Monday, December 06, 1999

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

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

Table of Contents

Executive Summary

In 1998 U.S. regulators conducted the first in depth NAIC onsite review of Lloyd's. That review was prompted by a request from Lloyd's for relief from the 100% gross liability funding requirement for U.S. Situs Excess or Surplus Lines Trust Funds. Five states and NAIC staff conducted the review and recommended that the percentage of funding be reduced, subject to a follow-up review of certain Lloyd's new initiatives. The results of that first review were documented in "Lloyd's: A U.S. Regulatory Review" dated September 14, 1998, available on the NAIC web-site (http://www.naic.org) or from the NAIC Publication Department at (816) 374-7259, and copyrighted by the NAIC. The Review Team's report recommended that additional reviews to monitor progress of the new initiatives be performed in future reporting periods. It went on to recommend that based on these additional reviews, US insurance regulators should re-evaluate the appropriate level of funding requirements for Lloyd's US Situs Excess or Surplus Lines Trust Funds.

Pursuant to the conditional recommendation in 1998, the NAIC Surplus Lines (E) Task Force's 1999 charges included:

1. Perform a follow-up on-site review of the structure and workings of Lloyd's in 1999 to revise and update the explanatory brochure for state insurance regulators. Complete fieldwork by May 1999 and complete revisions to the brochure by September 1999.

2. Review the appropriate level of funding for the Lloyd's US Situs trust funds – surplus lines. Complete any fieldwork and make recommendations by June 1999.

An onsite planning trip was conducted in April, 1999, to make a preliminary assessment of Lloyd's progress on 1998 initiatives, to identify any changes or new initiatives subsequent to the 1998 review, and to develop a plan for the 1999 review. The review itself was conducted during a two-week period in June, 1999, by staff of the California, Florida, Louisiana, New York and Texas Departments of Insurance, assisted by staff of the NAIC International Insurers Department.

This report is written in two parts. The first part is an update to Part 1 of the 1998 report describing the organization and operation of Lloyd's. The second part contains the hypotheses tested by the Review Team, the work steps performed, and the resulting observations, conclusions, and recommendations. These are summarized in further detail below.

Part 1 Highlights:

In its over-300 year history, Lloyd's has always been described as a market. Historically, this has been a difficult concept for much of the world outside of Lloyd's to understand. Yet there remains no better description. Its unique structure continues to provide an important alternative to the more widely understood insurance providers. This year's Part 1 approaches the description of Lloyd's from an organizational structure perspective, first discussing Lloyd's the Market by identifying its participants and how those participants work together. Second is a discussion of Lloyd's the Corporation, which carries out the administrative functions such as policy issuance, claims payment, financial reporting, and regulation of the Market.

This 1999 report supplements, updates, and makes frequent references to the 1998 Report, and the reader is encouraged to refer to the 1998 Report for a comprehensive description of Lloyd's. For the hurried reader, the brief overview paragraph leading each section and the description of the Chain of Security on pages 29 through 33 will serve well to give a flavor of that report and to provide an understanding of the security for Lloyd's policyholders.

In this report, the section on Lloyd's the Market identifies the changes occurring within the Lloyd's Membership, specifically the shift from capital provided by individuals to capital provided by corporations and the resulting impacts on the Member's Agents, syndicates, Managing Agents and brokers. The consolidation of syndicates, for efficiency and risk diversification, mirrors the trends to consolidation happening around the world in virtually every industry. In spite of the decrease in the number of syndicates, the utilization capacity remains fairly constant.

At the same time, Lloyd's has strengthened the four links of the Chain of Security. One of the more important events is the purchase of insurance to provide an additional £500 million of coverage over the next five years to the Central Fund.

The section on Lloyd's the Corporation identifies top management goals and specifically discusses the role of the Prudential Supervision Committee, who sets policy for the financial, solvency and capital requirements of the regulated entities within Lloyd's. This section further discusses the changes in the Regulatory Division, the Market Risk Unit and the Market Reporting and Solvency Division, as well as the models and tests used to better control the movement of capital. This section also reviews the reorganization of Insurance Services, as well as other efforts to maximize operating efficiencies and modernize policy processing and claims handling.

The financial modernization legislation in the UK is redefining the role of the Financial Services Authority (FSA), and may impact the regulation of Lloyd's brokers. Lloyd's is progressing in the coordination of their current internal processes with the responsibilities of these newer entities.

Actuarial certification requirements for Lloyd's opining actuaries have added an extra element of qualification to sign Lloyd's opinions. Lloyd's has added a qualified actuary to staff to address solvency issues.

Y2K preparations are on schedule. Equitas continues to be monitored and run-off continues satisfactorily.

In short, Lloyd's is a unique and dynamic organization that has changed greatly in the past few years and will no doubt continue to do so.

Part 2 Highlights:

Part 2 describes the hypotheses tested during the review and the work steps conducted by the team, as well as the team's observations, conclusions and recommendations. The hypotheses and work steps were developed based on the follow-up items identified in the 1998 Report, and on changes identified during the 1999 planning trip and the 1999 review itself.

Like the 1998 review, work steps relied heavily on observations and extensive interviews, from the Chairman and Chief Executive Officer, to department heads and intermediate management, to rank and file employees. The team also had substantive discussions with Market participants, UK regulators, London company market representatives, UK Government and independent actuaries, and the Managing Director of the new General Insurance Standards Council. Appendix 1 lists these individuals.

The Review Team concluded:

- No material evidence was found that the processes and internal controls now in existence were not sufficient to assure quality data and reliable financial reporting.

- The Chain of Security has been strengthened through i) improvements in Funds at Lloyd’s and increases in provisions for assessments to the active market and ii) insurance of the Central Fund, and continues to provide adequate security to policyholders.

- The regulatory division at Lloyd’s continues to develop and improve its oversight process, making use of technological developments and specific monitoring programs for premiums and loss development, and has demonstrated the will to intervene when necessary. On a parallel development, the new Financial Services Authority (FSA) continues to develop and integrate with Lloyd's internal regulatory division, to provide a sufficient overall regulatory structure to support the integrity of the Chain of Security and the operations of the market.

- Actuarial procedures, supported by a qualified actuarial profession, continue to evolve during their second year of actuarial-based reserves to support the soundness of the reserve setting process.

A list of Anticipated Lloyd’s Activities follows the conclusions at the end of this report and identifies areas of interest to US Regulators. The Team has every reason to believe that these are all areas that Lloyd’s will include in its plans or initiatives in one form or another, and recommends that the Task Force monitor their progress.

Regarding the Surplus Lines Task Force charges, (1) the review has been completed; and (2) the Review Team was satisfied that it was not inappropriate to lower the funding level for the US Situs Trust funds from 50% to 30% of liabilities, subject to a $50 million increase in the Joint Asset Trust Fund to $250 million. In making this recommendation, the Review Team is aware that Lloyd's will likely experience underwriting losses for the current open years, and is satisfied that the strengthened Chain of Security and contingency plans are sufficient to maintain policyholder security.

Benefited by the experience and retention of several 1998 Review Team members and by Lloyd’s experience from that first review, the 1999 review probed far deeper into exploring and understanding the workings of Lloyd’s. The Review Team expresses its sincere appreciation to the many people and organizations who made the 1999 review possible and successful. These include:

- the Chairman, Chief Executive Officer, North American Unit and other top management of Lloyd’s who devoted their own time for multiple sessions with the Team to discuss policy and direction, and to support the priority and cooperation shown the Team by all levels of Lloyd’s staff. A special note of appreciation to the Regulatory Division, Lloyd’s internal counterpart to U.S. regulators, for its candor and proactive sharing of information.

- the middle management and staff of Lloyd’s, for pre-review materials and scheduling efforts, for the dedicated time and effort throughout the review, and their continued efforts subsequent to the onsite review time.

- the Managing Agents and Underwriters for the syndicates selected for the 1999 review, who gave valuable perspective on their own operations as well as the market as a whole.

- the Lloyd's Brokers, who provided the London link in tracing U.S. policies through the full cycle process and who provided valuable insight from a broker's perspective.

- the U.S. Stamping Offices, agents and brokers who provided the U.S. links in tracing U.S. policies through the full cycle process.

- the insurance regulators at the UK's Financial Services Authority, for their unceasing willingness to exchange regulatory ideas and information and to update US regulators on the progress and new developments in UK statutory provisions.

- the UK Government Actuary and Office, for their cooperation with the Review Team's own actuaries.

- the management of Equitas, for their time in discussing the progress of Equitas' internal processes, run-off of pre-1993 claims and related financial condition.

- the leadership of the new General Insurance Standards Council, for sharing its vision for the future oversight of London and worldwide brokers bringing business into the Lloyd's and London company markets.

- the London company market representatives, who continue to provide invaluable perspectives on the London and worldwide insurance and reinsurance developments.

- any others who directly or indirectly provided time or information toward the 1999 review and this report.

I would personally like to thank the members of the 1999 Review Team, Woody Girion and Bob Loo, California Department of Insurance; Craig Gardner and Stewart Guerin, Louisiana Department of Insurance; Kay Cleary, Florida Department of Insurance; Bernie Ganley, New York Department of Insurance, Holmes Gwynn and Joy Little, Texas Department of Insurance; and Rob Esson, NAIC International Insurers Department, for their diligent efforts and cooperative team spirit. I would particularly like to thank the NAIC leadership; Louisiana Commissioner Jim Brown, Chairman of the NAIC Surplus Lines Task Force; and our Texas Commissioner Jose Montemayor, Chair of the NAIC International Insurers Department (IID) Plan of Operation Review Group and Team Chief for the 1998 Review Team; for their leadership, for their faith and confidence in me to take a leadership role in the 1999 review, and for the opportunity to experience firsthand the closeness and reliance US markets and regulation share with our worldwide counterparts.

Betty Patterson

Senior Associate Commissioner, Texas Department of Insurance
Team Leader
1999 NAIC Review Team
December, 1999

Part 1 – Structure and Operations of Lloyd's

Part 1 approaches the description of Lloyd's by first describing Lloyd's the Market and then describing Lloyd's the Corporation. The section on the Market identifies the participants and how those participants work together. The section on the Corporation describes the various administrative functions such as policy issuance, claims payment, financial reporting, and regulatory responsibilities.

Within the Lloyd's Market, Members provide the capital to underwrite and bear the risk for insurance policies issued by Lloyd's. The Corporation of Lloyd's provides the business management and processes to facilitate the issuance and service of policies underwritten in the Lloyd's Market, and the financial reporting evidencing the results of Market activity. Ultimately, the Council of Lloyd's supervises and regulates the Lloyd's Market and manages the Corporation. In addition to the following discussions, the reader may wish to refer to ***Lloyd's: A Review by U.S. State Insurance Regulators***, hereafter referred to as the 1998 Report, for a more comprehensive description of the governance structure.

A table updating the numbers contained in the 1998 Report is included as Appendix 2.

Lloyd's – The Market

The Lloyd's Market is comprised of participants who work together for the purpose of providing insurance. Market participants are Members, who supply capital; Member's Agents, which advise Members; syndicates, who underwrites business; Managing Agents, which manage the business operations of syndicates; and Lloyd's Brokers, which bring business into the Market. The 1998 Report, pages 13 - 19, fully describes these participants and the Market's operations. This report concentrates on changes since the 1998 Report and evolving developments in the Market.

The Participants

Two major shifts have occurred at Lloyd's. First, Corporate Members (including conversion vehicles) have increased in number and account for a much larger percentage of the capital and underwriting capacity in the Lloyd's Market, correlated to a decreasing number of Individual Members and their underwriting capacity. Secondly, the number of brokers and syndicates has decreased as consolidations have taken place, not unlike the corporate consolidations taking place in many industries worldwide. These two shifts have occurred while the total underwriting capacity and estimated premium has not fluctuated substantially (see the chart "Premium/Capacity History" under the "Members" section below).

The following table illustrates the shifts in the numbers of market participants.

	1/1/98	1/1/99	% Change
Members	7,260	5,171	-28.8%
Individual	*6,825*	*4,503*	*-35.0%*
Corporate	*435*	*668*	*53.6%*
Member's Agents	19	12	-36.8%
Managing Agents	66	63	-4.5%
Main Syndicates	155	139	-10.3%
Lloyd's Brokers	187	138	-26.2%

Members

The shift from Individual to Corporate Membership took a dramatic upturn in 1998, with 35% fewer Individual Members, and a 54% increase in Corporate Members. At least partially based on the lower certainty of positive underwriting gains some Individuals have chosen to exit the Market or to seek alternative mechanisms that provide greater protection to the Individual's assets. At the same time, Corporate Membership has become attractive. In particular, major world insurers appear to have a strong interest in participating at Lloyd's. Some are satisfied just to participate as members of syndicates; others want to have management capabilities at the syndicate level. Several even prefer to provide 100% of a syndicate's capacity and to own the syndicate's Managing Agent. In spite of the reduction of overall membership, capacity remains very close to the 1997 levels, as illustrated by the following chart.

PREMIUM / CAPACITY HISTORY				*All Figures in £m*		
	1994	**1995**	**1996**	**1997**	**1998**	**1999**
Individual	9,289	7,835	6,985	5,824	4,105	2,700
% of Total Members	*85.24%*	*76.90%*	*69.89%*	*56.41%*	*40.37%*	*27.36%*
Corporate	1,609	2,360	3,009	4,500	6,064	7,170
% of Total Members	*14.76%*	*23.10%*	*30.11%*	*43.59%*	*59.63%*	*72.64%*
Total Capacity	10,898	10,195	9,994	10,324	10,169	9,870
Capacity Utilization	*70.27%*	*78.72%*	*69.80%*	*65.80%*	*72.96%*	
Resulting Premium	**7,658**	**8,025**	**6,976**	**6,793e**	**7,419e**	

Note: 1997-1999 utilization figures are Lloyd's forecasts. During the review period, the exchange rate was approximately *£1 to US$1.75.*

Member's Agents

As the number of Individual Members of Lloyd's has decreased from a maximum of over 34,000 in 1988 to some 2,700 in 1999, so has the need for Member's Agents, whose numbers are now down to twelve.

Presently, private capital makes up almost 35% of the market, although an increasing proportion of this private capital is being provided in the form of limited liability vehicles rather than the traditional unlimited liability bespoke Member. Indications are the trend will continue as individual Members continue to transfer to some type of limited liability mechanism during 1999. Alternative opportunities for Member's Agents are beginning to become available, as Lloyd's seeks ways to keep private capital in the mix of capital providers.

Syndicates

Corporate capital continues to enter the Lloyd's market bringing with it the trend to merge syndicates, to create single back offices and more efficient operating systems. Consolidation of syndicates has also occurred due to the desire of managing agents to form composite syndicates of diversified lines of business to underwrite across multiple sectors.

There are several forms of syndicate participation. The first has no particular name, but is regarded as a traditional syndicate. Such a syndicate has a diverse spread of Members, many of whom are private individuals participating as bespoke Names.

Corporate syndicates are syndicates backed by corporate capital. A syndicate with a single corporate capital provider is often referred to as a dedicated corporate syndicate. If a dedicated corporate syndicate has common ownership of the corporate capital provider and its Managing Agent, it is called an Integrated Lloyd's Vehicle (ILV).

Some corporate syndicates have attempted to gain 100% control of the capital structure of syndicates either through the auction process, capacity offers, or bilateral deals. Such action tends to limit the ability of Individual Names and other spread vehicles to distribute their risk over a number of syndicates. Because Lloyd's still wants to attract individual capital, a consultation document was issued in April 1999 introducing the concept of proportional reinsurance syndicates (PRS). The PRS would reinsure an agreed proportion of the whole account of another syndicate. The PRS will have its own manager who will represent the Members when setting up the reinsurance portfolio.

Lloyd's hopes that the PRS concept will provide a balanced solution toward the needs of the Corporate Members and the Individual Members. Lloyd's intends to introduce this structure as an option available to the market from the 2000 underwriting year forward.

Another option for individual names is to become shareholders in Corporate Members, thus protecting their other personal wealth, to the extent it is not pledged to the Corporate Member.

From an operational standpoint, a newer type of syndicate is a parallel syndicate, brought on by corporate capital. As the name implies, these exist in parallel with another syndicate which is not necessarily controlled by a Corporate Member. Usually, the parallel will be backed by dedicated corporate capital and it will write in parallel with a traditional syndicate, i.e. there is a fixed split of all policies between the two.

Incidental syndicates exist as a part of a parent syndicate. The accounting is done at the parent level. The incidental syndicate has no separate constitution relative to its parent syndicate. It is really just a profit center for the parent, or a marketing convenience. As consolidations in the market have occurred, and pre-existing syndicates have been included under the capital umbrella of larger parent syndicates, the old identity has been retained for the convenience of the brokers and others who are used to dealing with the old syndicate's name and number. The incidental syndicate mechanism enables them to continue to do so, even though in fact the only entity capable of underwriting business is the parent syndicate. Hence, although a policy bears the stamp of the incidental syndicate, only the Membership of the parent syndicate bears the risk.

Managing Agents

The number of Managing Agents has not changed significantly over the past few years. Even though there are fewer Members and main syndicates, the expertise of Managing Agents is still needed and highly regarded – particularly underwriting expertise on a line-by-line basis. Their roles under corporate control may be revised, particularly in the area of allocating capacity by line, or percentage of retention of an individual risk, depending on established corporate goals and objectives.

Brokers

Currently, virtually all business placed in the Lloyd’s Market is arranged through Lloyd’s Brokers.

There were no significant changes in the way Lloyd’s regulates brokers since the 1998 Review. Lloyd’s is statutorily obligated to register Lloyd’s brokers and, currently, Lloyd’s regulates these brokers. However, there is uncertainty as to who will regulate brokers in the future, Lloyd’s or the General Insurance Standards Council (GISC).

The GISC is a recently formed self-regulatory body in the UK. The UK government does not intend to continue to regulate brokers. Consequently, the major insurance bodies in the UK, being the Association of British Insurers, the International Underwriting Association (IUA), Lloyd’s and others have jointly created an organization to effectively provide broker regulation. The GISC is expected to take over the regulation of Lloyd’s Brokers in the future.

As yet undecided is whether the community of brokers registered to access the Lloyd’s Market should be widened and opened up to non-UK intermediaries. Because the GISC will only have authority to deal with UK broker Members, not overseas brokers, there would be a need for regulation of non-UK brokers. Managing agents may be expected to perform due diligence regarding such brokers. Presently, Lloyd’s Regulatory Division verifies the existence of D&O cover, proper client accounting & management, and financial soundness.

The Lloyd's Act requires Lloyd's to ensure brokers are registered. Even if broker regulation is delegated to the GISC, the Lloyd's Regulatory Board will need to perform some measure of regulatory oversight until it is satisfied with the supervision exercised by the GISC.

How the Market Works

The 1998 Report, pages 11-18, describes in detail how the participants work together to create the Lloyd's Market. These interrelations continue very much as they were then. There are, however, evolving pressures and considerations triggered by competition, world economies, and the move to corporate capital, and this may result in changes to the Market in the future.

Inter-relationships Between Participants

The "signing" process continues to enable risk sharing between syndicates, although risk sharing may be diminished with more corporate decision making taking place that affects underwriting.

Reinsurance between syndicates is still significant. Of approximately £2.1 billion in total reinsurance ceded during calendar year 1998, £0.33 billion or 16% was assumed by other syndicates. Systems are in place both at the syndicate and regulatory level to ensure that any spirals are carefully monitored and the exposures controlled.

The effect of corporate capital in the market, which tends to focus more long term, coupled with the "soft" market, may help explain the projected loss ratio deterioration anticipated for the current years.

Annual venture

Over the past year, there has continued to be an intermittent debate regarding the retention of the annual venture, with a degree of controversy over a prediction by the prior Chief Executive Officer of its eventual decline. There seems little doubt that, all other things being equal, many of the corporate capital providers would prefer to do away with the annual venture and therefore move to continuous capital. This would also mean the end of the reinsurance-to-close process, and would probably enable the current three-year accounting system to move to an annual accounting system.

There is a major roadblock, however, regarding any change in the annual venture. As part of the European Union (common market), the United Kingdom is required to enact and maintain legislation in accordance with European Union directives. At present, the annual venture is effectively enshrined in the European Union's Annex to the Insurance Accounts Directive, and consequently any change would require action at the level of the European Union.

It is envisioned that the only practical change would be to delete the Annex in its entirety, which would mean that all Lloyd's Members would be treated in the same way as other insurance enterprises in the European Union. It is therefore expected that any change would need to embrace all Members of Lloyd's, not, for example, just Corporate Members. Such a change would involve action by the UK Government with the EU in Brussels, and indications are that the time is not yet right for this. Moreover, the process could take a number of years to bring about.

Reinsurance To Close (RITC)

In general, syndicates close their business after three years by reinsuring to close into a succeeding year's syndicate. The last underwriting year to close was 1996, which closed after three years at December 31, 1998. In aggregate, the market declared profits for 1996. Many of the syndicates were profitable, but, for the first time, not all profits were returned to the Members. The main reason for this is the "Glass Test". Under this new test, approved and circulated by the Council in 1998, profits from a closing year may be retained to ensure that there are sufficient Members' funds to cover the higher of all solvency deficits on the open years of account together with a margin or the highest capital requirement of Members for the last three years of account.

Generally, a syndicate will reinsure to close into the next year of account for the same syndicate. When there is no succeeding year of account, the syndicate is then referred to as an orphan syndicate. Orphan syndicates can either endeavor to find a market RITC with another syndicate, or failing that, must be held open to run its liabilities off. Prior to Reconstruction and Renewal (R&R), there were many open syndicate years and many orphan syndicates, but these were all RITC'd into Equitas. Since 1993, there have been far fewer orphan syndicates and open syndicate years.

As of December 31, 1998, there are a total of 17 years of account in run-off for 13 syndicates. The list shown below presents some of the details regarding these open years of account.

Open Syndicates as of December 31, 1998

Synd	Life/Non-Life	Managing agent	Years in Run-Off	Reason Code
0103	Non-Life	P&B Run-off Ltd	1993	1
0240	Life	Chartwell Managing Agents Ltd	1991 1992 1993 1994	6
0256	Non-Life	Turret R/O Services	1993	2
0577	Non-Life	Amlin Underwriting Ltd	1993	3
0687	Non-Life	Amlin Underwriting Ltd	1993	2
0718	Non-Life	Owen & Wilby	1993 1994	4
0923	Non-Life	Chartwell Managing Agents Ltd	1996	6
0947	Non-Life	Chartwell Managing Agents Ltd	1996	6
0950	Non-Life	Turret R/O Services	1993	5
1053	Non-Life	P&B Run-off Ltd	1993	5
1112	Non-Life	Turret R/O Services	1993	3
2923	Non-Life	Chartwell Managing Agents Ltd	1996	6

2947	Non-Life	Chartwell Managing Agents Ltd	1996	6

Reason Codes

1	Syndicate participated in a PA spiral. There are efforts to reach a settlement, but this cannot be done while an action is ongoing by a non-Lloyd's insurer which is seeking to avoid its liabilities on various reinsurance treaties.
2	This year of account is remaining open pending identification of a suitable reinsurance vehicle on commercially acceptable terms.
3	No successor reinsurer has been found due to the unknown effect of a potentially large loss, Turbomeca / Rocky Mountain Helicopter Loss. The original claim was settled in October 1998 and RITC is now being sought.
4	Syndicate 718 wrote a PA LMX account, which while still at an early stage of development, is not showing the pattern of development expected, due mainly to the relatively small number of spiral participants. The main issues facing 718 are the cashflow implications of this LMX portfolio, the characteristics of its current and anticipated claims and the willingness of certain reinsurers to respond to valid claims. This gives a material element of uncertainty so it is prudent to leave the years open.
5	At 12/31/1997 the Board considered it appropriate to defer recommendation to Names for a quote for RITC until the potential bad debt position of a non-Lloyd's insurer had been clarified. No estimate from their liquidator of amounts to be paid to creditors is yet available.
6	Uncertainty re pattern and ultimate settlement on Extended Warranty business. On this type of business, the policy exposure remains open years after the policy itself expired. Appendix 3 discusses this situation in more detail.

Chain of Security

Of primary interest to U.S. Regulators is the Chain of Security that backs Lloyd’s policies. Although the form of security differs from that of traditional insurance companies, the Lloyd’s market has provided a secure financial structure that has operated well, even when tested by the losses which led to Lloyd’s Reconstruction and Renewal.

In the 1998 Report, pages 28-33, the four links in the Chain of Security backing Lloyd’s policies; i.e. the Premium Trust Funds, Funds at Lloyd’s (FAL), Other Personal Wealth (OPW), and the Central Fund, were set forth in detail.

Several important changes have been made in the Chain of Security since the 1998 Report. The following chart shows the percentage changes for the minimum requirements for FAL (2nd link) as well as the changing requirements for OPW (3rd link). The transitional credit is a concession to the Individual Names so that they can phase in the new minimum capital requirements that will put the Individuals on the same basis as Corporate Members for minimum capital requirements. These are discussed in more detail in the following sections.

	1998		1999		2000	
	Corporate	Individual	Corporate	Individual	Corporate	Individual
Minimum percentage FAL	50%	32½%	50%	35%	45%	40%
OPW requirement	-	7½%	-	10%	-	5%
Transitional credit	-	10%	-	5%	-	-
Minimum capital	50%	50%	50%	50%	45%	45%

The First Link - Premium Trust Funds

Lloyd's Members are now required to fund 50% of their gross U.S. surplus lines liabilities in their U.S. Situs Excess or Surplus Trusts. At the time of the last report, this 50% funding requirement was only applicable to U.S. surplus lines business incepting on or after January 1, 1998. In 1998, the NAIC membership approved an amendment to the IID Plan of Operation providing that the funding was to be 50% of gross liabilities for all U.S. surplus lines business incepting on or after August 1, 1995, subject to a minimum of $600 million. The New York Insurance Department, as the regulator where the trust is domiciled, also agreed to the new funding level.

The change in the level of funding was supported by an increase in the Joint Asset Trust Fund for Surplus Lines from $100 million to $200 million.

Aside from the US premium trust funds, trust funds are held in the U.K. to support Lloyd's business worldwide. The U.K. premium trust funds are subject to FSA and Lloyd's regulatory requirements regarding the deed of trust, qualified investments, credit for reinsurance and other rules.

There also continue to be trust funds backing American business incepting before August 1,1995, specifically the Lloyd's American Trust Fund (LATF), and the Equitas American Trust Fund (EATF). The New York Insurance Department is currently performing an independent review of these funds.

The Second Link - Funds at Lloyd's

The second link in the Chain of Security is a Member's Funds at Lloyd's ("FAL") which constitute the underwriting capital of each Member.

Members' assets comprising their FAL may be held in three trust funds; the Lloyd's deposit, the special reserve fund, and the personal reserve fund. Special investment criteria for FAL are designed to ensure that the assets are readily realizable. Permitted assets include cash, marketable securities (including non-dollar denominated), letters of credit, and bank guarantees.

Historically the level of FAL required from a Member was derived as a percentage of the intended premium capacity. Under the Lloyd's Risk Based Capital (RBC) criteria, the capital required for any Member is the greater of the minimum capital requirement and the RBC calculated value. The RBC model has continued to evolve and is discussed in greater detail later in this report.

At the time of the previous NAIC review, Lloyd's had planned to bring the minimum capital requirements for Individual and Corporate Members into line with each other at 50%. Lloyd's has now determined that the minimum capital should instead be set at 45%. However, the risk based capital (RBC) model has been adjusted to demand greater capital from those Members with underwriting portfolios of a higher risk profile so that the aggregate quantum was unchanged.

In its Global Report and Accounts as of December 31, 1998, Lloyd's reported an increase in the FAL from $10.1bn to $10.9bn.

	31 December 1997	31 December 1998
Lloyd's Deposits	$9,012m	$10,065m
Personal Reserve Funds	$976m	$682m
Special Reserve Funds	$110m	$186m
	$10,098m	$10,933m

A significant proportion of the FAL is provided by third-party guarantees such as Bank Guarantees and Letters of Credit. As of December 31, 1998, such guarantees accounted for 53% of the total FAL.

Criteria for the approval of such guarantees and LOCs for FAL are set by Lloyd's Regulatory Board, which requires the use of standard wordings. Lloyd's restricts any one institution from providing in excess of 7.5% of Lloyd's total net resources or in excess of 20% of the institution's net tangible assets.

LOCs are restricted to being evergreen with an initial validity of at least 5 years and issued or confirmed by a branch of an approved UK credit institution. Further details on the letter of credit rules are available in Appendix 2 to Lloyd's "Membership and Underwriting Conditions and Requirements Bulletin for 1999".

The Third Link - Other Personal Wealth

The third link in the Chain of Security is the other personal wealth (OPW) of Individual Members and any assets of Corporate Members other than FAL. Each Individual Member has been required to show a minimum level of personal wealth of £250,000 of which 60% must be liquid while the other 40% may be less liquid (for example property other than personal private residence), but Members are liable to the full extent of their wealth. Lloyd's has scheduled over the next three years, an increase in the total means, i.e., wealth, which an Individual Member must prove to Lloyd's. The scheduled increases take the minimum total means for Individual Members to £350,000 for the 2002 underwriting year.

As Individual Members exit from Lloyd's, their contribution to the Chain of Security decreases, most notably to the extent of known OPW. Corporate Members are liable to the extent of their net worth but have no requirement to demonstrate any "other personal wealth" beyond its Funds at Lloyd's.

The decrease from year-end 1997 to year-end 1998 is:

	31 December 1997	31 December 1998
Declared Other Personal Wealth	£726m	£560m

.

The Fourth Link - Lloyd's Central Fund

The fourth link in the Chain of Security is the Lloyd's Central Fund (CF). The CF is capitalized by annual contributions made by all Members. At the discretion of the Council of Lloyd's, CF assets are available to meet policyholders' claims in the event of Members being unable to meet their underwriting liabilities through the first three links of the Chain of Security. The CF is similar to a pre-assessment guarantee fund, acting as the ultimate safety net for Lloyd's policyholders. In addition, since January 1997, the CF can be supplemented by an extra $498 million callable from Members' premium trust funds.

From December 31,1997 to December 31, 1998, there was an increase of $113m in Central Fund assets.

	31 December 1997	31 December 1998
"Old" Central Fund	$26m	$61m
New Central Fund	$214m	$291m
Total	$239m	$352m

The "old" Central Fund was revised via a new by-law dated June 5, 1996, largely to fund Equitas with monies from the old fund. Accounting for the two Funds remains separate.

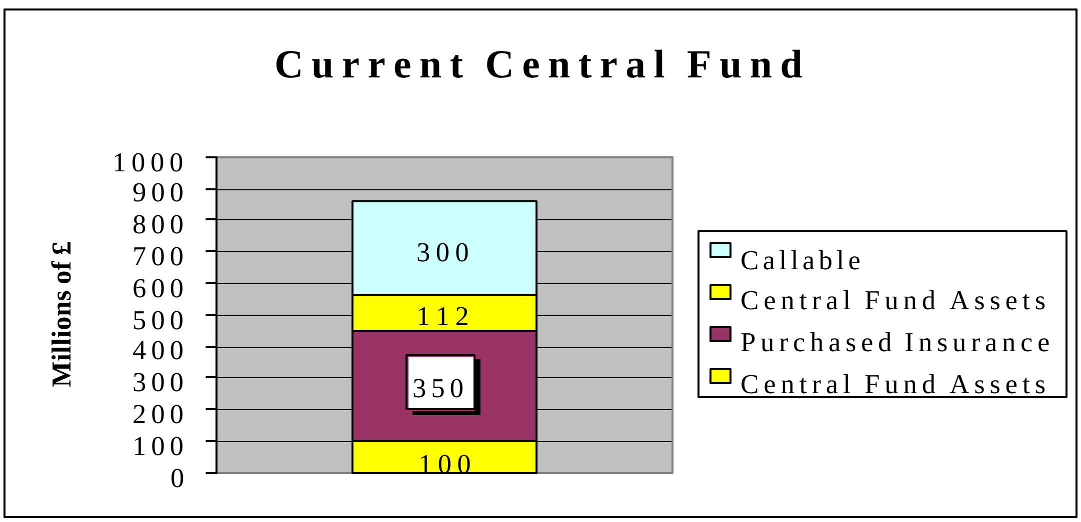
Lloyd's has also worked to design, develop and refine a Stochastic Model which has enabled the testing and modeling of the impact to the Chain of Security of a wide range of modeled loss scenarios derived using both deterministic and Monte Carlo approaches. This model has allowed Lloyd's to perform extensive tests of the resilience of the CF and was used in the pricing of a new insurance policy covering the CF.

Central Fund Insurance

In late April 1999, Lloyd's announced that it had arranged a layer of insurance to protect the Central Fund. The policy, which is effective for each of the next five years (1999 through 2003), has an annual attachment point of £100 million ($166m), an annual limit of £350 million ($582m) and an aggregate maximum limit over the five-year period of £500 million ($830m). The coverage is provided by the six insurers listed below.

	AM BEST	S&P
Swiss Re	A+	AAA
Employers Re	A++	AAA
The St. Paul Companies	A+	AA
Hannover Re	A+	AA+
XL Mid Ocean Re	A+	AA
Chubb Corp	A++	AAA

The chart below demonstrates Central Fund components in a given year. This can change based on drawdowns or increases on a year-to-year basis.



The combined CF is now £862 million, or $1.42 billion, which supports the approximately £7 billion, or $12 billion, in premium written by Lloyd's.

Major Changes to the Market

To summarize, over the last eighteen months there has been significant change and development in the Lloyd's market. Key changes are:

- The movement from individual capital to corporate capital,
- The consolidation of syndicates,
- The strengthening of the Central Fund.

Lloyd's – The Corporation – Administrator of the Market

The administration or governance of the market has had several significant developments since the 1998 Report, pages 35-48. There has been some turnover of top management, the most critical being the retirement of the CEO, Ron Sandler, and elevation of Nick Prettejohn to that position. Mr. Prettejohn was the Managing Director of the North America Unit and the Business Development Unit prior to the promotion. The new Managing Director of the North American Unit is Julian James.

Under the direction of the Council of Lloyd's (and the Market Board and Regulatory Board), Regulatory and Finance work together to regulate and provide the tools to regulate the market participants and to provide new efficiencies toward allocating capital.

The Insurance Services Unit (ISU) continues to have jurisdiction over the Lloyd's Policy Signing Office (LPSO) and the Lloyd's Claims Office (LCO), the two main data centers for Lloyd's. However there have been considerable changes made to these two departments with responsibility for claims data processing being transferred to the LPSO and the LCO Professional Services Unit carrying out claims adjusting and recovery services.

Top Management

Strategically, top management's main goal is ensuring that Lloyd's remains the most attractive market for their customers to place business. Management believes that this will be achieved by ensuring that the market is well regulated, secure and efficient.

The governing bodies continue to be the Council of Lloyd's, the Lloyd's Market Board (LMB), and the Lloyd's Regulatory Board (LRB). Membership on these Committees is usually for three years. Since the 1998 Report, changes have occurred to strengthen Individual Names' voting rights.

Major issues for the Boards include:

- excess capacity in almost all sectors contributing to intense rating pressures,
- restructuring and consolidation within the industry resulting in increased reliance on technology,
- making improvements to the operating efficiency to keep operating costs at competitive levels,

- adequately investing in new technologies to sustain competitive levels.

Boards reporting to the LMB include the Business Development Unit Board, the Insurance Services Unit Board, the Member Services Unit Board, the North America Unit Board, and the Property Services Unit Board.

Committees reporting to the LRB include the Authorization Committee, the Business Conduct Committee, the Monitoring and Investigations Committee, and the Prudential Supervision Committee (PSC). The PSC is the forum where efforts of the Market Risk Unit (MRU; identified below) and Regulatory come together.

Prudential Loadings

The Prudential Supervision Committee (PSC), is a standing committee of Lloyd's Regulatory Board, and is charged with setting policy for the financial solvency and capital requirements of regulated entities and individuals operating in the Lloyd's Market.

The PSC develops "filter loadings" which are applied within the RBC model by the MRU, under Finance which is described later in this report. These are based on syndicates' Realistic Disaster Scenario ("RDS") returns to the Underwriting Agents Department (UAD) Monitoring. The loadings, which address shortcomings in the current RBC model in soft market conditions, have been strengthened for underwriting year 2000.

UAD Monitoring determines loadings of 10% or 20% that are applied to syndicates and agents who are perceived by UAD Monitoring to have management controls sufficiently below average to warrant such an extra capital loading. Key areas assessed by UAD are the agent's strategy and planning, the board and management competence, financial control and compliance, underwriting supervision and control, claims and outwards reinsurance and recoverables. Effective in 1999, these UAD loadings are being disclosed to the relevant parties.

On a day-to-day basis there is liaison between the MRU and the UAD Intelligence Team. The Intelligence Team is responsible for collating both "soft" information, and "hard" information from, for example, exception reports run on the Automated Transaction Monitoring System (ATMS). A consultant developed ATMS, which utilizes the vast transaction level data held within the Corporation by LPSO, in 1998. ATMS allows the analysis of LPSO transaction data, by syndicate, by risk code, by broker, or by county of origin, from the aggregate level down to specific contracts and transactions in seconds.

Regulatory carries out further investigations whenever syndicates show material deviation from their forecasts and business plans. If appropriate, they discuss the case with MRU to determine the impact of the deviation on the syndicate's RBC ratio and the need for any additional loadings.

On a case-by-case basis, MRU and the Regulatory Division liaison regarding the RBC loading to be applied to new syndicates. The Authorizations Department of Regulatory Division sets these loadings. Because new syndicates have no financial track-records, their loadings are based on a more subjective analysis including:

- factors from a syndicate's business plan such as its RDS information,
- its expected reliance on reinsurance,
- the quality of its reinsurers,
- its intended underwriting controls (such as maximum gross lines),
- qualitative factors such as the clarity of the business plan and the Managing Agent's ability to respond speedily to queries.

Liaison will also take place between MRU and Regulatory Authorizations in instances where existing syndicates apply either to increase or to decrease their capacity which will, in general, result in changes to the capital ratios of the underwriting Members.

The MRU also has an important role in protecting the Lloyd's Central Fund, and thus policyholders, by studying systemic risk. They analyze issues that can have an impact across the Market. For example, the data collected by the Regulatory Division in each syndicate's Realistic Disaster Scenario returns can be analyzed to assess the Lloyd's Market's overall reliance on specific reinsurers. There is close liaison between MRU and Regulatory on systemic issues to minimize duplication of data collection and analysis.

Regulatory Division

Regulatory has undergone some restructuring since the 1998 Report. The Policy Unit has been disbanded and its functions transferred to other units. Quality control of information produced by the syndicates has been largely transferred to the Monitoring Unit. Quality control of actuarial opinions was transferred to the Market Reporting and Solvency Department.

Subsequent to the Team’s visit a management change occurred at the top of the Monitoring Unit as Richard Murphy left and was replaced by Stephen Manning.

Regulation of Syndicates

The goal of the Monitoring Unit is to ensure there is a market consisting of well managed syndicates, competently underwritten that are properly managed, monitored and controlled by competent managing agents.

Monitoring has access to a wide variety of data from a number of different sources, which is reviewed throughout the year. The data analyzed includes Realistic Disaster Scenario Returns, Investment Data, Reserving Data, Risk Based Capital, Transaction Monitoring, Auction Reports, Syndicate Business Plans, Syndicate Reports and Accounts, and Analysis Group Reviews. In addition, Monitoring also conducts inspection visits, spot reviews, slip reviews, and themed visits.

Each syndicate is required to make a prescribed annual return of their worst-case scenario; covering eight specified disasters and one alternative. Each scenario requires aggregate exposure, gross loss, PMLs, net loss, and reinsurance recoveries, by class of business. Regulatory also requires all syndicates to identify those reinsurers accounting for 90% of the recoveries on their largest RDS. The re-insurers are then compared to the list of reinsurers with vulnerable security as rated by AM Best and S&P. The transaction monitoring system is also used to spot any potential inward reinsurance, or spirals. Regulatory then conducts follow-up visits to any agents and syndicates highlighted by the analysis.

All syndicates are required to produce business forecasts for the following year of account. The plans are reviewed to ensure that the contents accurately reflect the syndicate’s business intentions. Monitoring has classified the syndicates into various peer groups, based on the type of business written. Each peer group, and therefore each syndicate, is reviewed bi-annually by the Syndicate Analysis Group (SAG), which discusses the current market conditions for the peer group and reviews certain reports providing comparison within the peer group. During each SAG meeting, each syndicate discussed is rated on a scale of 1 to 4 (1 being the worst rating).

Regulation of Lloyd's Brokers

Regulatory regulates all business placed by Lloyd's brokers and umbrella brokers, not just business placed at Lloyd's.

Regulatory is responsible for the admission and monitoring of those entities supplying the Lloyd's Market with premium. Many of those brokers also place business in the company market. Three brokers account for nearly 50% of the business placed at Lloyd's. As well as authorizing new Lloyd's brokers, Regulatory is also responsible for granting consent for the operation of "umbrella" arrangements whereby a non-Lloyd's broker can place business at Lloyd's under the "umbrella" and supervision of a Lloyd's broker.

Much of the Division's attention is focused on the financial position of Lloyd's brokers, and the oversight of Insurance Broking Accounts (IBAs). The IBAs are segregated bank accounts maintained by each broker for all insurance monies, including premiums and claims. Through the Lloyd's Security and Trust Deed, Regulatory has the power to take control of IBA assets, and appoint a receiver, if circumstances dictate.

Brokers are required to submit financial returns annually, or more often as required. Returns detailing each broker's errors & omissions coverage are also submitted annually.

As with syndicates and managing agents, brokers are segregated into peer groups and rated by the Broker Analysis Group (BAG). Each broker is rated 1 to 4 to identify those brokers requiring on-site visits. The Group focuses on the brokers' financial returns, results of previous on-site reviews, past experience with the broker, and soft market information to determine the rating assigned. Regulatory also has the authority to send in reporting accountants to determine the financial viability, or solvency, of a broker.

Regulatory also monitors brokers through the Automated Transaction Monitoring System (ATMS), slip reviews, spot reviews, themed visits, and prudential supervisory reviews. Prudential supervisory reviews are high level reviews performed for the largest brokers on a bi-annual basis.

Regulation of Managing Agents

Regulation of managing agents consists primarily of inspection visits, and Agents Analysis Group (AAG) reviews to ensure adequate systems of control are being utilized. No changes of note have occurred since the 1998 Report.

Regulation of Member's Agents

The Monitoring Unit conducted an on-site review of each Member's agent during 1998. Because Member's agents are becoming increasingly similar to investment advisors, the reviews focused on the Member's agents' competency and the operation of controls to minimize conflicts of interest.

Finance

Like Regulatory, Finance is made up several units. These include Treasury, Market Finance, Taxation, Financial Controller, Market Risk Unit and the Market Reporting & Solvency Department. The latter two were very much within the scope of this review, because they both impact the greater topic of solvency.

Market Risk Unit

The Market Risk Unit (MRU) is part of the Finance Directorate and is primarily a technical services unit providing the tools to more efficiently use capital and further protect Lloyd's by ensuring capital adequacy at the Member level.

Risk Based Capital

In recent years, Lloyd's has developed and used a risk assessment framework to set the capital requirements for its Members. The risk assessment framework determines the required capital for any given Member's underwriting portfolio based on two main factors:

- a risk based capital (RBC) formula,
- loadings applied to agents/syndicates to reflect risk factors not included in the formulaic approach.

RBC is used by Lloyd's to promote the efficient production of capital in relation to the liabilities it supports. RBC reduces the possibility of each Member being required to mutualize the losses of others through calls on the Central Fund (described above as the fourth link in the Chain of Security). By requiring greater FAL for those who have higher risk business, the burden of carrying capital to protect the Central Funds falls more equitably.

RBC Formula

The Lloyd's RBC formula was first applied in 1995 following development work primarily by Tillinghast. RBC requirements have been applied to Corporate Members since 1995 and were extended to Individual Members in 1998. The RBC model was discussed in the 1998 Report.

Since February 1998, there have been further refinements of the RBC model, stemming from the inclusion of an extra year's data. The additional data has allowed the updating of the model's parameters on premium development patterns, claim run-off patterns, intersolvency-category correlation coefficients, expected ultimate discounted combined ratios and standard deviations, the standard deviation of reserve estimates, and the expected ultimate loss ratio by year of account by class of business.

The RBC model has been redesigned to accommodate syndicate level analysis. This has allowed the model to provide, from the 2000 underwriting year, the use of a syndicate's own reinsurance purchases to be included in the RBC calculation rather than simply presuming a market average reinsurance program.

Lloyd's plans on future enhancements to the model which, in the same way that the RBC model was adapted to allow the use of a syndicate's own reinsurance program, will allow the use of a syndicate's own reserves rather than using average levels.

Lloyd’s also outlined a plan to enhance the flexibility of the model by a system of “headroom risk codes”. These are general risk codes which a syndicate may include in its business plan and which, while treated punitively by the RBC model, will allow a syndicate a degree of flexibility in being able to write lines on attractive business opportunities which arise unexpectedly.

The disclosure of UAD loadings has enabled the MRU to issue capital modeling software to Managing Agents to allow the calculation of the capital requirements associated with different business plans.

The Stochastic Model

The staff of MRU has developed and continues to develop a stochastic model for the purpose of providing a mechanism for estimating the overall security afforded by Lloyd's Chain of Security. The probability of losses of a given size impacting the Central Fund can be established given certain assumptions about the net loss profile of each of Lloyd’s risk codes. The results of this model were instrumental in the pricing negotiation of the Central Fund Insurance contract.

Coupled with RBC, Lloyd’s now has two powerful tools for use both in assessing the impact on market security of a wide range of loss scenarios, and in adjusting one or more of the links in the Chain of Security

Market Reporting & Solvency Department

The Market Reporting Solvency Department (MRSD) is part of the Finance Directorate, but like the Market Risk Unit, interfaces heavily with Regulatory. Data calls are made by MRSD to the syndicates and data is returned to this unit. Data quality checks are done here, as well as reasonableness checks. Actuarial opinions are filed by the syndicates and are checked for qualifying language regarding a syndicate’s reserves. A qualified actuary has just been added to the staff of MRSD for the purpose of adding an oversight to the actuarial opinion process, as well as an oversight to the professionalism of the individuals who produce the opinions.

To determine Member level solvency requirements, analysis begins at the syndicate level to determine if cash calls are necessary. The cash calls are passed back to the Members. The annual solvency process requires the managing agent to estimate all current and future liabilities and provide for them. This includes an assessment of the liabilities of the two most recent open years of account. These liabilities are subject to a statement of actuarial opinion.

Punitive Reserves

Subsequent to the NAIC 1999 review, Lloyd’s changed the way punitive reserves are set. If a syndicate is unable to obtain an unqualified actuarial opinion, the FSA will be notified. The Lloyd’s actuary will then set the punitive reserves, keeping the FSA informed. The details of this procedure are set forth in a Market Bulletin dated November 8, 1999 from Market Reporting and Solvency.

Member Level Annual Solvency Tests

The MRSD carries out three types of annual solvency tests. Two are Member level tests, the third is at an aggregate Lloyd's level.

Lloyd's Member Level Test

Members are obligated to keep sufficient funds at Lloyd's to meet their liabilities and to satisfy any request for funds with respect to audited losses or for future liabilities. By examining each Member's underwriting position, it is possible to identify Members who do not have sufficient funds present in their Premium Trust Funds and Funds at Lloyd's to meet their known and unknown outstanding liabilities.

Lloyd's solvency controls require that there are always sufficient assets to cover the liabilities of its Members. Where Members of Lloyd's have insufficient funds at Lloyd's to meet their share of the estimated future liabilities of the syndicates on which they participate, the Central Fund contributes to the assets available to meet their solvency requirements. Once the Member provides sufficient additional resources, the Central Fund is restored.

Members who do not replenish their funds at Lloyd's must reduce their underwriting for the following year. If a Member's funds drops below a minimum level, the Member must cease underwriting.

UK Member Level Test

Under 1997 UK legislation, Members need to meet an additional solvency calculation that requires effectively free funds of each Member per a formula. These requirements mirror those for insurance companies under European Union directives. This solvency test was first effective January 1, 1998. Under this test, Lloyd's must demonstrate that each Member has sufficient assets to meet his liabilities plus a solvency margin. This margin is calculated, individually for each Member, essentially as the greatest of 16% of total annual premium income or 23% of average claims incurred over a three-year period. A credit for reinsurance recoverable is provided, again calculated separately for each Member, but limited to 50% of the liabilities.

Where the requirements to cover the additional margin create or augment a solvency deficiency, in most cases, the Member's FAL will cover the deficiency. In the minority of cases where the deficiency is not fully covered by the Member's FAL, centrally held assets would cover the shortfall. In this respect, the additional test increases policyholder protection by obtaining, at an early stage, additional security from Members who potentially have the greatest exposure to poor underwriting results, thereby reducing the risk of requiring withdrawals from Central Fund assets to pay Members' losses.

Aggregate Annual Solvency Test

The additional test, which complements the two tests previously applied, reflects the fact that Members of Lloyd's have several, not joint, liability, while recognizing that Names do not have unlimited assets and that Lloyd's does have centrally held assets that can be used to cover any shortfalls. It provides policyholders with an additional degree of protection against any adverse development. Should Lloyd's have insufficient central assets to cover Members' solvency shortfalls, then the powers of the FSA to intervene would be automatically triggered.

Lloyd's must also demonstrate that there are sufficient assets to meet an aggregate statutory minimum margin of solvency. Each year Lloyd's files a statutory solvency return with the Financial Services

Authority (FSA). Traditionally, this document is filed at the end of August. The aggregate assets of Lloyd's and its Members have always been more than sufficient to cover this minimum margin.

Coming into Line

An interrelated but separate exercise relates to the 'coming into line' process, which is a prospective look at the ability of a Member to continue to underwrite in the coming year. Hence at December 31, 1998 the coming into line process looks at the 2000 underwriting year. The coming into line calculation is based on the ability of a Member to support the risks written in the subsequent years. Only those Funds at Lloyd's less any open year deficits and open cash calls are taken into account when calculating a Member's underwriting limits for the coming into line process.

Reports Produced For the IID

Approximately 37 states rely on the NAIC's Quarterly Listing of Alien Insurers explicitly for the purpose of determining the eligibility of Lloyd's syndicates to write surplus lines business in their state.

At the beginning of 1999, a rationalization of the reports provided to the IID took place. The purpose of this rationalization was to cut down on duplication of effort and to provide a way for Lloyd's to provide more information in an electronic form more amenable to data manipulation. As part of this rationalization a number of the syndicates return forms (normally referred to by their number such as SR9 or SR16) were modified to show U.S. dollar translations, as well as their original pound sterling numbers. These forms were then provided to the IID on CD-ROM in a Microsoft Excel format. The advantages were ease of data manipulation and data cross check work performed by the MRSD would also tend to preserve data integrity.

In addition, certain schedules are required from the syndicates directly to the IID.

The requirement for a balance sheet and income statement has been met by the provision of the SR2 and SR9 forms. The SR10 form replaces the IID schedule of invested assets, and the SR 11 through SR 13 forms meet the breakdown of other assets, etc. The SR 16 forms, which analyze solvency reserves, are required as a way of cross checking to the actuarial reports. In addition, two other syndicate return forms are requested, which are not required in the case of company filings. These are the SR 14 US dollar business forms and the SR1 form being an analysis of the global results.

The IID forms required, in addition to the syndicate return forms, are a schedule of reinsurance ceded, breaking the recoverables down by company, and a set of loss and premium triangulations by type of business. The types of business are US Situs Business Surplus Lines, US Situs Business Reinsurance, other US business, and rest of world business. These triangulations are then automatically combined into a final triangulation for the syndicate as a whole.

IID forms cross check back to various numbers on the syndicate return forms to ensure that, to the extent possible, the figures reported on the IID forms have been audited. In addition to all these forms, there are the normal IID requirements for a set of interrogatories, audited financial statements and actuarial opinions.

The IID requirements differ somewhat from those required by the New York Insurance Department (NYID) in their role as domiciliary regulator of the Lloyd's trusts. In particular, the NYID requires a schedule of reinsurance ceded for the surplus lines (and reinsurance) trusts specifically. The IID form looks at the reinsurance credit risk for the syndicate as a whole not simply at the Situs trust level. In addition, the NYID requires a Schedule P equivalent showing the loss triangulation for the surplus lines liabilities which differs from the IID triangulations. The IID triangulations are on a signed premium and paid loss basis and do not endeavor to reflect full incurred losses. This is because previous attempts under the IID reporting at a full accrual basis triangulation were very difficult to reconcile. Consequently, the IID felt that the signed premium and paid loss triangulations, which can be directly reconciled to syndicate returns, were more useful.

Role of the New Actuary

In the 1998 report, a recommendation was made that Lloyd's employ a new actuary to assist with central review of syndicates' opinions. Lloyd's has responded to that recommendation and the Market Solvency and Reporting Department has employed an actuary with previous Lloyd's market experience.

The new actuary is to review actuarial opinions and reports, monitor the adequacy of syndicate reserves, and ensure FSA and US regulatory requirements are met. He is to identify problems and issues and to propose changes as needed. Special attention is to be given to reserving for Y2K, and to year-end valuation of liability rules, including the "minimum percentage reserves" (punitive reserves). Revisions to the existing minimum percentage reserve rules have been agreed for the year ending December 31,1999. The revised rules set out that where an unqualified opinion is not obtained, then Lloyd's Actuary will consult with the opining actuary in order to establish solvency reserves required. The Lloyd's actuary will inform the FSA and will provide a detailed actuarial report. Lloyd's Regulatory Division will carry out additional monitoring reviews.

Lloyd's has also introduced two benchmarking systems - one dealing with worldwide reserves, the other with reserves for US Situs business. Actuarial expertise is needed and expected in collecting and validating data for the benchmarking systems. The results of the benchmarking exercise are fed to Regulatory's Monitoring Team for follow-up with the Managing Agents as part of the review process. The new actuary will participate in these on-site reviews when required. .

Regulatory developments make it imperative that the various agencies (FSA, GAD, Lloyd's, the London Market) maintain close working relationships with each other. Lloyd's new actuary is to formalize such relationships among the various members of the actuarial community and to provide a proper basis for exchange of regulatory information.

Insurance Services

The Insurance Services Unit (ISU) is the service arm of Lloyd's. Its goal is to enable syndicates and managing agents to realize shared benefits of scale with respect to business processing. ISU is comprised of five units: LPSO, LCO Professional Services, Agency, IT Services and Commercial Services. These component parts share a common history and rationale – the centralization of people and technology resources to deliver economies of scale within a mutual market place. However, the far-reaching changes in the structure of the market during recent years have necessitated an assessment of the range and nature of their services and the ways in which they are delivered.

During 1998, Lloyd's initiated an extensive and fundamental review of the Insurance Services Unit with the help of external consultants. The review had two principal objectives: first, to identify ways in which significant cost reductions could be achieved; and second, to develop a long-term strategy for business processing and associated technological development.

The drive to reduce costs and improve productivity in the ISU was given added impetus by the decision of Equitas to cease its core usage of Lloyd's processing services by January 2000. Because a significant proportion of the resources of the Lloyd's Claims Office had been devoted to servicing

Equitas, the loss of this business and its associated revenue stream would have a considerable negative effect on the economics of the ISU. As a result of the review, a comprehensive restructuring of the ISU is underway. This has included merging the processing functions of the LCO with those of the Lloyd's Policy Signing Office (LPSO) and the creation of a single IT Services division. The implementation of the restructuring is expected to be completed by the end of 1999, reducing the number of jobs in ISU by approximately 300, and resulting in an annual savings in excess of £10 million.

Currently, there are costs associated with the withdrawal. Although there is no formal agreement related to the withdrawal, Equitas will pay its proportional cost of the downsizing. A formal contract will be entered into for any future services provided.

Reorganization of Insurance Services (LCO and LPSO)

A technological reorganization of processes was instituted for the Lloyd's Policy Signing Office (LPSO) and the Lloyd's Claim Office (LCO) resulting in a new professional service and processing organization. Under the new structure, LCO is now known as LCO Professional Services, and will provide claims adjusting services, peer review of claims and marine recovery services based in London**.** A limited London presence of LPSO, which now handles claims processing, is maintained for face-to-face contact with brokers. Numerous other functions formerly handled by the LCO are now handled by the LPSO as more processes are being transferred to Lloyd's Chatham location. The LPSO will handle claim data entry and advising functions. By next year a more complete review of claims services will have been completed.

The New LPSO

Having completed the consolidation of processing functions into LPSO, a number of changes and reforms are under way to heighten efficiencies and service.

In recent years, the LPSO's method of charging for services provided has changed and will continue to evolve. User pay systems will be instituted, whereby fees will be charged based on usage.

In February 1999 LPSO introduced a File Tracking System to identify the whereabouts of all claims files being handled within LPSO in London and Chatham, and to provide management with statistics on output and productivity. The system uses bar coding technology to create an extensive transaction history. Lloyd's plans to begin using workflow, imaging, and document management in the future. There are plans to extend it to premiums and policies during 2000. This will be an additional tool to track the progress of risks through LPSO as part of the audit trail behind the final reporting packs.

The majority of processing work is now carried out in Chatham, with remaining processing work for certain types of business due to transfer there by the end of 1999. Plans are being considered to merge the user interface of the premiums and claims systems (LIDS and COSS) at the desktop, so that one technician can handle the processing of transactions relating to the same risk at the same time.

98% of non-urgent claims are processed in five days. Urgent claims are processed within a 24 hour turnaround from receipt of the claims file. A chasing system is used for those advised losses where no updated movements have been passed to LPSO over the previous twelve months. The broker is contacted and asked to report the latest position on such claims.

Quality Information System (QIS)

The Quality Information System (QIS) was developed to improve the quality of broker submissions, reduce queries, improve turnaround times and increase productivity. The impetus for the QIS is to reduce the cost of transactions to the market by minimizing rework. The QIS is predominately targeted at the Lloyd's brokers because they provide the bulk of information to the market.

The incoming work from brokers was long perceived to be of a poor standard. However, no management information existed to support that perception. Roughly 20% of the broker submissions were queried because of the perceived problem. Queries range from adding a simple code to redrafting broker policies. Going forward, Lloyd's intends to fix the problems in-house, or with a phone call, whenever possible. As a last resort, Lloyd's will send the policy back to the broker for correction. QIS has enabled LPSO to monitor the progress of brokers' improvements and to provide advice and training assistance where appropriate. However, guaranteed prevention of future errors remains difficult since LPSO has "no teeth" at this time to penalize the broker for poor quality submissions.

Lloyd's As Any Other Insurer (LAAOI)

Lloyd's as any other insurer (LAAOI) is a phrase, which means what it says. People who bring business to the market should be able to deal with the "back office", that is, the administration and processing of business, for business placed at Lloyd's on the same basis as that for business placed with any other insurer. The goal is to do this at least as easily, and with the same or better levels of service, as when business is brought to other risk carriers. The intention is that no barrier to doing business with Lloyd's is created through the continuance of unhelpful practices or the perception of inefficient systems. A key factor in realizing the aims set out in the Lloyd's Market Board document "Priorities for Growth" is international process compliance, i.e. adapting the administrative process to meet emerging international standards, and as far as possible, remove these unique practices peculiar to the market.

Change in Processes

The current planned changes affect how Lloyd's deals with business from the time risks are written to the time all administration and premium movements are completed. The processing of claims is not directly affected at this stage. The changes touch three stages of this continuous process, i.e. Risk Registration, De-linking, and Accounting Splits. The last two of theses three are being undertaken in close co-operation with brokers and the International Underwriting Association (IUA). The IUA via its bureau, the London Processing Center (LPC), already operates a risk registration and premium monitoring regime.

Risk Registration

Risk Registration (and premium monitoring) involves capturing basic information as soon as a risk is written. The first objective is to pass control and responsibility for processing a risk from a Lloyd's broker to Lloyd's, starting from the moment it is written. Consequently it becomes easier to deal with producers of business who are less tolerant or unfamiliar with Lloyd's processes. Secondly, coverage confirmation of signed lines and issuance of insuring documentation can be done earlier in the process. Risk Registration will also improve underwriting by accumulating data to provide league tables showing poor performers, providing faster information to underwriters of their own actual and relative position, reducing 'missed' premiums, and in general, avoid being at a disadvantage with competing company markets.

De-linking

De-linking removes a roadblock to timely premium settlements. Lloyd's does not operate conventional debtor accounts as other insurers do. Instead there is currently an automatic link that ties processing a risk to cash settlement. This link is a disincentive for brokers to move to early processing. De-linking removes the link and replaces it with a settlement trigger (i.e. where a broker initiates payment against a signing number and date). In addition to removing the disincentive, de-linking makes it easier to deal with a wider population of producers. De-linking encourages earlier submission of premium and claims documentation by brokers once signed line information is known – something brokers say they welcome.

Accounting Splits

Historically, Lloyd's brokers have been required to provide LPSO with risk information in a very specific way and, in particular, to provide 'accounting splits' data. Other insurers perform this work in-house. The accounting splits change means this work will be carried out by Lloyd's, just as any other insurer, and delegated to LPSO. Lloyd's will perform splits for the broker; therefore the broker is motivated to utilize Lloyd's services.

This removes one requirement of Lloyd's brokers to deal with Lloyd's in a unique way, and removes a constraint on Lloyd's of dealing only with producers who are willing and able to meet this requirement. Much of the cost benefit will accrue to brokers. Brokers will be able to submit transactions to Lloyd's without the overhead of holding, or presenting data, at a level that is required solely for Lloyd's internal, regulatory, or taxation purposes. It reduces reconciliation problems for brokers and underwriters and means a reduced number of advices to Lloyd's underwriters where a premium is split solely for Lloyd's central requirements.

The quicker that signed lines information is on the system, the sooner it gets to underwriters for verification. It helps provide an environment where policy documentation can be signed and sealed and dispatched, for forwarding to the insured soon after a risk is placed. It will provide information to assist underwriters in production of GAAP style accounts, which may be important for the Corporate Members. Potentially it reduces the additional costs some brokers perceive they incur in closing business to Lloyd's and reduces costs for underwriter organizations by reducing effort in chasing brokers for signed line information, estimating of exposure, capacity and reinsurance.

Central Accounting Settlement & Trust Fund

Central Accounting Settlement between syndicates and brokers takes place on a daily basis. Settlement files are created from the Lloyd's Central Accounting system and an aggregation program is run to combine all the individual contract amounts for each syndicate and broker into a single cash transaction each day for each market player. Paper and electronic advices are created from within the settlement system and are delivered to all affected players two days before the cash movements occur.

The current version of the Lloyd's Central Accounting System is able to settle in virtually any currency, and is currently operating in the following currencies - US Dollars, Sterling, Canadian Dollars, Euro, Australian Dollars, Japanese Yen, Swiss Francs and South African Rands.

New syndicate accounts are set up with Citibank by telex instruction following receipt of a properly authorised request from the Managing Agent. Citibank confirms the account has been set up by sending a telex back to Lloyd's.

Each quarter, a reporting pack is completed by managing agents with respect to each syndicate detailing movements and outstanding liabilities for their Credit for Reinsurance and Surplus Lines Trust Funds, and calculating the necessary top up or repatriation figures. This reporting pack is returned to reporting staff in MRSD. The individual Cash Movement Instructions produced from the pack are sent to the Settlement and Trust Fund Office (STFO) who create electronic credit and debit files which are transmitted to Citibank New York using the same method as for Central Accounting Settlement. The STFO and Citibank New York reconcile these cash movements to the output from the reporting packs.

Data Warehouse

Lloyd's data warehouse contains premium and paid claim data from 1-1-93 to present. The data warehouse was implemented so that the old non-compliant system could be decommissioned, and to meet the growing demands for information requests more effectively. Data flows into the warehouse from LIDS, LORS, and COSS, and is turn utilized by LPSO, other Lloyd's divisions, and selected 3rd parties.

Each year approximately 3,000 routine reports are generated, including those for regulatory agencies. In addition, ad hoc reports are produced and usually available within a week and sometimes within the same day. Most reports are electronic and e-mailed in an Excel format.

Market Wordings Database

The Market Wordings Database (MWD) is an electronic library comprised of over 7,000 of the most commonly used wordings clauses, policy forms and schedules in the London insurance market. The MWD is a joint London Market initiative to promote the speedier production of policies and cover notes by servicing the placing process and issuance of documentation to clients at all stages of the business cycle. The MWD is available to all organizations involved in the business of insurance in the London Market.

Audit of LPSO

In 1985, the syndicate auditors requested that an independent audit of LPSO be conducted. In 1998, there were three audits (January-March, April-September, and October-December). During the review, the team obtained a copy of the report covering the period from 10/1/98 to 12/31/98 in which a qualified opinion was issued. The LPSO audit report identified a deficiency in the physical access procedures for people no longer requiring access to the mainframe computer suite. LPSO responded by stating that IT Services staff are present in the computer suite 24 hours a day and would expect to challenge unauthorized personnel. Except for the preceding issue, the auditors concluded that LPSO's policies and procedures were operating with sufficient effectiveness to provide reasonable assurance that the related control objectives were achieved.

Starting in 1999, there will be a different approach due to a change in audit regulations. For periods less than one year an update may be used instead of an entire report. Therefore, in 1999 LPSO will receive one report plus updates.

Starting in the year 2000, the audit will also include claims processing, which is partly due to regulations in Australia & South Africa.

Year 2000 Preparations

US insurance regulators have taken great steps to determine the preparedness of and financial impact of Year 2000 (Y2K) issues on the US domestic insurance industry. Likewise, Lloyd's has taken steps to ensure the continuing trading abilities of both the Corporation and the Lloyd's Market due to the millennium changeover.

Y2K Internal Processes

Lloyd's Year 2000 Programme Office developed a certification scheme aimed at demonstrating that market entities are taking reasonable steps to achieve Y2K compliance. The scheme consists of four phases: Planning and Control, Internal Testing, Market Testing, and Contingency Planning. Once an entity within the Market has demonstrated compliance with each phase, a validation certificate is issued.

At the request of the Year 2000 Programme Office, an independent external review was conducted of Lloyd's Year 2000 Programme. The external consultant determined that Lloyd's was taking the Year 2000 problem seriously, the Programme addressed all major areas, and that the certification program was an appropriate method of seeking Market compliance. Lloyd's appears to have adequately addressed all recommendations made by the consultant. Among these were the establishment of guidelines for contingency planning, and the establishment of a failure management team.

Lloyd's internal insurance services have been thoroughly tested and found to be compliant. An external consultant was selected to review Insurance Services' two main computer systems: LIDS (Premium) & COSS (Claims) for Y2K compliance. The consultant utilized the "Beyond 1999" automated tool-set and a proven methodology that uses a collection of specially designed procedures to automate the validation of components from many different platforms and languages. This permits identification of dates both expanded and not expanded, windowing procedures, or other processes used to render the date fields Year 2000 compatible. The systems' Y2K readiness appears to have been validated.

In some cases, testing was slightly behind schedule. Some brokers needed dispensations or extensions of time. Dispensations in the timetable for Y2K reporting were given to certain firms until June 30, 1999. These extensions of time were largely due to major system conversions and the need to test only the new ones. The final end-to-end testing revealed minor logistical problems but no Y2K related problems. Most are moving toward business continuity and contingency planning. During the period from December 20 through February 18, information systems staff will not be permitted vacation leave.

Y2K Exposures

Syndicates have attempted to limit their Y2K exposure by the use of exclusionary language, letters of intent and underwriting questionnaires. Silence in the policy language is considered more effective than exclusionary language due to a laundry list of claims that may result from exclusions. In 1998, eight syndicates had written Y2K coverage. Five of these had under £5 million aggregate coverage exposure. Two syndicates retained protection from themselves.

The reinsurance market takes a stronger line, excess of loss side to liability coverage: exclusive rate on reinsurance is approximately 50%. To date, there is no real modeling performed to quantify losses.

The calculation of syndicate solvency reserves must take Y2K exposures into account. The exclusion of these exposures is not acceptable in any circumstances. Any opinion on reserves that have been calculated excluding Y2K exposures will be deemed to be qualified.

Managing agents must consider any potential claims arising from lawsuits such as “sue and labour”. These lawsuits are recognized as being at an early stage in the proceedings, believed to have strong defenses and believed that final judgment is not expected for some considerable time. Managing agents must also consider the need to establish reserves required with respect to likely defense costs associated with these actions.

Agency Department

The Lloyd’s Agency system was established in 1811 at a time when primarily only marine insurance was written and when there were no electronic or other rapid means of communication. Under the original system, agents reported when ships sailed, when ships arrived and when ships were lost.

Today Lloyd’s Corporation has over 400 appointed agents throughout the world. Approximately two dozen of these are located in the US, primarily along the Great Lakes, and the Atlantic, Gulf of Mexico, and Pacific coasts; they can be found in the telephone directory under “Lloyd’s Agent”. Agents may also appoint subagents, today numbering about 500, to gather information in outlying areas. Lloyd’s sets standards for appointment and performance of its agents, and chairs regular regional meetings to inform agents on expectations and to update them on the London Market. Underwriters worldwide use the services of Lloyd’s agents. The London Company Market and company markets in other countries have similar systems that utilize Lloyd’s agents.

The primary responsibility of Lloyd’s agents is to provide shipping and survey information to the Lloyd’s market and the world maritime community. For certain cargo risks an insured, when obtaining insurance coverage through Lloyd’s underwriters, may also obtain a Lloyd’s certificate evidencing the insurable shipment. In the event of loss, a Lloyd’s agent inspects the damages and, if authorized, settles the claim. Approximately 250 of the 400 Lloyd’s agents have this claims settlement authority.

The Lloyd’s Agency system also provides services on behalf of the Lloyd’s market and world maritime community to mitigate total losses by salvage recoveries. These services are operative through a standard Salvage Agreement approved by the Council of Lloyd’s and based on the International Convention on Salvage.

These Lloyd's Agents are not agents in the sense of a Managing General Agent.

Legal Services

The Legal Services Division is a separate Division within Lloyd's, reporting to the Chairman and CEO. As well as providing a range of legal services to the Corporation, they continue to deal with the litigation left over from the reconstruction and renewal (R&R) process. Approximately 5% of the Names did not accept R&R, which required that accepting Names stop any litigation against Lloyd’s. The non-accepting Names are distributed between the UK, US, Canada and Australia and therefore present a multi-jurisdictional problem for Lloyd’s. One can split the caseload of the Legal Services Division philosophically into two separate areas: one being “offensive litigation” while the other would be “defensive litigation”.

Offensive litigation is the situation of Lloyd's suing the non-accepting Names for recovery of debts owed to Lloyd's. As part of the R&R process Lloyd's ultimately paid to Equitas the debts of the non-accepting Names, thereby assuming their obligations. Although all of these recoverables have been written off, Lloyd's continues to pursue recovery of some part of these debts from the non-accepting Names. In total, there is approximately £400 million outstanding. Lloyd's has obtained orders in the UK courts for recovery of its debts, which have been recognized by Illinois courts. However, a similar case in New York, the Grace Case, has not yet been adjudicated even though a hearing regarding the enforcement of the UK order has taken place.

Defensive litigation is the situation of Lloyd's defending itself against various allegations of fraud, etc. in the years leading up to R&R. Many of these cases have been brought outside the UK. Lloyd's has defended itself on the basis of the forum selection clause, which required Names to bring any actions relating to their membership in the UK courts. In the United States Federal courts, all cases regarding Lloyd's forum selection clauses have prevailed. One, the West case in California, remains in state court and awaits trial.

In the UK there is a fraud trial referred to as the "Jaffray Case" which has been postponed to January 2000. Most of the plaintiffs in the Jaffray case are UK Names. A certain amount of publicity will likely surround this case, which will be tried before a judge.

In addition there is an investigation by the US Attorneys Office of the Southern District of New York, which was started in 1996. The basic focus of this inquiry is believed to be non-disclosure in the early 1980's.

There was a case regarding the premium trust deeds. Lloyd's prevailed in the House of Lords, the highest UK court. In this case approximately £21 million had been paid into escrow and represented the proceeds of various successful court actions by action groups prior to R&R. This money will now be paid to Lloyd's and therefore could conceivably release some of the non-acceptors of R&R from liability in the UK.

There are also some actions in both Australia and Canada regarding allegations of fraud in the 1970's and 1980's although the cases are not close to trial. Lloyd's expects that precedents regarding forum selection clauses will prevail in both countries.

Regarding the defensive actions over various allegations of fraud, etc. there have been fifteen major cases, eleven of which have been dismissed entirely, two settled and two, Jaffray and West, are still outstanding.

In addition to these 'offensive' and 'defensive' actions, there are two significant third party cases where Lloyd's is neither a plaintiff nor defendant. These is a case against LeBeouf, Lamb, Greene and MacRae (General Counsel in the United States to Lloyd's Underwriters) and a case against Citibank for breach of fiduciary trust. Lloyd's Legal Services is monitoring both of these cases closely although neither plaintiff is expected to prevail.

Other Departments

Lloyd's has additional support units not discussed here, because they did not directly relate to the charges of the '99 review team. These include Human Resources, Property Services, Corporate Communications, and Member's Services. Likewise there were sub-divisions of some of the major units that were not included within the scope of this review.

Major Changes to the Corporation

The areas of major change since the last review are:

- The Risk Based Capital formula continues to become more sophisticated. The key enhancements relate to improved treatment of reinsurance in the model and fine-tuning of its parameters to reflect the availability of an extra year's data.

- The Market Risk Unit developed the Stochastic Model. It is used to assist Lloyd's in calculating the strength of the Chain of Security under different scenarios. The validity of the stochastic model was an important factor to the carriers who provided the insurance layer for the Central Fund, described below.

- The Central Fund has been supplemented and further protected through the purchase of a £350m xs £100m layer of insurance, with a £500m five-year limit, provided by six A+ rated carriers.

- The Regulatory Division continues to monitor the market for solvency and performance. The recently developed Automated Transaction Monitoring System is now a significant tool to assist the Regulatory Division. Regular inspection visits to syndicates, underwriting agents and brokers have continued. Ad hoc and themed inspections have also taken place. Breaches of disciplinary codes have continued to be prosecuted, although the number of administrative breaches decreased in 1998.

- A new actuary has been appointed into the MRSD staff to further enhance the scrutiny to which existing actuarial reports are subject.

- The LPSO Processing Office has worked to enhance the efficiency of its central services and to increase the cost transparency to its users.

Other Impacts on Lloyd's

Several other organizations impact how Lloyd's does business. The Financial Services Authority is the external regulator, the International Underwriting Association is a chief competitor, and Equitas is the independent runoff company for coverage written before 1993.

Financial Services Authority (FSA)

During the last year, work on the UK Financial Services and Markets Bill has been underway and the Bill has now had its second reading in the House of Commons. The FSA issued a consultation paper, CP16, last November regarding the Future Regulation of Lloyd's, and issued a response paper in June 1999. Both papers are available on the FSA's website, www.fsa.gov.uk. The FSA's preferred approach to the future regulation of Lloyd's is to fully carry out some functions – including authorization & approval of persons – but to require Lloyd's to carry out other functions including prudential regulation using Lloyd's powers under the FSA's direction. Based on the responses to the paper, this was the favored approach.

The FSA expects to collapse the current three part solvency test for Lloyd's into a single test, while expanding the current Statutory Statement of Business to show more detail.

The FSA seems to be generally supportive of the current structure of Risk Based Capital at Lloyd's, although it recognizes that there is always room for improvement.

It is expected that there will be many discussions between the FSA and Lloyd's as the Financial Markets Bill moves forward.

It is expected that the FSA will set minimum standards but that Lloyd's will set a number of important additional or potentially more stringent standards for market participants. The Regulatory Division is expected to continue to be a key player in the protection of the Lloyd's brand and franchise, and as such expects to continue its role in investigations and discipline.

International Underwriting Association (IUA)

The International Underwriting Association (IUA) was created on January 1, 1999 when the former London International Insurance and Reinsurance Market Association (LIRMA) merged with the Institute of London Underwriters (ILU). The ILU had represented marine, aviation, and transport and energy insurers since 1984, while LIRMA was founded in 1991 by reinsurers and non-marine insurers. Membership in the IUA includes most major international insurance and reinsurance groups in the world.

The IUA provides a range of functions for its members, covering research, information, education and training. It also represents members' interests to governments and regulators worldwide.

The IUA is the sole owner of the London Processing Centre (LPC) which is the central service for policy checking, processing, and the settlement of premiums and claims in the London Company Market. The London Market Document Centre was established wherein a broker brings documents to one place for distribution to LPSO or LPC.

Several joint programs between Lloyd's and the London companies market have been undertaken in an effort to improve service delivery, streamline back-office processing and to align Lloyd's procedures and computer systems more closely with the London company market. Some of the initiatives proposed are likely to require significant changes to business processes.

Lloyd's also participates in a forum with the IUA, formally known as the IUA/Lloyd's Forum. The Forum, consisting of the two chairmen and two chief underwriters, for a total of four members, is discussing underwriting capability and delivery of services for company subscriptions. The Forum was established to ensure that the underwriting expertise of the London Market is matched by a modern, flexible and open trading infrastructure and delivers world-class commercial standards of customer service. The Forum's intended goals will likely require significant changes to business processes within Lloyd's.

Equitas

Equitas continues its function as a run-off company of coverage underwritten at Lloyd's pre-1993. The potential exists for Equitas to not have current assets to pay ultimate liabilities and that shortfall to eventually financially impact Lloyd's and/or its Members. For that reason the run-off of Equitas remains of interest. The following Balance Sheet shows remarkably little movement over fiscal year 1998, but more movement in fiscal year 1999. Nevertheless, in both years there was an increase in Equitas' retained surplus. In 1998 Equitas was still identifying claims, because of the poor quality of data it inherited. In fiscal year 1999 Equitas was able to demonstrate a considerably higher degree of control and began the efforts necessary to settle claims and move the company toward its goal of closure, and return premium to the Names.

Equitas Group Balance Sheet

In millions of £

1997 / 1998			*%*
Assets	3/31/97	**3/31/98**	Change
Investments	7,477	**7,554**	1.0%
Reinsurance - Claims Outstanding	3,128	**3,046**	-2.6%
Debtors - Reinsurance & Other	1,977	**1,931**	-2.3%
Other Assets - Cash & Tangible	74	**77**	4.0%
Prepayments & Accrued Income	80	**92**	15.0%
Total Assets	12,736	**12,700**	-0.3%
Liabilities			
Gross Claims Outstanding	11,830	**11,521**	-2.6%
Deposits From Reinsurers	15	**15**	0
Creditors	267	**446**	67.0%
Accruals & Deferred Income	7	**0**	-----
Retained Surplus Funds	617	**718**	16.3%
Total Liabilities	12,736	**12,700**	-0.3%

1998 / 1999			*%*
Assets	3/31/98	**3/31/99**	Change
Investments	7,554	**7,351**	-2.7%
Reinsurance - Claims Outstanding	3,046	**2,312**	-24.1%
Debtors - Reinsurance & Other	1,931	**1,853**	-4.0%
Other Assets - Cash & Tangible	77	**54**	-29.9%
Prepayments & Accrued Income	92	**90**	-2.2%
Total Assets	12,700	**11,660**	-8.2%
Liabilities			
Gross Claims Outstanding	11,521	**10,348**	-10.2%
Deposits From Reinsurers	15	**15**	0
Creditors	446	**525**	17.7%
Accruals & Deferred Income	0	**0**	-----
Retained Surplus Funds	718	**772**	7.5%
Total Liabilities	12,700	**11,660**	-8.2%

Specific changes made by Equitas include a more organized approach toward claims and reinsurance. Claims are receiving executive attention from the most serious down in an effort to close larger claims sooner. The larger claims also have the most serious reinsurance aspects, which still commands a great deal of Equitas manpower to unravel. To better collect reinsurance recoverables, the Actuary has been put in charge of negotiating commutations of reinsurance treaties directly with the reinsurers. The improved organization is reported to have a positive impact on the organization.

The estimate of ultimate liabilities has changed very little since the inception of Equitas, because of a series of offsets. Reserves for asbestos, pollution, and health (APH) remain the most uncertain. Even though the claims environment and legal developments have been stable, loss deterioration within pollution has occurred largely because of settlements that relate to oil companies. Medical and professional indemnity has developed favorably. Loss reserves are discounted at a rate close to the actual rate of return of return expected. In 1998 the discount rate was lowered from 6.0% to 5.25%. Because of favorable bond returns in the U.S. and U.K. the actual yield rate has been considerably higher than the discount rate in the past two years.

Major Changes to Equitas

Equitas has a better understanding of the actual number of claims outstanding. This in turn provides a higher degree of certainty regarding their ultimate liabilities, and gives them better control of their expenses. Reinsurance recoverables still have a high degree of uncertainty, particularly because the spiral effects are difficult to determine. The Actuary has been put in charge of negotiating reinsurance commutations, bringing the negotiations to a quicker resolve. Incurred but not reported (IBNR) losses are now made claim by claim on larger claims, again aiding the settlement of those claims. Surplus has grown, largely because investment returns have exceeded discount rates.

In summary, the financial statements of Equitas continue to be highly qualified and expected to be so for some years to come. This will require continued monitoring.

The Actuarial Profession

The Property and Casualty actuarial role continues to strengthen, as more opinions are required at the syndicate level. If an unqualified actuarial opinion is not obtained for a syndicate's reserves, it is viewed as an extremely serious matter. Since the NAIC review team's visit, Lloyd's has taken additional steps to assure the independence of the opining actuary so that market pressures do not unduly influence solvency reserves.

As is the case in the US, work papers that are understandable to another actuary must support actuarial opinions. Lloyd's now has a staff actuary who can review these work papers.

Government Actuary's Department

The Government Actuary's Department (GAD) continues to provide an actuarial consulting service to government and to certain public sector bodies.

The GAD has been retained by the FSA to review Lloyd's RBC system, including both the objective and subjective formula components. The GAD also reviews Equitas' reserves.

The GAD has provided the FSA with a draft of their RBC review, which was completed subsequent to the NAIC team's visit.

Certification to Perform Lloyd's Actuarial Opinions

The UK actuarial societies have implemented requirements for opining actuaries to obtain and maintain a "Certificate to Provide UK Actuarial Opinions for Lloyd's Syndicates." Application for a certificate must be made every year to the Practising Certificates Committee for approval. The application includes details about the individual's personal and occupation/employment history, and must provide information in sufficient detail to demonstrate qualifications to provide opinions. The committee may impose conditions upon the approval of such a certificate, such as a formal mentor relationship with a more experienced actuary for an applicant who is relatively new to reviewing Lloyd's syndicate reserves.

The application also provides certification that the applicant has read the applicable Guidance Notes, and has completed requisite continuing education and professionalism activities. Credentialling of actuaries to do Lloyd's opinions is rigorous, requiring a high level of experience with Lloyd's opinion work.

Major Changes to the Actuarial Profession

The workload for individual opining actuaries has increased considerably as they now have to do four opinions (UK, Net Overall for NAIC, Gross Surplus Lines for NYID and NAIC, Gross Reinsurance for NYID) for each syndicate. Guidelines are provided and revised annually.

Part 2 – The 1999 Review of Lloyd's

The 1999 Review of Lloyd's was conducted in response to the recommendations and conditions of the 1998 Review for certain improvements by Lloyd's and to follow-up onsite reviews by US regulators to monitor the progress of new initiatives at Lloyd's. This follow-up was documented in the 1999 Charges of the NAIC Surplus Lines (E) Task Force as follows:

1. Perform a follow up on-site review of the structure and workings of Lloyd's in 1999 to revise and update the explanatory brochure for state insurance regulators. Compete fieldwork by May 1999 and complete revisions to the brochure by September 1999.

2. Review the appropriate level of funding for the Lloyd's US Situs trust funds – surplus lines. Complete any fieldwork and make recommendations by June 1999.

Clearly the 1999 review built on the knowledge gained from the first 1998 review, and went more in depth to the processes and strategy of Lloyd's.

The 1999 Review Team was comprised of representatives of the California, Florida, Louisiana, New York and Texas Insurance Departments assisted by staff of the NAIC International Insurers Department. A multi-discipline approach utilized expertise of the Team, specifically in the areas of management, accounting and internal controls, information systems, and actuarial. The review was conducted in two phases: a planning trip in April 1999, identifying a preliminary work plan and changes at Lloyd's since the 1998 Review, and a two-week trip in June 1999, to carry out the work plan and identify additional changes at Lloyd's.

Part 2 describes much of the onsite and subsequent work conducted by the Review Team. The five initial Hypotheses stated below led to the work steps, from which observations were made and conclusions drawn.

Scope & Limitations

The 1999 review was conducted to test the following hypotheses:

1. Lloyd's core processes and internal controls continue to provide a reliable financial reporting infrastructure in an evolving market environment.

2. Security to policyholders continues to be provided by Lloyd's Chain of Security in an equal or greater level than at the previous review.

3. Regulatory processes continue to be sufficient to assure that the processes and infrastructure of Lloyd's supports the integrity of the Chain of Security.

4. Actuarial requirements are sufficient to support the integrity (soundness) of the reserve setting process.

5. All organizations within the Lloyd's Market will continue to be able to trade through and beyond the millennium changeover with little or no business interruption.

The Team set out a number of work steps to examine the validity of the Hypotheses. Several work steps were designed to examine all or some of the Hypotheses in combination. In addition to specific work steps, extensive discussions with Lloyd's personnel and other parties, as well as among Team Members, contributed greatly to the knowledge of the Team regarding Lloyd's and its future.

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

Multiple Hypotheses Work Steps

1. Interviewed key managing agent personnel at six syndicates writing US Situs surplus lines business. Interviews covered type of business written, broker relations, premium remittances, and internal controls. Financial topics covered RBC, reserving, and the actuarial process. Management topics covered the trend to corporate capital, as well as mergers and consolidations. The interviews extended to those syndicates under common management of the managing agent.

2. Syndicates that did not close for closing year 1996 were reviewed to determine the circumstances for not closing.

3. Discussed and compared the reporting requirements of the New York Insurance Department and the IID regarding reinsurance ceded and premium and loss triangles.

Internal Controls (Hypothesis 1) Work Steps

1. Obtained a sample of policies from the Surplus Lines Association of California, and a surplus lines broker domiciled in Louisiana, for the purpose of tracing the policies through the Lloyd's market and the US Situs trust funds.
2. Observed procedures on the Lloyd's market floor for the placement of risks by Lloyd's brokers with syndicate underwriters.
3. Reviewed various phases of the LPSO business processes:

    - Observed and tested, on a limited basis, procedures at Lloyd's Policy Signing Office (LPSO) located in Chatham for receiving placement slips from Lloyd's brokers, for issuing policies, for coding policy submissions by Lloyd's brokers and for capturing policy and premium information related to US business.

    - Observed procedures used by the LPSO for entering and settling claims, including proper coding for US Situs business.

    - Interviewed key personnel within Lloyd's involved in the consolidation of the LCO into the LPSO, as well as the newly formed LCO Professional Services Unit.

    - Interviewed key personnel within both Lloyd's and Equitas regarding the decision by Equitas to cease using Lloyd's core processing services.

    - Reviewed the external limited distribution report on the LPSO by Ernst & Young for the period October 1, 1998 through December 31, 1998.

4. Interviewed staff in Chatham responsible for trust funds and reviewed documentation on quarterly funding of US Situs trust funds.

5. Interviewed the Controller of Agencies to discuss the history and purpose of Lloyd's agency system and to discuss the appointment of Lloyd's worldwide agents and services.

6. Interviewed key personnel within Lloyd's on the cooperative efforts between Lloyd's and the London Company market.

7. Interviewed key personnel within Lloyd's relating to implementation schedule for transactions denominated in the new Euro currency.

8. Interviewed key personnel regarding the turnover rate in the Information Systems staff.

Chain of Security (Hypothesis 2) Work Steps

1. Reviewed the process and timing for solvency tests and coming into line (CIL).

2. Reviewed the Annual Member solvency test and the model used to produce the results.

3. Interviewed Lloyd's internal legal services personnel regarding ongoing litigation both to recover assets from non-accepting Names and to defend against allegations of fraudulent activity.

4. Interviewed a Member's agent regarding changes in capital structures for both natural names and limited liability vehicles that can be used by individuals.

5. Interviewed the Director of Finance regarding the interrelation of FAL potential future losses in the market; and the current limitations and enhancements to the RBC model and RDS.

6. Reviewed Lloyd's factors going into RBC on a name level that determines the funds at Lloyd's.

7. Reviewed the factors used for the new syndicate level RBC.

8. Reviewed the use of the stochastic model, and discussed various models for testing the Central Fund at various levels of the Chain of Security.

9. Reviewed the insurance contract protecting the Central Fund.

10. Interviewed top management regarding claims runoff and the future of Equitas.

11. Observed Regulatory's direct link to Citibank that is used as a tool to monitor syndicates' portfolios.

Regulatory Processes (Hypothesis 3) Work Steps

1. Interviewed key personnel regarding the structure of the Regulatory Division, and any structural changes that have taken place since the prior Review.

2. Reviewed the "**Lloyd's Regulatory Plan for 1999 and Regulatory Report for 1998**".

3. Interviewed key personnel on the functions and responsibilities of the Monitoring Unit.

4. Interviewed key personnel responsible for monitoring Realistic Disaster Scenarios, Reinsurance, and Spirals.

5. Interviewed key personnel responsible for Agent/Syndicate Analysis & Monitoring. Reviewed work papers relating to on-site reviews of managing agents & syndicates.

6. Interviewed key personnel responsible for the Automated Transaction Monitoring System (ATMS).

7. Interviewed key personnel responsible for monitoring Investments & Reserving.

8. Reviewed exception reports and discussed what triggers a Regulatory Division response.

9. Determined how the Capital Adequacy Syndicate Testing (CAST) is applied.

10. Interviewed key personnel responsible for Broker monitoring.

11. Interviewed a Lloyd's Broker regarding the regulation of brokers.

12. Interviewed the Chief Executive of the General Insurance Standards Council (GISC) regarding the progress of Board appointments and implementation plans for regulating brokers in the London Market.

13. Reviewed the structure and performance of the Prudential Supervision Committee.

14. Met with the FSA to discuss the Financial Services and Markets Bill and expected future regulatory changes regarding Lloyd's.

15. Reviewed work papers relating to an ongoing on-site investigation of a managing agent.

Actuarial Processes (Hypothesis 4) Work Steps

1. Interviewed the Chief Actuary, Government Actuary's Department (GAD) regarding her role in monitoring Lloyd's and Equitas, as well as trends in the profession and market cycles.

2. Interviewed Lloyd's new actuary to determine his perception of duties required by this new position.

3. Discussed Lloyd's certification requirements for actuarial opinions with a representative of the certification committee.

4. Reviewed a confidential analysis performed by one of the actuarial houses for Lloyd's regarding the actuarial opinion process.

5. Reviewed the four published Guidance Notes relating to Lloyd's Actuarial Reporting.

6. Discussed reserving methods and procedure with those actuaries opining on selected syndicates' reserves.

7. Discussed with a leading actuary, the UK Actuarial Society certification requirements for Lloyd's actuarial opinions.

8. Interviewed the Equitas actuary about the progress of the runoff and commutation of the reinsurance.

Y2K (Hypothesis 5) Work Steps

1. Interviewed top management regarding the market's overall strategy to become Y2K compliant.

2. Reviewed and determined actions taken by Lloyd's relative to the external audit of its Y2K Programme by Unisys.

3. Interviewed key personnel within Lloyd's to determine that Council members and senior management are aware of and receive regular reports relative to the Corporation's and Market's Y2K readiness.

4. Reviewed the status of Lloyd's Y2K program and goals, as well as the status of Lloyd's Y2K Certification Programme with the manager of the Y2K Programme Office.

5. Confirmed that no changes are planned to Lloyd's Information Systems for the last quarter of 1999.

6. Determined the extent of regulatory oversight performed by the Financial Services Authority (FSA) relating to the Y2K changeover.

7. Determined what Y2K policy exclusions are currently being used.

8. Interviewed LCO management regarding any Y2K claims presented thus far.

Observations

Throughout the course of the two trips to London in 1999, as well as follow up material provided, the Team made a large number of observations, based on the work steps cited, as well as observations made independently of the work steps.

Internal Controls (Hypothesis 1) Observations

1. No changes were noted in the fundamental business processes at Lloyd's since the last review, although Lloyd's Insurance Services Board has sought to streamline operations and reduce costs.

2. No common policy number or other tracking characteristic exists between US Stamping Offices or US brokers and Lloyd's systems. However, the Review Team was able to track several policies through the Lloyd's system by determining which Lloyd's broker placed the business. By knowing who the Lloyd's broker was, the LPSO was able to determine, through direct contact with the Lloyd's broker, the LPSO Signing Number & Date. The Lloyd's broker maintains these unique identifiers which are generally not known to US brokers or stamping offices, greatly complicating the tracking process.

Chain of Security (Hypothesis 2) Observations

1. Lloyd's has established new solvency criteria that are objective, measurable and are more responsive to replenishing capital.

2. Members' capital requirements better reflect the underlying risk assumed.

3. All syndicate US Situs trust funds are held in accounts with Citibank. Regulatory has recently obtained a direct link to the assets held in these funds.

4. Regulatory is currently developing a system to monitor investment concentration, sudden shifts in values and volatility on a daily basis.

5. Regulatory has also developed a reporting facility relating to assets held in Names' FAL, which will allow the monitoring of investments at Name level.

6. Ernst & Young has been commissioned to set up a reserving benchmarking system based on gross figures. Each syndicate's business will be analyzed at solvency code level, where emphasis is placed on market trends rather than purely ultimate loss ratios.

Regulatory Processes (Hypothesis 3) Observations

1. The structure of Regulatory has remained essentially the same, except the work performed by the Policy Group has been reallocated to other areas, either within Regulatory, or MRSD.

2. The Monitoring Unit's aim is to ensure that:

   - There is a market consisting of syndicates competently underwritten, which are properly managed, monitored and controlled by solvent and competent agents;

   - The Central Fund is protected from incompetence, and, as far as is possible, dishonesty;

   - The Central Fund is protected from systemic risk (e.g. spirals, common cause, liability events, etc).

3. The work papers related to the investigation of a managing agent were comprehensive, and compared favorably with US examination work papers.

4. The Regulatory Division continually monitors transactions in the Lloyd's market for the purpose of detecting trends, and to highlight items that needs further investigation. Each day members of the division's staff review 100 slips selected at random. This process reveals inconsistencies, which are investigated with the syndicate, agent, or broker concerned. Through this process, Regulatory is able to spot potential problems and take any action deemed necessary, including deregistration.

5. The transaction monitoring tools available to the Regulatory Division appear to be powerful, and give Regulatory the ability to react proactively to potential problems.

Actuarial Processes (Hypothesis 4) Observations

1. At the close of each year of account each syndicate is required to provide a Statement of Actuarial Opinion before the distribution of any profits or losses. In addition, there are two important checks that are carried out Regulatory.

2. A qualified actuary has been added to the staff of MRSD to provide an extra measure of quality control to the actuarial opinion process.

3. The actuarial profession has an established procedure to admit qualified actuaries to sign actuarial opinions for Lloyd's.

4. The Guidance Notes governing actuarial opinions are regularly updated for changes.

5. Equitas continues to improve its reserve establishment process and overall runoff continues close to prior year projections.

6. Subsequent to the NAIC review team's visit, the MRSD issued a bulletin emphasizing the importance of obtaining an unqualified actuarial opinion and strengthening the independence of the opining actuary.

Y2K (Hypothesis 5) Observations

1. The Director of the Y2K Programme Office reports regularly to The Market Board, Audit Committee and the Insurance Services Board. On a monthly basis, the Y2K Programme Office circulates a monthly status report of the Y2K readiness of underwriting syndicates, Lloyd's brokers and the Corporation to the Lloyd's market.

2. The Y2K Programme Office has implemented the recommendations addressed in the Unisys audit.

3. The regulatory approach taken by the FSA is substantially similar to that taken by US regulators relating to the Y2K changeover.

4. The Actuarial Certifications that are submitted with the syndicates' annual return require the actuary to opine on exposures relative to Y2K issues.

5. At least one syndicate currently offers coverage for Y2K exposures.

6. LCO has established procedures to identify Y2K related claims. As of the date of this report, the claims office has been advised of 36 claims. Payments and reserves for these claims do not appear to be material.

Conclusions Regarding the Hypotheses

1. No material evidence was found that the processes and internal controls now in place were not sufficient to assure quality data and reliable financial reporting.

    - No evidence was found to indicate that control policies and procedures over premium and claims data that Lloyd's receives are insufficient.

    - No evidence was found to indicate that a policy cannot be tracked through the Lloyd's system if sufficient information is known, primarily the LPSO Signing Number & Date.

2. The Chain of Security has been strengthened since the 1998 Report.

    - Risk Based Capital and the Solvency Model are tools that have improved the fairness and timeliness of the capital requirements.

    - The addition of Central Fund insurance has contributed an additional £500 million over the next five years so as to provide an additional layer of protection.

    - There is improved monitoring of FAL.

    - Research continues toward improved reflection of Members' ultimate liabilities on a more timely basis.

3. The Regulatory Division at Lloyd's continues to develop and improve its oversight process making use of technological developments and specific monitoring programs for premiums and loss development, and have demonstrated the will to intervene when necessary.

   - The oversight and monitoring conducted by Regulatory compares favorably to regulatory efforts in the United States. Through initiatives undertaken, Regulatory is in a much-improved position to quickly detect and mitigate the potential for losses across the market.

   - The new FSA oversight continues to develop and integrate with the internal Regulatory Division, to provide a sufficient overall regulatory structure to support the integrity of the Chain of Security, and the operations of the market.

4. Actuarial procedures continue to evolve to support the soundness and credibility of the reserve setting process.

   - The addition of a staff actuary to address solvency issues strengthens the accountability of the reserve setting process.

   - The actuarial profession recognizes and has addressed special Lloyd’s credentialling.

   - Guidance Notes are provided to establish standards required to opine on Lloyd’s reserves.

5. No material evidence was found to anticipate a technical problem with the new millennium.

   - As of the date of this review, indications are that Lloyd’s internal systems have been demonstrated as Y2K compliant. Lloyd’s internal environmental systems (i.e. heat, air conditioning, elevators, building services, etc.) have, where necessary, been remedied.

   - Most managing agents, Members’ agents and brokers have achieved compliance with the required certification phases. Those entities that have not demonstrated compliance have been granted dispensations for valid business reasons.

Anticipated Lloyd’s Activities

The NAIC review team recognizes the progress made since the 1998 Report. The following are areas of importance to US Regulators that the team expects will be perpetuated.

1. Regulatory will be staffed and supported at the level necessary to provide the current high level of service and protection of the credibility of Lloyd’s.

2. The Chain of Security will be monitored and maintained at all levels.

3. Actuarial opinions and the related work products produced by the opining actuaries will be monitored in more depth by the Lloyd’s staff.

4. Actuarially based reserving will be refined to reflect technological developments and new sources of data.

5. Operating efficiency of policy processing and claims administration will continue to be addressed.

6. New financial modernization legislation in the UK will be coordinated with internal regulatory practices.

7. Y2K developments, both systems-related and exposure-related, will be monitored and addressed.

8. Syndicates that are questionable will be monitored and the underlying reasons analyzed.

9. Analysis of the 1998 and 1999 underwriting years will be conducted to determine the causes of unfavorable underwriting results.

For Future NAIC Reviews

1. Verify that the internal regulation of Lloyd's has not diminished due to cost reductions, or other Corporation initiatives.

2. Perform further analysis of the migration from private to corporate capital and its long-term impacts on Lloyd's and the Lloyd's Market.

3. Evaluate changes made to the Lloyd's Regulatory rulebook in its effort to streamline regulation.

4. Determine how the regulation of brokers by Lloyd's has been affected by the GISC.

5. Evaluate the evolving relationship between Regulatory and the FSA.

6. Assess the effects of the Equitas withdrawal from using LPSO processing on both the Lloyd's market and on Equitas.
7. Review the resultant impact of the consolidation of the LCO into the LPSO.
8. Evaluate the status of current and future cooperative efforts between Lloyd's and the London company market.
9. Continue monitoring external reviews of Lloyd's control policies and procedures.
10. Perform more comprehensive tests on Lloyd's premium, claims, reporting, and trust fund systems.
11. Monitor the impact of Y2K on Lloyd's and the London Market.
12. Continue to monitor the underwriting trends and business cycles that may impact the market.
13. Continue to monitor the strength of the Chain of Security.
14. Continue to monitor the run-off of Equitas.

Response to the Charges of the Surplus Lines Task Force

Regarding the first charge, the Review Team has completed their follow-up review. The timeline was by necessity extended, but the time lapse has been helpful in reaching this final product. This document is an update to the 1998 Report.

Regarding the second charge, the Review Team was satisfied that it was not inappropriate to lower the funding level for the US Situs Trust funds from 50% to 30% of liabilities. This is subject to a $50 million increase in the mutualized joint asset trust fund to $250 million for the premium year 2000.

The recommendation is based on the continued progress and improvements in the Members' capitalization requirements. Notable improvements include the use of an improved risk based capital model to better reflect Members' true risk, and a “coming into line” formula that reflects open year loss potential. Also, syndicates complete “realistic disaster scenarios” so as to better prepare for catastrophic events.

The new Central Fund insurance has added a large extra layer of protection to the Central Fund, greatly strengthening the fund for at least the next five years.

The Review Team found that there are new reliable and innovative regulatory controls in monitoring the syndicate results. There is a high degree of confidence in the actuarial based reserving and that the corporation, as well as the syndicates, continue to implement initiatives that have resulted in greater efficiency and a general decrease in expenses.

The Review Team also took comfort in the fact that Lloyd's has developed contingency plans that will enable it to obtain additional security and additional funding in case of adverse development. Although Lloyd's is cognizant that underwriting losses will likely occur for the Market for current open years, management believes that there are sufficient checks and balances to preserve Lloyd's financial strength. The Review Team's conclusions were not inconsistent with this position, including the ability for adjustments on the market should the need arise.

APPENDICES

Appendix 1 – Interview Contacts

Lloyd's

Max Taylor	Chairman
Nick Prettejohn	Chief Executive

North America Unit

Julian James	Managing Director
Al Skwiertz	President and Chief Counsel, Lloyd's America Inc.,
Ed MacKenna	Regional Manager
Anita Hawkins	Regional Executive

Regulatory Division

David Gittings	Director of Regulation

Monitoring

Richard Murphy	General Manger, Monitoring
Kim Fox	Assistant Manager, Monitoring
Chris Denniston	Intelligence Officer
Matthew Chandler	Manager, Business Conduct Review Department
Stephen Manning	Manager, Brokers and Correspondents Department
Tim Coskun	Assistant Manager, Brokers Department
Mark Daly	Assistant Manager, Brokers Department

Enforcement

John Baker	General Manager, Enforcement

Finance Directorate

Bob Hewes	Director of Finance
Market Reporting & Solvency Department	
Pat Hakong	General Manager, MRSD
Bill McConnell, FIA	Actuary, MRSD
Leslie Rosenberg	Assistant Manager, MRSD
Kevin Nethersell	Senior Technical Officer, MRSD
Market Risk Unit	
Roger Sellek	Managing Director, MRU
Andrzej Czernusewicz, FIA	Senior Actuary, MRU
Kathy Walker	Manager, Systemic Risk, MRU
Graham Dennis	Y2K Project Officer, MRU
Capital Structure Projects	
Gavin Steele	Head, Capital Structure Projects

Insurance Services

Michael Taylor	Director of Insurance Services
Lloyd's Claims Office - Professional Services Unit	
Bob Moore	General Manager, LCO Professional Services Unit
LPSO	
Len Bateman	Deputy General Manager + Head of Reinsurance Operations

LPSO - Technical Services Unit

Rob Meyers	Head, Technical Services Unit
Sue Blackman	Insurance Business Consultant, TSU Service Development
Clive Campbell	Insurance Business Consultant, TSU Service Development
John Ticehurst	Insurance Business Consultant, TSU Service Development
Tracy Adie	Principle Insurance Technician, TSU Business Support
Paula Aveil	Principle Insurance Technician, TSU Business Support
Jane Bridger	Principle Insurance Technician, TSU Business Support
Tracey Fewtrell	Principle Insurance Technician, TSU Business Support
Nick Parker	Principal insurance Technician, TSU Business Support
Russell Flood	Manager, TSU System Support
Stuart Goddard	Principle Insurance Technician, TSU System Support

LPSO - Settlement & Trust Fund Operations

Ian Wootten	Manager, STFO
David Whitby	Settlement Supervisor, STFO

LPSO

Alan Williams	Supervisor, LPSO Chatham Barrier
Amanda McGregor	Principle Insurance Technician, Non-Marine Department
Sarah Parrish	Principle Insurance Technician, Non-Marine Department

IT Services

Tim Gregory	General Manager, IT Services
Mike Shepheard	Senior IT Consultant, Systems Development Group

Y2K Programme Office

Ian Simister	Manager, Y2K Programme Office
John Marshallsay	Customer Relations Manager

Agency Department

Mike Stott	Controller of Agencies

Legal Services

James Butler	Director of Legal Services
Nick Demery	Solicitor

LeBoeuf Lamb Greene & MacRae

William C Marcoux	Attorney
John P Mulhern	Attorney

Managing Agents

Chartwell Managing Agents Ltd	Management Team
Liberty Syndicate Management Ltd	Management Team
Hiscox Syndicates Ltd	Management Team
Amlin Underwriting Ltd	Management Team
ACE UK Underwriting Ltd	Management Team
Bankside Syndicates Ltd	Management Team

Member's Agents

Sedgwick Oakwood Lloyd's Underwriting	John Barber, Chief Executive and Deputy Chairman

Brokers

Bell & Clements Ltd	Peter Barrett, Director

Equitas

Jane Barker	Finance Director
Paul Jardine, FIA, MAAA	Chief Actuary
Jeremy Heap	Head of Business Planning and Analysis

Financial Services Authority

Peter Casey	Head, Lloyd's and London Market Supervision

General Insurance Standards Council

Chris Woodburn	Chief Executive

Institute/Faculty of Actuaries

John Beck, FFA	Tillinghast Towers Perrin

Consulting Actuaries

D M Hart, FIA	Bacon & Woodrow
P Archer-Lock, FIA	Bacon & Woodrow
A Gray, FIA	English Matthews Brockman
J Butler, FIA	Watson Wyatt
C Czapiewski, FIA	Lane Clark & Peacock

Government Actuary's Department

Catherine Cresswell, FCAS

Appendix 2 – Statistical Updates To the 1998 Report

Page # in 1998 report	**Description**	**1998 figure**	**1999 figure**
4	Level of calendar year surplus lines writings (NB prior report figure of $1.6bn updated to exclude brokerage)	$1,161,760,000	$1,207,639,000
4,7	1997/8 worldwide gross premiums (in US dollars)	$12,800,000,000	$11,800,000,000
4,7	Percentage of worldwide premiums originating from the US	32	35
4	Total premiums originating from the US (in US dollars)	$4,100,000,000	$4,100,000,000
4,7	Total premium capacity (in US dollars)	$16,800,000,000	$16,400,000,000
4, 7	Expected percentage of capacity to be written	70	70
4	Number of Individual and Corporate Members, combined	7,260	5,171
4,8,14,16	Number of Members' Agents	19	12
4,8,15	Number of Managing Agents	66	63
4,8,14,15	Number of main syndicates	155	139
4	Number of registered brokers ('98 figure approximate)	200	138
4	Number of registered broker groups	120	117
7	Premiums from Illinois (in US dollars)	$75,200,000	$70,000,000
7	Premiums from Kentucky (in US dollars)	$25,800,000	$23,000,000
7	Premiums from US Virgin Islands (in US dollars)	$31,900,000	$29,000,000
7	Worldwide reinsurer size ranking	5th	8th
8,14,16	Number of Individual Members	6,825	4,503
8,14	Number of Corporate Members	435	668
	Council of Lloyd's		
11, 13	Total Number of members of the Council of Lloyd's	19	18
11, 13	Number of Elected working members	6	6
11, 13	Number of Elected external Individual Members	5	3

11, 13	Number of Elected external Corporate Members	2	3
13	Number of Nominated members	6	6
	Regulatory Board		
13	Total number of Regulatory Board Members	14	12
13	Number of Working Member(s) of the Council	1	0
13	Number of External Members of the Council	2	2
13	Number of Nominated Members of Council	4	4
13	Number of Appointed external Members	2	1
13	Number of Appointed working Members	4	4
13	Director of Regulation	1	1
	Market Board		
13	Total number of Market Board Members	18	15
13	Number of working and external Members of the Council ('99 includes the CEO)	3+3	6
13	Number of appointed external Members	1	0
13	Number of additional market practitioners	8	7
13	Number of Corporation executives	3	2
14	Number of licensed Lloyd's advisors	11	8
16,17	Percentage of capacity provided by Corporate Members	60%	73%
16	New Individual Members admitted	7	4
17	Capacity provided by Individuals (in pounds sterling)	£4,105,000,000	£2,700,000,000
17	Capacity provided by Corporate Members (in pounds sterling)	£6,064,000,000	£7,170,000,000
17	Total Lloyd's capacity (in pounds sterling)	£10,169,000,000	£9,870,000,000
17	Percentage of Capacity provided by Individuals	40.37%	27.36%
18	Number of Member's Agents Pooling Arrangements (MAPA's)	43	35

18	Capacity of MAPA's (in pounds sterling)	£2,190,000,000	£1,370,000,000
18	Number of syndicate capacity auctions	8	6
32	Amounts held in US trusts (in US dollars), approximate	$12,000,000,000	$12,000,000,000
33	Amounts held in Funds at Lloyd's (in US dollars)	$10,000,000,000	$10,900,000,000
33	Aggregate value of personal wealth of Individual Members, not including Funds at Lloyd's (in US dollars)	$1,200,000,000	$929,000,000
33	Value of assets held in the New Central Fund (in US dollars)	$238,000,000	$291,000,000
34	Percent of premium contribution to NCF required of Corporate Members	1.5	1.0
34	Amount callable from Member's premium trust funds to supplement the NCF (in US dollars)	$320,000,000	$498,000,000
34	Amount expected to be called from NCF (in US dollars) * 1998 value changed to "approximate"	$5,000,000	$5,000,000
49	Ratio of actual global solvency to minimum required global solvency	8.4 to 1.0	7.8 to 1.0

Appendix 3 – The Extended Warranty Problem

When it came time to close their 1996 policy year in 1998, several syndicates did not close. These included Chartwell's 923 and 947, as well as their parallels 2923 and 2947. The problem was due to uncertainty surrounding a block of extended warranty business. The variability of the reserves was regarded as too high to enable an equitable RITC premium to be developed.

Most of the extended warranty business was placed in the London Market by a single broker and related to automobile extended warranties in the United States and Canada. These warranties were up to eight years in duration. The maximum term of extended warranty was five years over the manufacturers three years. On average the extension period was less than the maximum five years. Included with extended warranties on new cars were so-called extended eligibilities, which were equivalent to offering warranties on used vehicles. The problem arose from the assumption that these option years would perform like the newer years, however the experience turned out much worse.

In November 1998 and as a result of revisions to profit forecasts on the Stock Exchange, this potential market problem came to the attention of the Regulatory Division. It is believed that there could be a market loss in the region £120 million and part of the reason for this may be weak claim handling by administrators in the United States. Indeed it has been suggested that the business itself is subject to a moral hazard in that the car dealership that will sell a customer a car also tends to sell the extended warranty. In the event that the customer has a problem, the dealership may wish to retain the customer and is therefore more likely to suggest that a problem could potentially be covered by the extended warranty than to risk alienating the customer by denying the claim.

As a result of the perceived market problem, a steering group was set up chaired by Michael Payton of Clyde and Co. (solicitors). Its tasks include managing the losses and seeking legal recourse against those persons in the chain who may not have performed their jobs properly.

The steering group recognized that if the claims paid to date were too high due to inadequate claims handling then the projections for the future could be seriously wrong and, obviously, too high. The group has appointed actuaries to re-examine the claims to date and has also appointed Ellison and Co. to audit the claims administrators. Future litigation against fronting companies and claims administrators is not out of the question.

In addition, there may have been a problem with premium recording in that claim funds have been retained early in the chain and not reported as premium. Hence claims will have tended to be recorded at nil over a period of time until the claims fund is exhausted and then suddenly seem to increase exponentially.

The net premiums received by the reinsurers have tended to be very low in comparison to the original premium charged to the customer. For example for an extended warranty for which a consumer may have paid $1,000, the reinsurer may have only received $80. The remainder will have been paid out in commissions to the car dealership and other brokers in the chain together with fronting fees and claims funds.

Most of the policies written by Lloyd's syndicates have been assumed reinsurance policies written on a stop loss basis. The underlying fronting producers for much of the business have been Virginia Surety/Aon, AIG and GE. Under the terms of the stop loss treaties, once the claims breach the stop loss the underwriters at Lloyd's have been able to cut through to exert more influence on the claims administrators.

In addition to the steering group, which is made up of approximately of 17 syndicates and London companies that have been harmed by this extended warranty business, certain of the members of the steering group have already performed claims audits as a result of their own deteriorating results.

ACE Syndicate 47 for example has two members of staff on the steering group committee but has also asked for an independent actuarial review of these contracts by Tillinghast. They continue to have a concern that there is not a good split of data between the various forms of extended warranty so as to enable a good actuarial projection to be made. Nonetheless this particular syndicate has stated that they have carried reserves in excess of those recommended by their actuaries on this particular book of business at 12/31/98.

W:\Dec99\TF\SURL\surlAtt3.doc

