GREENWICH

Greenwich Insurance Holdings PLC
February 2002 Bulletin

1. *Chairman's Strategy Group*

In March 2001 the Council of Lloyd's, following an initiative of the Lloyd's Market Association, appointed the Chairman, Sax Riley, to form a Strategy Group supported by the management consultants, Bain & Company. Nearly a year later the findings of the Chairman's Strategy Group (CSG) have been published and there has been considerable press coverage in relation to the proposals, which are based around a package of radical reforms designed to modernise the Lloyd's Market. These proposals have been cleared for consultation by the Council and include:

- **Creation of a franchise** – A Franchisee Board will replace the existing Lloyd's Market and Regulatory Boards and their committees. It is proposed that Lloyd's will act as a franchisor in the management of the market and managing agents will be the franchisees.

- **Annual Accounting** – Lloyd's current three year accounting system will be replaced by annual GAAP accounting.

- **Unlimited Liability and the Annual Venture to Cease** – No new unlimited liability Names will be accepted after 2002 and existing Names who wish to continue underwriting will have to convert to limited liability by 1st January 2005.

- **Continuing Third Party Capital to Participate Via a New Vehicle** – The proposed vehicle, called a Single Reinsurance Syndicate (SRS), will provide the opportunity for Names and other third party capital to continue to support syndicates on a contractual basis. It is further proposed that Names will receive compensation for giving up their current participation in a combined concept described as a "Sale and Lease Back".

In announcing these proposals, Lloyd's Chairman Sax Riley said:

> *"Our aims are profitability, modernity and transparency. Investors and policyholders have a choice of where they go, and we want them to be able to compare us easily, and favourably, with our competitors.*
>
> *This package of measures, selected from many options examined by the Chairman's Strategy Group, will help to reshape Lloyd's of London into a business that remains a force in international insurance markets throughout the 21st century".*

The proposals are now subject to informal market consultation over the next few months and after that, the Membership of the Society of Lloyd's will receive a final set of detailed proposals prior to voting on the reforms in the Autumn.

Comment

The CSG proposals have gone further than many Market pundits predicted. Whilst the franchise and annual accounting reforms were anticipated, until September 2001 it had been generally thought that the CSG would duck the ending of the annual venture and unlimited liability. The events, however, of 11th September and the need for the Lloyd's Market to find replacement capital only served to accelerate the process of reform. As outlined in our December Bulletin, capital raising in Bermuda at nearly $20 billion far exceeded anything achieved by Lloyd's entities. Existing corporate capital providers made it clear to the CSG that the annual venture and three year accounting are substantial barriers to raising capital for Lloyd's.

Greenwich's response to these proposals can be summarised under the following headings:

Franchise – For some time Lloyd's financial rating has been under threat as a result of a prolonged period of substantial underwriting losses. Rating agencies such as Best's, S & P and Moody's have consistently, prior to 11th September, expressed concerns regarding the inadequacy of the Central Fund and the perceived poor control of underwriting: in particular, the results of the "bottom quartile" syndicates. The franchise proposals include a greater control of market practitioners and an adherence to higher quality underwriting. Any franchise would be proactive in closing down businesses before, not after, they lost money. Those working in the market and external parties have welcomed these proposals which are likely to secure in the longer run an improved rating for the Lloyd's Market. Undoubtedly there will be some difficulties in formulating the requirements for franchisees but the proposal that the current capital providers should become owners of the franchise could achieve considerable value to participants such as Greenwich and act as an incentive for change.

Annual Accounting – In order to make Lloyd's underwriters comparable to insurance companies it has to make sense for the Market to move to annual GAAP accounting. Indeed, syndicates are being required to account in this manner in parallel to three year accounting for the 2001 Account: Greenwich commenced this process in 2000.

Third Party Capital – We have long predicted that Lloyd's would bring to an end participation in the Market by way of unlimited liability and we welcome the CSG's findings that it is "inappropriate" for future capital to be provided in this form. What, however, is clear is that finding a replacement vehicle is immensely complex. Former Names will recall that proposals have been considered in the past all of which were based round some form of reinsurance contract of which the most recent proposal is the Single Reinsurance Syndicate. We do not underestimate the difficulties of finding a solution. Overall, however, the proposals are designed to allow those businesses who wish to move entirely to their own paid up capital to do so, whilst those Managing Agents who wish to retain support from third party capital can also do so. It is to be hoped that the Members' Agents who continue to advise third party

capital will find ways to maintain their trading arrangements with those Managing Agents who have a like interest. At the same time it is clear that those Managing Agents who wish to move to a different basis must pay a proper level of compensation to their existing third party capital providers, be they limited or unlimited.

Process – In order for these proposals, when they are finalised, to be sanctioned, an EGM will be called in the Autumn. The current voting structure which is described as archaic by its critics, is a one Member, one vote system for all Members including Corporate and Run Off. Given that Run Off Names are in excess of 10,000, effectively they have the casting vote since Active Names number 2490 **(See 2002 Underwriting Capacity)** and Corporates number 920. Accordingly, in these circumstances it is perhaps surprising that the proposals contain no measures in relation to the closing of open syndicates. Given that this is a priority for the remaining Run Off Names and given that the number of these syndicates is likely to proliferate with the results of the 1999, 2000 and 2001 Accounts, it is a regrettable omission. Indeed, Greenwich will be recommending to the CSG that in order to obtain the requisite support from voting Members the package should include some proposals relating to the closing of open syndicates – possibly Equitas Mk II?

In the longer term once these changes have been agreed by the Membership there will be a need for a change in the Lloyd's Act 1982.

2. *WTC Loss Update*

Five months after the events of 11th September we are no clearer as to the ultimate insurance losses arising from the terrorist attacks. Economic forecasters suggest that the loss is in the range of $30 billion to $70 billion, whilst individual insurance companies, through various announcements, have identified losses up to $25 billion. Whatever the outcome there is a belief that most insurers, including Lloyd's, have sufficient capital and reserves to meet their liabilities: this is especially important in view of the dependence on reinsurance. In our December Bulletin we advised that the gross loss for the Lloyd's Market was £5.7 billion, up from £5.4 billion, whilst the net loss was identified at £1.9 billion, up from £1.3 billion. There has been no revised Market forecast since that time with the only significant Company announcement being that made by Cox who identified in January that their loss had doubled from its original estimate to £125 million.

The well publicised dispute between the head leaseholder of the twin towers, Silverstein Properties and the insurers continues. The insurance coverage totalled $3.6 billion representing approximately half the value of the buildings based upon an apparent assumption that the major risk was fire and therefore the need to have full cover was removed. As it is now known, Silverstein Properties are claiming that the terrorist attacks are two events and as a result their entitlement to claim doubles to $7.2 billion. Insurers have, (led by the Swiss Re), maintained that the attacks were one event and have sought a declaratory judgement from a Federal Court. The dispute, however, has a further complexity in that although the policy had been agreed and the cover was in place through Willis, the precise terms had not been finalised. It is acknowledged that whatever the result of the initial court case, it is highly unlikely to be an end to the dispute with the probability of appeals by either party.

The cash funding of losses and the agreement reached with the National Association of Insurance Commissioners requires the balance of the funding of 40% of gross claims to be finalised by the end of March 2002. As predicted, cash calls have been announced by a number of syndicates which are listed below together with the percentage cash call and year of account. It can be seen these gross funding requirements have impinged on earlier underwriting years as well as 2000 and 2001 where the WTC losses lie. The calls total £488 million in addition to £780 million raised in October: however, these latest calls also involve funding of earlier years and non WTC losses.

Syndicate	*Year of Account*	*Managing Agent*	*% called*
2*	1999	Kingsmead	15.00
55	1998	Duncanson & Holt	3.00
55	1999	Duncanson & Holt	11.00
79*	1999	Limit	10.00
138	2001	R F Bailey	12.23
205*	1999	Jago	7.50
205*	2000	Jago	12.50
205	2001	Jago	15.00
271*	1998	Kingsmead	2.50
271*	1999	Kingsmead	15.00
271*	2000	Kingsmead	13.00
435*	1999	Faraday	9.00
456	1999	Limit	45.00
456	2000	Limit	20.00
506	1999	Kingsmead	30.00
529*	1998	Commodore	15.43
529*	1999	Commodore	25.87
535*	1999	Capita Syndicate Mgmt	29.99
535	2000	Capita Syndicate Mgmt	26.67
588	2001	XL Insurance	11.28
727	1999	S A Meacock & Co. Ltd.	5.00
727	2001	S A Meacock & Co. Ltd.	5.00
808	2000	Crowe	210.00
861*	2000	XL Insurance	13.48
861	2001	XL Insurance	34.04
957*	1997	Duncanson & Holt	15.00
957*	1998	Duncanson & Holt	46.00
957	1999	Duncanson & Holt	9.00
991	2000	A E Grant	20.00
1093*	1998	Commodore	9.85
1101*	1997	Duncanson & Holt	16.00
1101*	1998	Duncanson & Holt	27.00
1101*	1999	Duncanson & Holt	26.00
1141	2000	Amlin	19.77
1173*	1999	Sackville Syndicate Mgmt	55.00
1173	2000	Sackville Syndicate Mgmt	10.00
1242	2000	Marlborough	11.11
1308*	1999	Duncanson & Holt	5.00
2791	2001	MAP	5.00

*Greenwich's involvement in the WTC losses is by way of participation in these Syndicates.

In response to the Market's request to have a co-ordinator of the WTC claims, Lloyd's has appointed Jeremy Pinchin in the role of special counsel. A former Sedgwick Group Director, Jeremy Pinchin will work with individual syndicates and the market generally to ensure claims are handled efficiently. He is a qualified solicitor and will be able to co-ordinate and examine the legal and technical issues arising from the complex nature of the losses.

3. *Underwriting Conditions*

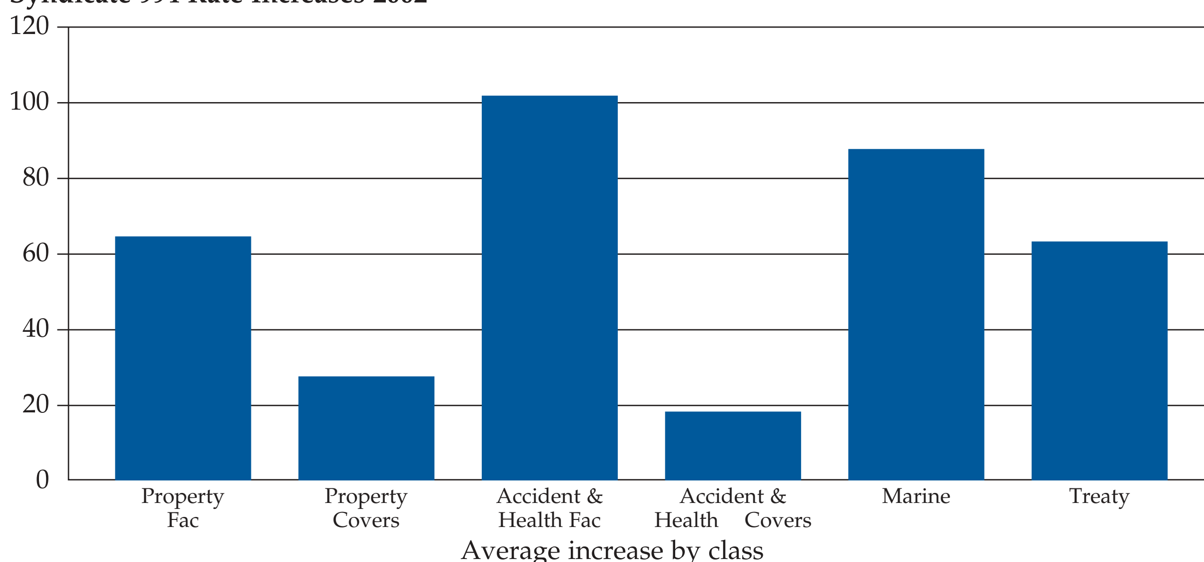
Published statistics for the quarter ended 30th September 2001 show the 2001 Account with the best loss ratios since 1993: evidently the World Trade Centre losses will compromise the final result. The year is now anticipated to produce gross income at £10.6 billion being an increase from £9.8 billion in 2000, itself an increase from £8.6 billion in 1999. As anticipated the underwriting market post 11th September produced a renewal season which was described by brokers as "like no other". Rating increases were just one side of the coin. Long term insurance contracts were no longer available. Self insured risk retentions (i.e. deductibles and excesses) have been raised considerably. Premium payment terms have tightened and insurers are reluctant to delegate underwriting authority. Insurers were forced to re-evaluate underwriting practices in the light of 11th September and in particular the catastrophic accumulation of losses. Where possible underwriters have reduced their exposures by restricting coverage on "all risks" policies to what are described as "defined perils". In particular, business interruption coverage has come under scrutiny and exposures curtailed and pressure from reinsurers is limiting the provision of War and Terrorism coverage. Above all there were real concerns as to the availability of underwriting capacity particularly in the catastrophe reinsurance market.

Post the renewal season brokers report that overall their fears of being unable to obtain capacity had, in most circumstances, been unfounded. Undoubtedly a factor was the increased availability of underwriting capacity from the new entities created in Bermuda. Whilst not taking a leading role, this market has been happy to support premium levels which reflect the fact that they have no prior year losses to take into account. Consequently UK and European catastrophe reinsurance renewals which had expected to carry increases of 50%-60% were completed at lesser levels of increase. GE Frankona Re reported "capacity hasn't shrunk as was anticipated. This looks to be down to a combination of new players and new capacity". However, there are limitations in coverage with underwriters analysing their true exposures and unsurprisingly, terrorism is generally being excluded although some reinsurers have been willing to offer cover for specific lines of business such as personal lines but at the same time deductibles are reported to have increased by between 50-100% in some territories.

Whilst capacity has been available for property risks, there are reports of severe shortage in the liability markets with rate increases where capacity is available being in some instances over 500%. The shortage of reinsurance capacity in accident and health is also apparent. Clearly, this part of the market has been severely affected by the huge exposures arising from the 11th September with severe territorial restrictions.

Greenwich has analysed the business underwritten by Syndicate 994. Figure 1 shows the average rate increases by class achieved during a recent sample period. Whilst these increases are not necessarily indicative of the increases over the entire year, they do demonstrate that the recent changes in the Underwriting environment have been fundamental, and that a very substantial profit is therefore likely for 2002.

Figure 1
Syndicate 994 Rate Increases 2002



4. *2002 Underwriting Capacity*

As reported in our December Bulletin various entities were able to achieve increases in underwriting capacity for their Lloyd's underwriting operations albeit at lower levels than might have been expected. Overall (see Figure 2) underwriting capacity increased from £11.06 billion to £12.3 billion, an increase of 11%. Within this increase was a fall in the number of individual Names from 2852 to 2490, consistent with the trend of the last five years. There was also a reduction in the number of syndicates from 108 to 86.

Figure 2

Year of Account	*Names*	*Syndicate*	*Capacity £bn*	*Managing Agents*	*Members' Agents*
1998	6825	156	10.17	68	16
1999	4503	139	9.87	63	12
2000	3296	123	10.06	58	9
2001	2852	108	11.06	57	7
2002	2490	86	12.30	49	5

Clearly the Lloyd's Market is moving towards more concentrated, financially strong syndicates with the CSG proposals likely to accelerate the process.

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