GUY CARPENTER

The Lloyd's Market in 2004

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Introduction

Guy Carpenter & Company Ltd is pleased to present its second annual review of the Lloyd's Market.

Geoffrey I K Bromley
President
Non-Americas Operations

It is our pleasure to report on the good progress made by Lloyd's over the past 12 months. Having returned to profitability in 2002, the pro forma annually accounted result more than doubled to £1.9 billion in 2003, demonstrating Lloyd's continued ability to perform strongly in a hard market. Looking ahead, general underwriting conditions remain good, which bodes well for 2004. Against this backdrop, Lloyd's financial strength ratings continue to exhibit considerable stability, relative to the wider industry.

It should be noted, however, that incurred natural catastrophe losses remain below the long-term average and this trend cannot be expected to continue indefinitely. It is also noteworthy that Lloyd's is expecting to report a cumulative deficit of almost £1.5 billion over the period 1993 to 2003, on the traditional three year accounting basis. Much of the momentum behind the implementation of the franchise reforms is derived from Lloyd's need to avoid the massive losses sustained in the last soft market. The Franchise Board has been established, but now faces its first real test, as underwriting conditions begin to weaken in some areas. For these reasons, and to the credit of Lloyd's management, there is no sign of complacency at the centre.

There are several initiatives underway at Lloyd's designed to have real impact, both in terms of the proactive management of the underwriting cycle and the improvement of business processes. Whether these initiatives will succeed depends largely on the attitude and support of market participants. We believe that the vision of the management team deserves our support and commitment. A strong Lloyd's certainly benefits our clients globally.

Guy Carpenter & Company Ltd would like to recognise and thank Lloyd's of London for its extensive assistance in providing data and research material for this report.

Executive Summary

- On a pro forma annually accounted basis, Lloyd's profits more than doubled to a record £1.9 billion for 2003, after prior year reserve strengthening of £545 million. Gross and net written premium reached record highs of £16.4 billion and £12.3 billion, respectively.

- The combined ratio improved to 90.7 percent in 2003, from 98.6 percent in 2002, and is expected to compare favourably with Lloyd's international peer group.

- Net resources, being total assets less policyholder and other liabilities, stood at £10.1 billion at the end of 2003, representing a 150 percent increase since the end of 2001. This is Lloyd's closest proxy to shareholders' funds.

- Central charges, also known as the 'costs of mutuality' have been reduced from 3.25 percent of capacity in 2003 to 1.75 percent in 2004. The 2 percent premium levy, which was imposed on all members in the wake of the US terrorist attacks, ceased at the end of 2003, having achieved its objective of increasing central assets.

- Continuing investor appetite is reflected in record opening market capacity of £15 billion for 2004. Market conditions remain good, although a degree of recent softening has been observed in certain areas. Capacity and its utilisation are expected to shrink from this peak level over the next few years.

- The profile of the capital base has remained relatively stable for 2004, with limited liability corporate vehicles supplying 87.5 percent of the market's capacity and unlimited liability Names the remaining 12.5 percent.

- The Franchise Performance Directorate has established its authority and made good progress in implementing measures designed to prevent under-performance at syndicate level that threatens the market as a whole.

- Under the leadership of Iain Saville, significant efforts are being made to improve the market's business processes, including policy production and premium and claims payment, with Kinnect re-positioned as a key enabler of contract certainty.

- Lloyd's financial strength ratings – Standard & Poor's: 'A' (Strong), AM Best: 'A-' (Excellent) – continue to demonstrate great stability relative to the wider market, having been lowered by only one notch since their introduction in October 1997.

- The Central Fund expanded by 49 percent during 2003, to reach £711 million at the year-end. Were the dispute over the Central Fund Insurance Policy to result in full rescission, the maximum exposure to net central assets would be £290 million. Lloyd's is proceeding to arbitration and remains confident of its case.

- On 1 January 2005, a new risk-based capital adequacy regime will be introduced for the UK general insurance market. In May 2004, the Financial Services Authority published a consultation paper on its proposed prudential requirements for Lloyd's.

Market Results

ACCOUNTING METHODS

Lloyd's has traditionally reported its results under a three year accounting system, whereby all premiums, claims and expenses are linked to the underwriting year in which the policy starts and the underwriting result is not fixed until the closure of the account after three years. The result for the market as a whole is based on an aggregation of the results reported by all syndicates separately in their audited returns, the most recent closed year being the 2001 account.

For the last three years, Lloyd's has also presented a Pro Forma Annual Accounting Statement (PFAAS), again based on an aggregation of syndicate results, but on a basis generally comparable with the wider insurance industry. This is in preparation for a switch to full annual accounting, in accordance with UK GAAP, from 1 January 2005.

2003 PRO FORMA PROFIT AND LOSS ACCOUNT

Gross written premium income at Lloyd's reached a record high of £16.4 billion in 2003, a year which is widely expected to represent the top of the current underwriting cycle. Growth in direct property and casualty business more than offset a contraction in the motor and accident and health accounts, while treaty reinsurance continued to represent 25 percent of the overall portfolio. A significant rise in overall business retention resulted in a near 10 percent increase in net written premium to £12.3 billion.

LLOYD'S PRO FORMA TECHNICAL ACCOUNT SUMMARY 2000-2003

£m	2000	2001	2002	2003
Gross Written Premium	12,641	16,112	16,203	16,422
Net Written Premium	9,017	11,072	11,160	12,250
Net Earned Premium	8,338	9,888	10,669	11,711
Net Incurred Claims	-7,816	-10,332	-6,652	-6,697
Net Operating Expenses	-2,630	-3,541	-3,872	-3,922
Underwriting Result	-2,108	-3,985	145	1,092
Investment Return	1,128	1,098	902	1,020
Other Expenses	-231	-223	-213	-220
Pro Forma Pre-Tax Result	**-1,211**	**-3,110**	**834**	**1,892**

Source: Lloyd's 2003 Annual Report

Underwriting conditions were very favourable during 2003 and net catastrophe losses remained well below the long-term average. Lloyd's was able to out-perform its international peer group in such an environment, with pro forma profit more than doubling to £1.9 billion, based on an improved combined ratio of 90.7 percent. This was after prior year reserve strengthening of £545 million, mainly in respect of US professional liability business written over the period 1997 to 2001. Equitas insulates Lloyd's from many of the prior year problems faced by much of the wider market.

The PFAAS does not present a consolidated view of Lloyd's business taken as a single entity and, in particular, does not eliminate inter-syndicate reinsurances. Premiums and claims paid in respect of such business totalled £644 million and £388 million, respectively, in 2003.

In US dollar terms, the market's estimated ultimate gross and net losses stemming from the US terrorist attacks remained stable throughout 2003, rising by under 2 percent to US$8.9 billion and US$3.3 billion, respectively, at the year-end. The actual incurred loss at 31 December 2003 stood at US$7.9 billion, of which US$4.7 billion had been paid and US$3.2 billion remained outstanding.

LLOYD'S 2003 ACCIDENT AND CALENDAR YEAR COMBINED RATIOS

%	Accident Year	Prior Year Movement	Calendar Year
Casualty	94.8	15.6	110.4
Property	89.1	0.3	89.4
Reinsurance	84.9	4.4	89.3
Motor	96.8	-3.2	93.6
Marine	95.6	-5.9	89.7
Energy	88.6	-5.2	83.4
Aviation	94.2	-1.2	93.0
Lloyd's of London	**86.0**	**4.7**	**90.7**

Source: Lloyd's of London

Funds available for investment have increased as a result of the growth in premium income, but the average return generated by syndicates was only 2.7 percent in 2003. This was due to the weakness of the US dollar, coupled with the low interest rate environment. Lloyd's is primarily a fixed-interest investor.

2003 PRO FORMA BALANCE SHEET

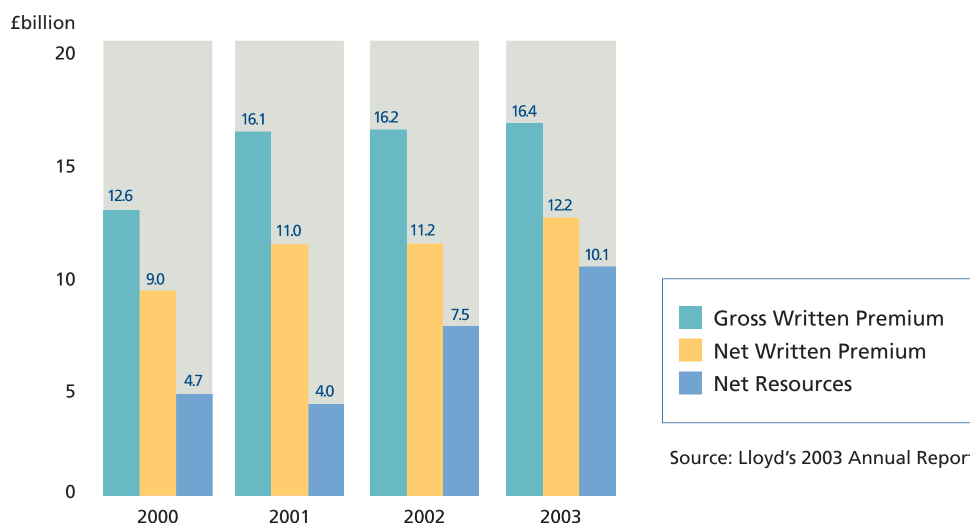
There has been a significant strengthening of Lloyd's balance sheet since the end of 2001. The investment portfolio has expanded on the back of strong premium growth, while effective collection of WTC recoveries has resulted in a reduction in reinsurance leverage. Some 87 percent of the total reinsurance asset is due from reinsurers rated 'A-' or above and around 30 percent is placed with the top five reinsurance groups. Bad debt is reserved at 7.4 percent of the total reinsurance asset across the market.

LLOYD'S PRO FORMA BALANCE SHEET SUMMARY 2000-2003

£m	2000	2001	2002	2003
Cash and Investments	16,597	20,296	24,512	27,893
Reinsurance Recoverables	10,351	15,864	13,693	11,180
Debtors	6,354	8,656	9,184	8,135
Other Assets	1,699	1,597	1,907	1,695
Total Assets	**34,971**	**46,413**	**49,296**	**48,903**
Technical Provisions	26,799	37,788	37,090	35,093
Other Liabilities	3,442	4,573	4,697	3,665
Net Resources	**4,730**	**4,509**	**7,509**	**10,145**

Source: Lloyd's 2003 Annual Report

LLOYD'S UNDERWRITING LEVERAGE 2000-2003



Source: Lloyd's 2003 Annual Report

'Net Resources' is Lloyd's closest proxy to shareholders' funds, representing total assets less policyholder and other liabilities. The components are members' Funds at Lloyd's, syndicate results declared on an annual accounting basis which have not yet been distributed to (or called from) members and the net assets of both the Central Fund and the Corporation of Lloyd's. It should be borne in mind that the majority of the capital base operates on a several liability, rather than mutual, basis.

2001 RESULT – 3 YEAR ACCOUNTING

Underwriting conditions began to improve meaningfully during 2001 and the year was not impacted by any major natural catastrophe. However, results were dominated by the impact of the US terrorist attacks, which accounted for the majority of the pure year underwriting loss of £1.4 billion. On a more positive note, a number of syndicates were able to take advantage of substantial rate increases on many of the specialist classes of business written at Lloyd's in the immediate aftermath of September 11th.

Reserves on earlier years of account (2000 and prior) experienced an overall deterioration of £580 million at year-end 2003, split £251 million on years of account reinsured into the 2001 year of account and £329 million on years of account left open.

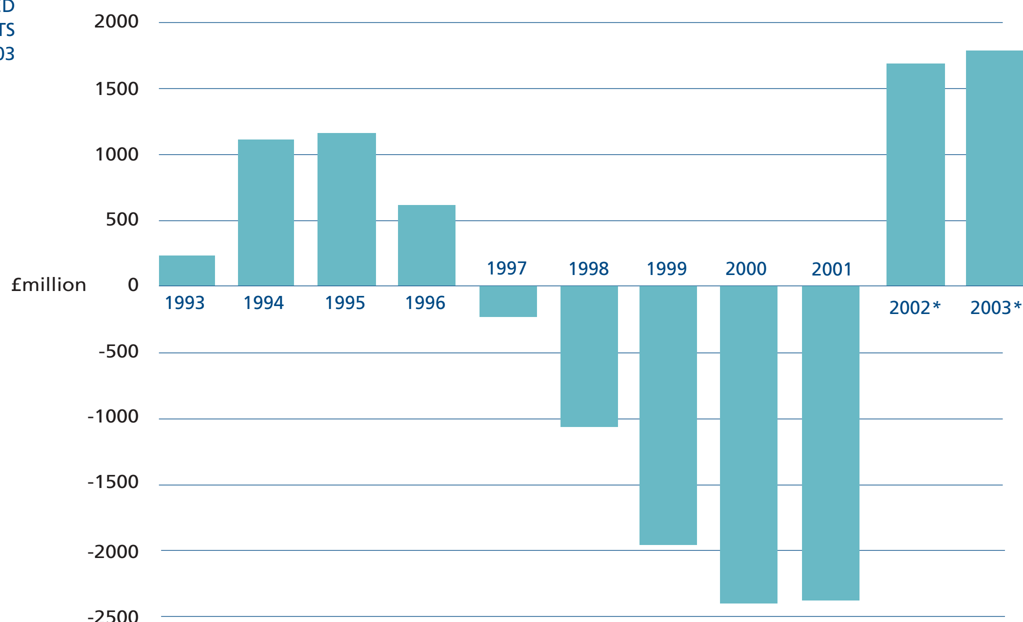
LLOYD'S 3 YEAR ACCOUNTED RESULT SUMMARY 1994-2003

£m	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003
Net Premium Written	5,690	5,893	4,810	4,709	4,869	5,785	6,203	6,930	8,600*	10,000*
Pure Year Underwriting Result	1,604	1,515	575	4	-904	-1,563	-1,794	-1,396		
Prior Year Underwriting Result	58	87	160	159	127	-166	-329	-580		
Underwriting Result	1,662	1,602	735	163	-777	-1,729	-2,123	-1,976		
Result after Personal Expenses	1,095	1,149	606	-209	-1,065	-1,952	-2,397	-2,378	1,671*	1,780*

*Market forecasts as at 31 December 2003
Source: Lloyd's 2003 Annual Report

Lloyd's is forecasting record profits for the 2002 and 2003 year of account. This is endorsed by Moody's Investors Service, who indicated in March 2004 that they expected the market to post profits of around £6 billion for the 2002 to 2004 years of account. These are substantial figures, but it is worth noting that even profits of this order would not be sufficient to outweigh the losses sustained over the period 1997 to 2001.

LLOYD'S 3 YEAR ACCOUNTED RESULTS AND FORECASTS 1993–2003



Source: Lloyd's of London

*Market forecasts as at 31 December 2003

OUTLOOK FOR 2004

Subject to the usual caveats, 2004 should be another healthily profitable year for Lloyd's, given that there is still £7 billion of unearned premium to flow through from the balance sheet. Rates in some specialist classes are still increasing, but the market is undeniably softening in other areas, particularly on the direct side. However, underwriting conditions remain good, with most of the classes affected coming off relatively high peaks.

LLOYD'S PREMIUM RATING INDEX

	2002	2003	2004
Casualty	100	121	130
Property	100	103	98
Treaty Reinsurance	100	104	102
Motor	100	107	106
Marine	100	115	121
Energy	100	104	96
Aviation	100	98	94

Source: Lloyd's of London

Ongoing adverse reserve development, the continued poor outlook for investment returns and increased rating agency pressure should combine to restrain the inevitable market downturn, particularly as the benign loss environment cannot be relied upon to continue. Having demonstrated that the market retains the ability to outperform its peers in a hard market, the question now is whether Lloyd's can successfully avoid the under-performance of the past during the harder times ahead. The Franchise Board has been formed precisely to deal with this issue.

REDUCED CENTRAL CHARGES

Lloyd’s fully recognises the need to provide a competitive trading platform given, in particular, the choice available to major trade investors. While business process reform seeks to address operational expenses and acquisition costs, one of the main aims of the internal risk-based capital model and the controls imposed by the Franchise Performance Directorate is to minimise the costs of mutuality in the medium to long term. Central charges have been reviewed for 2004, the most significant change being the removal of the 2 percent premium levy, which is said to have achieved its objective of increasing central assets.

LLOYD’S CENTRAL CHARGES

Note: The premium levy related to signed premium. All other charges relate to capacity.

%	2003	2004
Members’ Subscriptions	0.25	0.5
Premium Levy	2	Nil
Central Fund Contributions	1	1.25
Total Charges	**3.25**	**1.75**

Source: Lloyd’s of London

EQUITAS

At 31 December 1995, all Lloyd's pre-1993 non-life exposures were reinsured into Equitas, a completely separate UK-licensed insurance company. A summary of Equitas’ financial results for the year to 31 March 2004 can be found in Appendix 4.

Lloyd’s retains a contingent exposure to any future failure at Equitas, through the application of overseas regulatory deposits, the assets of present day individual members who also underwrote prior to 1993 and the impact such a failure would have on Lloyd’s relationship with the US regulators. It is considered unlikely that Lloyd’s will be adversely affected by Equitas in the near future, but uncertainty over long-term reserve development remains a negative rating factor.

Market Position

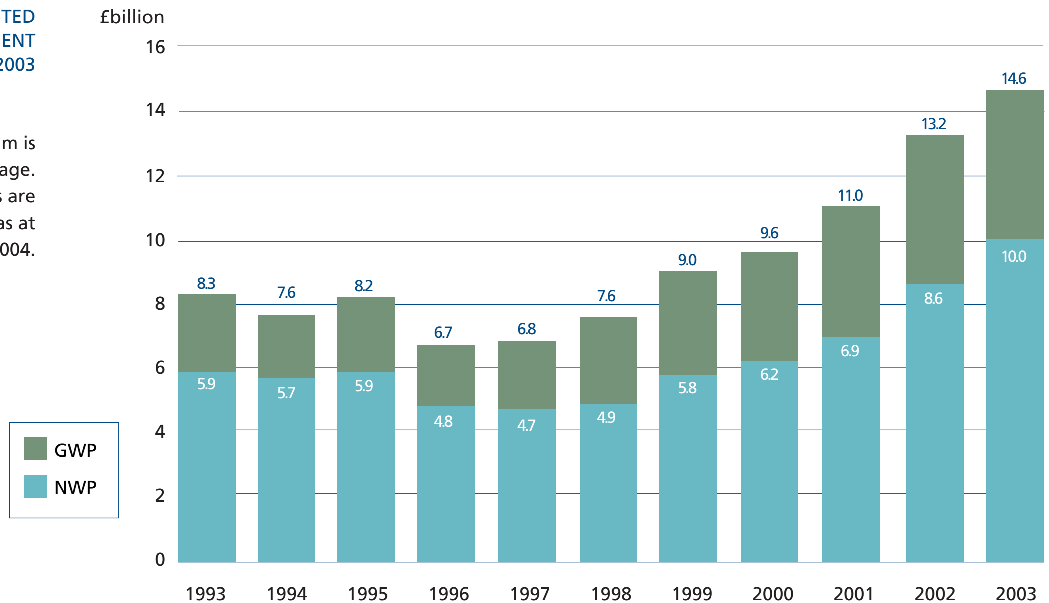
Lloyd's is the world's second largest commercial insurer and ranks fifth amongst global reinsurance groups, accounting for approximately 6 percent of gross reinsurance premium written worldwide (source: Standard & Poor's). The market remains the global centre for many traditional speciality classes and continues to be noted for its innovative underwriting and willingness to respond rapidly to client needs. This was demonstrated during the recent war in Iraq, when Lloyd's took a clear lead in pricing and writing the war surcharge for vessels travelling into the war zone.

OVERALL MARKET CAPACITY

There has been a dramatic improvement in the perception of Lloyd's relative business position since the dark days in the immediate aftermath of the US terrorist attacks. The strength of the relationships underpinning Lloyd's and the continued attraction of the brand have been clearly demonstrated in the hard market, by virtue of strong client loyalty and substantial new investment.

LLOYD'S 3 YEAR ACCOUNTED PREMIUM DEVELOPMENT 1993–2003

Gross written premium is shown net of brokerage. The 2002 and 2003 figures are Lloyd's projections, as at January 2004.



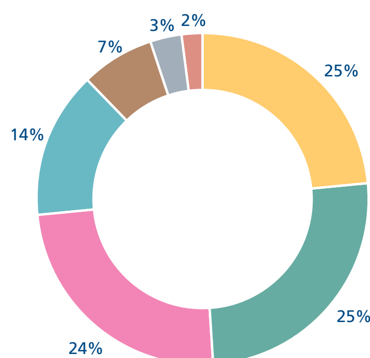
Source: Lloyd's of London

Strong management at the centre is partly responsible for the turnaround in fortunes. Lloyd's has been able to retain the support of its capital providers, aided by a significant reduction in the Central Fund levy for 2004, which should result in lower costs. However, probably of more significance is the extent of the difficulties confronting much of the wider industry. Strict investment guidelines have protected Lloyd's from recent equity market volatility and Equitas insulates the market from the growing asbestosis problem. These challenges have pressured the balance sheets and financial strength ratings of Lloyd's 'traditional' peer group. The resultant market dislocation has resulted in new opportunities and, together with the significantly improved rating environment, substantial premium growth at Lloyd's since September 2001.

Whether Lloyd's will be able to maintain its business position is largely dependent upon developments in two key areas. Firstly, the Franchise Performance Directorate must find a way to manage the downturn without compromising Lloyd's entrepreneurial nature, willingness to underwrite new, difficult and complex risks and ability to respond quickly to client needs. Secondly, progress must be made in improving the efficiency of the market's policy issuance and claims handling processes, for both insurance and reinsurance, to both contain costs and strengthen Lloyd's reputation in these areas. In a later section of this report, we address in some detail the role of the Franchise Performance Directorate and Business Process Reform under Iain Saville's leadership.

THE 2003 BUSINESS ACCOUNT

Lloyd's writes business from over 120 countries, but the US and UK markets between them account for around two-thirds of all business. Just under 60 percent of premium income is written in US dollars. Under Lloyd's pro forma annual accounting, gross written premium in 2003 was split as follows:



LLOYD'S IN THE US

Lloyd's has positioned itself as a specialist insurer and reinsurer to the US market and has adopted a high profile in lobbying for tort reform and for changes to the US trust funding requirements. The US is now Lloyd's most important market by some distance, the book having more than doubled over the past five years. Much of the growth has stemmed from the surplus lines market, Lloyd's being the largest single writer of such business.

Regulatory Status

Lloyd's is a licensed insurer in Kentucky, Illinois and the US Virgin Islands. It is an 'eligible excess and surplus lines writer' in all of the United States (except Kentucky and the US Virgin Islands) and an 'accredited' or 'trusteed' reinsurer in all states.

In line with all other 'alien' reinsurers, Lloyd's is required to hold collateral in the US equating to 100 percent of gross reinsurance liabilities. In Lloyd's case, this is done on a syndicate-by-syndicate basis, by way of the Credit for Reinsurance Trust Fund (CRTF), with reserving supported by actuarial opinion at the year-end. By contrast, US reinsurers are able to fund their US liabilities on a net basis, taking credit for reinsurance purchased, only posting collateral in states where they are not licensed. Furthermore, it is only when losses have been paid directly from syndicate resources that the associated funds are released from the CRTF back to the UK, meaning that Lloyd's must, in effect, 'double-fund' its US reinsurance claims. In the wake of the US terrorist attacks, these rules required Lloyd's to transfer as much as US$5.1 billion to its US trust funds by the end of March 2002. CRTF deposits totalled £4.5 billion (US$8.1 billion), as at 31 December 2003.

US syndicate-level trust funds can and will only be accessed if a member's deposits at Lloyd's, as supplemented by the Central Fund, ever prove to be inadequate to pay losses in the regular course of business. This is because, in order to claim against the syndicate-level trust fund, a claimant must have a valid claim which has been the subject of a final judgement and which has not been paid. This has never happened. Were it ever to be the case that the assets in the syndicate-level trust funds were inadequate to pay all mature claims in full, then policyholders affected would be entitled to draw down the reinsurance component of the market-wide Joint Asset Trust Funds (£61 million as at 31 December 2003).

The Debate Over US Collateralisation Rules

For four years, the European reinsurance industry, spearheaded by Lloyd's, the IUA and the Comité Européen des Assurances, has been lobbying the NAIC for changes to the regulations, arguing that unnecessary collateral requirements increase costs and artificially restrict capacity. The Europeans propose that US regulators should develop an 'approved list' of reinsurers meeting established criteria, so as to permit these companies to post collateral in an amount less than 100 percent of gross liabilities, the minimum being 50 percent (30 percent for affiliate reinsurance). Such reinsurers would be required to have a rating of at least 'A-', make significant financial filings with the US regulators and demonstrate that their home jurisdiction is prepared to enforce US court judgements.

Given the local collateral protection offered under the current rules, these proposals have met with significant resistance in the US, mainly on the grounds that non-US reinsurers are not subject to the same levels of financial and solvency regulation as domestic companies. The NAIC's Reinsurance Task Force, which had two sub-groups actively studying issues related to the enforceability of foreign judgements and international accounting standards, voted in March 2004 to defer consideration of any proposals to amend the Model Law on Credit for Reinsurance, "to allow time for the interested parties to work on alternatives." Despite much debate and strong views on both sides, there has therefore been no real progress over the past year. However, the issue is likely to remain a 'hot topic' and recent moves towards a harmonised reinsurance regulatory regime across the European Union may strengthen the European negotiating position.

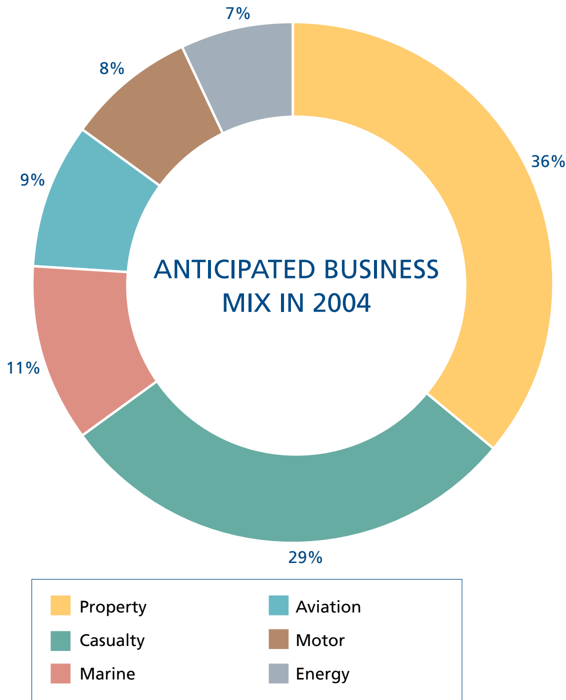
TARGETED GROWTH AREAS

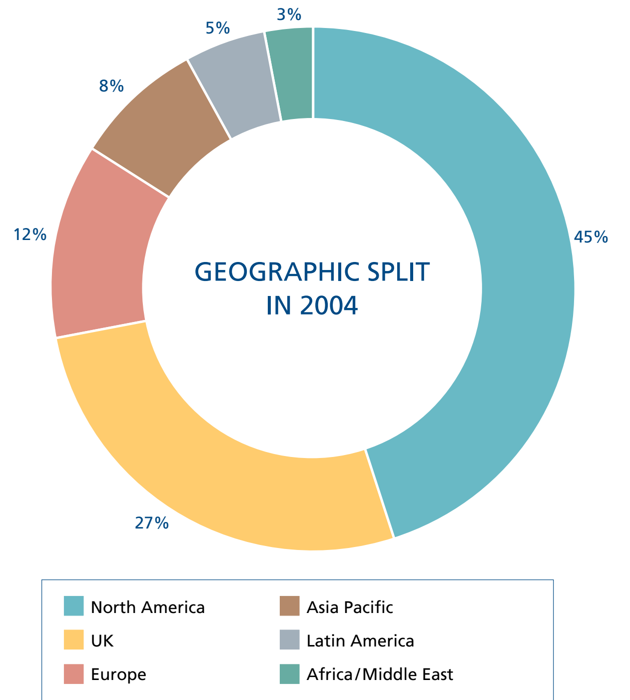
Lloyd's is keen to improve the spread of the account and, in particular, has targeted Continental Europe, which accounts for some 30 percent of the global insurance market, but just 12 percent of Lloyd's business. Reduced capacity and rating downgrades amongst traditional competitors have opened up opportunities for Lloyd's, with the result that some managing agencies have taken the strategic decision to expand their European books. A number of operations have invested significant resources into local people and office space, in an effort to overcome the linguistic and cultural differences that have always hindered growth in the past. In addition, Lloyd's has been authorised to underwrite all lines of business, other than compulsory third party motor liability, in the Eastern European countries just admitted to the European Union.

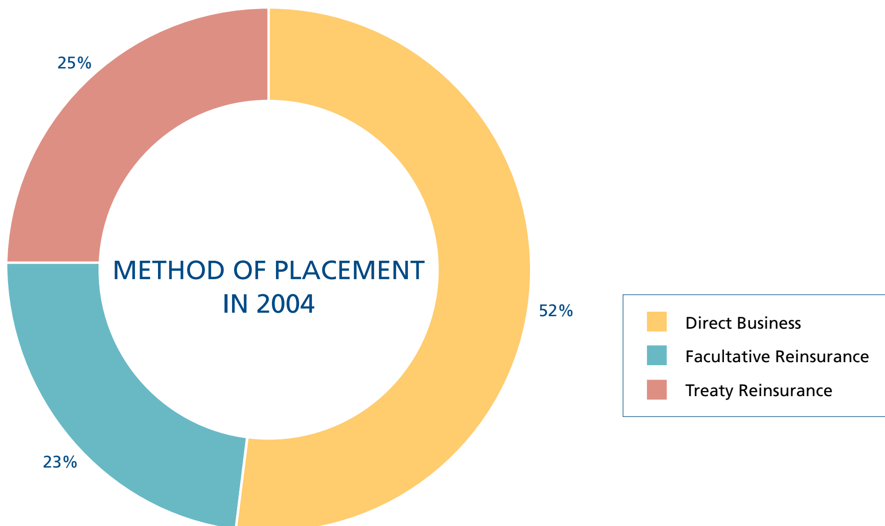
Another area in focus is the Asia-Pacific region, where Lloyd's remains under-represented, despite a near doubling of premium income over the past two years. A formal application for a local currency reinsurance licence was submitted to the China Insurance Regulatory Commission early in 2004.

THE MARKET IN 2004

Based on syndicate business plans, the anticipated business mix, method of placement and geographical spread for 2004 are as follows:







Source: Lloyd's of London

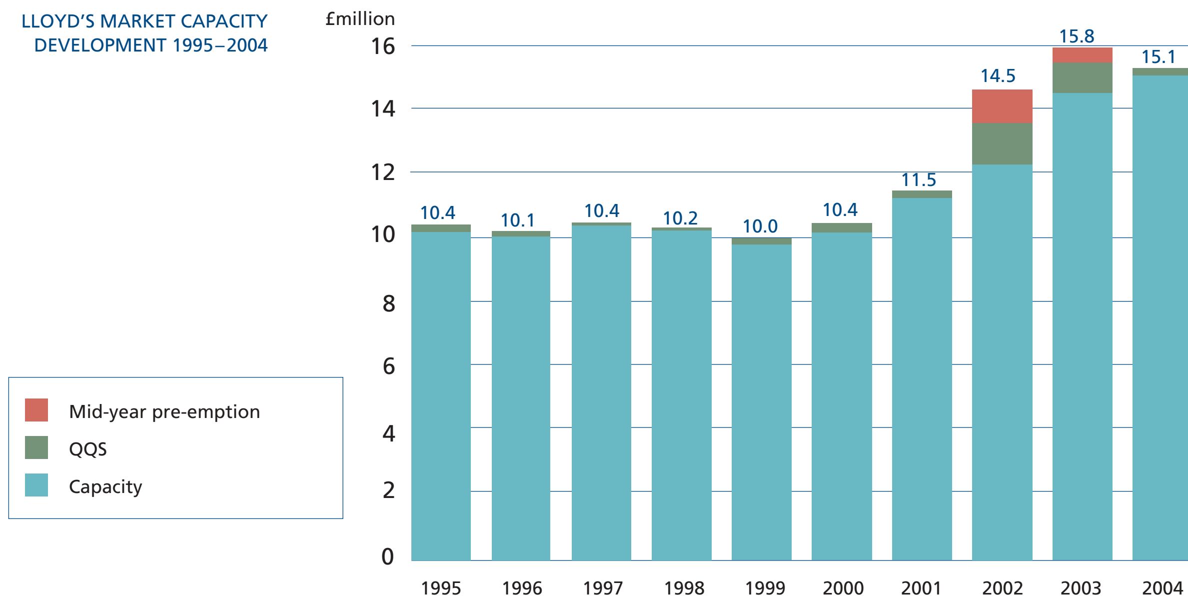
Trends in Lloyd's Capacity

"The capacity figure says much about the continued strength and underwriting discipline within Lloyd's businesses. The market's priority is to continue to improve the quality of its business, rather than chasing market share."
Nick Prettejohn – 6 January 2004

OVERALL MARKET CAPACITY

Market capacity is defined as the maximum volume of insurance and reinsurance premium, net of brokerage, that Lloyd's can accept in a single year, based upon the aggregated capital supplied by members. The market's diverse capital base has demonstrated strong financial flexibility in the wake of the US terrorist attacks, with around £6.5 billion of new capital attracted since September 2001. Although a proportion has been raised to meet regulatory solvency and US situs trust funding requirements, a significant amount has been allocated to Funds at Lloyd's, a direct response to the rapidly hardening market conditions. As a result, overall market capacity has increased by a third since the beginning of 2001. In addition, substantial use has been made of Qualifying Quota Share (QQS) reinsurance arrangements, which have provided around £2.5 billion of additional capacity over the past three years.

LLOYD'S MARKET CAPACITY DEVELOPMENT 1995–2004



Source: Lloyd's of London

Lloyd's began 2003 with capacity of £14.4 billion. Continuing corporate investor appetite was reflected in mid-year pre-emptions totalling almost £0.5 billion and QQS arrangements of £0.9 billion boosted total effective capacity to £15.8 billion by the year-end. The market opened 2004 with record capacity of just under £15.0 billion. Virtually all of the listed Lloyd's vehicles increased their participation, while several large trade investors scaled back their involvement. Managing the inevitable market downturn has been a key focus of the Franchise Performance Directorate and this has been reflected in much closer scrutiny of the business plans of both existing syndicates and potential new start-ups and in significant curtailment of the

allowable relief under QQS arrangements for 2004. Consequently, total effective capacity will be slightly reduced, relative to the previous year. Lloyd's has determined that pursuing premium growth and maximising underwriting capacity is not a logical strategy for producing consistent returns or for improving its financial strength ratings in a softening market. Capacity and its utilisation are therefore expected to shrink from peak levels over the next few years.

Qualifying Quota Share Arrangements (QQS)

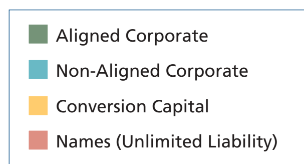
As far as syndicates are concerned, the key advantage of QQS arrangements is their flexibility – they can be put in place more quickly than permanent capital and raised mid-year rather than through the annual venture. Such arrangements performed a useful function in the wake of the US terrorist attacks, in allowing Lloyd's to maximise its underwriting potential. However, the additional capacity generated was clearly opportunistic and less desirable consequences included increased reinsurance gearing and credit risk. Lloyd's has therefore reduced the maximum level of QQS relief from 30 percent to 10 percent of syndicate capacity for 2004 and all arrangements must now be specifically approved by the Franchise Performance Directorate. As a result, QQS capacity is expected to reduce significantly, £230 million having been approved as at May 2004.

TYPES OF INVESTOR

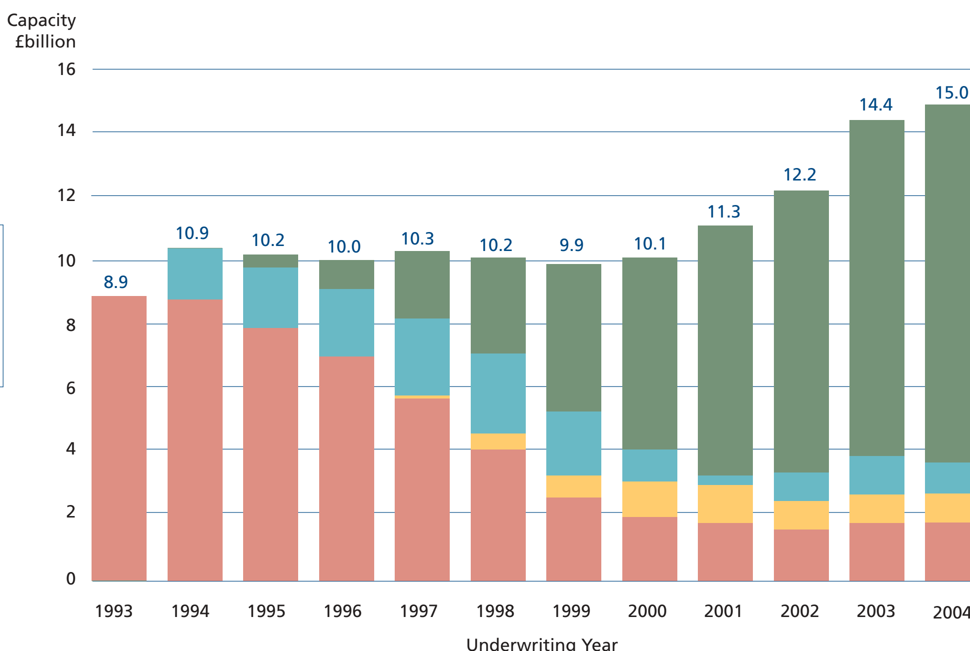
Limited Liability Capacity

752 limited liability corporate members account for 87.5 percent of Lloyd's capacity in 2004 (£13.1 billion), up marginally from 87 percent in 2003. Aligned capacity – management and capital forming part of the same corporate group – has increased by 8 percent to £11.1 billion in 2004. NameCos, Scottish Limited Partnerships and Group Conversion Vehicles, all of which are formed to enable Names to convert their unlimited underwriting into limited liability, supplied £0.95 billion of capacity.

PROFILE OF LLOYD'S CAPITAL PROVISION 1993–2004



Source: Lloyd's of London



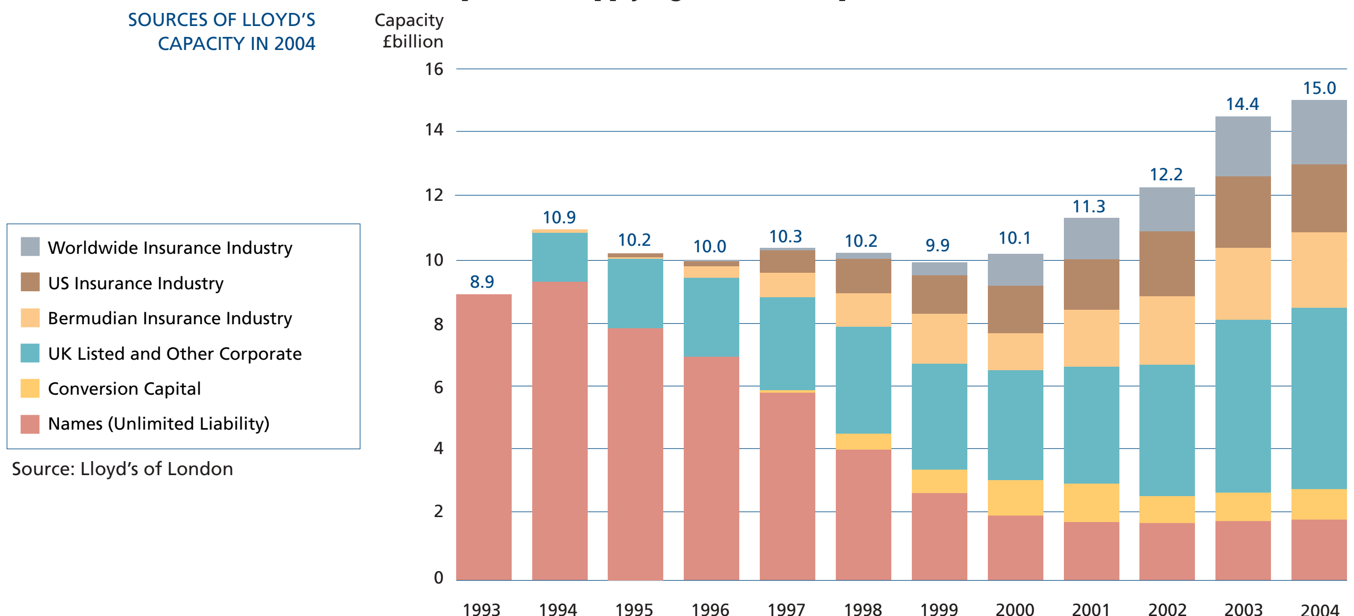
Unlimited Liability Capacity

The remaining 2,048 active Names provide 12.5 percent of the market's capacity in 2004 (£1.9 billion), down marginally from 12.8 percent in 2003. Lloyd's believes unlimited liability underwriting is inappropriate in the modern risk environment and has required all new members joining the market since 1 January 2003 to underwrite on a limited liability basis. Efforts are continuing to encourage the voluntary conversion of the remaining Names and changes to the tax rules announced by the UK Government in the March 2004 budget should aid this process. With effect from 6 April 2004, Names are able to carry forward income tax losses or defer capital gains when they form a limited liability company.

SOURCES OF CAPITAL

The capital base in 2004 remains diverse, with the top 20 direct capital providers supplying 62 percent of the market's capacity and no one capital provider supplying more than 7 percent of the total.

SOURCES OF LLOYD'S CAPACITY IN 2004



Source: Lloyd's of London

The involvement of trade players has reduced for 2004, but they remain the largest sector of the market. There were no major withdrawals (other than Trenwick Group Ltd), but several large investors with other options both within and outside the London market, decided to deploy a portion of their capital elsewhere. These included ACE Ltd, Berkshire Hathaway Inc, The St Paul Companies and Markel Corporation. The withdrawal of the relatively small Swiss Re-backed Dex operation was also significant, as it stemmed from Lloyd's refusal to accept the submitted business plan, due to a lead line size that exceeded the market's new underwriting guidelines.

The growing UK listed sector provides a counter-balance to the trade and venture capital providers, who tend to have a more opportunistic approach. Amlin, Atrium, Beazley, Chaucer, Hardy, Kiln, SVB and Wellington continue to write all of their business at Lloyd's, while Brit and Hiscox are also involved in the company market. Until recently, the small absolute size of many of these operations and the potential for results to be volatile were reflected in limited investor appetite and pressure for consolidation, but there are now signs of a change of attitude. Aided by the raising of substantial new capital, the collective market capitalisation of the Lloyd's listed sector has more than doubled since September 2001, a very strong performance relative to the wider industry.

The Franchise Performance Directorate

The stated goal of the Franchise Board is "to create and maintain a commercial environment at Lloyd's in which the long-term return to all capital providers is maximised." Improved operating performance across the cycle is seen as key to keeping the costs of mutuality to a minimum, attracting and retaining a solid long-term capital base and hence maintaining a market-leading position.

OVERVIEW

The Council of Lloyd's has redefined the relationship between the Corporation of Lloyd's (the franchisor) and the managing agents operating in the market (the franchisees) in a set of Franchise Principles, which detail the objectives of the former and the obligations of both. These cover three main areas: the overriding principles (relating to legal, regulatory, and corporate governance issues), the capital principles (which emphasise equity between capital providers and prudence in capital setting) and the operating principles (including setting the market supervision framework in accordance with Financial Services Authority requirements).

The Franchise Board was established at the end of 2002 and currently comprises three Lloyd's executives (Lord Levene, Nick Prettejohn and Rolf Tolle), three market practitioners (Steven Burns, Stephen Catlin and Edward Creasy) and four external independents. The Franchise Performance Directorate (FPD), headed by Rolf Tolle, was established in March 2003, to manage the commercial aspects of franchise implementation.

THE ROLE OF THE FRANCHISE PERFORMANCE DIRECTORATE (FPD)

The FPD's principal responsibility is to leverage its unique position to promote and protect the brand and reputation of Lloyd's. In the last soft market, poorly performing businesses undermined the results and reputation of the whole market. Implementation of the franchise system is designed to address this issue through the creation of a disciplined market place, where the standards of the best businesses, whose performance has been strong, will become the standards of the market as a whole. The FPD's role is intended to be primarily facilitative, but it has indicated that it will be prescriptive and apply constraints where required, if under-performance threatens the security and profitability of the market as a whole. Ultimately, the franchisor has the power to remove franchisees from Lloyd's.

Key Achievements to Date

- Franchise underwriting guidelines–control/manage underwriting exposures.
- New syndicate business planning regime–early identification of under-performance.
- Amended run-off management guidelines–more proactive commercial approach.
- Review of binding authority underwriting–new bye-law and code of practice.

Strategic Initiatives Underway

- Market Capitalisation Project–reviewing all elements of Lloyd's capital structure.
- Claims and reinsurance–market-wide review.
- Conversion to annual accounting–to be introduced from 1 January 2005.

UNDERWRITING GUIDELINES

Underwriting discipline has become a key focus of the FPD and guidelines representing best practice are at the heart of the new relationship. These include:

- Targeting gross underwriting profit on each line of business.
- Restricting maximum gross line size on an individual risk to 10 percent of syndicate capacity.
- Setting minimum net retention at 10 percent of the gross line, to limit dependence on reinsurance and to discourage arbitrage.
- Ensuring that each franchisee has an approved reinsurer selection process.
- Restricting maximum gross and net exposures to a single Lloyd's specified Realistic Disaster Scenario (RDS) to 75 percent and 20 percent of syndicate capacity, respectively.
- Ensuring that franchisees adhere to service standards covering policy production and premium and claims payment as defined by the London Market Principles (LMP).
- Multi-year policies will be expected to have matching reinsurance cover.

The FPD expects businesses to honour these guidelines, unless a convincing case is made to the contrary. Further activity in this area has resulted in significant tightening of the policy towards Qualifying Quota Share arrangements for 2004 and an ongoing review of the RDS process.

BUSINESS PLANNING AND MONITORING

A new business planning and quarterly monitoring process has been introduced, aimed at preventing financial under-performance before the event. A key tool has been the creation of loss ratio benchmarks by risk code, the objective being to reduce the gap between the bottom quartile of loss-making syndicates (which posted an annually accounted combined ratio of 126 percent in 2003) and the rest of the market. The FPD also plans to set average profitability targets at market and franchisee level. The Risk Management Division and the FPD are developing a framework setting out the key stages of the risk management process and specific questions on key issues will be incorporated into this year's business planning process.

RUN-OFF MANAGEMENT

If outstanding liabilities cannot be determined with sufficient accuracy after 36 months to allow a year of account to be closed by payment of a reinsurance to close premium to a successor syndicate, that year of account must remain open. As at 31 December 2003, there were 97 open years (2002: 98), of which 72 had no natural successor. Reserves retained in respect of these years had increased to £4.8 billion, from £2.9 billion a year earlier.

Lloyd's is well aware of the relevance of efficient run-off management to its claims-paying reputation and, at the same time, needs to minimise the threat to the Central Fund posed by open year exposures. For these reasons, the run-off management team, headed by Steve McCann, now forms part of the FPD under Rolf Tolle. In August 2003, amended run-off guidelines were issued, which are designed to result in the proper protection of the interests of syndicate members, policyholders and the Lloyd's brand. Lloyd's has also established a dedicated team to develop and implement a more active and commercial approach to open years. This has involved a centralised approach to investment management, a standardised approach to reinsurance asset protection and claims management and the placement of a centrally purchased reinsurance programme. All open years are now reviewed on a quarterly basis and Lloyd's continues to review and develop various methods by which closure may be achieved.

BINDING AUTHORITIES

There are currently more than 5,000 delegated underwriting arrangements at Lloyd's, covering 61 countries and generating around £3 billion in premium income (source: Lloyd's of London). Serious efforts are now being made to enforce sound underwriting practice in this area, in order to reduce risk to underwriters and to the market as a whole. A new bye-law and code of practice came into effect on 1 March 2004. Managing agents are now required to have clear written procedures for delegated authority, which should be agreed by the board and regularly reviewed. Checking that a scheme is being run according to guidelines is now a formal requirement and Lloyd's has the power to intervene and inspect books and records where appropriate. All new coverholder arrangements must now be approved by the FPD, using a standard application form and all contractual documentation between managing agencies and coverholders must be entered on a centralised Register of Coverholders, which is accessible to policyholders.

MARKET CAPITALISATION PROJECT

The structure and level of capital supporting Lloyd's is a key strategic and governance issue for the Franchise Board. As well as being a key issue for the rating agencies, there is now increasing regulatory pressure in the UK, stemming from the FSA's new risk-based capital adequacy rules. A comprehensive review of the market's capital structure began in June 2003, in conjunction with Deloittes, and with eleven managing agents, accounting for 44 percent of the market's capacity, represented on the working group. Areas for evaluation include the calibration of Lloyd's risk-based capital model in respect of the business cycle, what credit might be given for members' assets outside Lloyd's, the impact and capitalisation of large corporate members and the optimum size, structure and management of the Central Fund.

CLAIMS AND REINSURANCE

Increased focus in these areas saw Jeremy Pinchin appointed Head of Reinsurance and Claims in July 2003. The FPD is currently conducting a strategic review of the market's inwards claims and outwards reinsurance. Active oversight is regarded as a key priority, so that:

- Claims management best practice disciplines can be implemented market-wide.
- The market's response to major losses can be effectively co-ordinated.
- Relationships with the market's leading reinsurers can be managed.
- Process efficiencies can be identified and delivered.

ANNUAL ACCOUNTING

The traditional three year accounting system has technical merit, given the nature of the 'annual venture' and the associated requirement to preserve equity between reinsured and reinsuring members under the reinsurance to close mechanism. However, complexity has made it difficult to compare Lloyd's operating performance with the wider industry at a time when transparency has become increasingly important. Lloyd's has responded by announcing that it will fully implement annual accounting on a UK GAAP basis from 1 January 2005, with the intention of adopting International Accounting Standards when there is more clarity on the proposed standard on accounting for insurance contracts. This change should be attractive to both existing and new corporate capital providers, as it will allow earlier release of profit to support ongoing underwriting (subject to audit review). However, the continuation of unlimited liability underwriting beyond 1 January 2005 will result in the annual venture and the reinsurance to close mechanism remaining in place and Lloyd's will therefore have to continue with a secondary three year accounting system for those syndicates wishing to continue with backing from traditional Names.

Business Process Reform

Towards the end of 2003, Iain Saville, who in the mid-1990s led the Bank of England's project to eliminate paper from the share settlement system, was appointed as Lloyd's first Head of Business Process Reform. The first priority of these reforms is pushing for contract certainty at inception, with Kinnect being promoted as a key enabler. The second priority is improving claims processing and systems for accounting and settlement.

KINNECT

Ownership and Management

In October 2003, Iain Saville was appointed Executive Chairman of Kinnect, being joined, in January 2004, by Chief Executive Officer Toby Davies. A board of directors is currently being created, which will include representatives from the broking and underwriting communities. The Corporation of Lloyd's has invested almost £40 million in this project over the past two years and has agreed to provide further funding in 2004 and 2005, on the basis that Kinnect has a key role to play in establishing contract certainty. However, the ultimate goal is for the users to have both ownership and control.

What is Kinnect?

Kinnect is a Lloyd's funded initiative to introduce an adaptable, accessible and secure industry-wide platform to facilitate the electronic flow of commercial lines risk information between brokers and underwriters. It aims to improve the efficiency and effectiveness of existing trading relationships, by cutting out unnecessary administration. Rather than being an e-trading platform, Kinnect bridges the gap between the different data systems used by brokers and underwriters worldwide, by building integrated interfaces with leading industry software suppliers. As such, it supports, rather than dictates, business placement.

Why is Kinnect Needed?

Insurance is the only product-line regulated by the FSA that does not have contract certainty. The regulator is looking for progress in this area, as it wants to be satisfied that the industry understands and is adequately managing its risks. Contract certainty is, in any event, becoming a pressing issue for brokers, given the demand from clients for clearer and quicker documentation. It is anticipated that Kinnect will:

- Reduce re-keying of data, resulting in improved client response times, better data quality and more accurate pricing, which ultimately leads to quicker and higher quality business completion.
- Provide a permanent audit trail of all transactions, correspondence, changes and timings, helping to reduce errors and omissions and enabling easier compliance and dealings with regulators.
- Support subsequent front and back office processing much more efficiently than is possible today. Kinnect acts as an enabler to many of the reforms in the market, for example facilitating use of LMP Slips, together with standard wordings from the XIS Market Wordings database.

Progress to Date

On 31 March 2003, Marsh Ltd, Willis, ACE European Group, Amlin, Beazley and Wellington became the first companies to sign letters of intent to use Kinnect. The system went live in December 2003 with an initial focus on North American property business and the first complex open market risk was placed at the beginning of February 2004. In May 2004, it was announced that Kinnect had become one of the first organisations to meet the latest standards for data transfer set by global standards body, ACORD. This is seen as an important step in winning and retaining the commitment of major brokers and carriers. A second wave of Kinnect customers is expected to be announced in the third quarter of 2004, possibly including some users in the US. Lloyd's centrally believes the timing of this initiative is critical and is doing everything it can to encourage the market to embrace the new technology.

THE LONDON MARKET PRINCIPLES REFORM PROCESS

Mission Statement: "In a globally competitive marketplace, the LMP reforms will improve service to clients and increase efficiency, to retain existing business and attract new quality business to the London Market."

Overview

The LMP reform process, which is sponsored by the IUA, Lloyd's and the London Market Insurance Brokers Committee, is designed to enable the London Insurance Market to maintain its position as one of the world's primary centres of risk placement. Benchmarking is being used as a performance monitoring mechanism, with the object of supporting the adoption of best market practice.

Reform Delivery

Delivery of the reforms is being managed in a series of five projects:

1. The LMP Slip

Lloyd's has taken an important lead in mandating use of the LMP Slip with effect from 2 January 2004. These slips provide all of the information required to place a risk in a standard format, resulting in increased contract clarity. The Franchise Board is in the process of implementing a compliance framework to ensure that all business placed at Lloyd's conforms to the standard.

2. Accounting and Settlement

This project is focused on providing the market with a more efficient way of processing accounting and settlement transactions, the key element of the initiative being the adoption of ACORD electronic message standards for the communication of data.

3. Delinking

Delinking is the post placement process that separates the submission to the bureau of closing information from the instruction to settle. Delinking is key to the LMP reforms because streamlining of the closing process will enable faster flow of premium, earlier production of policies and the alignment of London Market processes with international standards.

4. Electronic Claims Files and Repositories

The claims reforms are focused on developing a single efficient claims process for the London Market, thereby facilitating rapid decision-making and faster payment of valid claims. The key objectives are the introduction

of a streamlined agreement process and the allowance of concurrent access to claims files. In July 2003, Xchanging Ins-sure Services announced that it had successfully merged Lloyd's traditional claims processing operation into the company sector's Claims Loss Advice and Settlement System (CLASS), thereby forming a single platform for claims processing across the London market. Xchanging is also establishing a new, market-wide shared repository for electronic claims files, which is being designed to comply with international ACORD standards. Xchanging and Kinnect will interact so that they can share information to support each other's processing.

5. Insurance Documentation

This project is focused on the implementation of improvements in the production of insurance documentation. The aim is to provide insuring documentation at inception wherever possible, in accordance with client needs and in a cost-effective manner.

The 2004 LMP Roadmap

When the LMP reform process was launched three years ago, it was hoped the changes would be adopted within 18 months, so as to make inroads into the more than £500 million of claims-handling expenses incurred by Lloyd's every year. In March 2004, a 'roadmap' was issued, setting out the key objectives of the reform programme, broken down into the various initiatives, and giving deadlines for their formulation and implementation by the market. This was regarded as an attempt to step up the pace of change while underwriting conditions were still good, to better enable the market to maintain its profitability when the market softens. Ultimately, however, market initiatives such as these will only deliver the benefits they promise if they are embraced by a significant majority of the participants.

Unfortunately, the intial focus being on insurance process reform means that the very necessary reforms required in reinsurance processing, particularly claims processing, will be addressed at a later stage.

Lloyd's and the Rating Agencies

MARKET RATINGS

Relative to many peers, Lloyd's financial strength ratings have exhibited great stability since they were first assigned in October 1997. The market continues to be rated 'A' (Strong) by Standard & Poor's and 'A-' (Excellent) by AM Best, and these ratings are expected to be affirmed in summer 2004. Both ratings were lowered one notch in the immediate aftermath of the US terrorist attacks, but no further action has been taken. Lloyd's has indicated that one of its medium-term goals is to see these ratings returned to their original level ('A+' and 'A', respectively).

SYNDICATE RATINGS

The market ratings remain the principal measure of financial strength to be applied to those underwriting at Lloyd's. However, demand for information on individual syndicates has increased dramatically in recent years and stand-alone syndicate assessments are becoming increasingly prevalent. While these assessments can add some value to the reinsurance-buying decision-making process, it is dangerous to place undue reliance on these products without having some understanding of the widely varying underlying methodologies. It should be pointed out that none of the individual syndicate assessments are endorsed by Lloyd's.

Standard & Poor's (S&P)

Generally speaking, S&P's insurer financial strength ratings are made by reference to the likelihood of regulatory default. S&P does not believe that syndicate-specific financial strength ratings are meaningful, arguing that the effective mutualisation of all market risks through the Central Fund means that, in the case of Lloyd's, the defaulting entity would be the market as a whole, rather than individual syndicates or their members. However, S&P has published assessments which differentiate between syndicates, not just in terms of pure credit quality, but also in terms of likely syndicate continuity.

1. Lloyd's Syndicate Assessments (LSAs)

Introduced in September 2002, LSAs evaluate the degree to which a syndicate is dependent on Lloyd's Central Fund, brand, licences, infrastructure and ultimately on the market's financial strength rating, following quantitative and qualitative analysis of publicly available information. The heads of analysis, with weightings, are Business Position (15 percent), Investments & Liquidity (10 percent), Reinsurance (15 percent), Operating Performance (25 percent), Reserves (15 percent), Capital (10 percent) and Ownership (10 percent). LSAs are assigned on the following rating scale:

	Dependency	% of Market Capacity at May 2004
LSA 5pi	Very Low	0
LSA 4pi	Low	7
LSA 3pi	Average	49
LSA 2pi	High	16
LSA 1pi	Very High	6
Not Assessed		22

S&P does not evaluate syndicates that have reported fewer than three closed years of account, syndicates that have undergone substantial recent restructuring or syndicates in run-off.

2. Interactive Lloyd's Syndicate Assessments
New for 2003, interactive LSAs are requested and paid for by syndicate management. They require full management participation and confidential information disclosure and are kept continuously under review. The 'pi' subscript is dropped from the assessment and the assessment scale is expanded to include '+' and '-' grades. The first interactive LSA was launched in December 2003 (Chaucer Syndicate CSL 1084, rated '3-').

AM Best Company, Inc
In contrast to S&P, AM Best believes that it is possible to assign meaningful financial strength ratings to individual syndicates. The Lloyd's market rating reflects the overall financial strength of the market and represents the agency's opinion of the 'floor' of security for all policies written at Lloyd's. However, AM Best believes that some individual syndicates have capital strength characteristics in their own right that can support a rating at, or above, the level of the market rating. Consequently, an interactive financial strength ratings product for individual syndicates was launched in November 2001. These are requested and paid for by syndicate management.

The rating methodology is based on a combination of quantitative and qualitative standards or norms, and the fundamental areas of analysis are the same as those employed for a traditional AM Best rating, i.e. capital strength, operating performance and business profile. AM Best believes ratings in excess of the market rating can be assigned to individual syndicates if at least one of the two following conditions is met:

1. The syndicate is backed by a capital provider that, in AM Best's opinion, offers a level of financial strength above that of the market and is fully committed to supporting the syndicate beyond the member's limited liability obligations and before recourse to Lloyd's Central Fund.

2. The business profile and/or operating performance of a syndicate is better, in AM Best's opinion, than that of the market overall.

These ratings are directly comparable with the companies market and follow AM Best's normal rating scale, but are differentiated with an 's' modifier. There were 12 active ratings in effect at 1 June 2004:

Atrium ATR	0570	A- s (Excellent)
Cathedral MMX	2010	A- s (Excellent)
Euclidian EUL	1243	A- s (Excellent)
Markel MKL	3000	A- s (Excellent)
Amlin AML	2001	A s (Excellent)
Atrium AUW	0609	A s (Excellent)
Beazley AFB	0623	A s (Excellent)
Beazley AFB	2623	A s (Excellent)
Catlin SJC	2003	A s (Excellent)
Hardy PWH	0382	A s (Excellent)
Kiln KLN	0510	A s (Excellent)
Omega GSC	0958	A s (Excellent)
Ascot RTH	1414	A+ s (Superior)

Moody’s Investors Service

Like S&P, Moody’s produces two different types of rating.

1. Syndicate Performance Ratings (SPRs)

Moody’s has assigned SPRs to individual syndicates since 1997, based on an assessment of both quantitative and qualitative information. They are continuously monitored and give Moody’s view of a syndicate’s potential future performance over the insurance cycle relative to other Lloyd’s syndicates, based on currently known factors. SPRs aim to address policyholder continuity, on the basis that only syndicates that are profitable over the cycle are likely to retain capital support and thus continue trading over the medium to long term.

It should be stressed that SPRs do not attempt to assess the security underlying Lloyd’s policies. The ratings are forward-looking, only using historical data as a basis for the assessment of the syndicate’s future potential. The emphasis is therefore on future performance (and thereby continuity), rather than claims-paying ability. The rating scale is as follows:

		% of Market Capacity at June 2004
A+	Excellent	0
A	Very Good	2
A-	Good	29
B+	Above Average	22
B	Average	23
B-	Below Average	5
C+	Below Average	1
Not Rated		18

2. Syndicate Insurance Financial Strength Ratings (IFSRs)

Moody’s was the first to introduce voluntary interactive syndicate financial strength ratings, four being released in 2000 and another one in 2001. These ratings remain in effect, as shown below, but there has been no further uptake. IFSRs are credit ratings, taking into account the syndicate’s earnings, Funds at Lloyd’s and any benefits from the Central Fund where applicable, and are thus comparable to Moody’s ratings on other insurance operations worldwide. The rating scale, which is further differentiated by the use of numbers from one to three (one being stronger), is as follows:

Aaa	Exceptional	
Aa	Excellent	(AGM 2488: Aa3)
A	Good	(WEL 2020: A1, AML 2001: A1, SVB 1007: A2,SVB 2147: A3)
Baa	Adequate	
Ba	Questionable	
B	Poor	
Caa	Very Poor	
Ca	Extremely Poor	
C	Lowest	

Capital Structure

LEGAL FRAMEWORK

Underwriting at Lloyd's is conducted by the membership, which participates through involvement in one or more syndicates. Members have the legal obligation to policyholders, but delegate management and control of their insurance business to managing agents who act on their behalf. Lloyd's syndicates have no legal personality and are merely the vehicles through which members underwrite. Because Lloyd's is a market of companies and individuals trading severally for their own account, the aggregate resources of Lloyd's do not represent the funds available to pay a policyholder's claims. The security offered by a particular policy relates to the resources supporting the syndicate(s) underwriting the risk and the resources of the Central Fund as a last resort. Note also each members Funds at Lloyd's are exposed to the operating results of any other syndicate supported by that member and to the results in three years of underwriting.

CAPITAL OVERVIEW

The capital structure of the Lloyd's market is unique and comprises:

- Assets held in trust in respect of each member at syndicate level – controlled by trustees appointed by the managing agent (£11,260 million at 31 December 2003).
- Overseas business regulatory deposits held, both at syndicate level and as joint funds, in overseas trust funds – primarily controlled by third parties (£7,735 million).
- Assets held in trust in respect of each member as Funds at Lloyd's – controlled by the Society of Lloyd's (£9,659 million).
- The net assets of both the Central Fund and the Corporation of Lloyd's – beneficially owned and controlled by the Society of Lloyd's (£781 million).

THE CHAIN OF SECURITY

CORPORATE MEMBERS	INDIVIDUAL MEMBERS	END 2003 (% change from 2002)
PREMIUMS TRUST FUNDS (PTFs)	PREMIUMS TRUST FUNDS (PTFs)	£18,995m (+11%)
FUNDS AT LLOYD'S (SET BY RBC) (FAL)	FUNDS AT LLOYD'S (SET BY RBC) (FAL)	£9,659m (+8%)
	OTHER PERSONAL WEALTH (OPW)	£278m (-1%)
CENTRAL FUND OTHER CENTRAL ASSETS CENTRAL FUND + OTHER CENTAL ASSETS		£711m £ 70m £781m (+39%)

Source: Lloyd's 2003 Annual Report

The chain of security only supports policies written for the 1993 and subsequent years of account. At 31 December 1995, all pre-1993 non-life Lloyd's business was reinsured in Equitas, a completely separate UK licensed insurance company. Equitas policyholders cannot access Lloyd's funds and vice versa.

PREMIUMS TRUST FUNDS

Every member of Lloyd's is required to execute a Premiums Trust Deed (PTD), under which all amounts received or receivable by him or on his behalf in respect of his insurance business at Lloyd's must be carried to a Premiums Trust Fund (PTF). Assets in a member's PTF are thus not available to non-insurance creditors in the event of insolvency. The PTFs are year of account specific and are segmented into funds covering non-US dollar cashflows (the Sterling Premium Trust Funds) and those covering US dollar cashflows (the Lloyd's Dollar Trust Funds). US regulations require that there are separate dollar trust funds held in New York to support reinsurance and surplus lines business for US policyholders (the Credit for Reinsurance and Surplus Lines Trust Funds and the Joint Asset Trust Funds).

PTF assets are held by, or under the control of, trustees appointed by the managing agent of each syndicate in the Managing Agents Sub-Fund (MASF). Each member has a discrete fund, but managing agents manage syndicate-level funds on a co-mingled basis. MASF receipts for a given year of account comprise mainly premiums, reinsurance recoveries and investment income and effectively constitute a syndicate's 'working capital'. Lloyd's places very conservative investment restrictions on these funds, to ensure that they are available when required. All claims relating to a particular year of account are paid out of the relevant PTF. Other than this, these funds can only be used to meet permitted expenses, as specified in the PTD, which include reinsurance premiums, return of premiums, brokerage, syndicate expenses, contributions/fees payable to Lloyd's and funding of overseas business regulatory deposits.

Members are required to ensure that there are sufficient funds available in their PTFs at all times. Where a shortfall is identified at syndicate level, managing agents must either make a 'cash call' on syndicate members or arrange alternative financing. Under the terms of the standard managing agent's agreement, members are contractually obliged to pay cash calls, or face compulsory drawdown from their Funds at Lloyd's.

Continuous Solvency Transfer

The Franchise Board introduced Continuous Solvency Transfer (CST) in April 2003, the aim being to allow members relief and help backers maintain or increase their investment in new underwriting, without releasing funds from the Lloyd's system. In 2004, CST allows limited releases from the PTFs on the 2002 and 2003 years of account to meet cash calls and loss payments. Any CST not applied to cash calls will be held in the personal reserve sub-fund until closure of the 2002 and/or 2003 year of account, but can be used towards meeting capital requirements within the coming-into-line exercise for 2005. At the discretion of managing agents, the surplus available for transfer is up to 50 percent of the cumulative annual accounting result declared up to 31 December 2003 on both the 2002 and 2003 years of account, less any CST made in May 2003 in respect of the 2002 year of account. If this result is greater than the 31 December 2003 syndicate solvency result, then the transfer will be restricted to the level of the available solvency surplus.

FUNDS AT LLOYD'S

All members are required to provide security in the form of Funds at Lloyd's (FAL), in advance, to support the business they propose to underwrite. FAL is held in trust for the protection of policyholders and must be kept in place so long as it is required to support business at Lloyd's. The amount to be provided is specified by Lloyd's and is determined using a risk-based capital

(RBC) methodology, subject to a minimum requirement of 40 percent of the overall premium limit (except for members writing mainly UK motor business, where the minimum is 35 percent). The RBC ratio is determined annually for each member, based on its spread of syndicates and business. Assets supporting FAL requirements must be liquid, but may include letters of credit and bank guarantees.

FAL is inter-available across underwriting years for a given member and typically comprises amounts required to support the previous two open syndicate years and the current/forthcoming active year. For example, after the coming-into-line process in November 2003, each member's FAL had to be sufficient to cover any net deficit on the 2001 and 2002 underwriting years for all syndicates on which the member participated, as determined by actuarial review at 31 December 2002, as well as the RBC ratio for 2004. Consistent with continuous solvency, it is proposed that coming-into-line should become a six-monthly exercise from 2005, with members having to demonstrate that they are 'in line' (i.e. adequately capitalised) at both 31 May and 30 November.

Lloyd's Risk-Based Capital Methodology

RBC requirements were applied to corporate members from 1994 and extended to all members from 1998, the aim being to equalise the expected loss to the Central Fund per unit of net premium/reserve. Inputs include profile of reinsurance protection, business mix diversification and credit for diversification across managing agents and across underwriting years. Additional FAL may be required in the form of Prudential Supervision Loadings, where the performance or management of a syndicate has failed to meet Lloyd's regulatory parameters. For the 2003 year of account, the RBC model was amended to include Realistic Disaster Scenario data directly in the RBC calculation for three natural catastrophe events (California Earthquake, Florida Hurricane and New Madrid Earthquake). For 2004, these have been extended to include UK Windstorm and Japanese Earthquake.

Realistic Disaster Scenarios

Realistic Disaster Scenarios (RDSs) were introduced in 1995 to manage catastrophe exposure at syndicate and market level. Every syndicate is required to calculate gross and net exposures to seven mandatory scenarios: Second Event (Hurricane Andrew in the immediate aftermath of a Northridge Earthquake), Florida Windstorm (comprising two separate events), California Earthquake (comprising two separate events), New Madrid Earthquake, European Windstorm, Japanese Earthquake and Terrorism. All syndicates must complete a minimum of nine scenarios. RDSs are used by syndicates to undertake disaster planning and to identify key aggregation and catastrophe risk exposures. They are used by Lloyd's to support the Franchise Guidelines on maximum exposures, as an input to the RBC system and to profile the prospective reinsurance asset. Lloyd's is currently working with risk modelling experts to develop further the framework and methodology for measuring catastrophe risk exposures at syndicate and market level.

OTHER PERSONAL WEALTH

Other Personal Wealth (OPW) represents additional assets declared by individual and corporate members, but not necessarily held at Lloyd's. Only the former is quantified, as this is all that can be automatically called upon by Lloyd's. However, corporate members are liable to the extent of their resources and may also have assets beyond FAL, which can be called upon to

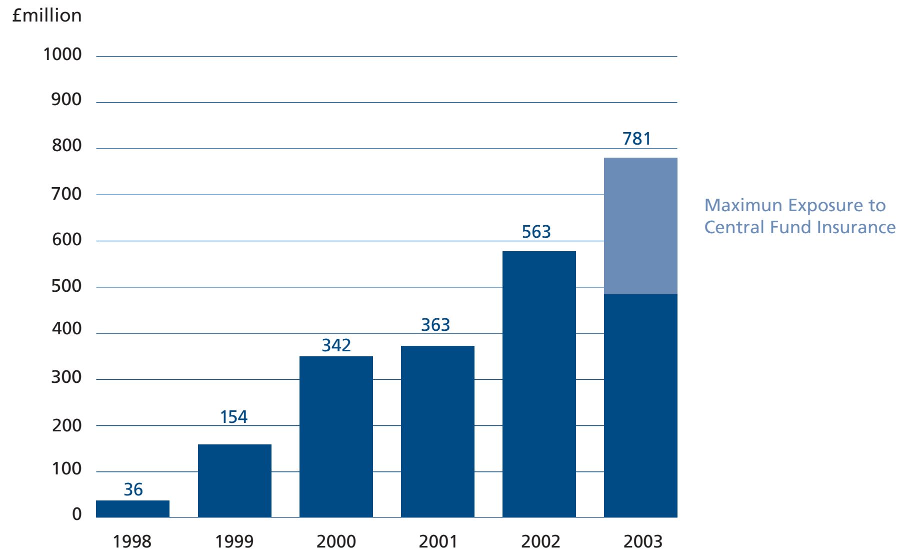
meet underwriting liabilities. For 2004, unlimited liability members continue to be permitted to provide a maximum of 20 percent of their overall capital requirement as OPW. However, this allowance will be reduced to 10 percent for 2005 and will be removed completely for 2006, as OPW is not an eligible asset under the UK regulator's new Enhanced Capital Requirement rules.

CENTRAL NET ASSETS

The mutually owned assets underpinning the Lloyd's market comprise the net assets of both the Central Fund and the Corporation of Lloyd's.

CENTRAL NET ASSETS DEVELOPMENT 1998-2003

Note: The 1998 to 2001 figures exclude the effects of a £285 million syndicated bank loan taken out in 1997 and fully repaid by the end of 2001.



Source: Lloyd's of London

The Central Fund

The Central Fund operates at the discretion of the Council of Lloyd's, receiving income in the form of regular member contributions and investment income and paying any claims that meet with member default. The contribution rate was 1 percent of allocated overall premium limit in 2003, raising £160 million. This has been increased to 1.25 percent for 2004, to provide more flexibility for the Central Fund, following the expiry of supporting insurance arrangements. Also from 2004, new corporate members will pay double the annual contribution rate (2.5 percent) for their first three years of operation at Lloyd's. This will not apply to conversion vehicles which are at least 85 percent owned by converting Names or to new corporate members which only participate on existing syndicates. Members also faced an additional levy of 2 percent of premium income received in 2003, which raised a further £279.5 million. This levy ceased at the end of the year, having achieved its objective of increasing central assets. Claims paid from the Central Fund totalled £191 million in 2003, down from £466 million in 2002, while undertakings given to insolvent members fell to £80 million from £85 million.

In the event of the Central Fund becoming depleted, Lloyd's has the right to access up to 3 percent of the PTFs from across the market to pay claims, potentially worth an additional £570 million for 2004.

The Central Fund Insurance Policy

The Central Fund is supported by a five-year insurance programme, which expired at the end of 2003. The contract has a limit of £350 million in excess of £100 million in any one year and an aggregate limit of £500 million. The

participants are SR International Insurance Company Ltd 32.5 percent (Swiss Re), Employers Reinsurance Corporation 20 percent (GE Group), St Paul International Insurance Company Ltd 20 percent (The St Paul Companies), International Insurance Company of Hannover Ltd 15 percent (Hannover Re), XL Mid Ocean Reinsurance Ltd 10 percent (XL Capital Ltd) and Federal Insurance Company 2.5 percent (Chubb Corp).

Lloyd's claimed the maximum recoverable amount of £350 million during 2002 and expects the amount claimed in respect of 2003 to increase to £150 million during 2004. The insurers initially paid £134 million with reservation of rights, but then disputed their liability to pay under the terms of the policy. Lloyd's is confident of its case and has resorted to arbitration involving all six insurers. The hearing is scheduled to commence on 31 August 2004. The worst case scenario, full rescission of the contract, would result in a maximum exposure to net central assets of £290 million, being the maximum potential claim, less premium paid (£78 million over five years), less tax.

The Corporation of Lloyd's

The net assets of the Corporation of Lloyd's fell by 20 percent to £70 million during the year to 31 December 2003. For 2004, the rate for all underwriting members' subscriptions has doubled to 0.5 percent of allocated overall premium limit, to provide the Corporation of Lloyd's with greater financial flexibility and, specifically, to provide funding for Kinnect.

SOLVENCY TESTING AT LLOYD'S

Under the terms of the Annual Solvency Test, the Financial Services Authority (FSA) requires Lloyd's to maintain net central assets sufficient to meet the aggregate of individual members' solvency deficits.

All members have an obligation to keep sufficient funds in trust to meet their liabilities and to satisfy any requests for funds in respect of audited losses or future liabilities. One of the most important controls on the solvency of members of Lloyd's is the Annual Solvency Test, which requires the managing agent of each syndicate to estimate and provide for all current and future liabilities for each year of account. These liabilities (i.e. solvency reserves) are subject to a statement of actuarial opinion. There were no qualified opinions at 31 December 2003.

Firstly, each member's solvency position is calculated. Each member must have sufficient assets – held in premiums trust funds, overseas regulatory deposits and FAL – to cover his underwriting liabilities and, on top of this, a solvency margin. The solvency margin is calculated separately for each member, determined essentially as the greater of 16 percent of total annual premium income or 23 percent of average claims incurred over a three-year period. Where a member's assets are not sufficient to cover the aggregate of his underwriting liabilities and his solvency margin, the member has a solvency shortfall. The second part of the test requires that Lloyd's central assets must be sufficient to cover the aggregate of all members' shortfalls calculated at the solvency test date, on a continuous basis. Central assets comprise the value of the Central Fund and Corporation net assets, including the amount of the effective callable layer and also recoveries expected to be received in connection with the Central Fund insurance policy.

Subject to discussion with the FSA, the solvency rules will be amended from 2005 to follow annual accounting principles.

Regulation

Since 1 December 2001, the Financial Services Authority (FSA) has been ultimately responsible for the regulation of the Lloyd's market, under the Financial Services and Markets Act 2000. Simultaneously, the governing body of the Society of Lloyd's, the Council, continues to retain statutory responsibility for management and supervision of the market under the 1982 Lloyd's Act. The day-to-day running of the market is delegated to a franchise governance structure, overseen by the Franchise Board.

THE DEVELOPING FRAMEWORK

Having initially concentrated its efforts at market level, the FSA has recently decided to exercise its responsibility for the regulation of the Lloyd's market more directly, beginning with a series of direct managing agency risk assessments carried out in March 2003. Lloyd's now interfaces with the FSA through its new Risk Management Division, which is tasked with processing market level risk data and developing a new risk model framework, marking a significant change in the role for the centre. The precise delineation of responsibility between the two is not yet fully resolved, but in the future there is expected to be a clear distinction between the FSA's responsibility for the prudential regulation of Lloyd's and that of the Society for risk management of the market.

THE FSA'S NEW RISK-BASED CAPITAL ADEQUACY REGIME

In July 2003, the FSA published CP190, a consultation paper setting out the regulator's plans for a new risk-based capital adequacy regime for the UK non-life insurance market, which goes well beyond what is required under current EU statute. The general intention is for Lloyd's to be treated in the same way as the rest of the market, unless there are justifiable arguments to the contrary.

In May 2004, the FSA published its consultation paper on the prudential requirements for Lloyd's. The proposed new capital regime will shift much responsibility from the centre to the managing agents, who have the closest understanding of syndicate-level risks and controls. Lloyd's will be responsible for setting the capital requirements of the members, while the managing agents will have responsibility for ensuring that each syndicate has adequate financial resources at all times. The FSA also proposes to revise its solvency test so that it addresses the obligations of members more directly. Introduction of the new rules is being targeted for January 2005, to coincide with Lloyd's move to annual accounting.

Key Features of the Proposed Regime for Lloyd's

The proposed new capital requirements for Lloyd's will involve the four key elements of the CP190 regime for general insurers. These are:

- A new Enhanced Capital Requirement (ECR), which is a higher and more risk-sensitive measure than the current EU Directive minimum. Managing agents will calculate the ECR for syndicates based on the guidelines issued by the FSA and the Society will do the same for members. The ECR will vary depending on the class of business and will be expressed as a percentage of claims, premiums or asset values. Initially, ECR is being introduced as a soft test, rather than a hard prudential requirement.
- A new requirement for managing agents to assess the financial resources needed to support the risks of the insurance business that they manage, taking into account the underlying risks, the effectiveness of controls that mitigate those risks and stress and scenario tests. This includes the Individual Capital Assessment (ICA). Managing agents will carry out an ICA for each syndicate, using the ECR as a benchmark, but also including broader risk-based considerations. Lloyd's will use the syndicate calculations to determine an ICA requirement for each member, including adjustments for Funds at Lloyd's assets and diversification.
- The FSA's intention to issue Individual Capital Guidance (ICG) on the amount of capital it believes should be held, based on the ICAs and ECRs.
- A new approach to classifying capital resources into 'tiers' according to qualitative criteria, based on permanency, availability and loss absorbency, rather than measuring eligible capital as simply being the total of admissible assets less foreseeable liabilities. Tier one is the highest quality and includes items such as Funds at Lloyd's, central assets, ordinary shares and profits. Despite reservations, the FSA will continue to permit the admissibility of letters of credit as tier one capital, on the basis that Lloyd's has never suffered a material loss as a result of their use. Tier two is of lower quality and includes subordinated debt and preference shares.

Obligations of Managing Agents Under the Proposed Regime

The proposed rules will require managing agents:

- To maintain appropriate controls over syndicates, including managing risks such as credit risk and market risk, within limits that are substantially the same as those defined for companies.
- To assess the capital needed to support each syndicate that they manage, to help engender a better understanding and management of the risks involved to ensure that financial resources are adequate at all times.

Obligations of the Society of Lloyd's Under the Proposed Regime

The proposed rules for the Society will require it:

- To maintain appropriate controls over the funds that it holds and manages centrally, including managing risk within appropriate limits.
- To assess the capital needs for each member, taking into account the capital needs of syndicates assessed by managing agents. This reflects the fact that the Society has an aggregate view across the market, but managing agents do not. The Society will have a continuing responsibility to ensure that central assets represent tangible protection for policyholders.

Perceived Advantages of the Proposed Lloyd's Regime

The FSA states that the new regime is designed to bring about:

- Improved risk management within the Lloyd's market.
- Better assessment of the capital needed to support each syndicate, ensuring that the financial resources supporting syndicates are adequate at all times.
- More effective assessment by the Society and managing agents of the capital needs of Lloyd's members.
- Greater protection for policyholders.
- Improved confidence in the Lloyd's market as a whole.

The FSA expects the capital requirements for some members to increase, but all members as well as policyholders should benefit from better risk management. The FSA has indicated that, in the longer term, continued consolidation at Lloyd's might make it appropriate for the FSA to regulate members directly, instead of the Society.

Appendices

APPENDIX 1 ACTIVE SYNDICATES IN 2004
APPENDIX 2 SYNDICATE DEVELOPMENTS 2003-2004
APPENDIX 3 LEADING MARKET PARTICIPANTS IN 2004
APPENDIX 4 EQUITAS–RESULTS FOR THE YEAR TO 31 MARCH 2004

PSEUDONYM	SYNDICATE	ACTIVE UNDERWRITER	MANAGING AGENT	AFFILIATION	ALLOCATED CAPACITY		2004 CAPITAL BACKING				* 2002 FORECAST	2001 RESULT	2000 RESULT	** PERFORMANCE RATINGS		** FINANCIAL STRENGTH RATINGS	
					2004 £m	2003 £m	Aligned %	Unaligned %	Conversion %	Individuals %	(% of Capacity)	(% of Capacity)	(% of Capacity)	Moody's	S&P	Moody's	AM Best
HIS	0033	R CHILDS	HISCOX	HISCOX PLC	847	842	65	10	9	16	25.0	(19.8)	(12.4)	A-	3pi		
JDB	0044	C RAY	CANOPIUS	TALISMAN HOLDINGS LTD	3	5	79	4	0	17	3.9	3.2	40.5	C+	2pi		
FRW	0190	T CORFIELD	LIBERTY	LIBERTY MUTUAL GROUP	541	267	100	0	0	0	12.7	(9.8)	1.0	B-	3pi		
EMP	0218	R WHITE	COX	COX INSURANCE HOLDINGS PLC	433	433	58	13	10	19	12.5	13.2	5.8	B+	3pi		
KGM	0260	C HART	KGM	PERSEVERANCE LTD	34	34	48	17	6	29	6.1	5.8	2.1	B-	1pi		
LSM	0282	A ELLIOTT	LIBERTY	LIBERTY MUTUAL GROUP	253	163	100	0	0	0	20.4	(49.5)	4.0		3pi		
KLS	0308	C TOONEY	KILN	KILN PLC	5	4	86	4	0	10	8.0	8.2	(9.0)	C+	1pi		
MSP	0318	M PRITCHARD	ENSIGN	ENSIGN HOLDINGS LTD	159	159	35	39	11	15	11.0	3.3	3.5	B	3pi		
PWH	0382	A WALKER	HARDY	HARDY UNDERWRITING GROUP PLC	115	100	87	4	1	8	16.0	11.2	7.0	B+	4pi		A s (Excellent)
DAC	0386	D CONSTABLE	LIMIT	QBE INSURANCE GROUP LTD	500	450	55	12	12	21	17.5	4.1	(3.6)	A-	3pi		
FDY	0435	P Ceurvorst/M Rayner	FARADAY	BERKSHIRE HATHAWAY INC	400	400	100	0	0	0	23.7	(31.2)	(25.0)	B	2pi		
WTK	0457	D Hoare/ O Crabtree	MUNICH RE	MUNICH RUCKVERSICHERUNG AG	230	225	100	0	0	0	10.0	-5.4	(19.9)	B	2pi		
KLN	0510	VARIOUS	KILN	KILN PLC	508	484	41	20	15	24	16.0	2.6	(3.6)	A-	3pi		A s (Excellent)
KCS	0557	A CARRIER	KILN	KILN PLC	55	55	23	18	22	37	37.0	(34.1)	18.1	A	4pi		
STN	0566	P GROVE	INCIDENTAL – SEE SYNDICATE 2999														
ATR	0570	N MARSH	ATRIUM	ATRIUM UNDERWRITING PLC	165	165	17	23	16	44	10.0	1.6	(4.5)	A-	3pi		A- s (Excellent)
AUW	0609	C DANDRIDGE	ATRIUM	ATRIUM UNDERWRITING PLC	180	160	16	23	17	44	15.0	4.3	4.5	A	4pi		A s (Excellent)
AFB	0623	A BEAZLEY	BEAZLEY	BEAZLEY GROUP PLC	345	330	1	48	19	32	11.0	0.6	0.6	B+	3pi		A s (Excellent)
IRK	0626	R CHILDS	INCIDENTAL – SEE SYNDICATE 0033														
SAM	0727	M MEACOCK	MEACOCK	SA MEACOCK & CO LTD	71	71	4	30	10	56	15.0	(9.8)	(8.5)	B	2pi		
CDL	0779	B JACKSON	ST PAUL	ST PAUL COMPANIES INC	30	20	14	22	0	64	8.9	9.0	22.7	A-	3pi		
ADV	0780	L TUNICLIFFE	ADVENT	ADVENT CAPITAL (HOLDINGS) PLC	216	228	47	16	11	26	30.0	(62.4)	(3.2)	B	3pi		
SDM	0807	S MATHERS	KILN	KILN PLC	113	87	34	15	26	25	16.1	5.8	(4.9)	B	2pi		
GSC	0958	J ROBINSON	OMEGA	OMEGA UNDERWRITING HOLDINGS LTD	225	154	2	34	21	43	13.0	2.8	2.9	B	3pi		A s (Excellent)
JDN	0980	J NEAL	LIMIT	QBE INSURANCE GROUP LTD	83	83	4	95	0	1	12.5	16.1	0.3	B	1pi		
SIM	0994	M SIMMONDS	IMAGINE	IMAGINE GROUP	40	40	100	0	0	0	7.0	(16.2)	(34.8)	C	1pi		
SVB	1007	J BUTCHER	SVB	SVB HOLDINGS PLC	216	151	81	4	3	12	14.5	(21.7)	(9.8)	B+	2pi	A2 (Good)	
COF	1036	C O'FARRELL	LIMIT	QBE INSURANCE GROUP LTD	100	90	100	0	0	0	7.5	7.8	0.2	B	3pi		
CSL	1084	H HAYWARD	CHAUCER	CHAUCER HOLDINGS PLC	400	102	85	13	0	2	12.5	(12.8)	(7.7)	B+	3-		
MGD	1176	M DAWSON	CHAUCER	CHAUCER HOLDINGS PLC	15	13	44	10	27	19	25.7	41.4	42.2	B+	3pi		
TAL	1183	C ATKIN	TALBOT	TALBOT HOLDINGS LTD	288	194	100	0	0	0	15.4			B+			
ROC	1200	L ROCK	HERITAGE	HERITAGE UNDERWRITING AGENCY PLC	118	80	26	64	0	10	27.5						
GER	1206	M MANNING	GERLING	GERLING-KONZERN ALLGEMEINE AG	60	55	100	0	0	0	10.0	0.1	(23.5)	C+	1pi		
XL	1209	N METCALF	XL	XL CAPITAL LTD	340	340	100	0	0	0	15.5	(49.5)	(34.7)	B+	2pi		
ODY	1218	S GORDON	NEWLINE	FAIRFAX FINANCIAL HOLDINGS LTD	145	115	100	0	0	0	12.2	(19.6)	(18.6)		1pi		
MLM	1221	C DINGLEY	NAVIGATORS	NAVIGATORS GROUP INC	150	125	97	1	0	2	10.0	0.8	(5.4)	B	3pi		

* MANAGING AGENCY FORECASTS AS AT 31 DECEMBER 2003
** ALL RATINGS STATED AS AT 16 JUNE 2004 AND SUBJECT TO SUBSEQUENT CHANGE

NOTE: SYNDICATES DESIGNATED AS 'INCIDENTAL' OPERATE AS SUB-SYNDICATES OF THE NAMED 'PARENT' SYNDICATE, THE UNDERLYING SECURITY BEING IDENTICAL.

PSEUDONYM	SYNDICATE	ACTIVE UNDERWRITER	MANAGING AGENT	AFFILIATION	ALLOCATED CAPACITY		2004 CAPITAL BACKING				* 2002 FORECAST	2001 RESULT	2000 RESULT	** PERFORMANCE RATINGS		** FINANCIAL STRENGTH RATINGS	
					2004 £m	2003 £m	Aligned %	Unaligned %	Conversion %	Individuals %	(% of Capacity)	(% of Capacity)	(% of Capacity)	Moody's	S&P	Moody's	AM Best
ALS	1225	P THORPE-APPS	AEGIS	AEGIS LTD	175	175	100	0	0	0	11.5	(1.9)	(20.5)				
FRW	1231	G JOHNSTONE	JUBILEE	JUBILEE GROUP	55	55	60	40	0	0	17.5						
EUL	1243	J COLLYEAR	EUCLIDIAN	EUCLIDIAN GROUP	252	350	100	0	0	0	5.2	(36.5)	(27.3)		1pi		A- s (Excellent)
JAT	1245	R DAVIES	HERITAGE	HERITAGE UNDERWRITING AGENCY PLC	36	38	11	46	0	43	10.0	0.0	(9.0)				
BGT	1301	P GAGE	CHAUCER	CHAUCER HOLDINGS PLC	38	35	0	100	0	0	10.0	(1.8)	2.8				
DRE	1400	M PETZOLD	DANISH RE	TRIDENT II LP	80	100	100	0	0	0	10.0	(24.7)	(16.3)				
RTH	1414	M REITH	ASCOT	AMERICAN INTERNATIONAL GROUP INC	284	269	100	0	0	0	28.5	35.4					A + (Superior)
JHA	1607	J THOMAS	CREECHURCH	CREECHURCH GROUP	33	11	9	91	0	0	3.8	(5.9)	(33.2)		1pi		
BRM	1861	J HENDERSON	MARLBOROUGH	BERKSHIRE HATHAWAY INC	90	185	100	0	0	0	13.5	(8.9)	(10.6)				
CSM	1923	A PITT	IMAGINE	IMAGINE GROUP	13	13	0	100	0	0	20.0	13.9	10.6				
HAR	2000	P GROVE	INCIDENTAL – SEE SYNDICATE 2999														
AML	2001	A HOLT	AMLIN	AMLIN PLC	1000	1000	100	0	0	0	17.0	1.1	(2.7)	A-	3pi	A1 (Good)	A s (Excellent)
SJC	2003	P BRAND	CATLIN	CATLIN GROUP LTD	500	450	100	0	0	0	12.5	(14.5)	(12.5)	B+	3pi		A s (Excellent)
MMX	2010	J HAMBLIN	CATHEDRAL	CATHEDRAL CAPITAL GROUP	200	160	48	15	15	22	15.0	0.6					A- s (Excellent)
WEL	2020	D FOREMAN	WELLINGTON	WELLINGTON UNDERWRITING PLC	730	700	56	13	10	21	12.5	(15.6)	3.6	A-	4pi	A1 (Good)	
HYL	2121	J HYLAND	SACKVILLE	SOC GROUP PLC	62	34	54	20	11	15	12.5	(21.8)	(13.7)				
SVB	2147	A HICKS	SVB	SVB HOLDINGS	286	286	100	0	0	0	11.5	(3.7)	4.7	B		A3 (Good)	
MFM	2468	S LOTTER	MARKETFORM	MARKETFORM HOLDINGS LTD	99	57	55	45	0	0	5.5	(30.3)	(14.1)				
AGM	2488	R PRYCE	ACE	ACE LTD	550	725	100	0	0	0	7.5	(3.1)	(13.8)	A-	3pi	Aa3 (Excellent)	
DLP	2525	D PRATT	ABACUS	CBS INSURANCE HOLDINGS PLC	74	42	0	43	14	43	10.0	(17.8)	(19.1)				
AGD	2526	A DORE	ABACUS	CBS INSURANCE HOLDINGS PLC	30	-	0	69	14	17							
TLT	2607	J THOMAS	CREECHURCH	CREECHURCH GROUP	15	20	100	0	0	0	1.2	3.0			1pi		
AFB	2623	A BEAZLEY	BEAZLEY	BEAZLEY GROUP PLC	397	330	100	0	0	0				B+	3pi		A s (Excellent)
PJG	2724	P GROVE	INCIDENTAL – SEE SYNDICATE 2999														
MAP	2791	D SHIPLEY	MAP	MAP EQUITY LTD	326	326	57	16	9	18	29.0	(13.3)					
PYE	2962	D PYE	CREECHURCH	CREECHURCH GROUP	7.5	13	100	0	0	0				C+			
BRT	2987	S CLAPHAM	BRIT	BRIT INSURANCE HOLDINGS PLC	500	500	100	0	0	0	13.5		(28.4)	B			
QBE	2999	P GROVE	LIMIT	QBE INSURANCE GROUP LTD	530	500	100	0	0	0	5.0	(12.6)	(28.5)	B	2pi		
MKL	3000	G ALBANESE	MARKEL	MARKEL CORPORATION	190	260	100	0	0	0	22.5			B+	2pi		A- s (Excellent)
MIT	3210	D WARREN	CHAUCER	CHAUCER HOLDINGS PLC	316	250	0	100	0	0	17.5	(9.2)	(44.3)	B			
LAW	3245	M LAWRENCE	HERITAGE	HERITAGE UNDERWRITING AGENCY PLC	50	15	44	26	1	30							
ILM	4040	D BURNISTON	ILLIUM	ILLIUM INSURANCE GROUP LTD	96	-	26	33	17	24							
CNP	4444	J GIORDANO	CANOPIUS	TALISMAN HOLDINGS LTD	230	-	100	0	0	0				B-	1pi		
SPL	5000	M GRAVETT	ST PAUL	ST PAUL COMPANIES INC	325	435	100	0	0	0	0.9	(37.7)	(39.1)		2pi		

* MANAGING AGENCY FORECASTS AS AT 31 DECEMBER 2003
** ALL RATINGS STATED AS AT 16 JUNE 2004 AND SUBJECT TO SUBSEQUENT CHANGE

NOTE: SYNDICATES DESIGNATED AS 'INCIDENTAL' OPERATE AS SUB-SYNDICATES OF THE NAMED 'PARENT' SYNDICATE, THE UNDERLYING SECURITY BEING IDENTICAL.

NEW SYNDICATES		2004 CAPACITY (£m)	COMMENCED TRADING
2526	Abacus Syndicates Ltd	30	1 January 2004
3245	Heritage Managing Agency Ltd	50	21 July 2003
4040	Illium Managing Agency Ltd	96	1 January 2004
	Total	**£406m**	

Source: Lloyd's of London

MERGED SYNDICATES AT 31 DECEMBER 2003		MERGED INTO SYNDICATE
0587	Chaucer Syndicates Ltd	1084
1096	Chaucer Syndicates Ltd	1084
0962	Creechurch Underwriting Ltd	1607
0839	Canopius Managing Agents Ltd	Re-numbered as 4444

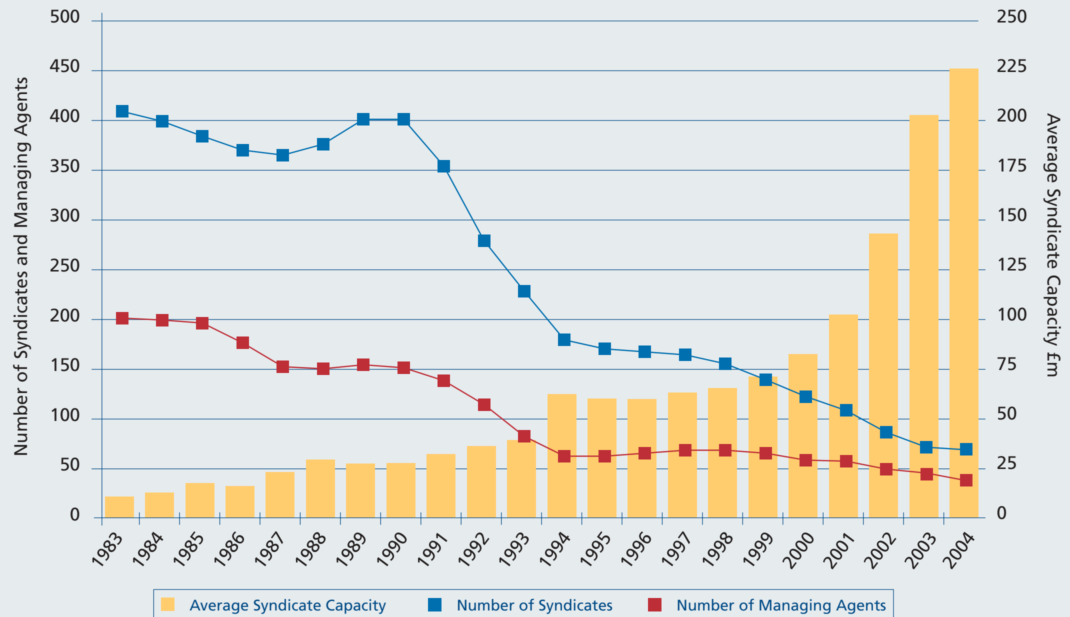
Source: Lloyd's of London

CEASED SYNDICATES		2003 CAPACITY (£m)	PLACED INTO RUN-OFF
0102	Goshawk Syndicate Management Ltd	173	31 October 2003
0389	Brit Syndicates Ltd	15	11 December 2003
1204	RJ Kiln & Company Ltd	28	31 December 2003
2040	Brit Syndicates Ltd	14	31 December 2003
2241	Thomas Miller Managing Agency Ltd	17	31 December 2003
	Total	**£575m**	

Source: Lloyd's of London

SYNDICATE TRENDS

In line with global insurance industry trends, Lloyd's has witnessed a great deal of consolidation and rationalisation in the last decade. In the drive for greater capital efficiency the number of syndicates has again fallen, from 71 at the start of 2003, to 66 at the start of 2004, while average syndicate capacity has further increased from £203 million to £227 million. The number of managing agents is unchanged at 45.



Source: Lloyd's of London

20 LARGEST SYNDICATES IN 2004

The 20 largest syndicates at Lloyd's account for 67 percent of total market capacity in 2004.

SYNDICATE NUMBER	PSEUDONYM	MANAGING AGENT	2004 CAPACITY (£m)	CAPACITY GROWTH vs 2003 (%)
2001	AML	Amlin	1000	0
0033	HIS	Hiscox	847	1
0623/2623	AFB	Beazley	742	12
2020	WEL	Wellington	730	4
2488	AGM	Ace	550	(24)
0190	FRW	Liberty	541	103
2999	QBE	Limit	530	6
0510	KLN	Kiln	508	5
2987	BRT	Brit	500	0
2003	SJC	Catlin	500	11
0386	DAC	Limit	500	11
0218	EMP	Cox	433	0
0435	FAR	Faraday	400	0
1084	CSL	Chaucer	400	392
1209	XL	XL London	340	0
2791	MAP	MAP	326	0
5000	SPL	St Paul	325	(25)
3210	MIT	Chaucer	316	26
1183	TAL	Talbot	288	48
2147	SVB	SVB	286	0
		Total	**£10,062m**	

Source: Lloyd's of London

20 LARGEST DIRECT CAPITAL PROVIDERS IN 2004

The top 20 investors providing capacity directly through a subsidiary capital provider supply 62 percent of total market capacity in 2004.

CAPITAL PROVIDER	2004 CORPORATE MEMBER CAPACITY (£m)	CAPACITY GROWTH vs 2003 (%)
Amlin	1,000	16
QBE (Limit)	972	15
Liberty Mutual	794	85
Hiscox	550	1
ACE	550	(24)
Berkshire Hathaway	534	(10)
Brit	500	(3)
Catlin Westgen	500	11
SVB	460	13
Wellington	411	5
Beazley	401	22
Chaucer	347	24
XL Capital	340	0
St Paul	329	(25)
Mitsui	316	25
Talbot	288	49
AIG (Ascot)	284	6
Kiln	263	11
Cox	252	0
Euclidian	252	(28)
Total	**£9,289m**	

Source: Lloyd's of London

20 LARGEST MANAGING AGENTS IN 2004

The leading 20 managing agents oversee 77 percent of total market capacity in 2004.

MANAGING AGENT	2004 MANAGED CAPACITY (£m)	MANAGED CAPACITY GROWTH vs 2003 (%)
Limit (QBE)	1,213	17
Amlin	1,000	0
Hiscox	842	1
Liberty	794	85
Chaucer	769	17
Beazley	741	12
Wellington	730	4
Kiln	681	4
ACE	550	(24)
SVB	502	15
Brit	500	(6)
Catlin	500	11
Cox	433	0
Faraday	400	0
St Paul	355	(22)
Atrium	345	6
XL London Market	340	0
MAP	326	0
Talbot	288	49
Ascot	284	6
Total	**£11,510m**	

Source: Lloyd's of London

EQUITAS – RESULTS FOR THE YEAR TO 31 MARCH 2004

On 8 June 2004, Equitas released its financial results for the year to 31 March 2004. Accumulated surplus after tax fell by £67 million to £460 million, but the solvency margin (accumulated surplus stated as a percentage of net claims outstanding) improved to 9.8 percent, from 8.7 percent previously. During the year, agreements were completed to close out asbestos claims for three of the five largest direct asbestos exposures and the largest reinsurance exposure. The technical account and balance sheet are summarised below.

EQUITAS TECHNICAL ACCOUNT SUMMARY

	2003 (£m)	2004 (£m)
Gross Claims Paid	(1,051)	(1,381)
Reinsurers' Share	222	173
Net Claims Paid	**(829)**	**(1,208)**
Change in the Net Provision for Claims	(5)	770
Net Claims Incurred	**(834)**	**(438)**
Other Technical Charges	(26)	(24)
Technical Balance	**(860)**	**(462)**
Investment Income	289	232
Return on Financial Reinsurances	76	14
Realised Investment Gains	83	139
Unrealised Investment Gains	245	10
Investment Return	**693**	**395**
Tax	15	0
Deficit for the Year	**(152)**	**(67)**

Source: Equitas Group

EQUITAS BALANCE SHEET SUMMARY

ASSETS	2003 (£m)	2004 (£m)
Financial Investments	5,780	4,717
Financial Reinsurances	587	381
Reinsurers' Share of Outstanding Claims	949	685
Reinsurance Debtors	705	419
Other Debtors	41	23
Other Assets	74	78
Total Assets	**8,136**	**6,303**

LIABILITIES	2003 (£m)	2004 (£m)
Gross Claims Outstanding	7,039	5,353
Reinsurance Creditors	496	398
Other Creditors	74	92
Shareholders' Funds–Retained Surplus	527	469
Total Liabilities	**8,136**	**6,303**

Source: Equitas Group

Gross provisions for outstanding claims are discounted to reflect the time value of money. For the year to 31 March 2004, the discount rate was reduced to 3.65 percent per annum, from 3.90 percent previously. Gross discounted reserves for asbestos claims totalled £2.8 billion, having been strengthened by £296 million at the year-end, primarily due to a trend towards higher pay-outs for mesothelioma victims and a worsening of claims for some key assureds. On a gross undiscounted basis, asbestos reserves totalled £4.0 billion at 31 March 2004 (2003: £5.3 billion).

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GUY CARPENTER

For further information, please contact your local Guy Carpenter office or visit our web site at:

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