Best's Rating of

LLOYD'S

2008

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Lloyd's

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Rating Rationale

The "A" (Excellent) financial strength rating (FSR) and "a+" issuer credit rating (ICR) of Lloyd's reflect its excellent capitalisation and reduced volatility in operating performance supported by enhanced risk management. In addition, as a result of implementation of phase one of the Equitas agreement with National Indemnity Co. (NIC), Lloyd's exposure to uncertainty relating to Equitas has been substantially reduced. The ratings continue to reflect Lloyd's excellent global business profile. The rating outlook is stable.

Excellent capitalisation – A.M. Best believes that underwriting discipline at Lloyd's is likely to be maintained through 2008 and into 2009. Whilst market capacity remained stable at GBP16.0 billion at the beginning of 2008 (2007: GBP16.1 billion), overall, existing syndicates reduced stamp by 5% and new entrants provided the balance of capacity. A.M. Best believes that Lloyd's rigorous review procedures of both existing syndicates and new applicants is likely to help prevent new insolvent members from emerging, despite the influx of new capacity entering the market this year. A.M. Best also believes that strain on the Central Fund from existing insolvent members is diminishing, owing to stabilising reserves and the closure of a significant number of open years. A.M. Best expects Lloyd's central solvency capital to remain excellent through 2008. It increased 20% to GBP 2,457 million at the 2007 year-end and was supported by the GBP 500 million subordinated loan note issued in June.

Less volatile performance – A.M. Best expects strong performance from the market in 2008, although some deterioration is anticipated on the excellent results achieved in 2007, as underwriting margins reduce and uncertainty in the capital markets continues. A good combined ratio of 95%-100% is forecast, incorporating a positive contribution from prior years, due to Lloyd's current reserve strength, which partly reflects the absence of major loss experience in 2006/7. At this stage, A.M. Best believes that subprime related losses arising from underwriting or through investments are unlikely to have a material impact on Lloyd's performance, although uncertainty as to underwriting losses from this source will continue for some time. Excellent performance in 2007 was supported by a strong underwriting result and by investment income. Underwriting performance benefited from benign catastrophe experience in the year and a strong rating environment for certain lines of business combined with a significant reserve release. A.M. Best believes that continued enhancement to governance at Lloyd's, internal oversight of the market and enhanced management information and peer analysis continue to raise risk management standards. These processes are likely to help identify emerging issues early and dampen the high volatility in Lloyd's performance observed in previous cycles.

Excellent global business profile – In A.M. Best's opinion, Lloyd's has an excellent business profile, which has enabled it to attract and retain business despite the development of alternative insurance centres in lower tax jurisdictions. Lloyd's benefits from a capital efficient operating structure and global underwriting reach that facilitate access to a range of different business lines and underwriting markets. Both factors provide strong support for Lloyd's business profile. In A.M. Best's view, expanding international trading platforms, such as those in Singapore and China, and reducing the cost of placing business at Lloyd's are likely to further enhance its profile, reducing its dependence on a single location at which to underwrite business. Lloyd's exposure to uncertainty relating to Equitas, which was previously an offsetting rating factor, has been substantially reduced following implementation of phase one of a two-phase deal with National Indemnity Co. (Nebraska). Completion of phase two, expected in 2009, would provide further benefit.

Business Review

In A.M. Best's opinion, Lloyd's has a strong competitive position in the global insurance market and benefits from its reputation for innovative and flexible underwriting. Its competitive strength derives from its marketplace structure that fosters the development of strong specialist underwriting skills. The collective size of the market enables its syndicates, which operate as individual businesses, to compete effectively with major international insurance groups under the Lloyd's brand.

The Lloyd's Franchise Board provides a commercial focus to management of the market and is responsible for setting minimum standards to help safeguard its future profitability. A.M. Best believes that this responsibility, coupled with the activities of the Franchise Performance Directorate (FPD), continues to improve Lloyd's oversight of commercial planning by its franchisees, although this does not extend to active management of Lloyd's overall mix of business.

Traditionally a market for marine insurance, Lloyd's has developed into a major insurer of global property and casualty business, attracting large and complex risks. A.M. Best expects Lloyd's to maintain a leading position in its core marine, energy, aviation and specialty markets, supported by the pool of underwriting expertise in the London Market. It is also likely to remain a significant writer of catastrophe and reinsurance business, despite intensifying competition from other international markets, particularly Bermuda.

Exhibit 1

Calendar Year Gross Written Premium by Main Business Class (2006-2007)

(GBP Millions)

	2006	2007	% change
Reinsurance	5,557	5,453	-1.9%
Property	3,638	3,809	4.7%
Casualty	3,572	3,364	-5.8%
Marine	1,153	1,226	6.3%
Energy	1,125	1,019	-9.4%
Motor	923	983	6.5%
Aviation	393	464	18.1%
Life	50	46	-8.6%
Total	**16,411**	**16,364**	**-0.3%**

Figures include brokerage and commission.
Source: Lloyd's Annual Report 2007

Exhibit 1 shows Lloyd's calendar year premium in 2006 and 2007 split by main class of business. Overall, gross premium income remained stable in 2007, despite the impact of the weaker U.S. dollar and downward pressure on rates across most business lines. Although pricing levels were past the peak, attractive underwriting opportunities remained, particularly for risks exposed to U.S. catastrophes.

Following substantial growth in 2006, energy premium fell by over 9% in 2007, with the impact of lower rates for offshore and onshore business only partly offset by higher asset values. In the property sector, rates for windstorm-exposed risks in the United States remained strong, supporting a 5% increase in premium volume. However, growth was dampened by rate reductions in other sectors, which accelerated as competitors sought to diversify underwriting exposure.

Casualty premium fell by almost 6% as intense competition placed downward pressure on pricing. Rates have been falling for this class since 2004, and A.M. Best believes that for casualty lines written outside the United States, underwriting margins are now minimal.

Following five years of underwriting profit, the aviation class continued to attract more capacity during 2007. Despite a fall in rates, syndicates increased their exposure to this business, and premium income rose by approximately 18%. Motor premium increased by 6.5% following several years of decline, reflecting a small upswing in the rating environment.

The split in premium income by method of acceptance (see **Exhibit 2**) shows that Lloyd's overall underwriting portfolio remains weighted toward direct business, with insurance representing 67% of gross premium in 2007 and reinsurance accounting for the balance.

The territorial scope of business written and Lloyd's worldwide market access remain positive rating factors. Through its global infrastructure and network of licences, Lloyd's gives its franchisees access to a wide international client base and continues to extend its global reach. In April 2008, following legislative changes, Lloyd's became the first admitted reinsurer in Brazil, opening a representative office in Rio de Janeiro.

A.M. Best expects Lloyd's to continue to build a local presence in certain key developing markets, with a particular focus on improving access to fast-growing markets in Latin America and the Middle East. In India, despite the withdrawal of its representative there, Lloyd's maintains its long-term goal of securing an onshore reinsurance licence. In addition, Lloyd's is expected to enhance its presence in Europe by applying for new licences and forming new representative offices. Despite these developments, the market is likely to maintain its significant geographical bias towards North America and the United Kingdom for some time. In 2007, these mature markets represented 44% and 24% of gross premium income respectively (see **Exhibit 3**).

Exhibit 2
Calendar Year Gross Written Premium by Method of Acceptance (2006-2007)
(GBP Millions)

	2006	2007	% Change
Direct	10,854	10,911	0.5%
Reinsurance	5,557	5,453	-1.9%
Total	**16,411**	**16,364**	**-0.3%**

Figures include brokerage and commission
Source: Lloyd's

Growth in Lloyd's U.S. situs business slowed to 4% during 2007, following a 27% increase in 2006 (see **Exhibit 4**). The reduction in growth reflects strong but deteriorating market conditions for catastrophe exposed property business and further rate softening in the casualty sector. Premium income from surplus lines business remained buoyant in 2007, but underwriting opportunities are expected to decline in 2008 as competition increases. Nevertheless, A.M. Best believes that Lloyd's profile continues to benefit from its substantial participation in the U.S. surplus lines market, despite the volatility that can be experienced in terms of both premium volume and performance.

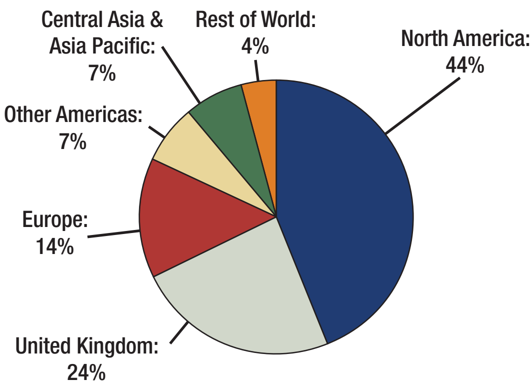
Lloyd's participation in direct U.S. business (excluding surplus lines) is relatively modest and has grown at only 5% per annum over the last five years. Lloyd's direct account in the United States comprises licensed business underwritten in Illinois, Kentucky and the U.S. Virgin Islands, as well as other business exempt from surplus lines laws (principally marine, aviation and transport risks). In the U.S. reinsurance market, where Lloyd's premium volume is substantial, the rate of growth is likely to decline in 2008, reflecting rate movements for catastrophe exposed business.

Business Environment

Market conditions

Global market capacity has continued to increase in 2008, as insurers with strong balance sheets, boosted by profits in 2007 and 2006, seek to deploy excess capital. Consequently, overall market conditions are

Exhibit 3
Gross Premium by Territory (2007)



Source: Lloyd's Annual Report 2007

deteriorating. Although concessions have initially been confined to pricing, the impact of competitive pressure is likely to spread to terms and conditions. In the absence of major catastrophes or significant adverse claims development, this trend is likely to persist into 2009.

In the energy sector, rates continue to fall from the 2006 peak but are still attractive by historical standards. Similarly, despite accelerating rate deterioration, pricing remains adequate for U.S. windstorm exposed risks in the property catastrophe and direct property markets. For non-U.S. property risks, competition is increasing and profitable opportunities in the market are becoming more restricted.

The subprime crisis is expected to have a minimal impact on pricing in the casualty sector in 2008, although rates for directly affected business are likely to stabilise. Competition in the sector remains intense, placing considerable pressure on overall rates and conditions.

Adverse loss experience in 2007 is likely to have a positive effect on rates for marine hull and protection and indemnity business. However, further softening is anticipated for cargo and specie business. In the aviation sector, favourable loss experience has attracted additional capacity to the market, leading to rate decreases since 2002. In 2008, rate deterioration is expected to slow as profit margins narrow further.

A.M. Best believes the downturn in the overall underwriting cycle, and a corresponding reduction in margins, increases the risk of insurers writing higher volumes of business to meet the return on capital demands of their investors.

Exhibit 4

U.S. Profile of Lloyd's (2003-2007)

(USD Millions)

	2003	2004	2005	2006	2007	CAGR
Lloyd's Surplus Lines Premium	4,492	4,596	4,675	5,989	6,360	9%
Total U.S. Surplus Lines Premiums	32,799	33,012	33,281	38,698	36,636	3%
Lloyd's Share of U.S. Surplus Lines Premium	14%	14%	14%	15%	17%	
Lloyd's U.S. Direct Business (Excluding Surplus Lines)	1,006	1,010	1,034	1,216	1,207	5%
Lloyd's U.S. Reinsurance	3,700	3,337	3,762	4,849	4,939	7%
Lloyd's Total U.S. Situs Business	9,198	8,943	9,471	12,054	12,506	8%

Source: Lloyd's, A.M. Best Co. and National Association of Insurance Commissioners.

However, there are signs that Lloyd's insurers are committed to prudent capital management as rates decline, with some returning capital to investors rather than using it to write unprofitable business. For the 2008 year of account, a number of managing agents have announced that they are curtailing the amount of business that they plan to write. Despite this, overall gross premium written at Lloyd's is likely to be stable, as a reduction in business written by large, established market participants is offset by the impact of new entrants and increases from certain smaller syndicates.

Operational Change at Lloyd's

In A.M. Best's opinion, business process reform is essential if Lloyd's is to maintain its competitive position in the international insurance market. Administrative processes are still regarded by many market participants as less efficient than those of peers and could serve to reduce Lloyd's attractiveness to policyholders. Meanwhile, the pressure on Lloyd's to accelerate the reform of its practices continues to increase, due to intense competition from insurers in the United States, Bermuda and developing insurance markets around the world.

Historically, reform has been hampered by the complex nature of the market. However, A.M. Best believes significant progress is now being made to update inefficient processes. In 2007 advances were made across the three main work streams designed to achieve the objectives set out in Lloyd's three year plan – the accounting and settlement (A&S) of financial transactions, electronic claims handling and pre-bind contract certainty. Reform is expected to continue apace in 2008, as key market participants seek to realise the sustainable competitive benefits of cost reductions and service improvements.

In 2007, the adoption of the A&S repository for processing documentation and data relating to premium transactions gathered momentum. By year-end, 65% of original premium related transactions were being processed using the system, and this increased to approximately 85% by the end of April 2008. Lloyd's is now expected to focus on system enhancements to widen the range of business that can be processed this way.

In addition, use of the electronic claims system grew rapidly, providing all insurers with an interest in a claim immediate, simultaneous access to a central copy of the claims file. By the end of 2007, almost 90% of non-complex new claims and 75% of all claims were being processed electronically. This was below the Market Reform Group's 100% target for new claims. Going forward, the group's key priority is to improve system functionality in order to realise a material reduction in the average time taken to settle claims.

Progress on contract certainty (to be achieved within 30 days of inception) and pre-bind quality assurance continued, supported by the provision, maintenance and enhancement of tools by the central Market Operations team. Contract certainty is now incorporated into Lloyd's underwriting standards and during 2007 was consistently achieved on over 90% of contracts.

In contrast to the reform of back office functions, the transition toward the electronic placement of risks remains difficult to achieve. Following the well-publicised failure of Kinnect Ltd., Lloyd's is reluctant to mandate a single market approach to electronic placing. Instead, it plans to adopt a cautious, step-by-step approach, initially endorsing a simple messaging hub that will allow users to send messages to each other that conform to ACORD standards. Although this will allow simple standardised risks to be placed electronically, A.M. Best believes that, without mandatory action, marketwide adoption will be slow.

Regulatory and Accounting Environment

Regulatory oversight of the Society of Lloyd's and its managing agents continues to be the responsibility of the United Kingdom's Financial Services Authority (FSA). The application of Individual Capital Adequacy Standards (ICAS) enabled the FSA to bring Lloyd's within the scope of its Prudential Sourcebook (PRU). However, some regulatory differences between Lloyd's and non-life companies in the United Kingdom remain. Currently, letters of credit count as tier I capital, and European Union insurance directives permit Lloyd's members to use letters of credit to fulfil funds at Lloyd's (FAL) requirements. However, under the European Commission's Solvency II proposed framework, letters of credit are likely to be considered as tier II capital.

The Solvency II framework is an attempt to bring a harmonised, principles-based approach to insurance legislation within the European Union. It is expected to substantially increase regulatory capital requirements for most insurers, although no extra capital is likely to be required for the insurance market as a whole. Lloyd's participates in EU quantitative impact studies and has sought to raise awareness of the implications of Solvency II.

To comply with the FSA's existing ICAS regime, managing agents conduct an independent assessment of the capital needs of syndicates known as the Individual Capital Assessment (ICA). The FSA delegates the annual review of syndicate ICAs to the Corporation of Lloyd's, although the FSA reviews a small sample of ICAs in order to validate the effectiveness of the reviews carried out. Lloyd's is required to assess the adequacy of syndicate ICAs before using these to calculate member ICAs. In addition, the Corporation must also conduct an ICA for Lloyd's overall, using the FSA's six risk categories – insurance, credit, market, liquidity, group and operational – to examine the risks that are not captured in each member's ICA.

Method of Accounting

A.M. Best believes that Lloyd's method of accounting remains complex, although the introduction of annual accounting has provided financial information comparable to other companies. The annual report includes pro forma financial statements (the financial results of Lloyd's and its members taken together) and Society of Lloyd's financial statements for which the Society has adopted International Financial Reporting Standards (IFRS). The traditional Lloyd's underwriting year of account information is no longer presented.

The pro forma financial statements (PFFS) include the aggregate accounts (based on syndicate accounts compiled in accordance with U.K. Generally Accepted Accounting Principles [GAAP]), members' funds at Lloyd's and the statements for the Society of Lloyd's. In order to ensure that the accounts are presented on the same basis as other insurers, certain adjustments are made to Lloyd's capital and investment return (there is a notional investment return on FAL included in the non technical account). The sum of the individual audited syndicate accounts is presented in the aggregate statements, the replacement for Lloyd's traditional three-year accounts. This includes syndicate-level assets but excludes members' FAL, which are held centrally by Lloyd's. The Society statements present the central resources of Lloyd's (e.g. the Central Fund). While the PFFS includes Lloyd's central resources, the presentation is in U.K. GAAP as opposed to IFRS, which is used for the Society statements.

Managing agents are required to prepare, subject to certain exceptions, underwriting year accounts on a three-year fund basis as well as annual accounts for each syndicate in accordance with U.K. GAAP. The syndicate underwriting year accounts largely resemble Lloyd's traditional three-year accounts. This method of accounting is appropriate for the annual venture structure under which third-party capital providers can join and leave syndicates each year. If all the members agree or if there is no underwriting year being closed, then these accounts are not required. However, underwriting year accounts are required for members' tax purposes because the existing tax regime has been maintained.

The move to annual accounting at Lloyd's has reduced the relevance of its open year forecasts. However, Lloyd's has not replaced these forecasts with annually accounted estimates or guidance for investors at this stage.

Litigation

Whilst Reconstruction & Renewal (R&R) in 1996 brought to a close many of the legal battles that Lloyd's was facing, it generated a new series of disputes arising from the issue of collection of the premium for the mandatory reinsurance of Names' 1992 and prior years liabilities into Equitas. Lloyd's continues to enforce the judgements which it obtained against Names who did not pay their liabilities arising out of the R&R programme and has successfully sued more than 600 Names who refused to pay this premium.

A number of highly publicised counterclaims to Lloyd's Equitas debt action were finally concluded in 2007. However, in October 2007, Lloyd's was served with a new claim by 51 Names. The Names claim that in the 1980s and early 1990s, Lloyd's fraudulently misrepresented the effect of reinsurance to close (RITC) by giving the impression that RITC ended a Name's liability for underwriting as opposed to being reinsurance policies leaving the Names potentially liable to policyholders should the reinsurance prove to be insufficient. Lloyd's application to strike out the claim succeeded in July 2008, but the Names have said they will appeal this decision.

Financial Performance

A.M. Best anticipates deterioration in Lloyd's performance over the period 2008 to 2010, owing to reduced underwriting profitability in a weaker pricing environment. For lines of business exposed to U.S. catastrophes, rates are falling from a strong level, and opportunities for underwriting profits are likely to remain in the near term. Elsewhere, competition continues to intensify, with underwriting profitability increasingly reliant upon uncertain prior year reserve releases. Competitive pressure is likely to spread to terms and conditions, and A.M. Best believes there is a risk that, without an appropriate increase in pricing, concessions will lead to higher attritional losses and reduce already thin margins.

Although prospective results are likely to be volatile, reflecting the nature of business underwritten at Lloyd's, A.M. Best believes that the more extreme performance downside from which Lloyd's suffered in previous cycles has been tempered. This is consistent with A.M. Best's view that underwriting and risk management standards at Lloyd's continue to improve, supported by the oversight of the Franchise Performance Directorate.

In 2008, Lloyd's combined ratio is expected to increase to between 95%-100%, up from 84% in 2007. This forecast incorporates a substantial allowance for catastrophe losses as well as a positive contribution from prior years, due to Lloyd's current reserve strength, which partly reflects the absence of major loss experience in 2006/2007. Further ahead, A.M. Best anticipates that performance will be adversely affected by more competitive market conditions.

A.M. Best does not expect Lloyd's to incur substantial direct subprime losses in 2008. Although the market has exposure to the lines of business that could be affected by U.S. subprime claims (principally professional indemnity and directors' and officers' insurance), syndicates have written less large U.S. financial institution business since 2000. However, A.M. Best believes that uncertainty as to underwriting losses from this source will continue for some time. As at the end of the second quarter of 2008, Lloyd's had only received a small number of subprime related claims notifications.

Performance in 2007

Lloyd's financial performance in 2007 was excellent, reflected in a profit on ordinary activities of GBP 3.8 billion (2006: GBP 3.7 billion) and a combined ratio of 84% (2006: 80%). The level of catastrophe losses, although higher than in 2006, remained below the market's long-term average, largely due to the low number of hurricanes making landfall in the United States. The market's exposure to the U.K. floods and Windstorm Kyrill was relatively small, and as at year-end 2007, the estimated net losses from the two events were GBP 215 million and GBP 85 million respectively.

A material overall surplus on prior year reserves of GBP 856 million (2006: GBP 270 million) reduced the year's combined ratio by 6.5 percentage points. Claims reserves on business written between 2002 and 2006 are developing favourably across all major business lines, and loss estimates for the 2005 U.S. hurricanes are stabilising. In addition, following several years of material reserve strengthening, claims reserves for casualty business written between 1997 and 2001 also appear to be stabilising.

Lloyd's operating expense ratio has remained relatively stable over the last five years at between 30% and 35% (expressed as a percentage of net written premiums). The most significant part of operating expenses is acquisition costs, which increased by almost 8% in 2007 to GBP 3,439 million. The other main element is administrative or management expenses, which rose 8% to GBP 887 million. The figures for administrative expenses exclude managing agency profit commission, which is disclosed separately within overall expenses. The main reason for the small rise in the expense ratio in 2007 was a large increase in managing agent profit commission, following an excellent profit in 2006, partly offset by a profit on exchange for the year of GBP 115 million (2006: loss on exchange of GBP 226 million). Into 2008 and 2009, A.M. Best expects upward pressure on expenses as brokers extract higher commissions from underwriters in a softening market.

Exhibit 5

Summary of Results (2003-2007, Pro Forma Financial Statements)

(GBP Millions)

	2003	2004	2005	2006	2007
Gross Written Premium	16,422	14,614	14,982	16,414	16,366
Net Written Premium	12,250	11,734	11,770	13,201	13,256
Net Earned Premium	11,711	11,797	11,785	12,688	13,097
Net Incurred Claims	6,697	7,646	9,505	6,219	6,547
Net Operating Expenses	3,892	3,685	3,785	4,101	4,566
Underwriting Result	**1,122**	**466**	**-1,505**	**2,368**	**1,984**
Other Expenses	-250	-266	-96	-367	-145
Investment Return	1,020	1,167	1,498	1,661	2,007
Profit on Ordinary Activities	**1,892**	**1,367**	**-103**	**3,662**	**3,846**
Loss Ratio	57%	65%	81%	49%	50%
Expense Ratio	32%	31%	32%	31%	34%
A.M. Best Combined Ratio	89%	96%	113%	80%	84%
Investment Income Ratio	9%	10%	13%	13%	15%
Operating Ratio	80%	86%	100%	67%	69%

Source: Lloyd's Annual Report, A.M. Best Co.

In 2007, the market's total investment income increased to GBP 2 billion (2006: GBP 1.7 billion), supported by an increase in invested assets. The overall investment income ratio was stable at approximately 15%. Income from syndicates' premium trust funds makes the largest contribution to Lloyd's overall investment income and is largely driven by returns in the U.S. dollar and sterling fixed income markets, owing to the high proportion of business transacted in these currencies. In 2007, the high credit quality of these investments insulated Lloyd's from volatility in the fixed income sector caused by the collapse of confidence in the credit markets. The premium trust funds produced a 5.2% return (2006: 4.2%), the highest return for the last five years.

The return on Central Fund assets also rose, increasing to 6.5% from 3.2% in 2006. A significant proportion of Central Fund assets comprise proceeds from the subordinated loan notes issued by the Society of Lloyd's and are held to immunise the long-tail liabilities of the Society of Lloyd's. Consequently, the return on these investments is subject to volatility. The return on members' funds at Lloyd's was stable at 6%. Subprime related losses were insignificant across the market as a whole.

Looking ahead, poor bond returns and low U.S. yields are likely to dampen Lloyd's investment return in 2008. A.M. Best believes this may serve to increase focus on underwriting as rates soften, because syndicates will be unable to rely upon investment returns to provide adequate cover for poor underwriting performance.

Exhibit 6 shows the class of business breakdown in Lloyd's performance based on the aggregate accounts. The three ratios shown – accident year loss ratio, prior year reserve movement and expense ratio – are components of the calendar year combined ratio for each class.

The chart shows that on a calendar year basis, all classes contributed positively to Lloyd's overall underwriting performance in 2007. Those classes exposed to U.S. catastrophes, namely energy, reinsurance and property, produced a particularly strong performance on both an accident and calendar year basis, supported by attractive, albeit deteriorating, market conditions, relatively benign loss experience and the stabilisation of reserves for 2005's U.S. hurricanes.

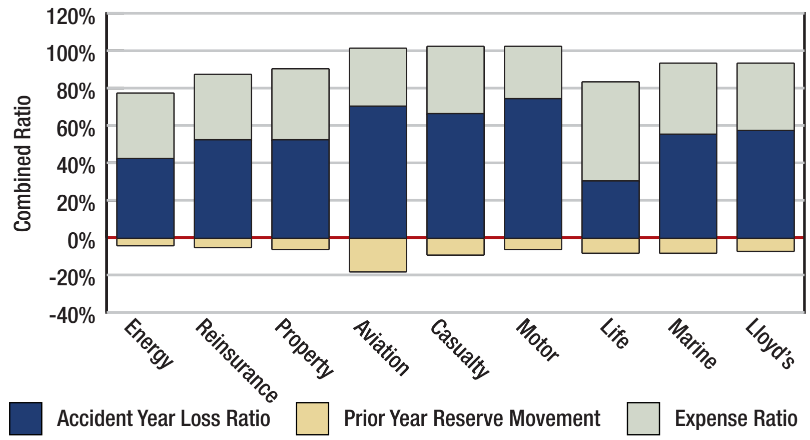
Aviation business performed poorly on an accident year basis, due to a sharp increase in loss experience and ongoing rate softening. However, a substantial prior year release reduced the combined ratio to an excellent 83%. In the casualty sector, downward pressure on premium rates pushed the accident year result into deficit, and a calendar year profit was dependent upon surpluses in respect of business written between 2002 and 2006. 2001 and prior years developed within expectations. The marine sector produced a strong accident year performance, as syndicates largely avoided material losses in the global hull and protection and indemnity markets. Motor profits remained dependent upon prior year releases, as a combination of higher claims costs and weaker market conditions resulted in an accident year combined ratio of 105% for the sector.

Lloyd's overall performance represents the aggregate performance of its separate trading businesses and may include outstanding performance from Lloyd's better businesses, as well as weak performance at the other end of the scale. As such, Lloyd's performance is not directly comparable to that of other insurers because Lloyd's results have not been actively managed at the centre in the way that the performance of an insurance company is. The Franchise Performance Directorate has a role in agreeing business plans and monitoring performance, but Lloyd's remains a market of competing businesses, each with its own separate decision-making processes. Exhibit 7 shows the quartile split in Lloyd's combined ratio. In 2007, the strongest performing quartile produced an average combined ratio of 70%, as compared with 104% produced by the weakest performing quartile.

Open Year Performance

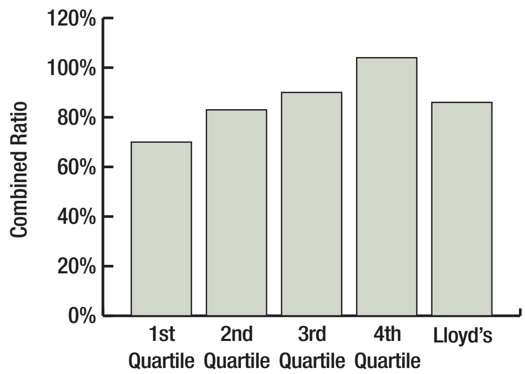
A.M. Best anticipates an excellent profit for the 2006 year of account (under Lloyd's traditional three-year accounting regime), in excess of GBP 2 billion, owing to exceptionally benign

Exhibit 6
Combined Ratios by Business Class (2007)



Source: Lloyd's

Exhibit 7
Combined Ratios by Quartile (2007)



Note: Combined ratings are stated prior to elimination of transactions between syndicates and the Society.
Source: Lloyd's

Exhibit 8
Global Net Incurred Loss Ratios (2001-2007)

Quarter	2001	2002	2003	2004	2005	2006	2007
1	1.1%	0.7%	0.7%	1.1%	2.1%	0.9%	1.2%
2	4.7%	2.5%	2.6%	3.0%	4.3%	2.6%	3.7%
3	15.2%	7.3%	6.1%	9.8%	14.0%	6.5%	8.9%
4	32.1%	15.9%	12.1%	21.6%	36.9%	12.9%	16.8%
5	44.2%	25.1%	19.1%	30.9%	47.2%	19.9%	
6	58.3%	32.7%	24.6%	39.3%	57.3%	27.0%	
7	67.5%	39.6%	30.1%	46.1%	65.7%	33.4%	
8	74.5%	45.4%	34.4%	55.4%	70.6%	38.5%	
9	80.0%	48.8%	36.8%	59.0%	72.5%		
10	87.2%	51.8%	38.9%	61.4%	74.8%		
11	93.4%	54.0%	40.3%	62.7%	76.9%		
12	96.0%	55.3%	40.2%	63.5%	78.5%		

Note: Denominator is estimated 12th quarter net premium (net of brokerage). Net incurred loss ratios exclude IBNR provisions.
Source: Lloyd's

claims experience and a favourable rating environment. Although performance is likely to deteriorate for the 2007 year, below-average catastrophe experience and attractive rates for some lines of business are likely to support a strong result. The 2005 underwriting year of account was boosted by reserve surpluses and closed at a profit of GBP 340 million. Taking into account the magnitude of the 2005 U.S. hurricanes, A.M. Best believes this represents a strong result for Lloyd's.

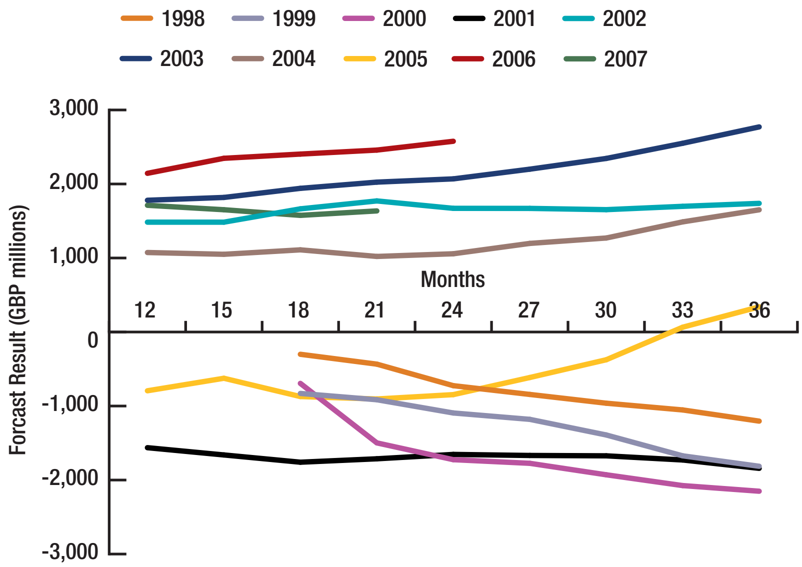
The expectation of weaker performance in 2007 compared with 2006 is supported by **Exhibit 8**, which shows development in Lloyd's loss ratios (including paid and outstanding claims net of brokerage). Market conditions have continued to deteriorate in 2008, and A.M. Best anticipates a further reduction in underwriting profits. Final performance will of course be dependent on a number of factors, including the incidence of natural catastrophes.

The move to annual accounting at Lloyd's has reduced the relevance of its open year forecasts. However, Lloyd's has not replaced these forecasts with annually accounted estimates or guidance for investors at this stage. In the absence of an alternative, **Exhibit 9** shows the progression in Lloyd's forecasts on a three year basis (the amalgamation of individual syndicate forecasts from managing agents) together with the ultimate result achieved after 36 months (for all years up to 2005).

The chart shows that for the 2005 year of account, Lloyd's significantly underestimated the profit finally achieved. Given the magnitude of the hurricane losses and difficulties all insurers encountered in producing reliable estimates, it is unsurprising that forecasts for the year exhibited volatility. Estimates for the 2007 and 2006 years of account are expected to be more reliable, reflecting low catastrophe activity. Looking forward, A.M. Best believes that Lloyd's is now subjecting syndicates to a higher level of scrutiny, and this is likely to be reflected in more realistic forecasts than seen during the previous soft market, when losses were consistently underestimated.

The Society of Lloyd's
Consolidated accounts for the Society of Lloyd's incorporate all Lloyd's activities

Exhibit 9
Global Forecasts (1998-2007)



Note: Forecasts are in respect of pure year performance except for certain syndicates that have included prior year forecasts in the Syndicate Quarterly Returns.
Source: Lloyd's

other than the underwriting market, which is covered in the aggregate accounts. The purpose of the Society is to facilitate underwriting of insurance business within Lloyd's by members and to protect members' interests.

The Society produced a surplus after tax in 2007 of GBP 164 million, an increase from a surplus of GBP 84 million in 2006. The increase was primarily attributable to higher members' Central Fund contributions, reflecting higher capacity in the year, and a reduction in Central Fund claims and provisions of GBP 134 million, partly offset by a contribution of GBP 90 million in respect of the Equitas-Berkshire Hathaway transaction.

In 2007, members supported the Central Fund partly through conventional contributions (1% of overall premium limit) and partly through interest-bearing loans from syndicate premiums trust funds (0.75% of overall premium limit). In 2007, the syndicate loans were replaced by funds from the Society's GBP 500 million subordinated debt issue and, in 2008, the conventional contribution rate was reduced to 0.5%.

Capitalisation

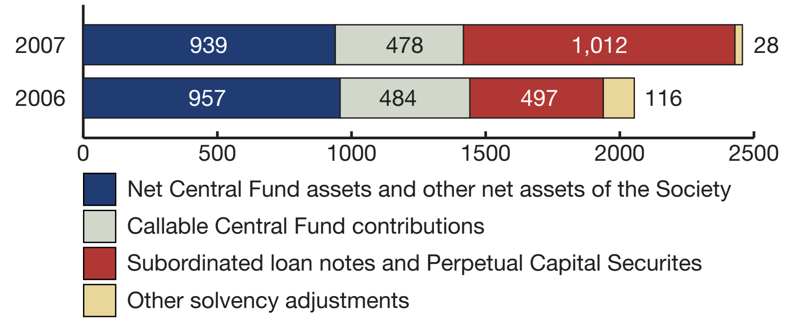
A.M. Best expects Lloyd's central solvency capital to stay strong through 2008 and in 2009, remaining at a comparable level to year-end 2007 (GBP 2,457 million). At this level, A.M. Best believes there is sufficient tolerance within central assets to withstand a significant stress scenario without threatening the market's solvency. A stable overall position in 2008 reflects an anticipated reduction in the callable Central Fund contributions, offset by a small increase in the Society's net assets. In 2007, the Society's GBP 500 million subordinated debt issue replaced syndicate loans, reducing the cost of mutuality for members and providing a more stable resource to Lloyd's that does not fluctuate with market capacity. In 2008, following a review of central capital adequacy, Lloyd's further reduced the cost of mutuality by lowering the members' contribution rate to 0.5% from 1%. From 2008 onward, the contribution rate is charged on gross premiums written rather than capacity.

Further ahead, A.M. Best does not anticipate large, unforeseen drawdowns on Central Fund assets, reflecting diminished strain on central assets from insolvent members. A further reduction in the number of syndicate years of account in run-off is anticipated, owing in part to the risk-based oversight of existing syndicates by the Franchise Board and an increase in the availability of reasonably priced reinsurance to close (RITC) transactions. In the medium term, the members' contribution rate is expected to remain stable at 0.5% instead of fluctuating with market performance as it has in recent years. Central assets for solvency purposes are expected to remain above GBP 2 billion.

Over the period 2009-10, A.M. Best anticipates a reduction in Lloyd's capacity as weakening market conditions restrict the range of profitable opportunities available to underwriters. Capital is supplied by members on an annual basis, and an important factor in A.M. Best's analysis of Lloyd's is its ability to retain and attract capital to support continued trading. Lloyd's capital is provided by a diverse mix of sources, including U.K.-listed companies, private individuals and insurance industry sources in Bermuda, the United States and the rest of the world.

Despite deteriorating market conditions, A.M. Best believes that underwriting discipline at Lloyd's is likely to be maintained through 2008 and into 2009. Whilst capacity remained stable in 2008 at approximately GBP 16.0 billion, overall, existing syndicates reduced stamp by 5% and new entrants provided the balance of capacity. Although new capital is entering the market during a downturn in the underwriting cycle, A.M. Best believes Lloyd's has a rigorous process in place to

Exhibit 10
Central Assets for Solvency (2006-2007)
(GBP Millions)



Source: Lloyd's Annual Report 2007

assess and monitor the syndicates, overseen by the Franchise Performance Directorate, which is likely to protect overall market performance and central capital. In addition, corporate members underwriting on new syndicates are required to contribute to the Central Fund at a higher rate for their first three years of operations at Lloyd's. The rate for 2007 was 2.5%. The capital requirement for new syndicates is also higher, with ICAs given an additional 20% loading.

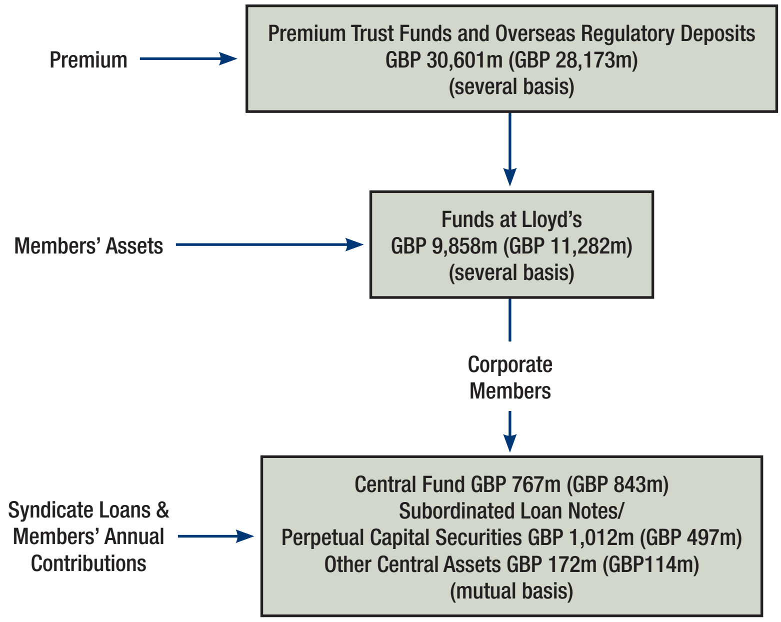
The Corporation of Lloyd's is responsible for setting both member and central capital. Lloyd's has made significant progress integrating ICAs into its member level capital-setting process. As a result, A.M. Best believes capital is aligned with risk in a more efficient and equitable manner than the risk-based capital (RBC) system used at Lloyd's previously. A.M. Best also believes that Lloyd's modelling now enables the potential severity of loss to the Central Fund to be taken into account. Implementation of the ICAS regime in Lloyd's provided an opportunity to improve on the RBC system used to determine funds at Lloyd's requirements for members. The RBC system was a rule driven system based on market average performance.

Overall Capitalisation

A.M. Best believes total capital available to support Lloyd's liabilities is likely to remain excellent. This assessment of overall capital strength factors the potential impact of future drawdowns by existing insolvent members and the successful completion of phase one of the two-phase transaction to reinsure and subsequently transfer the insurance liabilities of Equitas.

Any assessment of Lloyd's overall capital strength is complicated by the compartmentalisation of capital at member level. The first two links in the 'Chain of Security' are on a several rather than joint basis, meaning that any member need only meet their share of claims. However, the third and final link in the chain, Lloyd's central assets, is available, at the discretion of the Council of Lloyd's, to meet liabilities that any member is unable to meet in full and comprises the Central Fund and the net assets of the Corporation of Lloyd's. It is the existence of this partially mutualising third link, and the liquid Central Fund in particular, that is the basis for a market level rating.

Exhibit 11
Chain of Security



Note: Figures are shown as at 31 December 2007 (31 December 2006)
Source: Lloyd's Annual Report 2006 and 2007

Central assets available to meet unpaid cash calls rose in 2007 to GBP 1,951 million (excluding the subordinated debt liability and the callable layer), from GBP 1,454 million in the previous year. This exceeded A.M. Best's expectations, largely due to an improvement in Central Fund recoveries and a release of provisions established to meet unpaid cash calls of insolvent members. The syndicate loans were repaid during the year with part of the proceeds of the June 2007 GBP 500 million subordinated debt issue.

A.M. Best's believes the protection provided for Lloyd's policyholders by central assets is likely to remain excellent in 2008 and 2009. In this analysis, A.M. Best has included the Central Fund, the net assets of the corporation and subordinated debt. A.M. Best anticipates that taken together, these central assets are likely to remain stable in 2008 at approximately GBP 2 billion.

Lloyd's total net resources were equivalent to 152% of net syndicate technical provisions at 31 December 2007 (2006: 149%). Net resources, after deduction of liabilities and adjusted for differences between IFRS and U.K. GAAP in the Society financial statements, represent 109% (2006: 101%) of net written premium income. The improvement in both these ratios principally reflects an increase in syndicate level assets.

In addition to maintaining adequate resources at market level, Lloyd's must also demonstrate solvency at member level. In this context, Lloyd's "solvency" is taken to mean the extent to which aggregate members' solvency shortfalls are covered by central assets for solvency purposes. Lloyd's undertakes continuous internal solvency monitoring. Lloyd's solvency position continued to improve in 2007, with deficiencies covered approximately 14.6 times by central assets (2006: 8.1 times), owing to a reduction in solvency deficits and a sharp increase in central assets. A.M Best expects Lloyd's solvency position to remain strong through 2008 and in 2009.

Implementation of ICAS at Lloyd's

A.M. Best believes that application of the FSA's ICAS regime to Lloyd's has resulted in a higher level of scrutiny of Lloyd's capitalisation and has led to capital requirements for members that more closely match the risks to which the members are exposed. Under the regime, managing agents conduct an Individual Capital Assessment (ICA) to assess the capital needs of each managed syndicate. The FSA requires Lloyd's to assess the adequacy of these ICAs and the reasonableness of the calculation methodologies and assumptions used.

Both stress scenario and stochastic model-based approaches can be used by managing agents when calculating a syndicate ICA. Agents using stochastic models must be able to demonstrate that checks or reasonableness tests have been performed on model outputs. Where stress and scenario tests are used, the managing agent must be able to satisfy Lloyd's that the tests undertaken are appropriate to a syndicate's business and are sufficiently extreme to reflect a 99.5% confidence level. ICAs continue to be prepared on a one year time horizon.

As the implementation of Solvency II approaches, A.M. Best expects Lloyd's to work with syndicates to ensure that ICAs are embedded within the risk management framework and day-to-day operations of each managing agency. Syndicate ICAs are also expected to increase to reflect the impact of softer underwriting conditions.

In addition to reviewing syndicate ICAs, Lloyd's makes its own assessment of its capital needs, taking into account other business objectives, including maintenance of its brand, commercial position and financial strength rating. Lloyd's refers to this as its Economic Capital Assessment, or ECA. In 2008, Lloyd's arrived at the ECA by applying an uplift of 35% to the syndicate ICAs.

A.M. Best believes the introduction of syndicate ICAs has contributed to a marked improvement in Lloyd's knowledge of the risks faced by each of its trading businesses. Furthermore, enhancements to the analysis of the risks faced by Lloyd's as a whole for the purpose of producing the market level ICA for the Society of Lloyd's have led to a better understanding of the likelihood of claims being made upon central assets. Lloyd's uses syndicate ICAs as the key input to its stochastic model driving the underwriting risk component of the ICA for the Society. Lloyd's has also been able to use its stochastic model to assess the security of the Central Fund beyond the 99.5% threshold required for ICAs, taking into account both frequency and severity of loss.

The broad objective behind implementation of ICAS at Lloyd's was to ensure that managing agents take responsibility for the risks affecting capital needs of syndicates. Until 2005, Lloyd's used its own risk-based capital (RBC) system to assess members' capital requirements. Lloyd's continues to use the RBC model as a benchmark, and in 2006 changes were made to the RBC parameters to create a model that is more sensitive to the market cycle. For the 2007 year of account, syndicate capital was set within a 20% corridor (plus or minus 20%) of the capital level that would have been required using the RBC model. For the 2008 year of account and onward, the corridor has been removed.

Exhibit 12
Total Aggregate Resources (2006-2007)
(GBP Millions)

	2006	2007
Premium Trust Funds	28,173	30,601
Funds at Lloyd's	11,282	9,858
Net Central Fund Assets	843	767
Subordinated Debt	497	516
Subordinated Perpetual Capital Securities	–	496
Net Assets of the Corporation	114	172
Elimination of syndicate loan and interest receivable	-219	–
Total Resources of the Society	**40,690**	**42,410**

Source: Lloyd's Annual Report 2007

The RBC model continues to be used to set the initial capital requirements for new syndicates that are not able to produce a full ICA prior to commencing underwriting. Initial capital requirements are set using the RBC model benchmark plus a 20% new syndicate loading. Managing agents are required to submit a full ICA document to Lloyd's at the next formal submission date.

Catastrophe Exposure

A.M. Best also views Lloyd's catastrophe modelling work as vital in improving its ability to assess market exposure to large losses and hence improve confidence in overall risk-based capital strength. Lloyd's Realistic Disaster Scenarios (RDSs) are defined in detail annually by Lloyd's and are used to evaluate aggregate market exposures as well as the exposure of each syndicate to those specific events. Syndicate level scenarios are prepared by each managing agent, reflecting the particular characteristics of the business each syndicate writes.

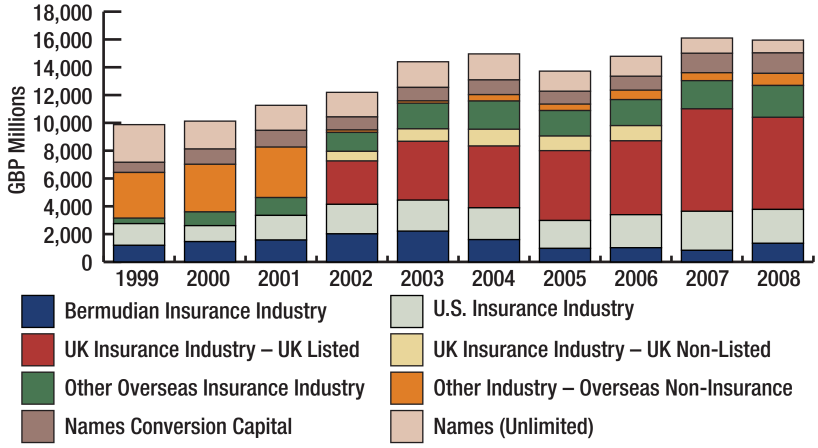
Following an overhaul in the wake of 2005 loss experience, the event scenarios have remained relatively consistent since 2006, although the size of events has increased to reflect underlying insurable values and demographic changes. For 2008, the political risk scenario was updated to reflect the changing political environment. A.M. Best anticipates that a U.K. flood scenario will be included in 2009.

Financial Flexibility

In A.M. Best's opinion, the quality of the insurance industry members of Lloyd's is a source of strength for the market. In 2008, the overall underwriting capacity of the market (net of acquisition costs) was stable at approximately GBP 16 billion. Several new overseas investors, particularly Bermudian companies, began underwriting at Lloyd's, attracted by the diverse underwriting portfolios written by Lloyd's syndicates and by the market's network of licences. Participation at Lloyd's was principally achieved through acquisition, although some companies chose to form new syndicates. Conversely, existing U.K. and U.S. investors reduced capacity in response to the deteriorating rating environment. Nevertheless, the U.K. and U.S. insurance industry remain the largest investor groups, representing 42% and 15% of the market's overall capacity, respectively. For 2009, A.M. Best anticipates a reduction in overall capacity at Lloyd's

Exhibit 13

Composition of Capital (1999-2008)



Source: Lloyd's

as market conditions soften and several syndicates elect to decrease underwriting as part of a more defensive underwriting approach.

A.M. Best believes that the diversity of Lloyd's capital structure enhances its financial flexibility. Approximately 15% of Lloyd's 2008 capacity is provided by private individuals (Names underwriting with either limited or unlimited liability), providing Lloyd's with a significant alternative source of capital, which may benefit Lloyd's when the insurance industry experiences capital constraints. The composition of Lloyd's capital 1999-2008 is shown in **Exhibit 13.**

Since the mid 1990s, there has been a trend for managing agents to become integrated Lloyd's vehicles, managing aligned capital only, and thereby reducing the number of syndicates accessible to private capital. As part of its three-year plan, Lloyd's conducted a review of the annual venture structure, which provides the means by which members can leave and join syndicates each year and facilitates the participation of private capital. The review addressed the commercial issues associated with unaligned capital, particularly the constraints imposed upon managing agents in respect of business planning and reaction to business opportunities, and the need to increase the attractiveness of this capital source to a wider group of managing agents. As a result, Lloyd's identified two key models through which private capital could participate: a more flexible agency agreement and special-purpose reinsurance syndicates. For the 2008 year of account, private capital fell 4%.

Reserve quality

Post-1992 reserving

Looking forward, A.M. Best does not expect prior year reserve deterioration to have a significant bearing on Lloyd's. Claims development for U.S. casualty business written in soft market conditions between 1997 and 2001 appears to have stabilised, and A.M. Best believes there is scope for releases from reserves for 2002 and subsequent years. In addition, although uncertainty as to the magnitude of subprime related losses is likely to persist, direct losses from this source are not expected to be substantial, owing to a material reduction in the market's exposure to large U.S. financial institutions since 2000.

Lloyd's as a whole has improved its reserving procedures and methodologies. There has been a concerted effort to address issues that may affect the entire market, including the major catastrophes and issues relating to large scale liability claims. All syndicate reserves are subject to actuarial sign-off, and this process is monitored by the Lloyd's Actuary.

In 2007, the overall surplus on prior years of GBP 856 million (2006: GBP 270 million) exceeded A.M. Best's expectation for the year. Positive development was driven by releases from reserves held in respect of business written between 2002 and 2006 for all major classes of business. In addition, following deterioration of GBP 415 million in 2006, estimates for 2005's U.S. hurricanes were stable. Reserves for 2001 and prior remained within expectations for a second year, suggesting that syndicates may have addressed the legacy issues that led to substantial reserve strengthening between 2001 and 2004. Overall, run-off years reported a deficit of GBP 48 million, as compared to a deficit of GBP 3 million in 2006.

A.M. Best believes the impact of run-off syndicates on prior year reserve movements is likely to diminish, owing in part to an anticipated reduction in the number of syndicate years of account in run-off. Work by the Franchise Board to identify and assist operating syndicates with problems is likely to reduce the number of new syndicates going into run-off each year. In addition, Lloyd's has strengthened its monitoring of run-off years and, as part of its strategic plan, has implemented a project to improve management of run-off syndicates, with a focus on promoting efficiency and finding a means to close syndicates. Significant progress was made during 2007 and as at year-end the number of syndicate years of account in run-off had fallen to 54 from 90 the previous year. The substantial reduction was partly due to an increase in the number of insurers writing third-party RITC business.

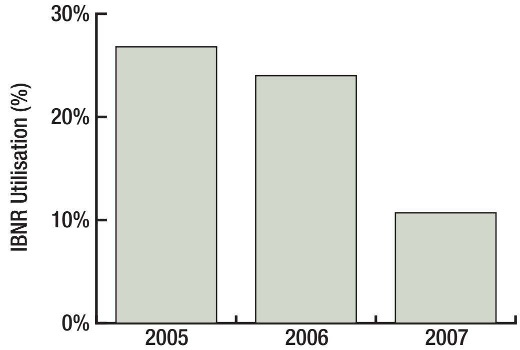
Exhibit 14 shows the declining trend in net incurred but not reported (IBNR) utilisation as a percentage of the overall IBNR amount in the period 2005-07. A.M. Best expects this favourable trend in IBNR utilisation to persist in the near term as 2002 and post underwriting years continue to develop favourably.

1992 and prior reserving: Equitas

In A.M. Best's view, the completion of phase one of the retrocession and run-off contract between Equitas and National Indemnity Co. (NICO) has substantially reduced Lloyd's exposure to uncertainty relating to Equitas' reserve development. This uncertainty has been a long-term term offsetting factor for the Lloyd's rating, albeit diminishing more recently.

Phase one of the agreement with NICO, a subsidiary of Berkshire Hathaway Inc, provides Equitas with USD 14.4 billion of reinsurance cover for a premium comprising all of Equitas' assets less GBP 172 million and an overall contribution of GBP 90 million from Lloyd's. The protection under the contract is USD 5.7 billion after taking account of Equitas' undiscounted claims reserves of USD 8.7 billion (at 31 March 2006). This significantly reduces Lloyd's potential exposure to any future failure at Equitas through the application of overseas deposits and the assets of present-day Names who also underwrote prior to 1993, as well as through Lioncover and Centrewrite.

Exhibit 14
Net Year-End IBNR Utilisation (2007)



Source: Lloyd's

A.M. Best believes the implementation of phase two, which will transfer liabilities of reinsured Names and provide additional reinsurance of USD 1.3 billion, would also be beneficial to Lloyd's. However, there are a number of hurdles to overcome before phase two can be implemented, including a change in U.K. legislation and High Court approval. Even if both these obstacles are overcome, the transfer may not be recognised by all overseas jurisdictions.

Liquidity

In A.M. Best's opinion, Lloyd's is likely to maintain good overall liquidity in 2008. The level of members' premium trust funds and overseas deposits increased 9.5% to GBP 30,601 million in 2007 (2006: GBP 27,954). In addition, the value of the central fund, corporation assets and subordinated debt increased to a total of GBP 1,951 million (from GBP 1,454 million in 2006), largely due to a second subordinated debt issue in July 2007 of GBP 500 million. The funds were partly used to repay all syndicate loans.

Lloyd's is required to hold trust funds in certain regions to support its underwriting operations. In 2007, Lloyd's negotiated a reduction in funding requirements in Switzerland and in respect of U.S. situs business, which led to the release of USD 500 million. Lloyd's continues to work with advisors and U.S. regulators to reduce the gross funding requirements in respect of insurance liabilities in the United States.

The high-quality assets held by syndicates have helped to provide insulation against losses arising from the subprime crisis in 2007. This strategy led to the highest investment return for the last five years, due to the high credit quality of most investment portfolios. The exposure of central assets to subprime losses was limited.

Lloyd's continuously monitors projected liquidity for its central assets, which are tailored to meet the disbursement requirements of the Corporation of Lloyd's and the Central Fund. Lloyd's also monitors liquidity levels at the individual syndicate level as part of its capital adequacy review.

In 2007, for the first time syndicates were allowed to combine premium trust funds and FAL for the purposes of investment management. However, few syndicates have taken up this option.

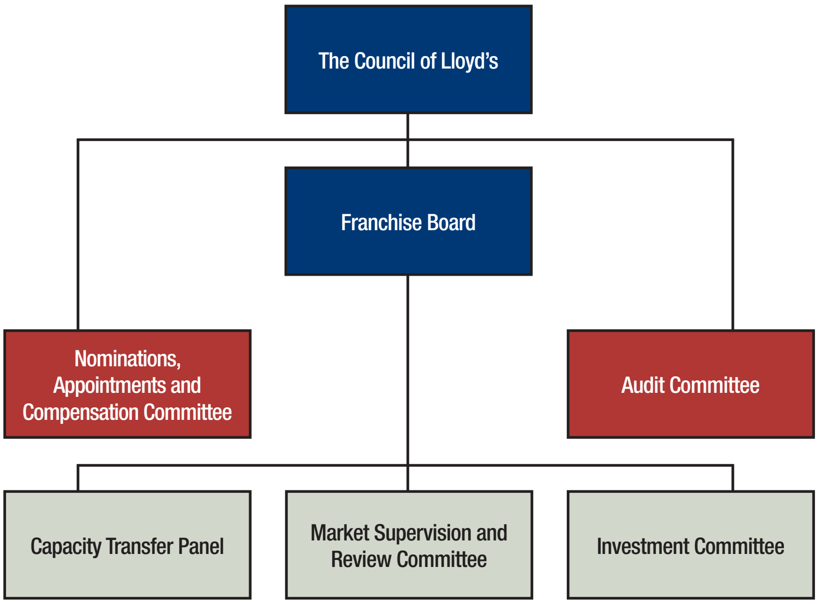
Management

A.M. Best believes that Lloyd's multi-layered approach to enterprise risk management (ERM) has promoted a strong awareness of risk both within syndicates and in the Society as a whole. As well as each syndicate taking responsibility for its own ERM, a managing agent review panel, referred to as the Lloyd's G5 Committee, makes an assessment of individual market franchisees for internal use. Additionally, Lloyd's manages risks that affect the market as a whole through its Risk Committee, which focuses on franchise and Corporation of Lloyd's risks.

The Risk Committee's function is to ensure that all risks within the six major categories defined by the Financial Services Authority (insurance risk, operational risk, group and capital risk, credit risk, financial markets risk, liquidity risk), plus a seventh defined by Lloyd's as regulatory risk, are identified and managed in accordance with Lloyd's risk policy. The Risk Committee utilises a system of continuous assessment to identify where risk resides, what each risk is and the frequency with which it should be monitored. For each risk in the register, a risk appetite is defined which is approved annually by the Risk Committee, Executive Team and Franchise Board. In A.M. Best's opinion, this approach enables Lloyd's to clearly articulate its risk appetite.

Franchisee risk is monitored by the G5 committee, which meets monthly and is attended by key members of Lloyd's management team. Syndicates are continually monitored against key indicators of risk and performance using a risk matrix covering the same seven major risk categories looked at by the Risk Committee. The focus is on ensuring that each syndicate meets or exceeds Lloyd's stated minimum standards. The purpose of the committee is to bring together franchisee risk and performance

Exhibit 15
Governance Structure



Source: Lloyd's Annual Report 2007

issues enabling coordinated decision making. Included within the monitoring process is the annual Individual Capital Adequacy (ICA) assessment and reviews of each syndicate's annual business plan (Syndicate Business Forecast) and Realistic Disaster Scenarios.

Central to the governance structure of Lloyd's is the Franchise Board. The main aim of the Franchise Board is to take an active role in overseeing trading activities within the Lloyd's market from a commercial perspective. The impact on Lloyd's performance of this approach is yet to be tested across a full market cycle. However, A.M. Best believes the catastrophe events of 2005 and the subsequent financial performance of Lloyd's provide some evidence of its effectiveness.

In A.M. Best's opinion, the franchise concept is a constructive approach by Lloyd's to improving its performance and strategic direction. Lloyd's monitors its syndicates closely and remains abreast of the leading trends that can have an impact on future performance through a network of different functional departments. The franchise structure gives Lloyd's a clear focus on its downside risk with detailed performance analysis, increased sophistication in capital modelling, a clear strategy for claims and reinsurance recoveries, coordination of risk management across the franchise, and management of open years and syndicate run-offs all being drawn together to control risk and exposure. This will, at least, facilitate an early response from Lloyd's to any future performance problems.

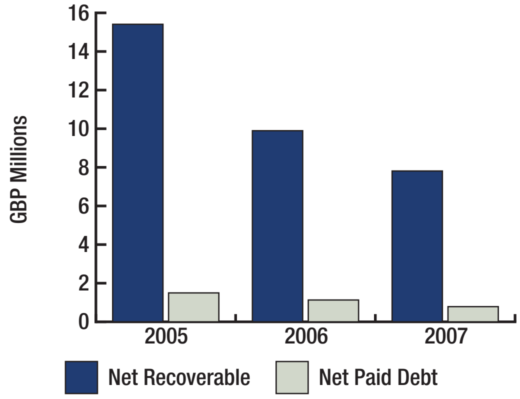
However, A.M. Best has some reservations as to how effective this management structure will be during a period of highly competitive market conditions and anticipates that it will be tested during the 2008 to 2010 financial years. Lloyd's remains a market of competing businesses, each with its own independent management structure, many of which report to large, external industry parent companies. It remains to be seen whether during a period of softening market conditions, Lloyd's management philosophy can interplay effectively with the separate commercial and possibly conflicting objectives of Lloyd's constituent businesses and their owners. The events of 2004 and 2005 served to postpone the downward phase in the cycle, but challenges to the structure are likely to be faced over the next three years. The Franchise Board objective of managing market performance across the cycle, without at the same time managing Lloyd's business mix will, in A.M. Best's opinion, be particularly difficult to accomplish.

The Franchise Performance Directorate is responsible for approving syndicates' business plans and monitoring performance quarterly, both against each syndicate's original plan and actual results for similar types of business written by other syndicates. One of the main aims is to identity significant underperformers and 'outliers'. In these cases, Lloyd's requires managing agents to explain underperformance and will either facilitate improved performance or apply constraints where necessary. Constraints include limiting premium volume from a certain line of business or insisting that a syndicate purchase additional reinsurance to cover overexposure to a particular realistic disaster scenario. A key tool in this work was the creation of loss ratio benchmarks by risk code to determine average and median performance.

Reinsurance

Reinsurance is purchased at syndicate level, rather than centrally by Lloyd's. In 2007, 20% of gross premiums were ceded on an aggregate level. This level has fallen relative to earlier this decade, when gross premiums ceded to reinsurers reached a peak of 31% in 2001. Cession levels have remained largely stable over the last few years. The fall compared to 2001 is partly due to the trend toward fewer but larger syndicates and also reflects the Franchise Performance Directorate's focus on this area in its review of syndicate business plans and quarterly performance monitoring.

Exhibit 16
Reinsurance Debtors (2005-2007)



Source: Lloyd's

It is the responsibility of managing agencies to vet the reinsurance companies they use. Reference is made to rating agency opinions, in addition to market knowledge on aspects such as "willingness to pay". Syndicates' reinsurance purchasing is also reviewed by Lloyd's in order to monitor concentration of exposure with a particular reinsurer that could affect the financial strength of the market. In 2007, approximately 95% of reinsurance assets related to entities with a minimum rating of "A-". Lloyd's analysis suggests that syndicate reinsurance assets are well spread among reinsurers. The top 10 reinsurers in 2007 accounted for just under 40% of total reinsurance assets.

In A.M. Best's opinion, Lloyd's continues to provide adequately for bad debt. Net recoverables fell 21% to GBP 7,811 million at year-end 2007 from GBP 9,897 million in 2006. The fall reflects the benign claims experience in 2006 and 2007, as well as reinsurance collections on the 2004 and 2005 windstorms. Net debt aged more than 6 months fell to GBP 251 million at year-end 2007, compared to GBP 344 million at year-end 2006. This represents 33% of the total net debt paid, which also fell in 2007 to GBP 786 million compared to GBP 1,130 million at year-end 2006.

Exhibit 16 shows the development in Lloyd's net recoverables and total net paid debt. This shows the substantial decrease in Lloyd's net recoverables, which nearly halved between 2005 and 2007. Net paid debt has also decreased significantly in this period from GBP 1,497 million in 2005 to GBP 786 million in 2007.

Appendix 1

Year-End Gross Premiums Written by Syndicate (2007)

(GBP Millions)

Syndicate	Managing Agent	Gross Premiums Written
33	Hiscox Syndicates Ltd	996
44	Canopius Managing Agents Ltd	2
218	Equity Syndicate Management Ltd	569
260	KGM Underwriting Agencies Ltd	49
308	R J Kiln and Co Ltd	14
318	Beaufort Underwriting Agency Limited	130
382	Hardy (Underwriting Agencies) Ltd	108
386	QBE Underwriting Limited	436
435	Faraday Underwriting Limited	258
457	Munich Re Underwriting Ltd	309
510	R J Kiln and Co Ltd	678
557	R J Kiln and Co Ltd	35
570	Atrium Underwriters Limited	117
609	Atrium Underwriters Limited	173
623	Beazley Furlonge Ltd	179
727	S A Meacock & Company Ltd	63
779	Jubilee Managing Agency Ltd	29
780	Advent Underwriting Limited	137
807	R J Kiln and Co Ltd	145
958	Omega Underwriting Agents Ltd	282
1084	Chaucer Syndicates Ltd	526
1176	Chaucer Syndicates Ltd	22
1183	Talbot Underwriting Ltd	344
1200	Heritage Managing Agency Ltd	325
1206	Sagicor at Lloyds Limited	56
1209	XL London Market Limited	210
1218	Newline Underwriting Mgt Ltd	90
1221	Navigators Underwriting Agency Ltd.	149
1225	AEGIS Managing Agency Ltd	240
1231	Jubilee Managing Agency Ltd	51
1301	Chaucer Syndicates Ltd	69
1400	Imagine Syndicate Management Limited	64
1414	Ascot Underwriting Limited	538
1861	Marlborough Underwriting Agency Ltd	97
1919	Marlborough Underwriting Agency Ltd	91
1965	Argenta Syndicate Management Limited	8
2001	Amlin Underwriting Limited	901
2003	Catlin Underwriting Agencies Ltd	1,215
2007	Novae Syndicates Limited	274
2010	Cathedral Underwriting Limited	212
2112	Spectrum Syndicate Management Limited	12
2121	Argenta Syndicate Management Limited	95
2243	Marlborough Underwriting Agency Ltd	2
2468	Marketform Managing Agency Ltd	110
2488	Ace Underwriting Agencies Ltd	393
2525	Imagine Syndicate Management Limited	42
2526	Imagine Syndicate Management Limited	30
2623	Beazley Furlonge Ltd	753
2791	Managing Agency Partners Limited	342
2987	Brit Syndicates Limited	647
2999	QBE Underwriting Limited	978
3000	Markel Syndicate Management Ltd	197
3010	Cathedral Underwriting Limited	4
3210	Mitsui Sumitomo Insurance Underwriting at Lloyds Limited	360
3245	Heritage Managing Agency Ltd	55
3334	Argenta Syndicate Management Limited	13
3820	Hardy (Underwriting Agencies) Ltd	41
4000	Pembroke Managing Agency Limited	59
4020	Ark Syndicate Management Limited	89
4040	HCC Underwriting Agency Ltd	51
4242	Chaucer Syndicates Ltd	38
4444	Canopius Managing Agents Ltd	469
4455	Diagonal Underwriting Agency Limited	12
4472	Liberty Syndicate Management Ltd	1,045
5000	Travelers Syndicate Management Limited	295
5151	Spectrum Syndicate Management Limited	8
5500	CMGL Syndicate Management Limited	21
5820	Jubilee Managing Agency Ltd	64
6101	Argenta Syndicate Management Limited	77
6102	Argenta Syndicate Management Limited	42
6103	Managing Agency Partners Limited	18
All other syndicates and inter-syndicate RITC adjustment		**-187**
Total		**16,366**

Source: Lloyd's Annual Report 2007

Appendix 2
Managing Agency Groups at 31 December (2007)
(GBP Millions)

Managing Agent	Gross Premiums Written
QBE Underwriting Limited	1,414
Catlin Underwriting Agencies Ltd	1,215
Liberty Syndicate Management Ltd	1,045
Hiscox Syndicates Ltd	996
Beazley Furlonge Ltd	932
Amlin Underwriting Limited	901
R J Kiln and Co Ltd	872
Chaucer Syndicates Ltd	655
Brit Syndicates Limited	647
Equity Syndicate Management Ltd	569
Ascot Underwriting Limited	538
Canopius Managing Agents Ltd	471
Ace Underwriting Agencies Ltd	393
Heritage Managing Agency Ltd	380
Managing Agency Partners Limited	360
Mitsui Sumitomo Insurance Underwriting at Lloyds Limited	360
Talbot Underwriting Ltd	344
Munich Re Underwriting Ltd	309
Travelers Syndicate Management Limited	295
Atrium Underwriters Limited	290
Omega Underwriting Agents Ltd	282
Novae Syndicates Limited	274
Faraday Underwriting Limited	258
AEGIS Managing Agency Ltd	240
Argenta Syndicate Management Limited	235
Cathedral Underwriting Limited	216
XL London Market Limited	210
Markel Syndicate Management Ltd	197
Marlborough Underwriting Agency Ltd	190
Hardy (Underwriting Agencies) Ltd	149
Navigators Underwriting Agency Ltd.	149
Jubilee Managing Agency Ltd	144
Advent Underwriting Limited	137
Imagine Syndicate Management Limited	136
Beaufort Underwriting Agency Limited	130
Marketform Managing Agency Ltd	110
Newline Underwriting Mgt Ltd	90
Ark Syndicate Management Limited	89
S A Meacock & Company Ltd	63
Pembroke Managing Agency Limited	59
Sagicor at Lloyds Limited	56
HCC Underwriting Agency Ltd	51
KGM Underwriting Agencies Ltd	49
CMGL Syndicate Management Limited	21
Spectrum Syndicate Management Limited	20
Diagonal Underwriting Agency Limited	12
All other syndicates and inter-syndicate RITC adjustment	**-187**
Total	**16,366**

Source: Lloyd's Annual report 2007

Appendix 3
Overview of Capacity and Membership (1985-2008)
(GBP Millions)

Year of Account	Individual Gross Allocated Capacity	Individual % of Total	Corporate Gross Allocated Capacity	Corporate % of Total	Total Gross Allocated Capacity	<---------Number of Active Members--------->		
						Individual	Corporate	Total
1985	6,432	100%			6,432	26,019		26,019
1986	8,291	100%			8,291	28,242		28,242
1987	10,039	100%			10,039	30,936		30,936
1988	10,740	100%			10,740	32,433		32,433
1989	10,622	100%			10,622	31,329		31,329
1990	10,742	100%			10,742	28,770		28,770
1991	11,063	100%			11,063	26,539		26,539
1992	9,833	100%			9,833	22,259		22,259
1993	8,784	100%			8,784	19,537		19,537
1994	9,289	85%	1,609	15%	10,898	17,526	94	17,621
1995	7,835	77%	2,360	23%	10,195	14,744	140	14,884
1996	6,985	70%	3,009	30%	9,994	12,798	162	12,960
1997	5,824	56%	4,500	44%	10,324	9,958	202	10,160
1998	4,105	40%	6,064	60%	10,169	6,825	435	7,260
1999	2,700	27%	7,170	73%	9,870	4,503	668	5,171
2000	2,003	20%	8,042	80%	10,045	3,317	853	4,170
2001	1,800	16%	9,258	84%	11,058	2,848	895	3,743
2002	1,766	13%	11,473	87%	13,239	2,466	837	3,303
2003	1,844	12%	13,015	88%	14,859	2,198	762	2,960
2004	1,869	12%	13,223	88%	15,092	2,048	752	2,800
2005	1,445	11%	12,277	89%	13,722	1,625	705	2,330
2006	1,434	10%	13,354	90%	14,788	1,497	714	2,211
2007	1,094	7%	15,008	93%	16,102	1,124	1,007	2,131
2008	921	6%	15,033	94%	15,954	907	1,155	2,062

1. Capacity figures exclude the small amounts that are unallocated in each underwriting year.
2. Only active members are shown. Members who are not underwriting but remain on the electoral register are not included in the figures.
Source: Lloyd's

Appendix 4
Pro Forma Financial Statements (2003-2007)
(GBP Millions)

	2007	2006	2005	2004	2003
Gross Premiums Written	16,366	16,414	14,982	14,614	16,422
Reinsurance Ceded	3,110	3,213	3,212	2,880	4,172
Net Premiums Written	13,256	13,201	11,770	11,734	12,250
Increase/(Decrease) in Gross UPR	-237	-644	230	380	-246
Reinsurers Share in UPR	78	131	-215	-317	-293
Earned Premiums	13,097	12,688	11,785	11,797	11,711
Total Underwriting Income	13,097	12,688	11,785	11,797	11,711
Net Claims Paid	6,226	6,598	6,763	5,420	5,543
Net Increase/(Decrease) in Claims Provision	321	-379	2,742	2,226	1,154
Net Claims Incurred	6,547	6,219	9,505	7,646	6,697
Management Expenses	1117	910	872	880	854
Acquisition Expenses	3,449	3,191	2,913	2,805	3,038
Net Operating Expenses	4,566	4,101	3,785	3,685	3,892
Other Technical Expenses	-115	226	-117	70	30
Total Underwriting Expenses	4,451	4,327	3,668	3,755	3,922
Balance on Technical Account	2,099	2,142	-1,388	396	1,092
Net Investment Income	2,096	1,729	1,498	1,167	1,020
Other Expenses	-349	-209	-213	-196	-220
Profit/(Loss) Before Tax	3,846	3,662	-103	1,367	1,892
Other Recognized Gains and Losses	106	38	42	-22	
Total Recognized Gains and Losses	3,952	3,700	-61	1,345	1,892

Source: Lloyd's Annual Report 2007

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