is administered and controlled by the Settlement & Trust Fund Operations, based on electronic output from the Central Accounting system);
- Preparation and communication of daily electronic signing messages which confirms signing and provides details of individual accounting transactions processed during the previous day; and
- Compiling and disseminating relevant information to market participants, internal regulators and external regulators in the UK and abroad.

The services provided are critical to the operating efficiency of the Lloyd's market.

As mentioned, this system assigns the premiums to the various trust funds and years of account. Depending on the policy inception date, the type of business written, and the currency in which the syndicate will settle, any one of several trust funds may receive the premiums. See the "Chain of Security" section of this report for a detailed discussion of the various trust funds.

Claims Processes

The role and responsibilities of the LCO are defined in the Lloyd's 1994 Claims Scheme. The LCO provides central claim authorization and processing services on behalf of Lloyd's syndicates. A daily file of completed claim and refund transactions authorized for settlement is transferred from the Claim Office Support System (COSS) to the LPSO for subsequent processing through signing message and mainframe Central Settlement Services.

The LCO is responsible for processing all reinsurance reinstatement premiums using LIDS, as these transactions are a direct consequence of the payment of claims on certain business types.

The LCO is also responsible for setting up Letters of Credit (LOCs) on behalf of underwriting Members as a mechanism for providing security for claims and for processing claims against those LOCs.

Claims are reported from the insured via the broking chain to the Lloyd's broker in London. The Lloyd's broker prepares a claims file and reports the details to the lead underwriter and to the Lloyd's Claims Office (LCO). The LCO acts on behalf of the other underwriters on the risk (the "following market") and co-ordinates with the lead underwriter to ensure claims are handled in an efficient manner. The claim is logged in Lloyd's central system and a link is made with the underwriting record created by LPSO, thereby identifying the underwriters on the risk. Decisions on the appointment of adjusters, appointment of experts, and settlement of valid claims are made by both the lead underwriter for the Members of his syndicate and by the LCO for the following market. Both the lead underwriter and the LCO must agree before any action is undertaken. Once the payment of a claim is agreed, the decision of the lead underwriter and the LCO is binding on the remaining underwriters.

Once agreement to the claims payment has been completed, LCO will create a settlement record on its computer system (COSS). Once the settlement has been confirmed, the details of the claim payment are provided to Lloyd's Central Accounting. On the due date of the settlement, LCA debits the relevant share from participating syndicates as part of their daily netting process and pays the total amount to the Lloyd's broker. The Lloyd's broker transmits the payment to the insured either directly or through the broking chain. If the broker has placed the risk with both the Lloyd's and the company markets, the broker must approach the company markets separately to agree to the claims handling approach, the settlement of any valid claims, and the transmittal of claims payment. In practice, the lead underwriter for the company market and the lead underwriter for the Lloyd's market, together with the LCO, frequently agree to a consistent course of action.

Reinsurance to Close

Lloyd's operates under a three year "year of account" accounting system, which is reflected in the Lloyd's Acts. This accounting method was established in the 17th century, as a result of the length of time it took for insured vessels to complete their voyage. It was a common practice in marine insurance and continues today as a result of the fact that syndicates are reconstituted annually and it is difficult to assess the profitability of an “underwriting” year in less than three years of maturity. In addition, it is the required method of accounting for all Lloyd's Members under the European Union Accounting Directive.

The "year of account" accounting system and the concept of “Reinsurance to Close” (RITC) is best explained by example: the 1995 "year of account" begins January 1, 1995. All premiums received in 1995, and any additional or installment premiums received in 1996 and 1997, in respect of risks underwritten in 1995, are credited to the 1995 year of account; similarly, expenses and claims in respect of these risks also are charged to the 1995 year of account. All the premiums are held in trust and invested in highly liquid securities until the close of the year of account. All the investment income is similarly retained in the trust and may be reinvested during the course of the year of account. The account closes at the end of the third year, i.e., on December 31, 1997.

At the end of the third year of a year of account, a syndicate’s entire portfolio of insurance is reinsured to cover claims that may subsequently be made against Members on the reinsured syndicate’s year of account, including any earlier accounts insured therein. Usually, this is accomplished by transferring the entire portfolio to a re-formed syndicate for a subsequent year of account by means of reinsurance. The ceding syndicate’s year of account is then closed out, and underwriting profit or loss is ascertained for the closed year. Members on the assuming reinsurer syndicate receive reinsurance premium income, salvages, reinsurance recoveries and late arriving direct insurance premiums; they also assume the risk of losses and pay all subsequent claims and expenses. In summary, each Member on the ceding syndicate pays a reinsurance premium to each Member on the assuming syndicate, and the Lloyd’s accounts reflect both the payment and the receipt of such reinsurance premiums.

Underwriting Members must reinsure their outstanding liabilities at the end of a year of account. Although Members on a particular syndicate customarily place closing reinsurance with the Members on the ceding syndicate’s immediate successor syndicate, they are not required to do so. This is usually done because they believe that reinsurance at Lloyd’s provides the best security for their policyholders and because it is the cheapest and most effective means of obtaining reinsurance. If Members on a syndicate do not reinsure with the successor (re-formed) syndicate, the Members simply purchase the requisite closing reinsurance from Members on one or more unrelated syndicates at Lloyd’s or from the reinsurance companies market. However, when Members utilize other reinsurance markets, they are required to pay intermediaries’ commissions, which increase the expense of the closing reinsurance premium. Lloyd's does not treat conventional reinsurance with a company reinsurer as an RITC.

Financial Reporting

Lloyd’s Market Reporting and Solvency Department (MRSD), under the Finance support unit of the Corporation of Lloyd’s, performs the financial reporting function for Lloyd’s.

Financial reporting is categorized in this section into two parts:

1) US Situs Trust Funds financial reporting, and

2) Reserving.

Financial data is generated from internal systems, capturing premiums and claims, and from filings made by the Managing Agents for their syndicates. For the US Situs business, this information is reconciled to the funds held in US Situs Trust Funds at Citibank, New York.

Lloyd’s US Situs Trust Funds Financial Reporting

The process for reporting on both the US Situs Credit for Reinsurance Trust Funds and the US Situs Surplus Lines Trust Funds is the same. This process is controlled and managed centrally by the Market Reporting & Solvency Department (MRSD).

As detailed in the explanation of premium flow above, gross premium data is captured by the LPSO as the broker reports the data. The LPSO also captures information on the state and the Surplus Lines broker for surplus lines business. Lloyd’s centrally provides syndicates with data on premiums signed, claims paid, and outstanding claims (by cedant for the US Situs Credit for Reinsurance Trust Fund). This data is provided on a daily basis and a quarterly basis in preparation for the quarterly filings.

The LPSO, the LCO, and Citibank also report data quarterly and monthly into the MRSD database. LPSO/LCO provide information on premiums signed as well as paid and outstanding claims. Citibank provides information on investment transactions and asset valuations. The MRSD prepares individual syndicate filing formats encompassing all underwriting data (i.e. premiums signed, claims paid and outstanding claims) as well as details of all investments movements during the quarter and valuations at the end of a quarter. The MRSD provides draft filing formats to each syndicate’s Managing Agent. The Managing Agent verifies the accuracy and completeness of the data with its own records. Managing Agents then calculate their syndicate reserve in accordance with UK actuarial practices and make necessary modifications for US reporting. The end of quarter reserve figures are placed into the filing formats and are reported back to the MRSD. The MRSD reviews the report looking for obvious inconsistencies or anomalies. The MRSD then updates the US formats with any amendments. The MRSD provides final formats to the Managing Agents who perform a final review and sign-off including notarization. The MRSD prepares a global report and files this together with syndicate data with the NAIC’s International Insurance Department (IID) and the New York Insurance Department (NYID). Finally, the MRSD obtains mandates from the Managing Agents to move assets from the Lloyd’s Dollar Trust Funds (LDTFs) located in Citibank, London, to the US Situs Trust Funds. MRSD instructs the Lloyd’s Settlements and Trust Funds Operation Department at the LPSO to make these transfers on the required date.

In 1998, Lloyd’s required syndicates to file reinsurance and loss data on US business in a manner similar to the NAIC Property/Casualty Blank Schedule F, Parts 2-8, and Schedule P. The MRSD performed a dry run of these filings as of September 30, 1997; official filings were first required for data as of December 31, 1997.

All reinsurance recoverable from sources external to Lloyd’s on Surplus Lines Trust Fund (SLTF), Credit for Reinsurance Trust Fund (CRTF) and Lloyd’s American Trust Fund (LATF) business is reported in separate schedules. The returns follow the NAIC blanks as amended for Lloyd’s syndicates. An aggregate Lloyd's Schedule F is reported for LATF business, and SLTF/CRTF Schedule F reporting is on an individual syndicate basis.

Since December 31, 1996, syndicates must provide US regulators with annual actuarial opinions on net overall reserves and gross reserves for US Situs business.

Reserve Requirements

Over time, the NYID, the IID, and Lloyd's have placed greater reliance on actuaries to determine the reasonableness of syndicate reserves.

Historical Perspective

Some Managing Agents employed actuaries prior to 1993 for reserving, pricing and related work. In addition, some Managing Agents used statistical and actuarial based projections derived from computer packages to assist in the determination of their solvency reserves. However, the involvement of actuaries in the reserving process increased significantly in the years 1993 through 1997. The increased use of actuaries was prompted by the start of the Equitas project in 1993 that culminated in 1997, with the requirement that syndicate solvency reserves for all years of account be subject to actuarial opinions.

In 1995, state insurance regulators instructed the NAIC's IID to start requiring actuarial opinions as part of reporting requirements used to determine eligibility for surplus lines placements. Because of different accounting rules and practices, it was necessary to customize the opinions, which the NYID subsequently negotiated with Lloyd's.

Early years

As early as the 1950's, Managing Agents were required to establish syndicate reserves at the higher of the following two methods:

- Test 1- minimum reserves, expressed as a percentage of premium; and
- Test 2 – the agent's and underwriter's estimate of reserves.

Managing Agents would determine Test 1 and Test 2 results separately for each solvency category and year of account. For each test, the results would be aggregated for all solvency categories separately by year of account. The required solvency reserves would be the higher of the aggregate reserves on a Test 1 or Test 2 basis, by year of account.

The Test 1 minimum reserve formulae were refined over time, particularly in the 1980's. As of December 31, 1989, an actuarial opinion requirement was established relating to runoff years of account (i.e. years of account that remained open at 36 months and beyond). This opinion has been required each year until the runoff year of account closes (unless the Regulatory Division grants a dispensation of the requirement to obtain the actuarial opinion). The scope of the actuary's opinion includes a determination of;

- Sufficiency of the Managing Agent's accounting records as a basis for determining the reserve amount to meet all liabilities;
- Reasonableness of the methods and assumptions used by the Managing Agent; and
- Materiality of the factors taken into account when forming the position regarding the possibility of not closing the year of account.

Increased involvement of actuaries in the reserving process

Beginning with the 1993 solvency test, a new caveat was added to the then existing rule that required syndicates to carry solvency reserves on each year of account at the higher of Test 1 and Test 2. The caveat only related to years of account that were closing (i.e. at 36 months) or in runoff (i.e. open at 36 months and beyond). It stated that: if Test 1 results were higher than Test 2 results, syndicates could carry a reserve figure lower than Test 1 (but equal to or higher than Test 2) if supported by an actuarial opinion. The precise form of this opinion was agreed upon by the UK Secretary of State.

The role of actuaries in the history of Lloyd's was cemented when, in October 1993, Lloyds embarked on the Equitas project. As part of this project, actuaries were involved in evaluating the syndicates' reserves for years of account 1992 and prior that would ultimately be reinsured into Equitas. A US actuary, with extensive experience in non-life insurance, headed the project and many of the leading actuarial firms from the UK and the US participated in the exercise.

Solvency Tests - 1994, 1995 and 1996

The solvency tests in 1994, 1995, and 1996 expanded the caveat included in the 1993 solvency test (which only applied to years of account at 36 months and beyond) to apply to all years of account and to include a minimum reserve requirement. Thus, for the 1994 through 1996 solvency tests, for each year of account separately, the solvency reserves were determined as follows:

- Determine the higher of aggregate Test 1 or Test 2 reserves.

- Where aggregate Test 1 reserves are in excess of the aggregate Test 2 reserves, reserves lower than the aggregate of Test 1 could be used if supported by an actuarial opinion in a form agreed by the UK Secretary of State, except that:

  - An additional safety margin, determined by the actuary, was required above the Test 2 reserve; and

  - In determining the safety margin, it was permissible to reflect future investment income.

Solvency Test – 1997

The Lloyd's "Chain of Security" document, issued in April 1997, recommended that syndicate reserves for all years of account be subject to actuarial opinion. Thus, for year-end 1997, the syndicate must establish the Managing Agent's estimate of reserves (previously akin to the Test 2 basis) and these reserves must be subject to a statement of actuarial opinion. The new requirement is reflected in the Valuation of Liabilities Rules as approved by the Government Actuary's Department and the Insurance Division of HM Treasury. Managing Agents who are unable to secure an unqualified opinion are required to use "percentage reserves" which are set at punitive levels. In addition, any syndicate that is not able to secure an unqualified opinion will be subject to review by Lloyd's Regulatory Division.

Actuarial Opinions - US Situs Trust Fund Opinions (December 31,1996 and subsequent)

Beginning with the 1996 year of account, Lloyd's syndicates writing US Situs business have been required to secure actuarial opinions as follows:

- As required by the IID, opinions on syndicate's world wide reserves net of reinsurance, and on the gross reserves reported in its US Situs Surplus Lines Trust Funds financial statements. These are due May 15th of each year;

- As required by the NYID, the same two opinions, but due on or before March 1st of each year;

- As required by the NYID, an opinion on the gross reserves reported in the US Situs Credit for Reinsurance Trust Fund statement. This is due on or before March 1st of each year.

A comparison of the specific requirements for these opinions and the UK Solvency Opinion is provided in Appendix 5.

Accounting Issues which impact the US Surplus Lines Statements of Actuarial Opinion

Following months of review and consultation among state insurance regulators on the NAIC's Surplus Lines (E) Task Force, the Task Force adopted a requirement that, beginning December 31, 1995, each Lloyd's syndicate file with the NAIC's IID an annual reporting package (pack). The pack includes an actuarial opinion on the syndicate's overall net loss reserves and its gross US surplus lines liabilities. Subsequently, the Task Force granted an exemption as permitted in the IID Plan of Operation for the actuarial opinions for year-end 1995.

In October 1995, Lloyd's representatives met with the NYID to discuss the contents and format of the quarterly and annual reporting packs. The NYID and Lloyd's agreed to the basis upon which syndicates would carrying their reserves at the end of each year and each quarter in the US Situs Trust Funds statements. The agreed to basis was that syndicates set minimum reserves using the Test 1 and Test 2 methodologies for the first three quarters of each year of account. At year-end reserves were to be calculated at the higher of Test 1 or Test 2. Following the implementation of actuarial opinion requirements on Lloyd's reserves for 1997, Test 1 percentages will no longer be necessary.

For year-end 1996, syndicates were required by the NYID and the IID to obtain an actuarial opinion on the gross loss reserves in the US Situs Trust Funds. The NYID required that the opinion include a statement indicating that the reserves "meet the requirements of New York Insurance Law as applied to syndicates at Lloyd's". For the 1996 exercise, as it was the first time that UK actuaries were required to opine on syndicates' reserves meeting these requirements, there was some variation in the manner in which reserves were presented in the Actuarial Opinions. These variations resulted from different interpretations of how UK Accounting and Reporting requirements for reserves and premiums, which are different from those for US Insurers, should be modified to meet the opinion requirements.

In October 1997, Lloyd's and representatives of the actuarial profession in the UK met with representatives of the NYID. The result of that meeting and follow-up discussions was the development of a "modified UK basis" of reporting reserves in the US reporting packs, including a newly developed Schedule P type exhibit, as well as refinements in the Actuarial Opinion. "The modified UK basis" of reporting reserves was intended to bridge Lloyd's syndicates' basis of reporting with the requirements established by the NYID.

In December, 1997, the Institute and Faculty of Actuaries provided detailed guidance to their members on the agreed modifications to the UK basis of determining the unearned premium reserve and on the establishment of a bad debt reserve on the earned unsigned premiums.

Professional and Regulatory Guidance on Reserves

Both Lloyd's and the Institute of Actuaries issue Professional guidance and regulatory documents. They serve to instruct the actuarial profession on the requirements for determining and providing a Statement of Actuarial Opinion (SAO) on reserves. Portions of these documents specifically address the US Surplus Lines Trust funds. Other portions relate to the UK solvency returns and more generally to Actuarial Practice in the UK. However, it should be noted that the UK solvency returns and the determination of the gross worldwide reserves are often the starting point for determining the gross US Surplus Lines and US Credit for Reinsurance Trust Fund reserves.

Following are the key documents that provide guidance to actuaries who are preparing statements of actuarial opinion on the reserves of Lloyd's syndicates:

- Advisory Note on Lloyd's US Opinions Issued by General Insurance Board - December 1997;

  This advisory note provides a description of the Modified UK Basis of reporting agreed to with the NYID;

- GN33: Actuarial Reporting for Lloyd's Syndicates Writing US Business;

  This guidance note provides the scope of reserves to be included in the SAO filed with the IID and NYID. It provides guidance on items to be included in the actuarial report; discusses actuary's responsibilities related to reconciliation of data, provides valuation principles applicable to the actuary's analyses, and provides disclosure requirements related to the relationship of the actuary to Managing Agents, underwriters and auditors;

- GN20: Actuarial Reporting Under the Lloyd's Valuation of Liabilities Rules;

  This document provides guidance to actuaries signing opinions for Lloyd's syndicates on their worldwide reserves both gross and net of reinsurance. It is similar in scope to GN33, but is specific to the requirements of the Council of Lloyd's;

- Manual of Actuarial Practice published by the Institute of Actuaries - Code of Professional Conduct;

  The Code of Professional Conduct provides guidance to actuaries regarding professional relationships with clients, other actuaries, and the public.

Annual Solvency Procedures

Lloyd's Market Reporting and Solvency Department (MRSD) generates financial statement blanks, as prescribed by the Lloyd's Council, for annual reporting of worldwide business by syndicates (greater detail is provided in the later section on Internal Regulation and the regulation of Lloyd's financial reporting). MRSD designs the blanks, and syndicates report data based on eligible asset rules and valuation of liabilities rules. These rules are established by Lloyd's Regulatory Division and approved by the UK regulators and the Council of Lloyd's, and are consistent with those applied to companies in the London market. The annual syndicate returns must be audited by an accountant approved under UK laws and regulations, and are due in March of each subsequent year, both in hard copy and diskette filing. Beginning with the 1997 annual return, each syndicate is required to obtain an actuarial opinion on reserves (discussed in further detail under the Reserving Practices section of this report).

Lloyd's requires the syndicate to make annual returns for three purposes: i) to produce Lloyd's Global Results; ii) to conduct Lloyd's global solvency test and to produce Lloyd's Statutory Statement of Business – Global Solvency; and iii) to calculate Members' individual solvency position.

The Global Results are published annually in time for the annual meeting of all Members. Lloyd's furnishes the publication annually to each Member and to all regulators worldwide. The Results reflect the aggregation of global trading of all Members and are compared to the aggregation of syndicates' audited results using the independent accountant's statement.

Lloyd's three-year accounting cycle typically ends through a reinsurance to close mechanism (RITC). Typically, each syndicate is treated as a separate entity and has a life of one year followed by a two-year run-off period. At the end of the three-year period, the RITC mechanism takes place whereby the Members forming the next year's underwriting syndicate reinsure the outstanding liabilities of the closing syndicate. After buying reinsurance to close for a syndicate, profits or losses are declared and distributed from the residuals. The RITC is a conventional indemnity reinsurance arrangement, not a novation, which means that the original Members remain liable should the reinsurance, for any reason, prove to be uncollectible.

Financial information from syndicates is ultimately accumulated or rolled up into Lloyd's overall financial statements, or Global Results.

Chain of Security

A unique chain of security backs Lloyd's policies. The links in this chain reflect both individual responsibilities for insurance liabilities undertaken by each Member, and, through certain joint assets, the mutualization of losses underwritten by the whole market. The Lloyd's chain of security consists of four links consisting of Premiums Trust Funds, Funds at Lloyd's, Other Personal Wealth, and the Central Fund. Each of these links is described below.

The First Link - Lloyd's Premium Trust Funds

The first link in the chain of security is the Members' Premium Trust Funds (PTF). To protect the interests of policyholders, all premiums and other monies received in connection with Members' underwriting business are initially paid into the PTFs that are managed by the Managing Agent of the syndicate involved. The funds are used to pay claims, reinsurance premiums, and other expenses. Profits, if any, are paid out of these funds when the underwriting year of account closes at the end of three years (or later).

There are two principal types of PTFs, one for general business and one for life business. The PTFs are denominated in pounds Sterling, US dollars, or Canadian dollars, depending on currency in which the business was written.

The US dollar PTFs include the Lloyd's American Trust Fund (LATF), the Lloyd's Dollar Trust Fund (LDTF), the Joint Asset Trust Fund for Surplus Lines (JATF - SL), the Joint Asset Trust Fund for Reinsurance (JATF -Reinsurance), the Lloyd's US Situs Trust Funds – Surplus Lines, the Lloyd's US Situs Trust Funds – Reinsurance, and separate trust funds in Illinois and Kentucky where Lloyd's operates as a licensed insurer.

The LATFs, established at Citibank, N.A. in New York in 1939 for each Member's US dollar denominated transactions, relate to business incepting on or before July 31, 1995. For business incepting on or after August 1, 1995, the LATFs were replaced by the LDTFs in London and the US Situs Trust Funds in New York. In September 1996, the LATF was reduced in order to permit Members' to pay their ceded reinsurance premiums due to Equitas, for 1992 and prior years of account. The transfer was made from the LATF to the Equitas American Trust Fund (EATF), both at Citibank N.A. in New York.

The Lloyd's US Situs Trust Funds are funded from the LDTF and have been maintained at 100% of gross US Situs Surplus Lines liabilities and US Situs Credit for Reinsurance through year end 1997. In December 1997, the Superintendent of New York determined that Lloyd's be allowed to reduce the US Situs Surplus Lines Trust Deed gross funding requirement to a 50% level for business incepting from August 1, 1995, subject to a minimum capitalization of $600 million. That decision was based upon events subsequent to 1994 at Lloyd's (R&R). The decision was contingent on an increase in the JATF-SL from $100 million to $200 million. The requirement for the US Situs Credit for Reinsurance remained unchanged.

The NAIC voted in December, 1997 to allow the US Situs Surplus Lines Trusts be reduced to a 50% level on surplus lines business incepting on or after January 1, 1998 only. A decision regarding the request for application of a 50% standard to surplus lines business incepting between August 1, 1995, and December 31, 1997, was held in abeyance. Further, the NAIC also voted to increase the JATF-SL to $200 million but agreed to allow the increase to be phased in over three years absent retrospective relief.

The JATFs were created in 1993 as required by NYID. The two separate funds, one for surplus lines and the other for reinsurance, were maintained at a minimum of $100 million on a joint and several basis provide protection to American policyholders, US Situs policyholders, and third party claimants. In December 1997, the NYID increased the JATF-SL requirement to $200 million as already discussed.

In January 1996, a new form of Lloyd's syndicate deposit trust fund was established to support Lloyd's admitted business licensed in Kentucky. Likewise a separate trust fund is maintained for licensed business in Illinois. These individual state trust funds are also funded through the LDTFs.

The following table summarizes these various trust funds.

NAME	ACRONYM	DATES/BUSINESS	BASIS
Lloyd's American Trust Fund Citibank, NY	LATF	Business from inception through 7/31/95; pre-1993 amounts reinsured to Equitas in 1996 and held in the Equitas American Trust Fund ("EATF")	Worldwide premiums denominated in US$
Lloyd's Dollar Trust Fund Citibank, London	LDTF	Business incepting on or after 8/1/95	Worldwide premiums denominated in US$

Surplus Lines US Situs Trust Fund Citibank, NY	SLTF	US Situs surplus lines business written on or after 8/1/95	100% of gross US surplus lines liabilities (decreased to 50% in 1998)
Credit for Reinsurance US Situs Trust Fund Citibank, NY	CRTF	US Situs reinsurance business ceded to Lloyd's syndicates on or after 8/1/95	100% of gross reinsurance liabilities relating to US ceding companies
Joint Asset Trust Fund – Surplus Lines Citibank, NY	JATF – SL	Supports the Surplus Lines US Situs Trust Fund; established in 1993	Minimum $100 million; increased to $200 million in 1998
Joint Asset Trust Fund – Credit for Reinsurance Citibank, NY	JATF – Reinsurance	Supports the Credit for Reinsurance US Situs Trust Fund; established in 1993	Minimum $100 million
Illinois Reserve Trust Fund First Illinois Trust Bank	(none)	Business written as a licensed insurer in IL	Liabilities on Illinois licensed business
Illinois §97/103 Trust First Illinois Trust Bank	(none)	Statutory deposit	$2.4 million
Lloyd’s Kentucky Trust Fund National City Bank, Louisville (NCBL)	(none)	Business written as a licensed insurer in KY; established in 1996	Liabilities on Kentucky licensed business
Lloyd’s Kentucky Joint Asset Trust Fund; NCBL	KY JATF	Incepted 12/95	Surplus account - $10.1 million at 12/31/97

The assets held in the US trust funds are predominantly US governmental bonds and governmental agency securities or other high quality securities. At year-end 1997, approximately $12 billion was held in the US dollar trust funds.

***The Second Link* - Funds at Lloyd’s**

The second link is Members’ *Funds at Lloyd’s* ("FAL") which constitute the underwriting capital of each individual Member. FAL is a Member’s equivalent of capital and surplus in an insurance company, whereas the PTFs are akin to an insurance company’s working capital. FAL consists of a Members Lloyd’s deposit, Special Reserves (which does not count for the purpose of determining underwriting for future years, but may be counted for the purpose of solvency), and the Personal Reserves. FALS must be at least equivalent to the minimum ratio of funds at Lloyd’s to the overall premium limit of the Member.

Special investment criteria for Funds at Lloyd's are designed to make the assets readily realizable. Permitted assets include cash, marketable securities (including non-dollar denominated), letters of credit, and bank guarantees. At the end of 1997, all FALs contained approximately $10 billion.

Lloyd's is currently increasing the FAL requirements on a phased basis. By 1999 individual Members will be required to maintain minimum FAL and Other Personal Wealth (OPW) equal to 50% (FAL to be 37.5% and OPW to be 12.5%) of their expected premium writings, up from the current requirement of 32.5% FAL plus 7.5% OPW.

In addition, starting with the 1998 year of account, individual Member FAL requirements are subject to Risk Based Capital Assessment which may require FAL/OPW in excess of the minimum ratio, based upon a member's risk profile.

Corporate Members are already required to maintain a minimum FAL ratio of 50% of underwriting capacity (except Members who exclusively underwrite UK motor business. Corporate Members have always been subject to Risk Based Capital assessment. Many Corporate Members maintain FAL in excess of the amount, and several even maintain FAL in excess of 100% of expected premiums.

Members' assets are annually reviewed by "the Members' Services Unit", which performs a standard market valuation (i.e., portfolio valuation). The Members' assets are also audited for solvency at year-end.

There are special investment criteria for FAL. Permitted assets include cash, marketable securities (including non-dollar denominated) letters of credit and bank guarantees. At the end of 1997, the FAL were approximately $10 billion.

The Third Link - **Other Personal Wealth**

The third link is the other personal wealth (OPW) of individual Members. Each individual Member is required to show a minimum level of personal wealth of £250,000 but Members are liable to the full extent of their wealth.

The declared wealth of Members, which must be confirmed annually by a qualified accountant, can include non-Lloyd's assets as well as funds held in trust at Lloyd's.

The aggregate value of means declared to Lloyd's by individual Members, not counting their FAL, was $1.2 billion as at December 31, 1997. In addition, individual Members of Lloyd's may have other assets, not declared to Lloyd's, which are legally available to meet claims, although they have experienced collectibility problems in the past.

The Fourth Link **- Lloyd's Central Fund**

The fourth link is the *Central Fund assets* of the Society. At the discretion of the Council of Lloyd's, the Central Fund assets are available to meet policyholders' claims in the event of a Member is unable to meet its underwriting liabilities. The fund is capitalized by annual contributions made by all Members. The Central Fund is similar to a pre-assessment guarantee fund, acting as the ultimate safety net for Lloyd's policyholders.

With the formation of Equitas, the New Central Fund was established to cover post-1993 business. The value of the New Central Fund was $238 million as of December 31, 1997.

For 1998, the Central Fund contributions are 1% of the premium income limit for individual Members and 1.5% for corporate Members. In addition, starting in January 1997, the Central Fund can be supplemented by an extra $320 million callable from Members' premiums trust funds.

Strengthening the Chain of Security

Lloyd's has continued to strengthen its chain of security. By establishing investment criteria and monitoring aggregate investment risks for premium trust fund assets, requiring annual actuarial opinions on reserves, increasing and applying risk assessment (including RBC) to Funds at Lloyd's requirements, and continued strengthening of the New Central Fund.

How the Chain of Security Works in Practice

If the Managing Agent determines that further funds are required in Lloyd's premium trust funds (i.e. the first link in the Chain of Security) then the Managing Agent issues a call notice to the Members' Agent for cash. The cash call may be based on underwriting losses exceeding the Member's Lloyd's premium trust funds. The Member has 28 days to respond from the date that the call is deemed received by the Members' agent.

The Members' Services Unit is also notified of the cash call. If a Member does not respond to the cash call within the specified timeframe, the Member's Services Unit will draw down on FAL, first from the Member's personal reserve, and then from the deposit.

If a Member's FAL are depleted and the cash call is still outstanding, the Council is asked to authorize a draw down on the Central Fund for the purpose of ensuring adequate syndicate funding and the proper payment of claims. In this event, the Managing Agent responsible for the collection of the cash call is required to consider, and if appropriate to pursue, litigation against the Member for the purpose of effecting the cash call. The approximate amount anticipated to be drawn from the Central Fund on an annual basis is projected by Lloyd's to be within a range of $1 to $5 million for the next five years.

If Members fails to pay a matured US surplus lines claim, and assets held in the chain of security are inadequate to pay the claim, a US policyholder with an appropriate court judgement could make a demand to the trustee of the Member's US Situs Surplus Lines Trust Funds (SLTDs). Finally if that demand is unsatisfied the US policyholder could make demand to the trustee of the Lloyd's American Surplus Lines Joint Asset Trust fund (JATF-SL). If assets in the JATF-SL dropped below a state's minimum requirement, Lloyd's would no longer be eligible to accept surplus lines business.

Lloyd's Risk Based Capital

Lloyd's recently implemented a new *risk assessment framework* that includes the use of a Risk Based Capital (RBC) formula. RBC requirements have been applied to corporate Members since 1994. Effective January 1, 1998, both corporate and individual Members are required to provide funds according to their portfolio risk. By requiring greater FALs for those who have an appetite for higher risk business, serves to further protect the Central Fund.

The risk assessment framework determines the required capital for any given Member's underwriting portfolio based on two main factors:

- the RBC ratios generated by the formula; and

- a rating, given to agents/syndicates by the regulatory monitoring teams, which may result in a loading being added to the RBC ratio, generated by the formula.

The capital requirement for any Member is the greater of 50% (i.e. 2:1 premium/capital ratio) or the risk assessed value. Individual Members however are permitted to provide some of their capital by way of OPW and are allowed a transitional period until the year 2000 to reach the 50% or risk-assessed value-level. One exception is the case of Members writing predominantly UK motor business where the minimum requirement can be as low as 40%.

The RBC model measures the risk and volatility of a Member's underwriting exposure in Lloyd's so as to determine whether a level of capital greater than the minimum should be required. The model looks at all syndicates on which a Member participates. For those Members with a well-diversified underwriting portfolio, the risk assessment formulae often have a minimal effect. For those with a concentrated portfolio, especially of higher risk classes of business, the risk assessment produces a higher FAL requirement.

RBC Formula

The Lloyd's RBC formula was developed in 1995 in conjunction with Tillinghast, as consultants. Drawing on data that extended back 25 years, the historical performance of each category of business underwritten was analyzed to determine what capital requirements to support future business should be. The formula is applied to each year of account to determine the capital required for underwriting on any particular year of account including the possibility of deficiencies in the reserves set for previous years.

The Tillinghast statistical analysis concluded that diversification among categories of business was a key to mitigating statistical deviations. Therefore, the RBC formula gives credits for diversification among different classes of business.

The original Tillinghast analysis also provided statistical evidence that the formula should reward a portfolio which is spread across Managing Agent groups, as compared with one which is concentrated on one Managing Agent group. Based on additional detailed analysis of the period from 1991 to 1995, the agent -diversification credit from 1998 forward will be applied at the risk code level (117 lines of business) to add greater sensitivity to the RBC model.

Another element of the formula is the diversification credit given when determining reserving risk capital. When reserves are held for a number of years, it is unlikely that all the years will be subject to the same amount of reserve inadequacies. Accordingly, the reserving risk capital requirement does not equate to the aggregate of required amounts for each individual year but is a lesser sum.

For the underwriting portfolio of every Member, the RBC formula examines the following items to determine underwriting and reserving risk capital:

- business mix,
- Managing Agent mix,
- reinsurance credit,
- credit for number of years in reserves.

From these, the formula produces a recommended FAL ratio.

Capital Loading

The second main element of the risk assessment framework is a loading that has the effect of increasing the formula-generated ratio for some Members. The loading is the result of the monitoring work performed by Lloyd's Regulatory Division. All managing agents and syndicates are awarded a rating from 1 (least good) to 4 (best), based on the regulatory view of their competence, their systems of internal control, their compliance culture and other factors.

The loading process will not affect those members whose managing agents and syndicates get a 3 or 4 rating, which is the majority of the market. A 1 or 2 rating will result in a 20% or 10% loading respectively. For example, if a Member's entire underwriting portfolio is comprised of a participation on a syndicate subject to a rating of 2, and the RBC ratio generated by the formula is 60%, the loading would increase the required RBC by 10% (i.e. to 66%). If a Member has only a small participation within his portfolio on a syndicate subject to a rating of 2, the loading will have a proportionately smaller effect.

Internal Regulation

Lloyd's has its own Acts of Parliament known as the Lloyd's Acts. These Acts, originally passed in 1871 and last revised in 1982, establish a self-regulatory scheme.

As a result of Lloyd's Reconstruction and Renewal program, the Council of Lloyd's established the Lloyd's Regulatory Board (LRB) to perform regulatory functions and established the Lloyd's Market Board (LMB) to handle business functions. The Council appoints members to the two boards as detailed on page 14.

The separation of regulatory functions from business functions was designed to enable the Lloyd's Regulatory Division and the LRB (which oversees the operations of the Regulatory Division) to mirror best-practice external regulation within the constraints of the current provisions of the Lloyd's Act.

The Regulatory Division

The Regulatory Division performs the following functions:

- assists the LRB in formulating regulatory policy;
- authorizes entities to trade in the market, ensuring that regulated entities and individuals comply with Lloyd's regulations through a process of inspection visits; and
- investigates allegations of misconduct and then counsels and prosecutes entities or individuals that have not complied with Lloyd's regulations.

The Regulatory Division is divided into five areas: Policy, Authorization, Monitoring, Enforcement, and Regulatory Proceedings.

The Policy Group

The Policy Group helps formulate regulatory policy for consideration by the LRB. The Policy Group is moving away from detailed bylaws and focusing instead on core principles of regulation, backed up by detailed codes of conduct.

The Authorization Group

The Regulatory Division's goal is to be proactive in preventing problems rather than curing them after the fact. Significant resources have been allocated to the registration of new entities and individuals before they are permitted to transact business at Lloyds.

In April 1996, Lloyd's passed bylaws requiring the registration of individual directors of underwriting agents and those who report to them, as well as active underwriters and senior underwriting staff. Each individual must seek prior approval and registration in respect of a particular regulatory function and/or a particular employer or "sponsor".

The Authorization Group also reviews applications for approval of reorganization, mergers, and changes of control of underwriting agents and syndicates. In 1997, 400 such applications were received.

The Monitoring Group

The Monitoring Group observes and reports on Lloyd's market activity. The Group performs comprehensive analysis of syndicate activity through its access to very detailed information on all syndicates. The Group gathers "soft" information from market sources, which, when combined with the high-level of statistical information available to the Group, places it in a unique position to monitor the day to day operation of Lloyd's market. In addition to monitoring individual entities, the Group supports the Market Risk Unit with the monitoring of systemic risks in the market (such as the aggregation of risks that resulted in the LMX spiral; see Appendix 2).

The Monitoring Group has initiated regular on-site inspections of Lloyd's market participants on a 24-month regulatory cycle. All active underwriting agents are subject to inspections. Inspections of individual syndicates are made to examine their controls and operating procedures.

As a direct result of the Monitoring Group's activities, one Managing Agent and four brokers have had their licenses revoked, and changes have been made to the senior management of many Managing Agents.

The Enforcement Group and the Regulatory Proceedings Group

In August 1996, the Council of Lloyd's approved amendments to the bylaws that strengthened the disciplinary process and modernized Lloyd's in line with best regulatory practices. The Council's intention was that acts of serious misconduct and acts that could bring Lloyd's into disrepute would be punished. A wider definition of misconduct charges the employer with the responsibility for wrongdoing by its staff and the introduction of fixed penalties and summary offenses have enhanced the disciplinary process. In addition, persons no longer actively trading in the Lloyd's market are now subject to disciplinary action. In addition to revising bylaws and associated procedures, the Council has made market participants aware that the Regulatory Division is to take its role seriously through the use of high profile disciplinary actions. Fines are being imposed on and warning letters issued to Managing Agents and Lloyd's brokers for breaches in compliance.

Regulation of Syndicates

Because the Chain of Security functions to support the liabilities of underwriting Members and ultimately the market as a whole, the focus of internal regulation is prudent business conduct and professional standards of the syndicate. The syndicate acts as an underwriting unit and is often considered an entity for administrative convenience for solvency purposes (although legally solvency is regulated at the member level).

Authorization

The Regulatory Division's Registration Unit, empowered by Lloyd's bylaws, has authority to approve all individuals in the Lloyd's market who perform "regulated functions." The "Guide to Applicants" outlines the procedures for Managing Agents to obtain the specific authorization to manage a new syndicate. The Registration Unit evaluates the character and suitability of the directors, the compliance officer, and the controller. The experience, qualifications and number of directors and staff reporting to the directors is also evaluated.

Monitoring

Lloyd's takes an "at risk" approach to the monitoring of syndicates. An intelligence capability that gathers hard and soft market information permits analysis of key numerical and intelligence data, which is internally reviewed. Based on the syndicate analysis process, the Regulatory Division annually prepares a plan that identifies specific syndicates for closer scrutiny. Typically, selected syndicates will include newly formed syndicates, syndicates identified as being particularly "at risk" due to the class of business underwritten, and any 100% corporate syndicates. In general, every syndicate and every Managing Agent will be reviewed every two years. Syndicates are graded one to four, with a grade of one and two indicating the least adequate management and requiring regulatory action, generally beginning with an on-site visit.

An on-site visit tests the Managing Agent's controls over the syndicate. Key information is requested in advance for analysis and a Review Approach Plan is developed on a diagnostic basis, i.e. focusing resources on the biggest at-risk elements. The on-site visit includes observing procedures and carrying out tests on slips, reinsurance cover notes, realistic disaster scenarios, and reinsurance to close. Premium and exposures are tested to determine if they have been accurately recorded and allocated to the correct risk code. The results of these tests are used to verify the procedures claimed by the Managing Agent.

A report is prepared following each on-site visit that sets forth requirements and recommendations including expected timelines and assignment of responsibility for remedial action. A follow-up on-site visit verifies that the recommendations and requirements have been satisfied.

A major recent initiative requires each syndicate to assess the effect of nine 'realistic disaster scenarios' (RDS) on its bottom line. Potential reinsurance recoveries and reinstatement premiums are included in the analysis. Syndicates must report their conclusions to the Regulatory Division and incorporate them into their business plans. The Monitoring Division monitors the RDS at syndicate level and for the Lloyd's market as a whole to protect the Chain of Security against aggregate exposure to a given catastrophe or combination of catastrophes.

The Monitoring Division regularly reviews the underwriting slips (for type of business, line size and coding) when they are submitted to the Lloyd's Policy Signing Office (LPSO) to determine that the business written is consistent with the syndicate's business plan. Approximately 100 slips are taken from the LPSO barrier and examined at noon each day. Any unusual features, such as potential 'spiral' business and "grossing up" of commissions, are identified for follow-up.

Regulation of Brokers

The Lloyd's Brokers Bylaw empowers Lloyd's to establish requirements regarding a broker's financial resources, maintenance of professional indemnity insurance accounting records, use of Insurance Brokerage Accounts (IBAs), annual returns, undertakings, and approvals of directors.

The Council, pursuant to the Lloyd's Brokers Bylaw, has issued a Code of Practice as a statement of principles that is applicable to the conduct of Lloyd's brokers. A breach of the Code does not constitute a breach of the Lloyd's Brokers Bylaw, but breaches of the Code may be taken into account when deciding if a broker is 'fit and proper' and in any disciplinary proceedings.

Prior to when the Brokers Department began regulating Lloyd's brokers, brokers were registered by the Insurance Brokers Registration Council (IBRC), under the Insurance Broker's (Registration) Act 1977. Lloyd's brokers complied with IBRC regulations, although Lloyd's accounting and business requirements and its requirements on professional indemnity insurance were applied on the grounds that they were more stringent than those of the IBRC.

The Brokers Department is part of the Authorization Division and has the day to day responsibility to regulate brokers. The Brokers Department evaluates policy issues affecting the future regulation of Lloyd's brokers, processes applications for new Lloyd's brokers, and processes applications for changes to a Lloyd's broker's management team. The Brokers Department reviews financial returns including annual solvency returns and audited accounts for each broker and quarterly IBA solvency statements. The Brokers Department conducts on-site diagnostic reviews of Lloyd's brokers. Inspection visits are made to Lloyd's brokers at least once every two years. Following the on-site review visit, the report to be issued to brokers is prepared. Where necessary, these reports contain requirements for a broker to strengthen its financial base or management controls in order to maintain its Lloyd's broker status. The Brokers Department is now implementing Quarterly Prudential Supervisory visits of the larger Lloyd's brokering groups.

In 1997, Lloyd's completed a review of its regulatory regime for Lloyd's brokers and other intermediaries. Lloyd's concluded, "the arrangements currently in place do not provide a coherent strategy towards, nor a level playing field between, different types of intermediary which are able to introduce business to the (Lloyd's) market". Consultation and strategy development to address these concerns is underway. Beginning in January 1997, coverholders accepting business on behalf of syndicates have been subject to an annual review to establish whether they meet the minimum criteria for continued approval. A Lloyd's broker must be "fit and proper", adequately capitalized, and meet Lloyd's quarterly requirements.

A Lloyd's broker may not be a Lloyd's Managing Agent, or be associated or connected with a Lloyd's Managing Agent in any way. The Council (or, in practice, the LRB and its agents, which actually deals with the registration of Lloyd's brokers) may take into account any relevant matters in judging an applicant's fitness and propriety. The same factors that apply to Managing Agents also apply to brokers. Capital requirements are a function of the volume and nature of the broker's business, its expense base, and any other obligations. Solvency is tested based on transactions, net assets, net current assets, and net assets.

All Lloyd's brokers are required to maintain Insurance Brokerage Accounts with approved banks. Banks in the UK must normally have tangible assets worth at least $100 million to qualify. Overseas banks are approved on a case by case basis. The broker may also invest IBA funds in certain short-term assets that are readily realizable and free of encumbrance if approved by the Council.

Lloyd's brokers must maintain records of all contracts of insurance, claims, and binding authorities. Records of private UK insurance and closed claim files for all types of business must be kept for 15 years. Records of contracts for other types of business must be kept for 80 years. Records may be kept in any manner, provided they are either in a legible form or are capable of being reproduced in a legible form.

Regulation of Individuals

Lloyd's has recognized that many different people interact within the market, and that, in order for the market to be efficient and to function with integrity, identification of individuals who participate in the market is an important step in maintaining regulatory control.

The Individual Registration Department has adopted the following mission statement.

> *"Provide a standard of regulation at least as good as any other financial regulator and to ensure that only those individuals fit and proper to be registered are so registered."*

The Registration Unit registers individuals associated with the following activities:

- Underwriting
- Buying Reinsurance
- Claims Handling
- Setting Reinsurance to Close Reinsurance Recoveries
- Syndicate Analysis
- Advising Capital Providers
- Maintaining Capital Providers' Accounts
- Compliance
- Maintaining Syndicate Accounts & Records

Lloyd's has recently adopted a bylaw that will add the Directors and Compliance Officers of Lloyd's Brokers as individuals who must register.

An individual applies by completing an Individual Registration Form that identifies the work history and qualifications of the individual. The Registration Unit checks the information against two different databases. Individuals determined to be unqualified are given the reason(s) in writing why they were not accepted and an individual may appeal the denial to a special appeal tribunal.

An individual's registration may be limited to certain specified activities. For example, an individual may be registered only to carry out run-off business. Lloyd's business processes are designed to identify improper activity, and appropriate registration is checked during the daily review of randomly selected underwriting slips.

Lloyd's Complaints Process

The complaints handling process is directed by the Lloyd's Regulatory Division. This structure provides for three separate section or departments, (Complaints, Investigations and Monitoring) to collectively carry out all aspects of handling and preventing complaints.

The Complaints Department handles complaints from policyholders and other market participants (for example, complaints from capital providers). The Complaints Department is charged with insuring that syndicates and their representatives take responsibility for settling complaints. The Complaints Department will intervene only if the complaint remains unresolved.

A US policyholder with a question or a problem should initially contact its broker. If the problem is not resolved, the US policyholder should contact its state insurance department, who will report the complaint to the Lloyd's Regulatory Division. Regulators of US policyholders can contact Lloyd's directly by a free 1-800-fax number.

The Regulatory Division is dedicated to resolving and preventing complaints. In addition to the Complaints Department, the Regulatory Division often involves the Monitoring Department to perform tasks similar to the market conduct examinations performed by US state insurance regulators. If the Complaints Department identifies potential misconduct or regulatory breaches, the Investigations Department is notified. The Investigations Department conducts a formal inquiry with formal interviews. If the investigation supports the allegations, a formal disciplinary process is initiated. Lloyd's has the statutory authority to hold disciplinary tribunals for those under its regulatory jurisdiction (underwriting agents, syndicates, Members, and Lloyd's brokers). The Disciplinary Tribunal decisions are generally publicized through press releases to the Lloyd's market.

The Market Risk Unit

The Report of Lloyd's Regulatory Review Group, published in May 1997, recommended that Lloyd's implement the best practices of other regulators by establishing a specialist unit "to further enhance the computer modeling of market exposures giving rise to risks of a systemic nature". The Finance Directorate adopted the recommendation and established the Market Risk Unit (MRU) in November 1997 to study areas of systemic risk in the Lloyd's market for both liabilities and assets.

The MRU monitors developments within the financial sector and assesses the resultant impact on the risk profile of the Lloyd's market. The MRU evaluates the market's aggregate exposure to risk, in part by modeling potential exposures to the Chain of Security. The MRU evaluates the market's ability to observe these exposures, and assists in the development of measures that will improve Lloyd's ability to manage its aggregate exposures through traditional and/or alternative-risk transfer mechanisms in order to limit systemic risk. The MRU also directs the development and refinement of the risk-based capital system. The MRU designs and issues its own calls for data collection to supplement data otherwise collected by Regulatory Division and other Corporation departments including Lloyd's Policy Signing Office (LPSO) and Market Reporting Solvency Department (MRSD).

The MRU's Steering Group (MRUSG) has members in common with Lloyd's Regulatory Board and one of its subcommittees, the Prudential Supervision Committee. MRUSG has responsibility for overseeing the work of the MRU in relation to systemic risk. The MRUSG is comprised of three Lloyd's directors (the director of strategic planning, the director of regulation, and the director of finance), and three market participants.

The MRU, in conjunction with the Lloyd's Regulatory Division, has been monitoring the risk of future "spirals" for the last four years. The MRU reviews syndicate business plans and monitors compliance by reviewing line slips to guard against Whole Account reinsurances with inadequate LMX exclusions. (Refer to Appendix 2 for the discussion of the "LMX Spiral" of the 1980's).

The MRU annually conducts a project that analyzes line slips to identify the syndicates and insurance companies insuring and reinsuring each other. By mapping and recording these relationships, a syndicate, that appears to have a heavy interchange of liability with other syndicates, is visited. The syndicate's systems to record aggregate exposures and its methodology for calculating loss scenarios are tested. Regulatory action, including mandatory limits on further underwriting, increased capital requirements, or letters of credit to secure reinsurance recoveries, are taken against a syndicate that is determined to have inadequate safeguards.

An automated transaction monitoring system to provide a more sophisticated analysis of relationships with spiral potential will be introduced in 1998. The system incorporates the use of artificial intelligence analytical techniques to help identify unusual trading relationships.

Regulation of Lloyd's Financial Reporting

While Lloyd's has external responsibilities, it must also take great care about the quality of information that is reported internally by the various entities.

Lloyd's Solvency Procedures

The Lloyd's Market Reporting and Solvency Department (MRSD) conducts the solvency testing under the supervising oversight of HM Treasury (discussed in the External Regulation Section).

Lloyd's is required to complete two solvency tests by the Insurance Companies Act of 1982. The MRSD conducts the annual solvency tests. The first solvency test establishes whether or not Members have sufficient assets to meet all the known and estimated future underwriting liabilities. A Members deficiency on this test must be covered by assets of the New Central Fund in order for Lloyd's to file its solvency certificates with HM Treasury. The second solvency test requires that Lloyd's submit a global solvency margin statement as part of its Statutory Statement of Business. Lloyd's first determines the aggregate assets minus liabilities for all Members. The net aggregate assets available, including central assets, must exceed the Required Minimum Margin (RMM). The RMM is a complex calculation broadly based on the highest of 16% of calendar year net premiums or 23% of annualized net claims for the last three years of account.

After consultation with regulators, a third solvency test was introduced December 31, 1997. The new test requires each member to maintain a minimum margin of solvency using a calculation broadly mirroring the RMM used in the global test.

Managing Agents are required to submit to Lloyd's a syndicate's year-end results for each open year of account. The Market Reporting and Solvency Department allocates the results to each Member and a Member's "solvency statement" is produced. Each Member's share of the results of all syndicates on which the Member participates is then aggregated and compared to the Member's minimum margin of solvency. If the result is a positive number, the amount is added to the Member's Funds at Lloyd's, but if the result is a negative number, the amount is deducted from the Member's Funds at Lloyd's. If the aggregate syndicate results (RMM and Funds at Lloyd's) are a positive number, the Member is considered solvent. If the aggregate results are a negative number, the Member must provide additional assets to eliminate the deficit. The Central Fund will earmark funds to ensure that the Member deficit is covered. Unless the Member eliminates the deficit within 28 days, a hold is placed on the Member's Funds at Lloyd's, and the Member will be suspended from underwriting business at Lloyd's effective the following January.

Members' Agents are required to annually report to Lloyd's details of all assets held on behalf of their Members as of December 31 of the preceding year. The report includes details of personal reserve funds, special reserves, the Lloyd's deposit, any assets provided after December 31 but before solvency clearance date (normally the beginning of August), and stop loss policies for which credit may be taken. If the funds are held centrally by the Members Services Unit/Members Funds department, details are provided directly to MRSD.

Syndicate Reporting

Lloyd's Solvency and Reporting Bylaw establishes the form for annual reports and the dates that syndicates must file with MRSD. MRSD develops financial statement blanks for the annual reporting of a syndicate's worldwide business. Reports must comply with the eligible asset rules and valuation of liabilities rules, established by the Regulatory Policy section of the Regulatory Division and as approved by the Treasury. The rules are consistent with those applied to companies in the London Market. Annual syndicate reports must be audited by an accountant and approved under UK laws and regulations. Beginning with the 1997 annual return, each syndicate must obtain an actuarial opinion of its reserves. Reports are due in March each year in both hard copy and on diskette.

Managing Agents monitor syndicates' performance throughout the year using their own records as well as upon premiums and claims data provided by LPSO and LCO. Loss development schedules maintained by individual underwriting year-of-account, enable Managing Agents to track results over time for each year of account.

Reserving Practices

Lloyd's Regulatory Board annually publishes rules for the valuation of assets and liabilities. Syndicate reserving practices vary according to the internal controls established by each syndicate's Managing Agent. The underwriter and the claims manager normally perform detailed reviews. These are usually done in conjunction with the actuary. The auditor will then audit the Reinsurance to Close (RITC) and the solvency reserves which are formally approved by the Board of Managing Agent. Lloyd's Regulatory Division monitors reserving practices and reports on problems or breaches of rules by syndicate auditors.

As part of the annual reporting process, syndicate reserves must be reported to Lloyd's and must be determined in accordance with the valuation of liabilities rules. In accordance with the new requirements approved by the Regulatory Division and mandated by the Council of Lloyds, syndicates must supply actuarial opinions for all business for the December 31, 1997 reporting. The opinions must be unqualified and prepared by qualified actuaries. Reinsurance To Close reserves must be no less than the actuarial opined reserves, but the Managing Agent can report greater reserves.

Lloyd's Audit Requirements

All Lloyd's Managing Agents are required to appoint auditors and provide audited financial statements for their syndicates.

The Regulatory Division requests and receives copies of the management reports, or if these do not exist, minutes of or notes on the meetings between management and external auditors. The Regulatory Division follows up on matters of concern.

It is the responsibility of underwriting agents' senior management to establish and operate adequate compliance arrangements in respect of its internal controls in satisfaction of Lloyd's sound and prudent management criteria. In addition, agents are responsible for conducting an annual compliance review to assess the effectiveness of their compliance and monitoring procedures which culminates in the submission of a statement of compliance to Lloyd's. When reviewing its internal controls, agents take into account:

- size of their business;
- diversity of their operations;
- the volume and size of transactions;
- the degree of risk;
- the amount of control by senior management over day-to-day operations; and
- the degree of centralization and the extent of reliance on information technology.

Agents need to test the system of internal controls to confirm that it provides reasonable assurance that each expenditure is:

- properly authorized and disbursed;
- all assets are adequately safeguarded;
- all liabilities are recorded; and
- all statutory requirements relating to the provision of accounts are complied with and all reporting requirements are adhered to.

As an adjunct to this, the recognized accountant will test the adequacy of internal controls and will report both to the directors of the underwriting agency and to Lloyd's on whether the internal control systems have been established and maintained in accordance with Lloyd's sound and prudent management criteria.

Regulatory Development at Lloyds

The following chart is a chronology of important events since May, 1995. These events have triggered stronger internal regulation.

Regulatory Developments at Lloyd's 1995-1998

May 1995	***Realistic disaster scenarios***	New regulations to require syndicates to calculate, file, and keep updated realistic disaster scenarios, as part of the business planning and annual reporting process followed in February 1996 by the requirement to submit to Lloyd's detailed exposures and loss assumptions.
Summer 1995	***Professional qualifications and continuing education***	Enhancement of existing requirements for key personnel to demonstrate professional insurance qualifications and the implementation of continuing professional education requirements.
October 1995	***Director of Regulatory Division***	Appointment of David Gittings, former Director of Surveillance at the Securities and Futures Authority in the UK.
January 1996	***Overhaul of regime for Lloyd's Underwriting Agents' Reviews***	All active underwriting agents reviewed in 1996 and over 1,000 recommendations for improvement enforced. Schedule of follow-up reviews implemented and regular 24-month reviews taking place, supported by "spot-reviews" undertaken based upon monitoring of 100 daily random samples of business transactions at Lloyd's.
February 1996	***Core Principles for Underwriting agents***	Promulgation of ten core principles setting out the standards of behavior for all underwriting agents, bringing Lloyd's into line with other regulatory bodies. Agents must demonstrate that they comply with these principles and any supplementary guidance. Failure to do so may result in disciplinary action.
Various	***Codes of Conduct***	Core principles are supported by the publication of detailed codes of practice, giving guidance to assist agents to comply with the core principles. Those published to date include guidance on sound and prudent management, on managing underwriting risks, compliance procedures, claims and complaints handling the management of investment risk and responsibilities to Members.

Regulatory Developments at Lloyd's 1995-1998 (cont'd)		
April 1996	***Syndicate Business plans***	New regulations requiring Managing Agents to file more detailed business plans on an annual and continuing basis. Minimum requirements set for core information including realistic disaster scenarios.
April 1996	***Introduction of Individual Registration***	For key personnel working in the Lloyd's market, including all directors of managing and members' agents, all key underwriting, finance and compliance personnel and all those giving advice to Lloyd's Members. During the implementation process, 4,872 applications were reviewed of which 51 were unsuccessful and 66 were conditional registrations.
August 1996	***Disciplinary Regime***	Implementation of new procedures to enable a scheme of fixed penalties and streamlined disciplinary process, ensuring swifter summary jurisdiction, award of penalties and the publication of the details of serious misconduct and compliance breaches of Lloyd's regulations. In addition, the definition of misconduct was also redefined and under the Bylaws vicarious liability has been established over employers for the actions of their employees. In 1996, there were 9 fines and 46 formal warnings for administrative breaches/delays in compliance (see 1997 section for 1997 disciplinary cases).
March 1997	***Role of Auditors***	Consultation under way on new requirements that auditors report on adherence to core principles, including internal controls and sound and prudent management criteria.
April 1997	***Capital structure and capital provider protection***	Building on rules implemented in 1996 to protect existing Members' preemption rights in syndicate merger situations, minority but-outs, mandatory offers, and other significant transactions. Further work on other issues including the auction. A system of auction transaction monitoring has been developed.
May 1997	***Report of Lloyd's Regulatory Review group***	Recommendations included that there should be a change in UK legislation to extend external accountability of the Lloyd's regulatory authorities to a UK statutory body for all aspects of regulation (i.e. not just solvency regulation, as at present). Development of the new FSA will achieve this end.

Regulatory Developments at Lloyd's 1995-1998 (cont'd)		
June 1997	***Chain of Security enhancements***	Publication of a report that makes wide-ranging recommendations for enhancement to Lloyd's chain of security. In particular, stricter requirements for the provision of Funds at Lloyd's by Members of Lloyd's were introduced for 1998. Codes of practice are being developed on reinsurance and on reserving. There will also be a greater focus on disaster modeling. Actuarial opinions for solvency purposes were mandatory for the 1997 year end reporting.
July 1997	***Broker Regulation***	Consultation document published with proposals to overhaul regulation of Lloyd's brokers: in particular to introduce individual registration of brokers.
July 1997	***Syndicate Transaction Monitoring***	A prototype transaction monitoring system was built, capturing all transaction data at syndicate level for the 1996 and 1997 years of account.
September 1997	***Chairman of Lloyd's Regulatory Board***	Appointment of John Young, former Chief Executive of UK Securities and Investments Board in succession to Sir Alan Hardcastle who retired in November 1997.
November 1997	***Market Risk Unit***	As recommended in the Regulatory Review Group report, the Market Risk Unit was established to monitor aggregate exposure of the market as a whole to reinsurance, catastrophe loss and investment risk.
December 1997	***Risk-Based Capital for all Members introduced***	A risk-based capital approach to determining the appropriate level of Funds at Lloyd's held by each Member was developed by Lloyd's, in conjunction with Tillinghast. The approach considers the risk and volatility of the business written by each Member in respect of their 1998 underwriting.

Regulatory Developments at Lloyd's 1995-1998 (cont'd)		
December 1997	***Investment Criteria - management of investment risk***	As recommended in the Chain of Security review, a new code of practice has been issued setting principles and objectives for investment management, giving specific guidance regarding liquidity risk, credit risk, market/duration risk, foreign exchange risk, operational risk and overseas compliance issues.
1997	***Disciplinary cases***	In 1997 a total of 36 disciplinary cases were concluded with fines levied up to £60,000 per case and three brokers permanently suspended from Lloyd's premises and from transaction of business at Lloyd's.
January 1998	***The Financial Services Authority (FSA)***	The Treasury (responsible for the regulation of all UK Financial Services) announces that it will have regulatory oversight of the Lloyd's market through the Financial Services Authority (FSA). The FSA is a new statutory body that replaces a number of regulatory organizations and will have responsibility for, inter alia, banking, insurance, securities, futures and investment managers.

External Regulation

HM Treasury / FSA

The Council of Lloyd' is the statutory body established and vested with the responsibility for management of the affairs of Lloyd's. Pursuant to Section 86(1) of the Insurance Companies Act of 1982, Lloyd's is annually required to submit to the Insurance Directorate of Her Majesty's Treasury, a report that shows it has passed a prescribed Solvency Test. The purpose of the Test is to ensure that all policyholders' claims can be met. All Members, regardless of their underwriting status (i.e. active, resigned, deceased, etc.) who have any syndicate participation are subject to the Solvency Test. The UK Government has recently announced that the Financial Services Authority (FSA) will assume responsibility for Lloyd's previously delegated to HM Treasury and that, in the future it will assume additional responsibilities relative to Lloyd's. Staff that oversaw Lloyd's had been transferred from the Department of Trade and Industry as an intermediary step to the establishment of a separate Financial Services Authority (FSA) that will assume responsibility for the regulation of Lloyd's. The details of the FSA authority are in the consultation stage, but it appears they will have powers over authorizations, auctions and discipline. The Lloyd's Market Reporting and Solvency Department conduct the Solvency Test under the supervisory oversight of HM Treasury. The test is conducted on two levels. The first test is applied at the Member level to establish whether or not sufficient assets are available to meet all the known and estimated future underwriting liabilities. Any Member's shortfall on this test must be covered by assets of the New Central Fund in order for Lloyd's to file its solvency certificates with HM Treasury.

The second test requires that, as part of the Statutory Statement of Business (SSOB), Lloyd's submit a solvency margin statement. In this, Lloyd's first determines the aggregate of all Members' assets less liabilities. In conducting this test, assets are then compared with, and must exceed, a Required Minimum Margin (RMM), which is determined using a complex calculation broadly based on the higher of 16% of calendar year net premiums or 23% of annualized net claims over the last three years.

In August 1997, Lloyd's met its global solvency margin as of December 31, 1996. The required minimum solvency margin had been covered 8.4 times, compared with 5.1 times as of December 31, 1995.

US Regulation – Pre Reconstruction and Renewal

From the modern standpoint, the first major US event for Lloyd's was the creation, in 1939, of the Lloyd's American Trust Funds or LATF. The LATF was set up at Citibank, N.A. in New York prior to the outbreak of World War II. Its purpose was to give assurance to United States insureds that, notwithstanding the impending war, payment of claims by Lloyd's would be uninterrupted by any difficulties experienced in removing funds from the UK. The LATF was established to accept US dollar premiums and pay US dollar claims. At the time that the LATF was created, most US dollar policies emanated from the United States. However, over time, the US dollar became the common currency for international insurance policies. As a result, the LATF became the trust fund used for many risks that had little or no connection with the United States.

In 1977, the NYID recognized Lloyd's as an accredited reinsurer. At such time, the NYID also deemed the LATF to meeting the requirement of the trust fund in New York. Subsequently, the NYID also recognized the LATF for purposes of eligibility of Lloyd's as a surplus lines writer. The substantial majority of other states also accepted the LATF for purposes of allowing Lloyd's syndicates to be recognized as accredited reinsurers and surplus lines writers.

US Regulation – Trans and Post Reconstruction and Renewal

As a result of concerns relative to the difficult financial problems faced by Lloyd's in the early 1990s, the NYID, as domiciliary regulator, undertook the first ever examination of Lloyd's by US regulators in 1994.

The NYID examination of Lloyd's determined that as of December 31, 1993, Lloyd's failed to maintain the minimum $100 million surplus required to be held in trust funds in New York pursuant to Regulation No. 20. The examination also determined that, as of January 1, 1994, Lloyd's failed to maintain the minimum $100 million surplus required to be held in trust funds. The examination determined that the surplus deficiency was $7.9 billion on a net of reinsurance basis and $18.5 billion on a gross basis. Details of these findings are set forth in the NYID Report on Examination of Lloyd's as of December 31, 1993, dated May 11, 1995.

Lloyd's and the NYID entered into negotiations that resulted in the May 24, 1995 stipulated agreement. Recognizing the practical difficulties in correcting problems that had developed over many years, New York regulators required that, for business incepting on or after August 1, 1995, Lloyd's establish individual syndicate trusts. These trusts were funded at 100% of gross US surplus lines liabilities (US Situs Surplus Lines Trust Funds) and separate credit for reinsurance trusts funded at 100% of gross US reinsurance liabilities (US Situs Credit for Reinsurance Trust Funds). A critical differentiation between the LATF and the new trusts is that the LATF accepted all US dollar premium and losses regardless of where the risk resided in the world. The Situs Trusts apply only to US business.

Insurance commissioners from other states in cooperation with New York regulators adopted the 100% gross US surplus lines liabilities trust requirement and revised the listing requirements in the NAIC's International Insurers Department (IID). Lloyd's had been listed on the *Quarterly Listing of Alien Insurers* as a single entity ("Lloyd's of London, Underwriters at") that meant any Lloyd's syndicate was eligible in any state that used the IID list. Beginning August 1, 1995, the *Quarterly Listing of Alien Insurers* began to list individual syndicates. IID has been receiving approximately 150 filings from individual syndicates consisting of audit reports, parts of the Lloyd's internal solvency return, an IID return and, since year end 1996, actuarial opinions.

Surplus Lines and the IID

Each state has its own laws and regulations that govern Surplus Lines placements. For regulatory efficiency, insurance commissioners acting together created the IID to provide individual states with support services with regard to eligibility of alien insurers including Lloyd's and its syndicates. Most states with significant Surplus Lines activity rely to some degree upon the NAIC's *Quarterly Listing of Alien Insurers* to determine the eligibility of Lloyd's syndicates to write Surplus Lines. For some states, by statute or practice, the listing of a syndicate on the *Quarterly Listing* of Alien Insurers is sufficient to establish eligibility of that syndicate to write Surplus Lines business in that state. The NAIC's IID operates in accordance with a Plan of Operation approved *by state insurance commissions.* The *Plan of Operation* requires that all decisions regarding listing or delisting of insurers be approved by the Chairs of the NAIC's Special Insurance Issues (E) Committee and the Surplus Lines (E) Task Force. In the event of a disagreement between the two Chairs, the President of the NAIC has a casting vote. The executive vice president of the NAIC oversees Day to day operations of IID. State insurance commissioners on the NAIC's Executive Committee oversee the operations of the NAIC staff.

The IID Plan of Operation sets three requirements for listing of Lloyd's syndicates. First, the Lloyd's market as a whole must maintain a trust fund of $200 million in lieu of capital and surplus. This requirement is satisfied by the JATF-SL. Second, each syndicate must maintain a trust fund at "an appropriate level". For business incepting on or after August 1, 1995, insurance commissioner's determined that the appropriate level was 100% of gross US Surplus Lines liabilities. For the 1998 year of account, insurance commissioners determined that "an appropriate level" was 50% of gross US Surplus Lines liabilities. Third, Directors employed by Managing Agents, the controllers of the Managing Agent, the active underwriter, and the controllers of corporate capital (if applicable) must meet standards of character, trustworthiness and integrity.

Once listed, and to maintain listed status, a syndicate must make an annual financial filing with the NAIC in a format approved by state insurance commissioners. The annual financial filing includes audited financial statements, certain schedules from the Lloyd's internal solvency return, and actuarial opinions on both the worldwide net reserves and the US gross reserves. In addition, Lloyd's and Citibank confirm the level of trust funds on a syndicate by syndicate and a year by year basis.

A significant volume of US direct business written by Lloyd's syndicates is classified not classified by state insurance laws as surplus lines. Such "exempt" business may be due to specific exemption in state statute such as an industrial insured exemption or a direct procurement.

Reinsurance

The ability of US insurers to take credit for ceded reinsurance in their statutory financial statements is limited by the restrictions imposed on such insurers by the insurance laws of the various states in which they conduct business. As with other alien markets, reinsurance ceded to Lloyd's syndicates is regulated by limitations on the ability of US domestic ceding companies to take statutory credit for reinsurance. A Lloyd's syndicate must execute US Situs Credit for Reinsurance Trust deeds, as a prerequisite for a state to consider an approval of the syndicate as an accredited reinsurer. The trust deeds require 100% of its gross US reinsurance liabilities be maintained in trust. Citibank, N.A., New York has been the trustee of the trusts.

Other US trust specific regulation

Under New York law, the New York Superintendent of Insurance has certain regulatory authority over the trusts held in New York. State insurance commissioners execute their statutory responsibilities to protect policyholders in their states by retaining certain authority over the operation of the trusts, including changes, by requiring alien insurers, including Lloyd's syndicates, use a NAIC standard form trust agreement.

The New York Insurance Department reviews in detail quarterly and annual trust fund filings made by Lloyd's for the LATF, the Situs Trusts, and the JATFs.

NYID required that, beginning with year-end December 31, 1997 syndicates file a Schedule P and Schedule F equivalent for their US Situs trust funds. The additional information provided will enhance the ability of US regulators to monitor the solvency of Lloyd's syndicates.

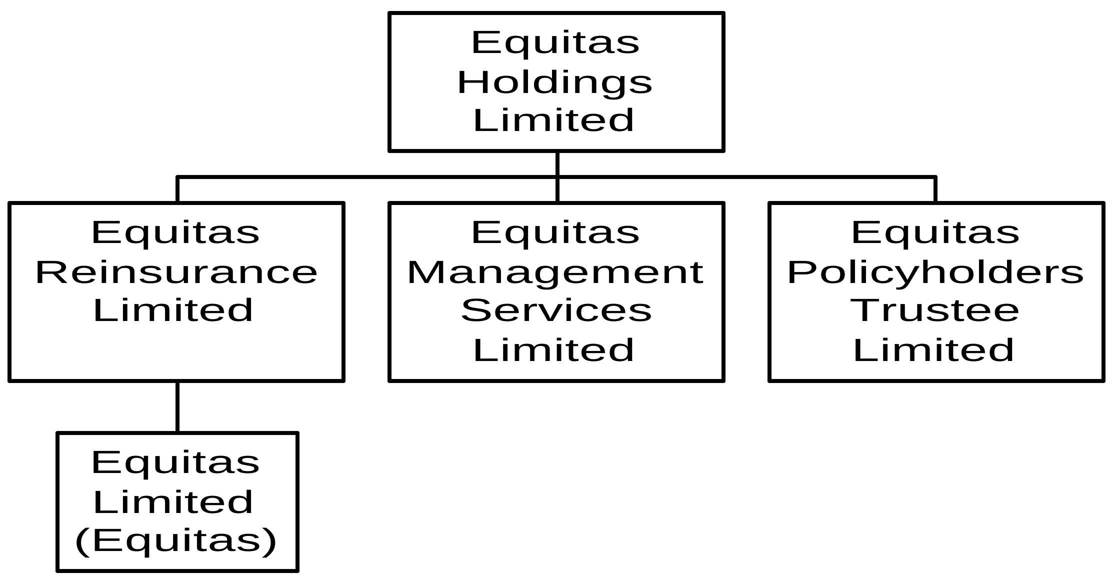
Equitas

As stated in the "Historical Prospective"; Reconstruction and Renewal (R&R) section of this report, Equitas referred to the groups of companies created to handle the runoff of pre 1993 non life business ceded by Lloyd's Syndicates.

The organization, operations and reserves of Equitas are discussed in the following sections.

Organization

The Equitas Group is headed by Equitas Holdings (EHL), owned by a discretionary trust of seven trustees who are Lloyd's underwriting members, and EHL's subsidiaries Equitas Reinsurance Ltd. and Equitas Management Services Ltd. Equitas Reinsurance Ltd. reinsured the 1992 and prior non-life business of Lloyd's Members, and then ceded that business to its own subsidiary Equitas Ltd. The Equitas Board has four Executive and eight non-Executive directors, one elected by the Corporation of Lloyd's and two elected by the trustees.



Equitas began operating started operations on September 4, 1996, reinsuring Members of Lloyd's participations on 745 syndicate years of account from almost 400 syndicates. On a gross, undiscounted basis, the reinsured reserves totaled approximately £21 billion, or US $35 billion. Net reserves, after estimated reinsurance recoverable of £6 billion and discounting on retained reserves of £4.5 billion, were approximately £10.5 billion, or US $17 billion. Reserve estimates were largely based on the three-year reserving project that was a major part of the R & R.

Equitas was funded by reinsurance premium from each member. Funds came from primarily two sources:

- from assets held as reserves in Members' premium trust funds, including those in the Lloyd's American Trust Fund (transferred into the new Equitas American Trust Fund, or EATF),

- from additional payments made by Members from their own assets or from funds comprising settlements due to them.

Also used were contributions from auditors, underwriting agents, brokers and other parties. By February 1998, Equitas had been fully funded except in so far as scheduling of payments had been previously agreed. Specifically, there were three installments of $40 million each to be paid by Lloyd's brokers supported by a contractual guarantee from Lloyd's and $20 million to be paid by Members of Lloyd's supported by a bank guarantee. In addition to this funding, Equitas took over approximately 250,000 reinsurance policies written by 2,900 reinsurers, making reinsurance recoveries a significant part of Equitas' financial success.

Operation

The operation of Equitas involves three main areas: investments, claims and reinsurance. The two main goals of the organization are to provide finality for the reinsured Members of Lloyd's and, if possible, to provide a return premium to them.

Equitas reports financial statements on a fiscal year ending March 31. The audited report by Coopers & Lybrand at March 31, 1997 reflected the following balances. Coopers & Lybrand's opinion was qualified because of the uncertainties of claims outstanding, reinsurers' share of claims outstanding, and reinsurance recoveries. Equitas' financial statements reflected the following balances:

Equitas Group Balance Sheet

In millions of £

	3/31/97	9/4/96
Assets		
Investments	7,477	5,001
Reinsurance - Claims Outstanding	3,128	4,285
Debtors - Reinsurance & Other	1,977	5,631
Other Assets - Cash & Tangible	74	1,055
Prepayments & Accrued Income	80	34
Total Assets	12,736	16,006
Liabilities		
Gross Claims Outstanding	11,830	14,757
Deposits From Reinsurers	15	16
Creditors	267	622
Accruals & Deferred Income	7	23
Retained Surplus Funds	617	588

Total Liabilities	12,736	16,006

As reported, Retained Surplus increased from £588 million at September 4, 1996, to £617 million at March 31, 1997. In spite of early positive results, Equitas' management recognizes that it is still too early to tell how successful the run-off, expected to take forty or more years, will be.

If, at any time, Equitas' directors determine the assets are insufficient to cover full liabilities, the agreement by which Equitas assumed the pre-1993 syndicate liabilities provides that the directors may implement a proportionate cover plan. This plan provides for liabilities to be restricted to assets available and claims to be paid at a reduced rate. In this event, Lloyd's Members originally reinsured by Equitas continue to be liable for any shortfalls.

Interim reporting does not include full financial statements, but rather mid-year updates on investment return, claims and operating costs paid, foreign exchange results, etc. The September 30, 1997 update was distributed in letters to reinsured Members in January 1998, and included information on improved investment earnings, reduced payments in claims, and minimal gain in foreign exchange rates. In addition, the update disclosed that in December, 1997, Equitas had completed (as originally intended and with the approval of the DTI) the reinsurance of liabilities previously reinsured by the Corporation of the Lloyd's subsidiary, Lioncover Insurance Company Limited. The result of this transaction was an increase to surplus of approximately £70 million and an increase in the investment portfolio of approximately £500 million.

The formation of Equitas and the acceptance of its existence by various regulators enables the current Lloyd's market to function as it does today.

As a result, the Lloyd's syndicates existing in 1993 and forwards have not accepted any Reinsurance To Close from 1992 and prior. They are therefore largely free of the problems of the past.

Equitas Ltd. and Equitas Reinsurance Ltd. are authorized and regulated by the U.K. regulator, HM Treasury. HM Treasury supervises Equitas as an insurance company under the Insurance Companies Act of 1982. The Treasury has placed a number of restrictions upon Equitas. These prevent Equitas from writing new business, negotiating new outward reinsurance, paying return premium to reinsured Lloyd's Members, and changing the company by-laws without prior approval from the Treasury. Equitas has no source of earnings in the future other than the investment earnings on its current funds. In addition, the Treasury has imposed certain restrictions on Equitas' investments, and requires quarterly financial and investment reporting.

As mentioned above, the funding of Equitas came from several sources. The largest source of funds was the LATF. Essentially, the majority of these premium trust funds were transferred from the LATF and into the newly created EATF in order for the EATF to be included within the balance sheet of Equitas. Presently, the EATF is valued at approximately $9.0 billion. The LATF will continue to pay claims for US dollar denominated business and will draw down the EATF as these claims are paid.

It should be emphasized that the creation of Equitas does not eliminate the possibility that Members may be called on again to supply funds to maintain the solvency of Equitas. In other words, a novation did not occur between the reinsured Members of Lloyd's and Equitas. Therefore, if Equitas runs out of funds, US policyholders will have to recover their loss payments directly from the Members. This would prove to be a time consuming and costly venture. Should this occur, the Lloyd's market would likely fund any shortfalls. As a result, the continued success of Equitas is a critical part of Lloyd's long term success.

Reserves

The reinsurance premium paid to Equitas was calculated from an immense reserve review of the 1992 and prior liabilities begun by Lloyd's in 1993, and that was to last for three years. To fund Equitas, each syndicates ultimate loss reserves were estimated and discounted. The reserve estimates were principally done by a number of external professional advisers, including leading actuarial and accounting firms and supported by a team from Lloyd's, supplemented by individuals with appropriate actuarial, accounting and data processing skills. Over two hundred actuaries were involved. The major hindrance to identifying liabilities was, and continues to be, poor data capture of losses in syndicate year records for years prior to the mid-eighties. As a result new claims still show up on a daily basis. To date, they have been absorbed with no impact to the initial ultimate reserves.

Currently the actuarial involvement of the Government Actuary's Dept. is to approve or disapprove the actuarial procedures and models.

Major reserving areas include:

- asbestos;
- pollution and health hazard;
- major catastrophes;
- professional indemnity line slips;
- Lloyd's agents E&O;
- outwards reinsurance; and
- discounting.

The current underlying discount rate is 6% and is re-evaluated annually. Equitas has recently completed work on their own reserve model, on which outside consultants assisted. The reserves are opined to by the staff actuary, and peered reviewed by an independent consulting actuary.

The Exxon Valdez has been their largest group of catastrophe settlements through 1997. While reserves were inadequate for this particular catastrophe, there was enough favorable development in other areas so as not to impact overall estimates of reserves.

Payout projections have been made through 2005. Very little reduction in asbestos liabilities was contemplated in the projection model. However, other claims are expected to run off much faster. The overall reduction in net reserves is anticipated by Equitas to be approximately £5 billion, from the £9 billion at 3/31/97 to £4 billion.

The process for profit sharing back to the Members appears to be in place, although is not anticipated for many years to come.

At the time of this writing the "Reports and Accounts for the Period Ending 31 March 1998" was not available. No serious new disclosures in that report are currently contemplated.

Summary

Lloyd's has a 350 year history dating back to the coffee house owned by Edward Lloyd. Throughout its history and evolution, the unique way of transferring and spreading risk has allowed Lloyd's to become a leading writer of risks that other insurers could or would not write. Lloyd's has survived R&R and continues to change to remain a player in a more competitive international market.

PART 2 – THE REVIEW OF LLOYD'S UNDERTAKEN IN 1998

As a result of Lloyd's request to reduce the current US Surplus Lines trust fund requirements, the NAIC's Surplus Lines (E) Task Force formed a Review Team in December 1997, to carry out the following charge:

> "Perform an in-depth and on-site investigation of the structure and workings of Lloyd's. Provide a written report and explanatory brochure for use by state insurance regulators. Complete field work and make recommendations regarding appropriate levels for Lloyd's US Situs Trust Funds – Surplus Lines by March 1998 meeting. Complete a report and explanatory brochure for use by state insurance regulators…."

The review was conducted in two phases by representatives of the Alaska, California, Louisiana, New York and Texas Departments of Insurance, and NAIC staff in January and February, 1998. The review used a multi-pronged approach that maximized the expertise of Team Members, specifically in the areas of management, accounting, information systems, and actuarial.

Part 2 describes much of the onsite work conducted by the Review Team, as well as the Team's conclusions and recommendations. In addition to the specific work steps discussed, extensive discussions with Lloyd's personnel and other parties, as well as amongst team Members, contributed to the team's overall evaluation of Lloyd's.

Scope & Limitations

As part of the initial planning, the Review Team formed four hypotheses, as follows:

1. Lloyd's has adequate internal controls over premium fund collections and coding processes for each policy underwritten at each syndicate.
2. Reserving methodologies are actuarially sound.
3. Regulatory and internal controls over financial reporting are adequate and ensure reliable, verifiable, financial reports at each syndicate.
4. There are no material differences in internal control structures and financial reporting between syndicates.

The onsite review in February 1998 subjected these hypotheses to limited testing. The testing was conducted through limited sampling of Lloyd's processes and extensive interviews of key Members and participants in the Lloyd's market and UK insurance regulation. Part 2 describes the scope and findings relative to the Review Team's work in the areas of Lloyd's business processes, regulatory environment, financial reporting, and Equitas.

The review was not intended to be an audit or examination of Lloyd's. An audit would require far greater time and personnel than was available to the Review Team. This review should not be relied on for such purpose. However, based on the scope and limitations described herein, the Review Team found no evidence that the hypotheses tested were not true.

Business Processes

The Review Team designed the testing of Lloyd's business processes to follow the placement of risk from the initial US contact through all stages of the Lloyd's market, including underwriting, policy issuance, premium and claim settlement and US trust funds. Each of these areas is discussed separately.

The Review Team considered management of Lloyd's a critical component of this review. Members of the Team met with top management of the Corporation of Lloyd's and Council of Lloyd's to discuss policy issues, future business operating goals, plans to preserve Lloyd's unique characteristics, and regulatory goals. The Review Team also had numerous discussions with key members of the North America division of the Corporation of Lloyd's.

Premiums, Claims, and Central Accounting Procedures

The Review Team tested the hypotheses using various work steps. Following are examples of the work steps performed:

- obtained listings of policies from the California Surplus Lines Stamping Office and attempted to trace these policies through the Lloyd's system;
- conducted onsite London office interviews with a Lloyd's broker who places US business with the Lloyd's Market and the London Company Market; on a very limited basis, tested claims information obtained from the broker through the Lloyd's system;
- conducted onsite office interviews with Managing Agents for a sample of Lloyd's syndicates; confirmed reporting and settlement processes; obtained financial information related to sampled syndicates;
- observed procedures on Lloyd's market floor for the placement of risks by Lloyd's brokers with syndicate underwriters;
- observed and tested on a limited basis procedures at Lloyd's Policy Signing Office (LPSO) in Chatham for receiving placement slips from Lloyd's brokers, for issuing policies, for coding policy submissions by Lloyd's brokers and for capturing policy and premium information related to US business;
- observed and tested on a limited basis LPSO's extensive information systems and automated controls; reviewed the external limited distribution report on the LPSO by Ernst & Young for the period January 1, 1997 through September 30, 1997;

- observed procedures at Lloyd's Claims Office (LCO) in London for entering and settling claims, including proper coding for US Situs business;

- reviewed validation checks and control reports of the LCO designed to assure that information disseminated to the market and regulatory community is complete and accurate;

- interviewed Lloyd's Central Accounting staff in Chatham and performed limited testing regarding settlement of brokers' accounts for premium and claims activity;

- interviewed staff in Chatham responsible for trust funds and reviewed documentation on quarterly funding of US Situs trust funds by syndicate;

- observed procedures, interviewed staff, and reviewed reports and filing packets of the Market Reporting & Solvency Department (MRSD) regarding financial reporting and verification, including US business results, Lloyd's global results, and solvency standards; discussed new requirements and preliminary results of filing Schedules F and P by syndicate.

Premiums, Claims, and Central Accounting Observations

1. No evidence was found to indicate that controls and financial reporting over premium and claims data that Lloyd's receives are insufficient to support Hypotheses 1, 3 and 4. Because of time and resource constraints, virtually no testing of expenses or reinsurance was conducted during this review. This is an area for follow up testing and evaluation.

2. No common policy number or other tracking characteristic exists between US Stamping Offices or brokers and Lloyd's systems. Therefore, the Review Team was unable to test the coding of US business from a US policyholder through the Lloyd's system. Because US agents or brokers might have a financial incentive to avoid premium taxation by coding surplus lines business as exempt business, the potential exists for US Situs Surplus Lines trust funds to be under-funded. Conversely, there may be incentives to bring exempt business under the protection of the US Situs Surplus Lines Trust funds. This too is an area for follow up testing and evaluation.

3. While syndicates obtain information from the LPSO and directly from brokers, each syndicate does not know whether their share of a particular risk has been reduced or "signed down" until the LPSO has processed the policy.

Financial Reporting

In addition to the work previously described for premium, claims, and central accounting, all of which impact financial reporting, the Review Team undertook the following work steps specifically related to such financial reporting:

- interviewed key staff of the Market Reporting and Solvency Department (MRSD) of the Finance unit;

- reviewed the processes for data capture from Lloyd's Policy Signing Office (LPSO) and Lloyd's Claims Office (LCO), for reconciliation's to syndicate records and US trust funds, and for reporting of Lloyd's US liabilities and its global results and solvency standards;

- performed cursory analysis of Lloyd's global results for 1996 based on Lloyd's unique three-year accounting method;

- reviewed Ernst & Young Report to the Council of Lloyd's regarding the Lloyd's Statutory Statement of Business for the year ended December 31, 1996;

- reviewed the recent requirement for syndicates to file Schedule F and Schedule P to capture certain reinsurance and loss data.

Financial Reporting Observations

1. No evidence was found to indicate that systems and controls were not adequate to ensure reliable, verifiable financial reports or that financial reporting was materially different between syndicates; i.e., no evidence was found to indicate that Hypotheses 3 and 4 are not true. In addition to certain data checks within LPSO and LCO, a level of control exists in that financial reporting relies on information from divisions under separate operating divisions, i.e., the Insurance Services division and the Finance division, within the Lloyd's structure. However, because of time constraints, the Review Team conducted virtually no testing of expenses or reinsurance during this 1998 review, and testing of actual syndicate data to global results was very minimal.

2. Filings of Schedule F and Schedule P were first required for the 1997 year-end and will, if accurately prepared, contain information of Lloyd's syndicates relevant to US business. Because the filings were not yet due, this data could not be reviewed or tested during this 1998 review.

Both of the above observations are areas for follow up testing, evaluation, and continued monitoring.

Reserving

The actuaries on the Review Team conducted the review of reserving practices, qualifications of actuaries, and syndicate actuarial opinions of Lloyd's. They performed the following work steps to test hypotheses 2:

- interviewed representatives of the Institute of Actuaries (IA) and the Faculty of Actuaries (FA) to determine UK actuarial education, training, professional standards and disciplinary procedures. Reviewed the professional guidance notes on reserves and other documents describing the actuarial standards in the UK. Comparisons with the US actuarial profession were made;

- reviewed regulatory guidance notes and advisory documents on reserves;

- selected six syndicates (two large-, two medium-, and two small-sized) for testing; conducted extensive interviews with opining actuaries, Managing Agents including key financial personnel of the selected syndicates;

- reviewed the actuarial opinions, as well as the actuarial reports supporting the opinions, for each of the selected syndicates and the qualifications of each opining actuary;

- reviewed selected syndicate's data quality checks, methodologies used to determine ultimate losses by line, and compliance with agreements with the New York Insurance Department regarding unearned premium and loss reserves;

- interviewed staff of Lloyd's Policy Signing Office (LPSO) who maintain the manual of classification codes; reviewed the groupings of risk code classes based on similar payout characteristics;

- gauged individual syndicate's knowledge of the reporting system for US Situs Surplus Lines Trust Funds;

- conducted other work related to Equitas and the regulation of Lloyd's (discussed under other sections of this Part 2).

Reserving Observations

1. No evidence was found to indicate that reserving methodologies are not actuarially sound, and therefore, that Hypothesis 2 is not true.

2. Opining actuaries, both syndicate-employed and hired consulting firms, were considered qualified, experienced and knowledgeable.

3. Data used for determining US Situs Surplus Lines liabilities by syndicate is fairly immature, resulting in greater uncertainty in the estimates.

4. The aggregation of data for purposes of the reserve analyses was reasonable and appropriate for the type of business written by the particular syndicate.

5. Use of consulting actuaries offered the smaller syndicates a broader body of knowledge and understanding gained from the actuaries experience in the London Market.

6. At the time of the review, 1997 actuarial opinions had not been prepared. Therefore, the 1996 opinions process was reviewed. Because of the relative immaturity of the opinion process, more review should be done in the future. This is an area for follow up testing and evaluation.

7. There is a limited number of qualified actuaries signing opinions for Lloyd's syndicates and there as many as four different opinions required for each syndicate. As a result, actuaries were under considerable time pressures to produce their year end opinions.

8. The Manual of Actuarial Practice, co-published by the Institute of Actuaries (English) and the Faculty of Actuaries (Scottish) is the repository for guidance notes and Code of Professional Conduct. The guidance is very specific regarding Lloyd's opinions, and the Code of Conduct is similar to that

published by the American actuarial societies. The opining actuaries who were interviewed were knowledgeable of the information contained in these documents.

Regulatory Environment

The Review Team conducted its testing of the regulation of Lloyd's on both an internal and external basis. The Team conducted work steps as follows:

- reviewed the Lloyd's organizational chart to determine the reporting chain for internal regulatory oversight of the Lloyd's market; reviewed the experience of senior appointments within the Regulatory Division;
- reviewed Lloyd's 1997 and 1998 Regulatory Plans;
- conducted extensive interviews with key personnel of the Regulatory Division, particularly top management of the Division and of the Monitoring and Regulatory Policy units; reviewed plans and progress for initiatives; reviewed the Division's analysis of syndicate ratings;
- conducted extensive interviews with key personnel of the Finance Division, particularly the new Market Risk Unit; reviewed its approach and progress on applying risk-based capital to all Lloyd's Members;
- interviewed key personnel regulating Lloyd's brokers and reviewed results of those monitoring efforts;
- conducted an onsite London office interview of a Lloyd's broker regarding the regulation of brokers for Lloyd's and the London market;
- conducted onsite interviews with leadership and actuaries responsible for insurance reporting to HM Treasury and the new Financial Services Authority.

Regulatory Environment Observations

1. The management personnel within Lloyd's Regulatory Division were considered highly qualified. The Division's work in minimizing various potential abuses in the market is noteworthy. However, much of the work is still in progress and is not solidified in legislation or external regulation. The Regulatory Division could be considered a cost center and a drain on syndicate resources, so that without external solidification the continuance and quality of internal regulatory functions are not assured.

2. There is a recognized need to fill a vacancy for a qualified actuary by the Regulatory Division to provide an extra measure of review of the actuarial opinions and the work product done in relation to those opinions.

3. The new Market Risk Unit is continuing to develop risk-based capital requirements for all Lloyd's Members. However, enhancements are still in progress and should continue to be monitored.

4. External regulation of Lloyd’s is evolving as the UK moves toward joint oversight of insurance, securities and banking under the new Financial Services Authority. These developments should continue to be monitored.

5. Internal regulation of Lloyd’s brokers is noteworthy, for example the requirement to establish Insurance Brokerage Accounts that will cover both the Lloyd's, and London companies’, portions of the risk. The FSA is considering the codification of this internal regulation in future legislation. These developments should continue to be monitored.

6. In addition there are provisions for "Umbrella Brokers" which are probationary Lloyd’s brokers supervised by registered Lloyd’s brokers.

Equitas

The Review Team conducted its review of Equitas from an actuarial, regulatory and business approach. The Team conducted work steps as follows:

- reviewed the organizational structure of Equitas, its relationship to Lloyd’s, its Mission Statement, and the qualifications of top management;

- conducted extensive onsite interviews with key management of Equitas in the areas of financial, actuarial, planning and policy-making; conducted brief interviews with personnel of Lloyd’s regarding its relationship to Equitas;

- reviewed the degree of actuarial involvement in the Equitas Project that started in October, 1993, and culminated in Equitas’ becoming operational on September 4, 1996;

- reviewed available financial results since Equitas’ inception; discussed results with management, including i) verbal and written confirmation that receivables from Lloyd’s were virtually all collected, ii) the first and only to-date independent audit (Coopers & Lybrand), and iii) the interim progress report to Members as of September 30, 1997;

- interviewed key management responsible for actuarial and solvency oversight at the Department of Trade and Industry, HM Treasury, and the new Financial Services Authority.

Equitas Observations

1. Currently Equitas is not subject to extensive external reporting or oversight. Management prepares complete financial statements only once a year and these are publicly distributed approximately six months after the end of the fiscal year of March 31. At the time of this review, the Team was unable to obtain copies of Equitas' business plan, its developing formula for risk-based capital, or its servicing agreement with Lloyd's. The Equitas business plan was not finalized until sometime after this review was completed.

2. The Board of Directors and key personnel of Equitas are considered qualified, and have professional credentials.

3. Equitas' solvency continues to be totally dependent on the sufficiency of reserves, discount and investment rates, and reinsurance recoveries. The sole auditor's opinion issued to date was heavily qualified in virtually all of these areas.

4. Payout projections have been made through 2005. Equitas anticipates that, as a result of claim payments, net reserves will be approximately £5 billion in 2005, down from the £9 billion at 3/31/97. Very little of this £4 billion reduction is expected to be due to asbestos related liabilities.

5. The reinsurance contract under which Equitas assumed the liabilities of Lloyd's Members provides for a "proportional cover", or reduced claim payments, if Equitas' assets are not sufficient to cover all liabilities. In this scenario, there would be an impact to US policyholders and Lloyd's US trading eligibilities, unless Lloyd's chooses to fund the shortfall.

Other Issues

In addition to the business cycles, the regulatory environment, and Equitas, the Team reviewed issues associated with the "millennium bug" or Y2K problem, and pending litigation that might be considered relevant.

Year 2000:

In line with actions taken by US state insurance regulators to determine the preparedness and financial impact of Year 2000 issues on the domestic insurance industry. The Review Team investigated Lloyd's preparations. The Review Team conducted the following:

- reviewed the volume of business conducted by Lloyd's and the hard copy and electronic processing required to be an ongoing market;

- interviewed key Information Systems personnel regarding Year 2000 issues as well as the team manager for the Y2K project in the Market Risk Unit;

- reviewed Lloyd's plans and allocation of budget and personnel resources to become Year 2000 compliant.

Y2K Observations & Conclusions

1. The Lloyd's market transacts more than £7 billion (approximately US $12 billion) of insurance business each year, conducted through hard copy and electronic process for approximately 2.5 million policy transactions and 22 million output transactions per year. The interdependence of the market players potentially increases the exposure to Year 2000 problems.

2. Lloyd's launched a Year 2000 program in 1997 and expects to be Year 2000 compliant by the end of 1998.

3. Lloyd's has experienced a high turnover in Information Systems personnel and has implemented a salary review package and other steps to retain qualified personnel in this critical area.

4. The Lloyd's market has a year 2000 exclusion that is widely used by the underwriters.

5. There is a program underway to have Lloyd's brokers certify their system readiness.

Pending Litigation Regarding Reconstruction & Renewal (R&R)

During the early 1990's, serious allegations made by Members of fraud by Lloyd's. Members residing in the US also alleged securities violations by Lloyd's. As a condition of accepting the R&R settlement, Members were required to give up their rights to further litigation against Lloyd's; 95% did so. However, a number of cases, in which US Members allege fraud and misrepresentation remain. Currently, all eight of the U.S. Circuit Court of Appeals that have heard the issue have upheld the Lloyd's membership contract provisions (called the forum selection clauses) that require all legal issues arising out of Lloyd's membership to be construed under English law in the English Courts. The U.S. Supreme Court has denied the plaintiff's petitions for certiorari in all cases except one, the Richards et al v. Lloyd's case, which the Court is still considering. Based on the previous denials of certiorari by the Court, Lloyd's believes that certiorari will be denied in this case.

Conclusions and Recommendations

Part 2 of the report was primarily written in response to the second aspect of the charge given to the Review Team. The charge was to test the adequacy of internal controls and financial reporting and make recommendations on appropriate levels of funding for Lloyd's US Situs Surplus Lines Trust Funds. This objective was accomplished through extensive interviewing of key people in the Lloyd's Market, and through the Team's observations and limited sampling of Lloyd's business and financial reporting processes.

Our conclusions and recommendations are based on our work and also based, in part, on the many initiatives and developments currently underway at Lloyd's and at HM Treasury to strengthen the chain of security for policyholders. The most noteworthy among these initiatives are a freshly revitalized regulatory group, the development of a risk-based capitalization approach, and the implementation of Schedule P and Schedule F type exhibits. Another major initiative is the requirement for syndicates to set reserves based on actuarial study.

Conclusions

- During our sample testing of internal controls and our observation of the Lloyd's financial reporting processes, as well as throughout the extensive interviews conducted, no evidence was found that Lloyd's internal controls over premium fund collections and coding processes were not adequate.

- No evidence was found that the reserving methodologies employed were not actuarially sound.

- No evidence was found that regulatory and internal controls over financial reporting were not adequate or that these controls did not ensure reliable, verifiable, financial reports at each syndicate.

- No material differences were found in the internal control structures and financial reporting between syndicates.

Recommendations

The Team made recommendations regarding several technical and management areas needing improvement. These areas were discussed at the exit interview and other meetings with Lloyd's management. The Team also noted many positive developments and improvements in capitalization standards, financial reporting, and reserving methodologies. In addition, the Team noted many positive initiatives in the internal and external regulatory structures at Lloyd's especially by the government regulators at HM Treasury. The major recommendations from the Review Team are as follows:

- The Review Team recommends that the 100% gross liability funding level be reduced to a lesser level, such as 50%, on a prospective basis. This recommendation is contingent on an increase in the Joint Asset Surplus Lines Trust Fund from $100 million to $200 million, and subject to a minimum capitalization of the Lloyd's US Situs Trust Funds-Surplus Lines of $600 million. If legal, the Team also recommends that the reduction in the required funding level be applicable on a retrospective basis as well. The Team recommends that the relief be conditional on continued progress in the areas of capitalization, reserving, market regulation, and financial reporting.

- The Review Team recommends additional on site reviews to monitor progress of the new initiatives at Lloyd's. The Team recommends that these reviews be conducted in the near future. At that time US state insurance regulators should address further modification to the funding requirements for the US Situs Surplus Lines Trust funds. Other key items for review will be:

    1. The evolving UK Financial Services legislation and its effects on the regulatory structure;

    2. The continuing changes in the capital requirements and their impact on the Chain of Security;

    3. The development of losses in Equitas on pre-1993 business; and

    4. The preparation for Year 2000.

Appendices

Appendix 1 – Interview Contacts

Lloyd's Corporation

Max Taylor	Chairman
Ron Sandler	CEO and President
Ian Agnew	Deputy Chairman
North American Unit	
Al Skwiertz	North American Unit, General Counsel
Rosemary Beaver	North American Unit, Regional Manager
Sarah Brookes	North American Unit, Regional Executive
Julian James	North American Unit, London, Office Chief
Peter Lane	North American Unit, Director
Bruce Tompson	North American Unit, Regional Manager
Regulatory Division	
David Gittings	Director of Regulatory Division
John Baker	General Manager, Enforcement
Barbara Merry	General Manager, Policy Regulatory Division
Richard Murphy	General Manger, Monitoring Regulatory Division
Peter Neville	General Manager, Individual Registration Unit
Wendy Whyte	Manager of Complaints Department Dept.
Other Lloyds Divisions	
Len Bateman	Manager, Lloyd's Policy Signing Office (LPSO) Reins Dept
Sue Bowen	Administration, LPSO
Jane Bridger	Lloyd's Claims Office
Andrzej Czernuszewicz, FIA	Actuary, Market Risk Unit

Andrew Duguid	Director of Strategic Planning
Tim Gregory	General Manager, Insurance Business Systems
Pat Hakong	Market Reporting and Solvency
Bob Hewes	Director of Finance
Andrew Hodson	Corporate Finance
Mike Roffey	Head of Claims Services, Lloyd's Claims Office
Roger Selleck	Market Risk Unit
Ian Simister	Manager, Management Consultancy
Mike Smith	Manager, Systems Planning
Michael Taylor	Managing Director, Insurance Services
Ian Wootten	Manager, Lloyd's Settlements and Trust Funds Section

LeBoeuf, Lamb, Greene & MacRae

William Marcoux	Attorney
John Mulhern	Attorney

Syndicates

672 Wellington Underwriting PLC	Management Team
861 Brockbank Syndicate Mgt LTD	Management Team
52 Hiscox Syndicates LTD	Management Team
490 RGB Underwriting Agency LTD	Management Team
102 Gammell Kershaw & Co. LTD	Management Team
362 Murray Lawrence	Management Team

Equitas

Jane Barker	Finance Director, Equitas

Jeremy Heap	Head of Business Planning and Analysis, Equitas
Paul Jardine, FIA, MAAA	Chief Actuary, Equitas

London Market

James Barker	Broker, Swire Blanche
Graham Rose	Broker, Swire Blanche
Tony Funnell	Chief Executive, Institute of London Underwriters
John Spencer	BMS Ventures Limited

Insurance Regulators (HM Treasury)

Peter Casey	Director, Lloyd's and London Market Supervision
Martin Brebner	Deputy Dir, Lloyd's Supervision, Ins Directorate, HM Treasury
Peter Hinton	Actuary, Insurance Directorate, Government Actuary's Dept.
Stephen Walton	Insurance Directorate, HM Treasury

Financial Services Authority (FSA)

Martin Roberts	Insurance Director

Institute/Faculty of Actuaries

David Ibeson, BSc, FIA	Technical Director & Group Actuary, Wellington Underwriting
John Beck, BSc FFA	Tillinghast Towers Perrin
David Hindley, BSc, FIA	Bacon & Woodrow, London Market Services

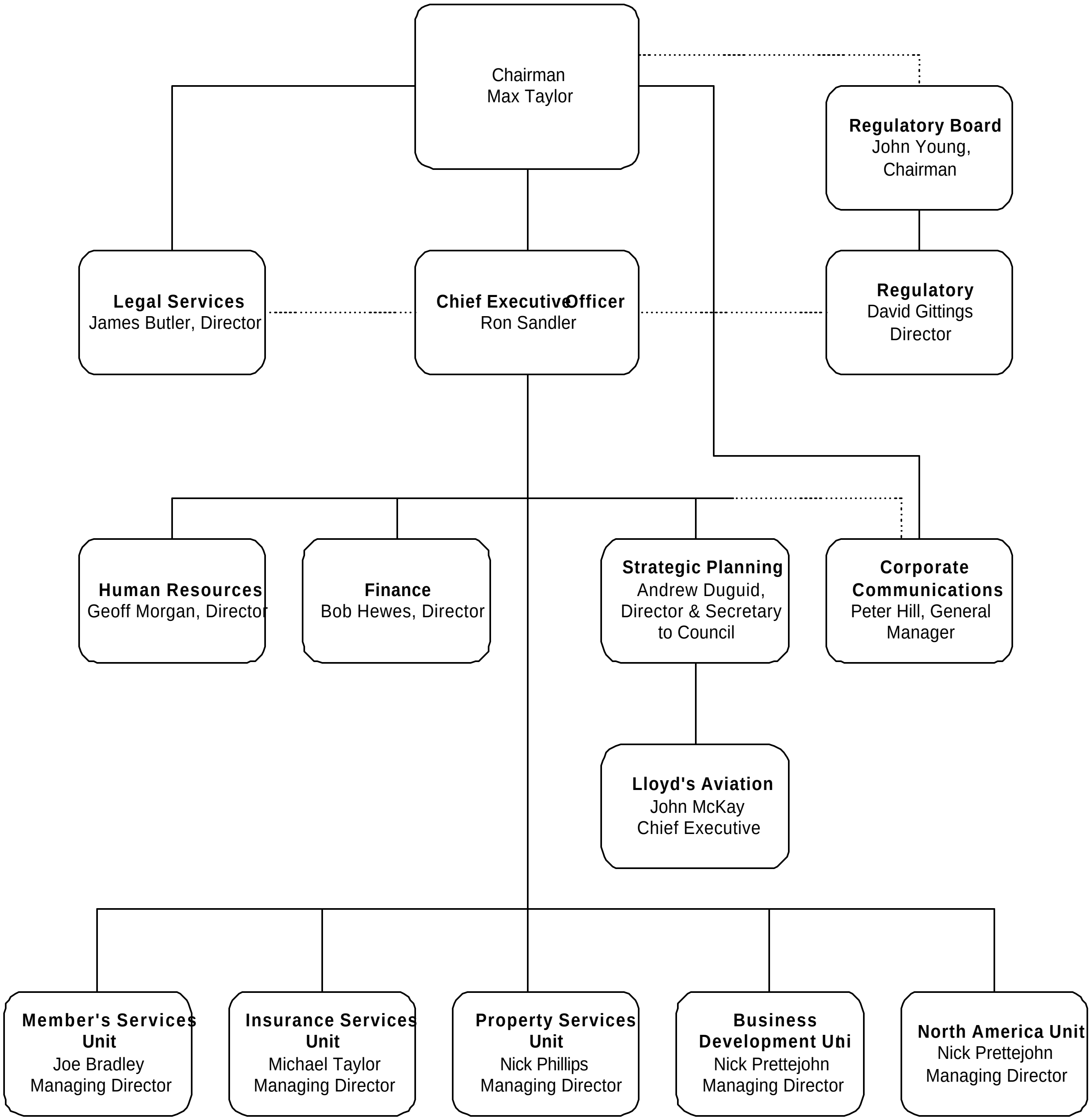
Appendix 2 – The LMX Spiral

The "LMX spiral" relates to a particular phenomenon in the 1980's whereby brokers would broker a particular piece of business with a syndicate. The syndicate would then purchase a whole account excess of loss reinsurance that would protect the business originally written. This whole account excess of loss would then be underwritten by various other Lloyd's syndicates and London market insurers. However, these other Lloyd's syndicates would also have whole account excess of loss coverages, which might be reinsured with the original syndicate and other of their co-insuring syndicates. The net result, after a few iterations of this, would be that losses would go from syndicate to syndicate, attaching at the excess of loss attachment point, and would bounce around the market. Ultimately, they would land up somewhere where there was not a whole account excess of loss protection or where the excess of loss protection was insufficient. Further, the incoming premium for the original risk would have been diluted by successive broker commission as the risk had been retroceded from syndicate to syndicate. Therefore, the ultimate loss would often be many orders of magnitude higher than the premium. If an underwriter failed to monitor the aggregate exposures adequately, it would not be until the loss was reported that the underwriter realized the possible magnitude of the syndicate's ultimate loss. A market wide disaster like the Piper Alpha explosion in the North Sea is but one example of an LMX spiral that ultimately concentrated the loss for the oilrig in a small number of syndicates.

US environmental impairment liability, especially regarding asbestosis and pollution, also constituted a significant unpleasant surprise for the Lloyd's market. The adjudication of the so-called "triple-trigger" was unforeseen. Lloyd's underwriters suddenly found themselves with reserves that had been reinsured to them in the past through the RITC process that were very inadequate for the newly identified liabilities. Having taken on prior years' RITC, the assuming syndicate had picked up liability dating back for long periods of time. Exacerbating this problem, certain syndicates reinsured the whole accounts for other syndicates that had been in existence for long periods and that had significant EIL. Two particular underwriters, Stephen Merrett and Richard Outhwaite, became infamous for having written these coverages at rates that subsequently turned out to have been inadequate by orders of magnitude.

During the early 1990's the Lloyd's market came to the realization that business written by various syndicates several decades ago had generated liabilities that far exceeded the syndicates' assets. Court decisions, primarily in the US, favoring policyholders for pollution and asbestos claims probably had the greatest impact on the adverse development of claims that were established many years earlier.

Appendix 3 – Lloyd's Corporate Structure



Appendix 4 – The Actuarial Profession in the UK

Before reviewing the actuarial processes at Lloyd's, the team met with representatives of the Institute of Actuaries (IA) and the Faculty of Actuaries (FA). The FA is an independent Scottish society, but they closely coordinate with the IA. For purposes of this report they are considered together.

In the United States there are separate learned societies for the major actuarial disciplines. The Casualty Actuarial Society (CAS), the Society of Actuaries (SOA) and the American Society of Pension Actuaries (ASPA) are the learned societies for Casualty, Life & Health and Pensions respectively. For the most part, each society has separate examination tracks that focus on their respective specialties. The American Academy of Actuaries (AAA) is an umbrella organization and includes actuaries from all specialties. In addition to setting qualification standards and standards of practice, a major purpose of the Academy is to act as the public information organization for the profession.

By Comparison, in the UK, there is only one society for all the disciplines, the IA, and essentially one exam track. All actuaries must take the eight of nine exams in common. However, the eight exams include one that concentrates on Life topics, one that concentrates on Pensions topics, and one that concentrates on P&C topics. The ninth and last exam is advanced topics, and the student chooses one of the three disciplines in which to be tested.

Many of the Fellows of the IA and FIA who perform reserve work for Lloyds syndicates did not take the advanced examination on property and casualty insurance topics. In large part, this is due to the fact that prior to R&R, there was not as great a demand for P&C actuaries in the UK. Today, a much greater proportion of the actuarial profession take the advance examination on property and casualty topics.

Appendix 5 – Opinion Requirements for Lloyd's syndicates

	Surplus Lines Trust Fund Opinion	Credit for Reinsurance Trust Fund Opinion	NAIC: IID Opinion	UK Solvency Opinion
Business Scope	US Situs Surplus Lines	US Situs Reinsurance	Worldwide Reserves	Worldwide Reserves
Years of Account	August 1995 and subsequent years of account evaluated as of December 31.	August 1995 and subsequent years of account evaluated as of December 31.	1993 and subsequent years of account as reported in line 3 of Solvency Form SR16	1993 and subsequent years of account as reported on lines 1 and 3 of Solvency Form SR16
Reinsurance	Gross of Reinsurance	Gross of Reinsurance	Net of Reinsurance	Gross and Net of Reinsurance
Reserve Provisions established	Reported outstanding claims, IBNR claims and provision for unexpired risks;	Reported outstanding claims, IBNR claims and a provision for unexpired risks and deferred premiums and funds withheld;	Reserves are analyzed between reported outstanding claims and IBNR claims and unexpired risks.	
Salvage & Subrogation	Net of salvage and subrogation	Net of salvage and subrogation	Net of salvage and subrogation	Net of salvage and subrogation
Discount	No discount for the time value of money	No discount for the time value of money	No discount for the time value of money	No discount for the time value of money
Bad Debt Provision on Unsigned Earned Premium	Minimum of 25%	Minimum of 25%	Implicitly Projected	Implicitly Projected
Scope	Reserves include a provision for future claims arising from unexpired periods of risk and are net of anticipated future premiums (net of acquisition expenses) on past and current business Bad debt reserve on earned unsigned premiums is at least 25% of the estimated earned unsigned premiums	Reserves include a provision for future claims arising from unexpired periods of risk and are net of anticipated future premiums (net of acquisition expenses) on past and current business Bad debt reserve on earned unsigned premiums is at least 25% of the estimated earned unsigned premiums	Reserves include a provision for future claims arising from unexpired periods of risk and are net of anticipated future premiums (net of reinsurance and acquisition expenses) on past and current business	Reserves include a provision for future claims arising from unexpired periods of risk and are net of anticipated future premiums (net of acquisition expenses) on past and current business Include an analysis for Canadian dollar and LATF business

	Reserve in respect of unexpired periods of risk is at least 100% of the estimated unearned premiums	Reserve in respect of unexpired periods of risk is at least 100% of the estimated unearned premiums		

Appendix 5 – Opinion Requirements for Lloyd's syndicates (cont'd)

Scope (cont'd)	Data contained in Schedule P reconciles with the Trust Fund data used for the purpose of preparing the opinion	Data contained in Schedule P reconciles with the Trust Fund data used for the purpose of preparing the opinion		
Years of account	1995 (from 8/1/95), 1996 and 1997	1995 (from 8/1/95), 1996 and 1997	1993, 1994 run-off years (where applicable) 1995, 1996 and 1997	1993, 1994 run-off years (where applicable) 1995, 1996 and 1997
Opinion	Reserves: are consistent with the "Modified UK basis" as agreed with NYID; are greater or equal to reserves computed in accordance with generally accepted claims reserving standards; are based upon factors relevant to policy provisions; and make reasonable provision for the unpaid claims and allocated claims expenses, net of anticipated future premiums as at 31 December [current year] under the terms of its policies and agreements	Reserves: are consistent with the "Modified UK basis" as agreed with NYID; are greater or equal to reserves computed in accordance with generally accepted claims reserving standards; are based upon factors relevant to policy provisions; and make reasonable provision for the unpaid claims and allocated claims expenses, net of anticipated future premiums as at 31 December [current year] under the terms of its policies and agreements	Reserves: meet the UK insurance regulations as applied to Lloyd's; are computed in accordance with generally accepted claims reserving standards; are based upon factors relevant to policy provisions; and make reasonable provision for the unpaid claims and allocated claims handling expenses, net of anticipated future premiums as at 31 December [current year] under the terms of its policies and agreements	Reserves comply with the Lloyd's Valuation of Liabilities Rules and each amount is no less than the expected future cost of the corresponding claims and allocated claims handling expenses net of anticipated future premiums for which the syndicate was liable at 31 December [current year]
Filed with:	NYID, IID (+ copy to Lloyd's)	NYID (+ copy to Lloyd's)	IID (+ copy to Lloyd's)	Lloyd's
Authority	NYID	NYID	IID	Lloyd's/HM Treasury

Appendix 6 – Glossary

ABI	**Association of British Insurers.**
APH	**Asbestos, Pollution and Health hazard.**
C & C S	**Consultancy & Commercial Services**, a division of the Insurance Services Unit of the Corporation of Lloyd's. The C&CS is responsible for the provision of business and I.T. consultancy to the Corporation of Lloyd's and the market; managing commercial services provided in conjunction with external I.T. business partners.
CRTF	**U.S. Situs Credit for Reinsurance Trust Funds.**
D/B	**Data Base.**
DTI	**UK Department of Trade and Industry.** The previous UK insurance regulator that was subsequently succeeded by HM Treasury and later the Financial Services Authority.
EATF	**Equitas American Trust Fund.** The EATF is the largest asset of the LATF.
FAL	**Funds At Lloyd's.** Liquid funds that Members have deposited centrally at Lloyd's. The amount of such funds will determine the amount that the Member can underwrite.
FSA	**Financial Services Authority.**
GBP	**Great British Pounds, i.e. pounds sterling.**
IT	**Information Technology Division.**
IID	**NAIC International Insurer's Department.**
ILV	**Integrated Lloyd's Vehicles.** During 1995, Lloyd's amended its bylaws to enable third parties to purchase Managing Agents. This has given rise to ILVs where a single corporate entity owns both a Managing Agent and a corporate Member provides all the capacity on the syndicate. The ILV approach is, essentially, a method for insurance companies to trade at Lloyd's.

JATF	**Joint Asset Trust Funds.** There are two established JATFs: one securing reinsurance business and the other securing Surplus Lines business. Each JATF contains U.S.$115 million. Cedants and policyholders may assert claims against these funds, subject to judicial approval, to the extent that their claims have not been paid by the other funds. In practice, the JATFs could be used to make up the shortfall if Equitas fails to pay its claims in full. This break in the Equitas 'firewall' results from the insistence of the New York Insurance Department that the JATFs are available to pay claims on both the business reinsured by Equitas and the ongoing (post 1992) business. If either JATF falls below U.S.$104 million, the ongoing Lloyd's market will be forced to reconstitute the funds in order to maintain its U.S. licenses and consequently its ability to do business in the U.S.
LATF	**Lloyd's American Trust Fund.** The LATF was established to hold all U.S. premiums as a method of security. Prior to August 1, 1995, all U.S. premiums, regardless of the actual Situs of the risk, were channeled into this trust fund, which will continue to provide security for risks incepting prior to the changeover date.
LCO	**Lloyd's Claims Office.** The LCO is responsible for adjusting claims; processing, recording and advising movements on claims; providing claims information to the market for business and regulatory purposes.
LCTF	**Lloyd's Canadian Trust Funds.**
LDTF	**Lloyd's Dollar Trust Fund.** On August 1, 1995, the LDTF was established in London to receive all U.S. dollar premiums for business incepting after this date. The LDTF has the same operational accounting functions as provided by the LATF and deals with premiums/claims cash flows for all the Lloyd's market's U.S. dollar business. This trust fund is constituted as part of the Members' Premiums Trust Funds held in London.
LIMIT	Some individual Members have converted their trading status at Lloyd's by resigning their Membership and acquiring shares in spread vehicles like LIMIT.
LMB	**Lloyd's Market Board.** The Council of Lloyd's develops the commercial business of the Society primarily through the LMB. The LMB is responsible for all other market services.
LMX	**London Market Excess of Loss.**

LPSO	**Lloyd's Policy Signing Office.** A division of the Insurance Services Unit of the Corporation of Lloyd's. The LPSO is responsible for preparing, checking and signing Lloyd's policies and the accounting and settlement of associated insurance transactions; capturing data and monitoring business for legislative and regulatory purposes; providing business and statistical information to the market.
LRB	**Lloyd's Regulatory Board.** The Council of Lloyd's exercises its regulatory role primarily through the LRB. The LRB is responsible for supervision and regulatory matters.
MAT	**Marine, Aviation and Transportation business.**
MAPA	**Member's Agent Pooling Arrangement.** A **MAPA** is a pool of capacity on a large number of syndicates giving Members a much broader spread of risk than would otherwise be available.
MRSD	**Market Reporting Solvency Department.**
MRU	**Market Risk Unit.**
NACC	The **Nominations, Appointments and Compensation Committee** recommends members for the Lloyd's Regulatory Board and the Lloyd's Market Board. Also responsible for determining the remuneration of members of the Council, Lloyd's Market Board and Lloyd's Regulatory Board.
OPW	**Other Personal Wealth** represents funds and wealth over and above Funds At Lloyd's.
PE	**Personal Expenses.**
PPR	**Principle private residence.** In the past, could be used as collateral for bank guarantees or letters of credit to demonstrate FAL and OPW.
R & R	Lloyd's **Reconstruction & Renewal** Plan which became effective in September 1996.
RBC	**Risk Based Capital**: a methodology used at Lloyd's to determine the appropriate level for a Member's Funds At Lloyd's. This should not be confused with the NAIC's RBC.

RDS	**Realistic Disaster Scenarios.** A major recent reform in the regulatory environment at Lloyd's is the requirement for syndicates to assess the effect of their bottom line of seven RDSs, after allowance for reinsurance recoveries and reinstatement premiums. Syndicates are now required to report their conclusions to the Lloyd's Regulatory Division and also include them in their business plans.
RITC	**Reinsurance to close.** A transaction whereby underwriting liabilities are transferred from one syndicate (the closing syndicate) to another syndicate, usually, but not necessarily, the same syndicate number for the succeeding year of account.
RMM	**Required Minimum Margin.**
SIB	**Securities Investment Board.**
Slip	A **Slip** is a document summarizing the coverage to which various underwriters will affix their stamps and signatures.
SLP	**Scottish Limited Partnership.** A popular conversion vehicle allowing the Member to maintain a participation at Lloyd's, but on a limited liability basis.
SLTD	**U.S. Situs Surplus Lines Trust Funds.**