Rating the Syndicates: A Peek at Lloyd's Operations From Inside and Outside Market

In a webinar presented on 13 May 2010, A.M. Best Senior Financial Analysts Catherine Thomas and Miles Trotter discussed financial results and market conditions for Lloyd's syndicates. They were joined by Bruce Bartell of Chaucer plc and Robert Childs of Hiscox plc. Both Chaucer and Childs operate syndicates active in the Lloyd's market.

LEE McDONALD: Welcome to our webinar on Rating Lloyd's Syndicates. We have an interesting topic and a strong panel. Welcome Bruce Bartell. Could you tell us a little bit about yourself and Chaucer?

BRUCE BARTELL: I'm chief underwriting officer for Chaucer Plc. I was appointed to that position in December 2009. Prior to that I was active underwriter of the largest syndicate that we manage, which is Syndicate 1084. Altogether for 2010 we have four syndicates with combined Lloyd's premium capacity of just under 950 million pounds. I've been in Lloyd's since 1988, prior to that in the London company market where I started in 1973.

McDONALD: Thank you. We're looking forward to a nice discussion and welcome Robert Childs.

ROBERT CHILDS: I've been in insurance nearly 40 years. I've only had two jobs. I've been with Hiscox since 1986. I'm the chief underwriter at Hiscox. We underwrite about $1.3 billion of the various syndicates in Lloyd's. Hiscox writes globally about $2.6 billion. It's a specialist reinsurance business. About a third of our income is reinsurance. That's predominantly property reinsurance. Two-thirds of our business is insurance. Our business is roughly split 50/50 between what I call big-ticket business and small-ticket business in which we sell that insurance through our various retail distribution arms in the U.K., in the U.S.A. and in Europe.

CATHERINE THOMAS: I'm a managing senior financial analyst here at A.M. Best. I'm responsible for the team that reports on and rates insurers in both the U.K. company market and the London markets including Lloyd's and Lloyd's Syndicates.

MILES TROTTER: I'm a general manager here at A.M. Best Europe. I'm responsible for our nonlife ratings in the U.K. and continental Europe.

McDONALD: Thank you. Our plan is to present a brief overview of A.M. Best's perspective on Lloyd's and the activities of its member syndicates. This part will be lead by Catherine Thomas with the help of Miles. After that we'll move into a general discussion with our two syndicate guests, including comments or questions submitted by attendees. Catherine, I'll turn the discussion over to you and Miles.

THOMAS: I want to start by giving a brief overview of how syndicates fit in to the overall Lloyd's market, particularly for those in the audience who aren't completely familiar with the structure. I'd then like to move on to how this affects A.M. Best rating criteria for syndicates and discuss how we view the current operating environment for Lloyd's businesses, particularly some of the challenges they currently face.

The first thing we need to clarify is that Lloyd's is not an insurance company. It's a society of members, both corporate and individual, who underwrite in syndicates. Its syndicates are supported by capital provided by Lloyd's members. It's the role of the managing agent to run one or more syndicates. The managing agent is responsible for the syndicate's business strategy and the employment of underwriters. Syndicates themselves are not continuous legal entities. They are annual ventures that form at the beginning of each underwriting year and close once the results of that underwriting year is determined. This is usually three years later and is achieved once all outstanding and IBNR claims are reinsured into a successful syndicate through the reinsurance close mechanism.

In addition to our rating on the overall Lloyd's market, A.M. Best also assigns interactive financial strength ratings to individual Lloyd's syndicates. The existence of the market rating and our ability to assign a market rating reflects Lloyd's chain of security and in particular the role of the central funds, which partly mutualizes the capital at the market level. Any member need only meet its share of claims. Lloyd's Central Assets, is available to meet liabilities that any member is unable to meet in full. The central fund insures that each syndicate is backed by capital consistent with a financial strength rating of at least that of the Lloyd's market. We can therefore describe the market rating as the floor of security for all policies written at Lloyd's. However, at A.M. Best we believe that there are specific characteristics of some syndicates which could be consistent with a financial strength rating that's either at or above the level of the market rating.

For the syndicates that approach us for a rating, we will publish a separate syndicate rating, which is identified by an "s" modifier. The market rating is a floor but it is possible for a syndicate to achieve a rating above that. Any change to a market rating would always prompt a review of all our syndicate ratings. We should stress that it wouldn't necessarily result in a change for that individual syndicate's ratings. When assigning these ratings, an individual is assessed according to our standard rating factors: capital strength, operating performance and business profile. Although, for example, standard measures of balance sheet strength can really only be analyzed at the whole market level, we can look at things that evaluate an individual syndicate: financial flexibility, the quality and appropriateness of its reinsurance program and the size of its technical reserves.

For example, a syndicate may have very strong financial flexibility because it's backed by capital from a large insurance group, which then enables them to provide capital infusion as required. When it comes to business profile I think really all syndicates do depend on a part of the business profile of Lloyd's as a whole. There are particular characteristics such as the type of business underwritten, the diversification of a syndicate' portfolio that can distinguish one syndicate from another. Some can also benefit from the brand profile of their corporate capital provider, particularly in certain territories.

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General Manager, A.M. Best Europe

Of course, we can't forget operating performance, which is often the key to differentiating between individual syndicates. As we move on to look at both the overall performance of Lloyd's over the last two years and that of individual syndicates, you can see how this can vary.

On the whole, 2009 was a pretty good year for the Lloyd's market, which reported an excellent profit before taxes of almost $3.9 billion. Underwriting results were buoyed by favorable price movements across a number of lines, a low level of catastrophe activity, particularly a benign hurricane season and net positive developments from prior years. In addition there was a strong rally in capital markets following 2008's lows, which boosted investment earnings.

Performance was by no means uniform, with some syndicates reporting record profits and others hurt by large, individual losses and conservative investment portfolios. In addition, earnings for many were reduced by foreign exchange movements and the results here are just to make clear they're based on an annual accounting basis.

Having said that, we have variation between different syndicates. Most syndicates in 2009 did report profits. Most results are bunched up towards the left-hand side there. We've really had but one syndicate which reports a material deficit which was exposed to some specific losses. The variation was perhaps more marked in 2008, which really tested the syndicate underwriting and investment portfolios. In general, underwriting results at Lloyd's are volatile owing to the nature of the business underwritten, particularly the large proportion of catastrophe business. However, one thing we have noticed is that the more extreme performance—downsides from which Lloyd's has suffered in the past—have been curtailed as a result of enhanced management for better risk and performance. In 2009 it was primarily investment returns that led to the variation of results across individual syndicates. Across the Lloyd's market, investment strategy has always been pretty conservative. However, in 2008 there was really third-market parties that have increased their exposure to investments, alternative assets and equities in order to enhance yield prior to the financial crisis. It was these syndicates that were really caught up in 2008. In 2009 it was largely these syndicates that outperformed.

On the whole Lloyd's syndicates went into 2010 in a pretty strong position on the back of several years of good results. Looking at 2010 and a little bit further ahead, A.M. Best feels that the environment for Lloyd's syndicates is likely to be challenging. The reinsurance business January renewals saw ordinary softening. Rating pressure is expected to increase as the year develops, on the back of a good 2009, and despite a relatively active year so far. Although there are signs that a downward trend in casualty rates is beginning to flatten, this is a class particularly vulnerable to the effects of the economic downturn.

On the reserving side, reserve surpluses are expected to decline as the good years of 2002 and 2006 mature and the impact of pressure on terms and conditions in more recent years becomes apparent. At the same time, investment yields are most likely to be low. Casualty insurers will really need lower combined ratios in order to achieve the same return on capital. We can't forget Solvency II. Across the market, considerable resources have been dedicated to this, both as to solvency and to the embedding of capital models. As Lloyd's itself has stated, developing an approved internal capital model is imperative to retaining its capital advantages. We certainly expect that over the next two years there will be strong pressure on managing agents to insure that this is achieved.

McDONALD: Miles, can you take us a little deeper level of detail of some of those challenges that we just reviewed? Why don't we begin with rates?

TROTTER: I think there is pressure on raising levels. We'd say that a cause to watch in Lloyd's is U.S. casualty. Rates peaked in this area in 2004 and drifted downward until about 2006, after which there was a sharp decrease until up to about 2008. Rates are still coming down now, against a background of low investment returns, worsening claims experience and stagnant demand for the product. We have a concern there about rates adequacy.

Non-U.S. casualty didn't have the 2004 peak in rates; it's really more of a long-term decline. At A.M. Best we're less concerned about rate adequacy as for the non-U.S. business. However; I think it's fair to say all casualty is something that we're watching carefully.

Energy has had a roller coaster ride in recent years, driven by losses in the Gulf of Mexico. Rates went up sharply in 2005, 2006 following the losses in the Gulf —Katrina and Rita in 2005—then down from 2006 until the losses in the Gulf in 2008, the loss which caused that upward spike. Rates have been falling more recently. Then there's the question about the impact that the recent Gulf loss will have on rates. One point worth making about energy is that the economics of that class for Lloyd's has been poor, whichever way you look at it—five years, 10 years—it's not been a good class for Lloyd's as a whole.

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Marine, on the other hand, has been favorable and profitable. Rates for marine business are stable or declining somewhat. For aviation business we've seen rates going up following the 2009 losses, Colgan Air and Air France. But it's still an issue over paying for significant aviation events if they occur. Property cat is the area where the phrase orderly decline is the most appropriate. There's even been some variation there centered on catastrophes. For example, it was possible to get some increases for business affected by Klaus in 2009. However, broadly speaking there's too much capacity now for catastrophe business and prices are coming down.

For direct property, it's more stable than treaty. However, reduction is still the main theme, particularly in the United States. Finally, U.K. motor, rates are improving but more rigorous action is really required if bottom line of business is to return to profitability.

Overall there's not a great deal of good news for insurers. The most favorable class is the use of this phrase, orderly decline, which we believe is fair for the time being. Whether it remains that way is of course an open question. There are factors that may support rates longer term. There's not going to be any investment income. There's a lot of uncertainty over regulatory capital. We believe reserving releases are likely to decline.

There is more to add. There's certainly uncertainty around because of the economic downturn. Going back to 2009, if you take the U.K. as an example; insurers were monitoring very closely the impact on claims of the economic downturn. Most of the evidence of this was not strong. For example, there wasn't a great deal of increased theft claims. This is despite some reports in the press that said there was really something quite serious happening here to insurance claims. It is something, obviously that can develop over long periods, particularly casualty. At Lloyd's, casualty insurers and reinsurers are receiving more claims notifications, although at this stage it does appear that these are largely cautionary advices. Broadly speaking we don't believe that you can have an economic situation of the gravity that we have without seeing some impact on claims experience.

If we look specifically at Lloyd's, ultimate loss ratio by accident year, 2002 to 2006, have all improved. We think for those years more releases are still likely, although diminishing, as the years reach maturity. But for 2007 and subsequent, claims experience is likely to be less favorable. We believe that the economic situation is another factor that will lead to less reserve stability for those years, 2007 and subsequent years.

McDONALD: What are we seeing on the investment side of the operation?

TROTTER: Investment returns in 2010 will be depressed for Lloyd's syndicates but they will be depressed for everyone. There is some reason for hope with Lloyd's syndicates in that their comparative position may well be better. Lloyd's investments are highly conservative, a high level of diversification and low exposure to the latest problem that the economic situation that's grown up. That is sovereign debt issued for the so called "PIIGS" – Portugal, Ireland, Italy, Greece and Spain. Lloyd's syndicates tend to have a low volume of business in southern Europe and investment exposure is also low in the area. So, certainly low returns for Lloyd's syndicates but perhaps a better position than many other markets.

McDONALD: In general what is the impact of Solvency II on syndicates and the Lloyd's overall system?

TROTTER: Lloyd's objective is to maintain the status quo with supervision and that means FSA supervision. Lloyd's wants to obtain approval for its internal model. In order to do that the managing agents and syndicates will have to reach the Solvency II standards themselves individually. In order to do this an enormous amount of work has been done in the market; the corporation of Lloyd's has developed six work streams. There are 90 people working on Solvency II. The annual cost to Lloyd's is estimated at something around 10 million pounds, the Lloyd's market as a whole, at over 50 million pounds. If there's an issue for Lloyd's as a whole it's really that smaller businesses may not come up to the mark, may fall behind. Many businesses in Lloyd's are well ahead with internal capital models. The ICAPS regime in the U.K. with individual adequacy standards was a useful prelude to Solvency II. If there's a concern, it's that smaller businesses may fall behind, but Lloyd's is really doing everything in its power to insure that that doesn't happen. It has this dry run which is a step-by-step process of continuous review and feedback. Each managing agency has a dedicated account manager and technical experts to help them with this work. If need be, ultimately Lloyd's can be proscriptive, it can limit a syndicate's growth. It can load up its capital or, indeed, close the syndicate down if it's absolutely necessary. So Lloyd's will comply and is making good progress with the Solvency II project.

THOMAS: On an individual managing agent basis, Solvency II is creating a considerable amount of work as well. We're seeing a lot of resources being dedicated to that. In 2010 and 2011 we're anticipating a continued high level of expenditure at the individual managing agent level. There's also really a lot of intense competition for personnel now to work on the Solvency II project. This is being addressed in part by the redeployment and training of existing staff from other areas and through the selective use of consultants, which obviously has its own expense implications. At the center, I think, they certainly have recognized that managing agents results are going to be stretched this year and the Lloyd's corporation has sought to reduce the regulatory burden by lowering the ICA submission requirements for some syndicates. I don't know whether Bruce could add anything to that, how it's affecting the managing agents.

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McDONALD: Robert, did you want to follow up on what Bruce said as far as any specific commitments or what you find Solvency II to be as far as the impact it has on Hiscox?

CHILDS: Yes. It's having a big impact. We've been working on it two years and that's just continued onward as Miles said. So it's been continuous investment in capital modeling. We must be spending a million dollars ourselves. I've just heard that Lloyd's is spending a million dollars of our own money as well for us, so it's costing us $2 million to prepare for Solvency II. It's an expense and I'm sure that it will be worthwhile.

McDONALD: Can you discuss Hiscox as far as some of the initiatives you're involved in at this point and some of the things you're focusing on? What are you seeing from your point of view today?

CHILDS: Just to summarize, we were pleased with the results. The gross written premium grew modestly by 6% or 6½%. I think the important thing to grasp is to see where it has grown. So we had grown what I would call our small ticket businesses by double digit percentages and it was in the London market business where we had seen the lowest growth. That's entirely in line with what we had expected because the London market business on the whole is a trading business and that's where we're seeing the greater competition. We told our investors that we're in this business for making money and we will reduce in those lines if we can't see the margin. In places like the U.K. and Europe we're seeing 15% growth. That's intentional. It's where we write the business 100% and where we're able to drive rate increases in that business. In the bigger figure business, a third of our business overall written in Bermuda and in London is reinsurance. We budgeted at the beginning of the year for something like a 5% reduction. It seems to be holding around that. We've just done one of our first big Florida renewals and that's gone through with a 5% reduction, so it's holding up.

Our reinsurance account on the whole is property cat and property risk excess and property pro rata and that business is doing pretty well. It represents a third of our business in 2010, whereas probably going back 10 years it was as low as 13% of our business. We've moved our catastrophe exposure from our insurance business to our reinsurance business because there are better margins there. I would say that the corollary of that is that we've reduced our property exposures because for some reason or other which I find it hard to fathom is that in the insurance business catastrophe perils seem to be underpriced but in the reinsurance business catastrophe perils appear to be properly priced. Having faced that conundrum, we've moved our exposure towards reinsurance.

If I look at where we are, Hiscox as a business, I would think that one of the key things I look upon as being a differentiator for us is that we're building a brand based around service and fair dealing.

As I was arriving at my station this morning, there are alternates at our stations: every two weeks there's an advert for Hiscox and then in another two weeks there's an advert for another insurance company and this week it's the other insurance company and they're saying you can have two months' insurance for nothing, for free. I thought that's really sort of leading with your chin. Our advertising is more about we provide you with a decent product at a fair price and we'll pay your claims. For us the concentration is differentiation around brand and then very much looking to build our specialist businesses. In the market what we do is we will grow the bigger ticket business and the reinsurance business when the time is right. But that very much is a trading business our control of the pricing in that area is limited. Whereas in the businesses we write 100% in our specialist lines we have control of the prices. And the growth there doesn't have to be 25%. In fact on the smaller ticket business it rates between 5% and 20%. That will continue to grow organically. That's what we're trying to do at Hiscox every year.

BARTELL: Rob has a bit of an advantage. Our IMS isn't due out until the 19th so I can't quote any numbers or refer to them. From our perspective, as we come into the year, very much I concur with Rob. I think the typical London market portfolio is under pressure. Coming into the year we did forecast the fact that the U.K. motor market was hardening—the U.K. motor insurance market. That was very much needed coming off a weak result in the U.K. motor sector. Consequently for us, growth in 2010 was really going to be very much on the motor side. Certainly I think we've seen rate movements in line with that forecast. Consequently we are hopeful that that's going to continue for the rest of the year.

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From Chaucer's perspective it's all about managing the cycle. Rather like Rob, we've recognized that reinsurance was an area that we wanted to focus in. We've set up internationally, writing a European reinsurance account in the late 90's and that's been performing extremely well. Within Europe rate hardening was seen, as Miles mentioned earlier, following some catastrophe loss activity through 2009 and 2010. We also are represented internationally in Singapore, in Houston and our philosophy is very much of going to where, at a specific class of business level, we think the returns are going to be adequate. We don't want to go plant flags around the world and just set up a general insurance entity in any one country. The whole reason for setting up in a particular area is because there is a specific class demand in that region, adequate returns in that region and then as other classes reach that same sort of stage, then we would look at broadening our offering. Again, philosophically we're looking at that at present. The brokers have developed a rather strong regional platform in a number of areas. Lloyd's equally has assisted through setting up some strong platforms and infrastructures to allow us to develop within certain regions quite cheaply. We're going to continue to do that.

From a London market perspective, again, very much along the lines that Rob mentioned, reinsurance for us has been an area where we consider prices to be adequate. Insurance pricing is falling both internationally and in the States, but we have, again, over the years been increasing our reinsurance element. From the point of view of diversification and achieving a good capital ratio, our bread and butter business has really been our U.K. motor. We further supplemented that with some other direct property insurances in the States through traditional binding authorities. One of the things we haven't been doing of late is diversifying blindly. I think that what some people have seen this year—and I would call it 'worsification' rather than diversification—is this rather rapid expansion for some international lines of business and clearly expansion into some casualty lines. What you'll be seeing through the results throughout 2010 and we saw to an extent at the end of 2009 is the cost of people dipping their toes in areas that they really don't understand and don't fully appreciate and don't recognize the degree of catastrophe risk they're taking on.

From our point of view it's very much sticking to what we're doing, looking internationally at areas where we can see there's a clear margin and really pushing the motor rates forward. Clearly we control the business that we write. We have a very significant market share in the motor sectors that we want to focus on. We don't have a significant market share in motor as a whole. We couldn't pretend to compete with a number of the major motor players in the U.K., but in our chosen areas the returns should be good. So, very much pushing forward as we did in 2009 and 2008 and I share the concerns about U.S. casualty that really it's an area to keep an eye on and clearly our income in that sector at the moment represents our views there.

McDONALD: There have been a lot of headlines this year about some of the most significant losses. We've had earthquakes, some storms, now energy. How's it shaping up in terms of losses and especially how it compares to other years and what we might be seeing from some of the other things that are developing as we speak?

CHILDS: I suppose really you're getting equalization over the two years. I mean 2009 was so benign that you get an equalization of losses, those losses moving into 2010. We said it's been a tough quarter. It started off for us with winter freeze losses in the U.K., then moving into Xynthia and then we haven't talked about the big mud slides in Madeira. Then you had the Chile loss. The Chile loss is a significant loss. It surprised people by how big an insured loss it could potentially be. One of the issues at the moment is trying to quantify it. We have very little direct insurance in Chile and we don't have much direct reinsurance. It's been a difficult job quantifying that. The actual claims that have made their way through to us are still tiny. I know Lloyd's is going to send some loss adjusters to Chile fairly soon just to do an assessment as to where the actual position is. You know, it's the beginning of the year. You budget to have losses in 2009 and we didn't have any so we said, "whoopee." Beginning in 2010 we budgeted to have losses and we probably didn't budget to have quite so many in the first quarter but we certainly budgeted to have more than that over the year.

As we look forward to the hurricane season, that, I think, is still the big risk for reinsurers. It's what happens in America, the hurricanes. That's the thing that really is going to drive the profitability of the businesses. Most businesses I would have thought are prepared and have budget and got rates to allow themselves to take a reasonable level of losses from an American hurricane season.

BARTELL: It's been interesting as far as there's been a frequency of largely natural perils losses but then I'd put Deepwater Horizon on the end of that. Certainly for the large part numerically they've been largely borne by the insurance sector. So whether it's Australian hail, mud slides, Haitian quakes, Mexican quakes, it's certainly been very active. Whereas with the Chilean quake and certainly with the Deepwater Horizon losses, both of those will be felt quite deeply by the reinsurance sector. Looking at the impact that they might have, I think it's pretty typical. It goes back to what Rob was saying earlier on. The insurance sector, where rates have been falling and now have been sustaining these losses, can really ill afford this. The reinsurance sector has been performing quite well. Now the reinsurance sector is getting hit as well.

It will be very interesting to see as we move into 2011 what impact that will have on some global, worldwide, retro and reinsurance pricing and whether indeed it does start to have the right effect that we're looking for on the insurance side. Certainly from my perspective, offshore energy rates will have to go up and the extent of which the Chilean quake has an impact outside of Chile remains to be seen. Whether it actually spreads to the rest of South American remains to be seen. At least these are two very significant losses in that area and hitting the reinsurance market particularly hard as well.

CHILDS: One of the good things about the Deepwater Horizon loss is that it's very well spread. It's spread all through the market and a lot spread through the market is much more likely to produce increases in rates.

BARTELL: It's a direct compulsion there on the parts of insurers to push up rates anyway. There's a recognition that reinsurance prices will go up next year. There is a definite need for insurance rates to be going up now. I don't think there's any danger of the direct market waiting to see what impact it has on their own reinsurance.

McDONALD: Miles, this question is about losses. What's the rating impact, if any? Is it too early to say on some of these headline ones? What are we seeing as a rating agency when we look at some of these fairly significant losses throughout the world?

TROTTER: This applies to Lloyd's and others and international companies as well. Experience in the first quarter has been poor. It needn't so far impact companies' overall annual profitability target. For many it's within their catastrophe budget. It would be fair to say that many syndicates/companies have burned a long way through that budget already. So, if we have a poor experience for windstorms or other catastrophes later in the year, then we're going to get into a situation where companies will not meet their profitability objectives. If I feed that through to ratings in saying there's no reason why many companies cannot meet their original probability objectives for 2010, that's not going to have any impact on ratings.

McDONALD: Robert, what's the interplay between Hiscox the insurance organization and Lloyd's the market? Where do the brands compliment each other and where do you have to establish yourself?

CHILDS: We have an established brand in the U.K. We advertise on television, newspapers, and billboards and so there's no confusion really. We trade as Hiscox in the U.K. The further we get from Europe the more I would say we trade on Lloyd's, because Lloyd's is known everywhere and Hiscox is known somewhere. Where we're known we trade as Hiscox and we are happy to use the Lloyd's brand in areas where we're not known. We've been building an onshore business in the U.S. now for five years and Hiscox is known there for some product lines, but predominantly it's known as trading at Lloyd's. So we very much have used the Lloyd's out of that. We use them as appropriate.

BARTELL: We trade exclusively under the Lloyd's platform. We have no other company underwriting platform around the world. First of all, our relationship with Lloyd's and our use of the Lloyd's name is fundamental to us. Obviously Lloyd's has done a lot for us in establishing platforms around the world. We've done quite a bit ourselves as with other Lloyd's agencies like Hiscox and getting out and reaching clients within region to familiarize them with brand. From a reinsurance perspective clearly any reinsurance buyer recognizes individual syndicate entities nonetheless so they will allocate signings according to their own preferences. Yes, we trade at Lloyd's but we do look to try and reach clients, risk managers, ceding companies wherever we can, whether it's coming from London or within the region.

McDONALD: Do the concerns of the larger syndicates differ from the concerns of the smaller syndicates? You touched on it a little bit as far as the preparations for Solvency II; obviously that's had an impact. Does it have a disproportionate impact on some syndicates and are there other considerations as well?

BARTELL: From a syndicate size perspective, obviously affordability when it comes to not just Solvency II but prior to Solvency II—modeling, actuarial resources, overseas network. Allied to that sort of exposure to even take on which leads to line size—is obviously very important when you're talking to some clients who've been looking to consolidate their programs. Having said that, the increased demand from the subscription market over the last couple of years has helped Lloyd's wholesale. The concentration risk both from an insurance perspective and a reinsurance perspective has been recognized as a bit of a risk, obviously, for some clients' cedents. The subscription market is extremely healthy. We just need to make sure the larger carriers are in a better position to protect their position within a panel than possibly some of the smaller players.

CHILDS: I would say that we were founded in Lloyd's so our roots are in Lloyd's and Lloyd's is still incredibly important to us as a business. I would say now that we're a global business that trades at Lloyd's rather than being a Lloyd's level business.

McDONALD: A question came in: if Lloyd's does shut down a syndicate or if it ceases operations, does Lloyd's then assume the liability?

TROTTER: No. It doesn't. The first layer of capital is syndicate funds at Lloyd's. If the funds at Lloyd's prove inadequate or members have no other resources, then at the discretion of Lloyd's the Central Fund will be applied to pay the losses. But it isn't simply an issue where a syndicate ceases and then it's straight into the Central Fund.

McDONALD: How do you distinguish developments in the London/European market versus Bermuda versus USA? Robert, perhaps we could start that with you. What's your perspective—at least at this point—as to the differences in markets among the three theatres?

CHILDS: Bermuda does look to be a healthy market. They have all rebuilt their balance sheets following Ike. The issue they have is distribution. Where can the Bermuda business continue to grow? A lot of them, for that reason, have moved toward London. A lot of them either bought Lloyd's businesses or looked to set up Lloyd's businesses. They formed a link with London. The London businesses as a whole are healthy businesses. Whether all the USA businesses are quite as healthy, I'm not so sure. They've had a tremendous number of attritional losses in the last couple of years. Also, the low interest rate environment has put a lot of pressure on the casualty underwriters. I get the feeling that everyone's hoping that this low-interest-rate environment and low investment rate environment is really a one in 100; the realization that it actually could be a one in five is probably taking some time to dawn. When it does dawn then there's going to have to be some corrective action.

In the European market we've seen a major European insurer being propped up by Berkshire Hathaway. Europe is at a sort of interesting period. But London and Bermuda seemed to be more linked and the European market is more separate.

BARTELL: The discipline that we've seen of late with London, Europe and Bermuda is pretty aligned. I don't think we've seen any real outliers. As we've moved into 2010 it's been broadly speaking pretty good. I do agree. Bermuda has a very limited potential to grow and with the balance sheet reparation, it's buying shares back or giving money back or acquisition. It's use it or lose it time for a number of them. In the U.S. market there are some significant casualty exposures, some long-tail exposures which are going to continue to require some serious thought in the coming years. London and Europe in general and Lloyd's in particular, the Lloyd's performance, has been particularly good in recent years. From a capital perspective it's very capital efficient. It's quite easy to put capital to use, given the breadth of distribution channels that we have in Lloyd's. It's no wonder that Lloyd's is attractive. It's a very healthy place to be at present.

McDONALD: Our last question is going to be looking to the future of Lloyd's and particularly Lloyd's syndicates. Where are the syndicates going to grow? We know that the strong ones will continue to grow and prosper but the new syndicates, the startups, the entrants to the markets, what are we seeing in that regard?

TROTTER: The old story now with interest from Bermuda is that we saw Bermudans start Lloyd's syndicates and purchasing managing agencies. I think that, as I say is old news. We're seeing more interest from the U.K. and the U.S. It's possible that we'll see broker-sponsored new entrants to the Lloyd's market.

THOMAS: It's probably also fair to say that we saw that wave interest in Bermuda in '07 and '08, often as Rob said, buying Lloyd's businesses themselves to enter that. Although we've seen continued interest in Lloyd's, the number of true new entrants has probably slowed this year. That's partly due to the rigorous process that Lloyd's has in place that limits new entrants to those that can demonstrate other value to Lloyd's. Given the current state of the underwriting cycle, that's very difficult to do. Also, we've seen some potential new entrants themselves deciding to shelve syndicate launches due to the market conditions and here I'm primarily thinking about the proposed syndicate that we would have seen from the ex-Beazley underwriter Johnny Rauls and would have seen him re-enter the market. That has been shelved and the reason for that was market conditions. Of course that's the corporate capital coming in. The 2010 capacity auctions also saw that there continues to be a lot of interest from some of the noncorporate capital. They've managed to gain some access in 2010 through special purpose syndicates set up by some established Lloyd's players such as Beazley.

CHILDS: We set up the first special purpose syndicate called Rising Catastrophe Reinsurance in Lloyd's. I don't think this is a time for the Lloyd's capacity to be growing. If the market is softening, then that is a time to be sticking, not a time to be growing. I would think it would be a worrying sign if Lloyd's capacity and Lloyd's written income could be see to be growing at a time when the market is falling. I would be anti, I think to entrants into the market because the options just aren't there. This is going to be robbing Peter to pay Paul. So I'd rather see the market capacity not go up in the current market conditions.

BARTELL: It's clearly incumbent upon managing agents to manage their syndicates or manage the cycle which, bearing in mind everything we've said so far, clearly we are overall in a softening cycle with some reasonably potentially poor returns in some areas. The managing agents have got to do their job properly. They've got to manage the cycle. It shouldn't be a point in the cycle where there is growth. The Performance Management department at Lloyd's are doing their part, but it shouldn't be them doing it. It's really down to the managing agent to do it first. They are merely performing a secondary check. For new businesses, it's quite difficult to come in at this stage and add value. Lloyd's is well-represented in most sectors. To come in and exclusively add new lines of business is very difficult. I concur. I think it's time for proper management of the cycle.

McDONALD: Thank you Bruce and Robert. Also, thank you to everybody who had a question. If you have any interest in learning more about A.M. Best, its services or ratings, contact Clive Thursby at 44-020-7397-0279 or e-mail him at *clive.thursby@ambest.com*.