

# Well placed to face the challenges ahead.

Amidst the unprecedented slump in the world economy, Lloyd's remains in good shape. This has been reflected in our full year results. We have reported a profit of £1,899m and a combined ratio of 91.3%. Albeit that our profits have inevitably been impacted by lower insurance rates, natural catastrophes and a reduction in investment income and offset by currency movements and prior year surpluses.

Our conservative investment strategy and sound underwriting performance have meant that our capital remains intact. Our solvency position continues to strengthen, with limited draw downs on our Central Fund to meet legacy claims, and no new member insolvencies since 2003.

At the same time it is to be noted that the rapid depreciation in sterling in the last four months of 2008 against the dollar, and other major currencies, has also had a significant impact on our results. Lloyd's holds a major proportion of its assets in the currencies in which it transacts business. The decline in the value of sterling means that profits generated in foreign currency are higher when converted back to sterling.

These results underline the importance which we have attached to risk management and underwriting discipline. Our focus on these core elements has been fundamental to the market's resilience and it will remain so as we look to the opportunities and the challenges the future brings. It was important that the market learnt the lessons of the past – pulling back from providing wide insurance cover for financial institutions in the wake of the Enron and WorldCom scandals. As a result, the impact of the sub prime crisis on the market is within the normal course of business.



We cannot of course expect to escape other financial and recessionary trends. We are already taking a long-term view of the potential issues that may arise from the fall in the value of sterling and are working with businesses to assess the impact on capital requirements to support our overseas business. We are also likely to see a rise in claims frequency as the recession starts to bite.

The challenges of the current economic conditions will, however, provide opportunities for insurers. Insurance is largely a non-discretionary product, and while asset values will fall, businesses and individuals will still need to buy cover for their risks. In fact, some argue that the demand for insurance will be even greater as businesses seek to protect their assets and shareholders. Our subscription model, which is underpinned by the concept of spreading risk, will continue to be fundamental in meeting our customers' needs. Less surplus capital in the industry and a low investment return outlook should also improve underwriting discipline, helping to improve market conditions.

Ultimately, the long-term trend in profitability for the industry is not linked to the economic cycle. Statistics show that the industry did better during the Great Depression than for most of the boom years of the 1980s. However, as a sector we are still vulnerable to the vagaries of the underwriting cycle.

### Market conditions

The recent run of calm summers ended in 2008 as Hurricanes Ike and Gustav roared into the Gulf of Mexico destroying hundreds of coastal homes and surging inland. Together these storms are projected to produce net claims for the Lloyd's market of £1,430m (\$2,574m).

The absence of major catastrophes in the last two years has, as always, been a double edged sword for the industry – reducing the volume of claims to generate good underwriting figures but also forcing down rates and adding to the already soft market environment. In the wake of Hurricane Ike and in light of the current economic conditions, some businesses are calling the bottom of the cycle, although it is too early to say if prices are improving outside catastrophe-exposed classes.

Hurricane Ike and the prevailing economic crisis have demonstrated only too well that risks continue to pose challenges for the market and we need to remain adept at meeting them, utilising our expertise and flexibility. Any upturn in the market should not detract from the continuing need to exercise underwriting discipline.

### The regulatory and global landscape

Like the wider economy the regulatory landscape has also felt the force of change. Despite this, Lloyd's lobbying efforts have helped to deliver progress for the market in a number of areas, both in Europe and North America:

- > Lobbying for the inclusion of letters of credit in the Solvency II Framework.
- > The US regulatory authorities considering a new framework that would reduce collateral requirements for non-US based reinsurers.
- > The UK Government agreeing to reduce the tax burden for corporate members by introducing tax relief in the form of a Claims Equalisation Reserve, finally bringing parity in the tax treatment of reserves with other UK insurance companies.

One of the consequences of the financial crisis has been to increase the political pressures around the world for more regulation. It is now more important than ever that Lloyd's continues to take part in these debates, offering a voice of experience and reason.

Closer to home we undertook to modernise our governance arrangements through a Legislative Reform Order, which, over the long-term, will also widen access to the market, helping Lloyd's to compete on an equal footing with our competitors. We are most grateful to HM Treasury for their help in achieving its successful passage through both Houses of Parliament.

### Summary

Sound risk management, effective oversight and management focus are the fundamentals that have supported Lloyd's well in recent years.

We have undergone a remarkable transformation but have always stuck to our core offering – devising innovative and tailored solutions for complex risks. There is no greater ambition for us than to be the world's leading insurance market.

We stand ready to continue our role in supporting the world's economy and its businesses – providing insight so that they can have the foresight to manage tomorrow's risks.

At Lloyd's we have the capital, risk appetite and expertise to help to shoulder the risks of the world. As a subscription market built on the concept of sharing risk, we also have the strength and flexibility that can only come from a marketplace of over 50 individual businesses and a 321-year history.

I would like to end by thanking all of those within the Corporation and market who have contributed to Lloyd's success over the last year. Richard Ward and his team within the Corporation have shown great leadership and the market has continued to demonstrate its professional approach, skills and attributes that have made it world famous.

I must also pay tribute to Bill Knight and Peter Morgan for their outstanding contributions during their nine years on Council and to Edward Creasy, Roy Brown and Stephen Hodge for their hard work and important contribution since the Franchise Board's inception. I look forward to working with the new members of both bodies.

### Peter Levene

Chairman  
23 March 2009

**BEHIND THE ICONIC  
GLASS LIFTS AND  
STEEL DUCTS IS ONE  
OF THE WORLD'S  
MOST DYNAMIC  
ORGANISATIONS.**

Lloyd's is the world's leading specialist insurance market, conducting business in over 200 countries and territories worldwide – and is often the first to insure new, unusual or complex risks. We bring together an outstanding concentration of specialist expertise and talent, backed by excellent financial ratings which cover the whole market.

Lloyd's began over 300 years ago in Edward Lloyd's coffee house – a place where shipowners could meet people with capital to insure them.

Since then, Lloyd's has grown from its marine insurance base to become the world's leading market for specialist property and casualty insurance.

To this day, Lloyd's remains a dynamic, innovative market where individuals meet face-to-face. Like any market, it enables those with something to sell – underwriters providing insurance coverage – to make contact with those who want to buy – brokers, working on behalf of clients who are seeking insurance. We gain our strength from the diversity of managing agents who choose to operate here, backed by capital from diverse sources around the world.

The Underwriting Room is central to the smooth running of the Lloyd's subscription market, where large and complex risks can be shared between market participants. We offer a range of distribution channels that allow managing agents to access specialist businesses.

We continue to introduce ways to make Lloyd's an easier place to do business, increasing efficiency and standards of service.

Our processes may change, but mutuality of capital will remain central to Lloyd's. It helps us to be more competitive and underpins our licences and ratings.

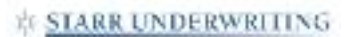
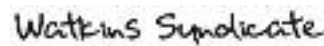
We continue our steady expansion into overseas markets to build our platform for the future. A major priority has been and continues to be managing performance throughout the cycle. Although our resolve has been tested over the past 12 months, our disciplined approach to underwriting and our conservative investment mix have ensured that we maintain our strong competitive position.

# About Lloyd's Managing agents

As at 31 December 2008, the Lloyd's market was home to 51 managing agents, shown below, and 80 syndicates. However, more important than sheer size is the breadth and depth of specialist broking and underwriting expertise, brought together under one roof at Lloyd's.

∞ More information on managing agents and syndicates on page 10.

∞ For information on Syndicate GWP see page 138.

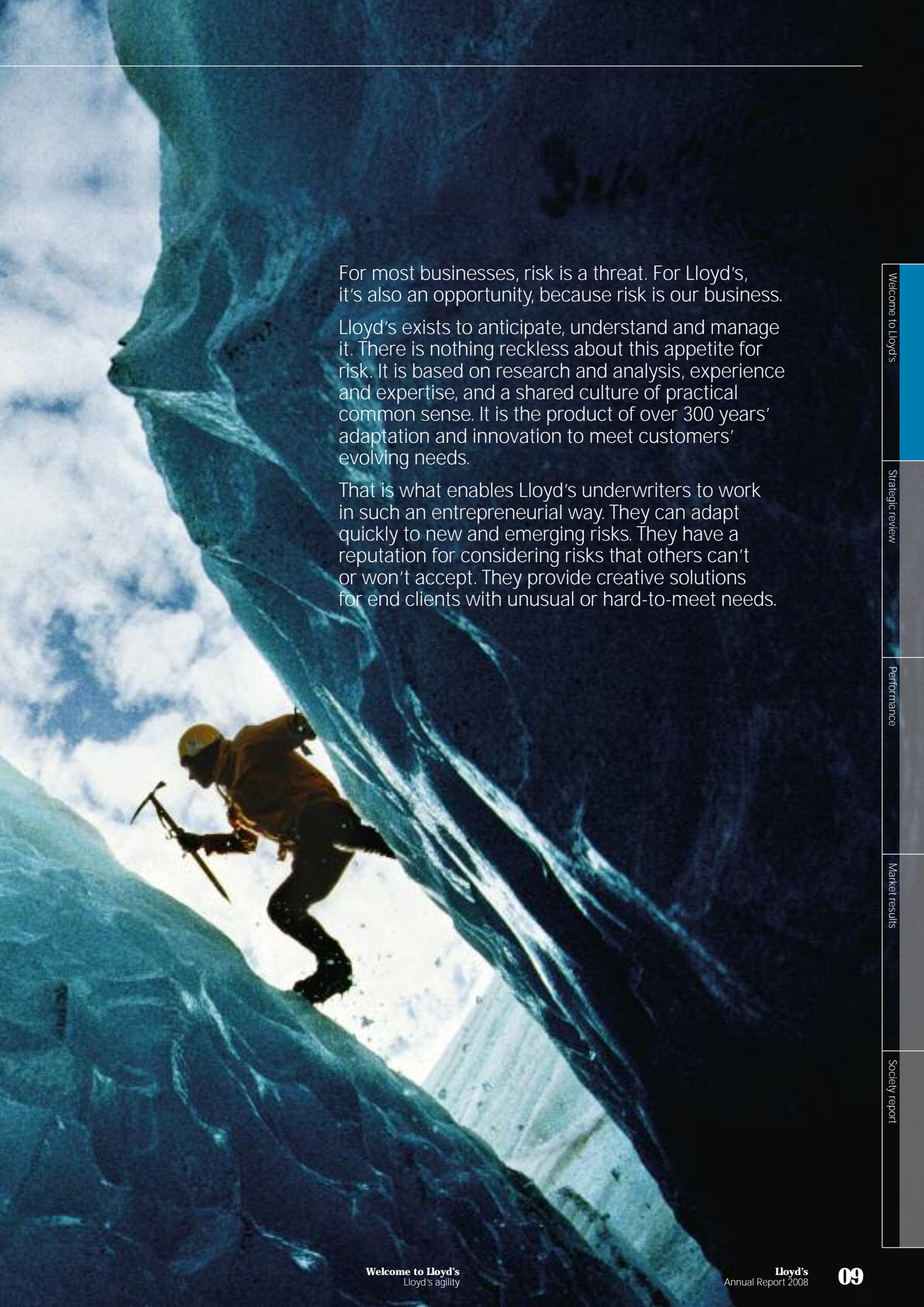


S.A Meacock & Company Limited

Mitsui Sumitomo Insurance Group  
MSIG

RITC Syndicate Management Limited





For most businesses, risk is a threat. For Lloyd's, it's also an opportunity, because risk is our business.

Lloyd's exists to anticipate, understand and manage it. There is nothing reckless about this appetite for risk. It is based on research and analysis, experience and expertise, and a shared culture of practical common sense. It is the product of over 300 years' adaptation and innovation to meet customers' evolving needs.

That is what enables Lloyd's underwriters to work in such an entrepreneurial way. They can adapt quickly to new and emerging risks. They have a reputation for considering risks that others can't or won't accept. They provide creative solutions for end clients with unusual or hard-to-meet needs.

# an agile market where capital and expertise join to cover risk worldwide.

Lloyd's is not an insurance company; it is a partially mutualised market where members join together as syndicates to insure risks. Much of Lloyd's business is written on a subscription basis, with more than one syndicate taking a share of the same risk.

## syndicates

### Writing the insurance

As at 31 December 2008, there were 80 syndicates at Lloyd's. They operate on an ongoing basis, although they are technically a series of annual ventures. Members have the right, but not the obligation, to participate in syndicates for the following year. In practice, most syndicates are supported by the same capital providers for several years. The stability of the core capital base enables syndicates to function like permanent insurance operations, under the Lloyd's umbrella.

A large proportion of our business is conducted in the Underwriting Room at One Lime Street, London, where most of the syndicates have a presence. Here, detailed negotiations take place regarding the risks brokers wish to place at Lloyd's on behalf of their clients. Most of these placements involve face-to-face negotiations, but work is under way to enhance the supporting business processes and electronic infrastructure. Some syndicates specialise in underwriting a certain class of insurance, while others write a range of classes. Having direct access to this concentration of underwriting skill gives us our excellent reputation for expertise, innovation and quick decision-making.

## Managing agents

### managing the syndicates

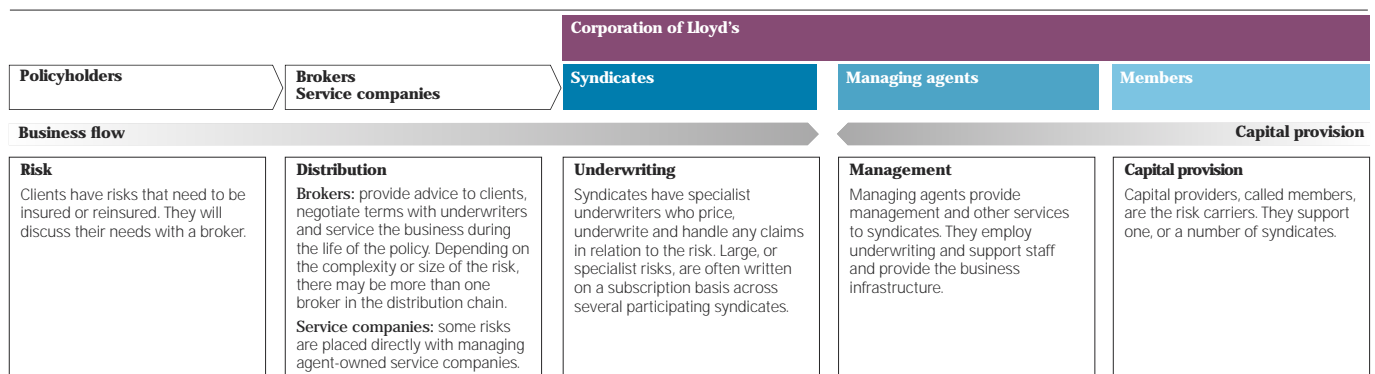
A managing agent is a company set up to manage one or more syndicates on behalf of the members who provide the capital. It employs the underwriters and handles the day-to-day running of the syndicate's infrastructure and operations. Many syndicates are now managed and funded by a single corporate group, integrating the management and capital provision. In a 'dedicated' model, the syndicate is supported by a single capital provider, ownership of which is not connected to ownership of the managing agent. For other syndicates, the capital is provided by a 'spread' of different members, who may include both individuals and corporate groups, and the managing agent may be separately owned and managed. Managing agents are also responsible for investing the syndicates' funds.

Together, the syndicates underwriting at Lloyd's form one of the world's largest specialist commercial insurance and reinsurance markets. As at 31 December 2008, there were 51 managing agents.



A list of managing agents and the syndicates they manage can be found on page 138.

## How we work



**members**

**Providing the capital**

It is the members of Lloyd's who provide the capital to support the syndicates' underwriting. Today, members are drawn from some of the world's major insurance groups and companies listed on the UK stock exchanges as well as individuals and limited partnerships. Corporate members provide a significant majority of the total capital of the Lloyd's market. Private members typically support a number of syndicates, while a corporate member usually underwrites through a single syndicate. Members' agents provide advisory and administrative services to members. A member is liable only for its share of the risks underwritten and is not responsible for meeting any other members' underwriting liabilities. The diverse sources of capital in 2008 are shown below.

- ∞ An outline of capital setting at Lloyd's begins on page 12.
- ∞ For information on the value Lloyd's brings to its stakeholders see page 34.

**Corporation of Lloyd's  
Supporting the market**

The Corporation of Lloyd's (the Corporation) oversees and provides services to support the market and Lloyd's worldwide licences. The senior executives of the Corporation exercise the day-to-day powers and functions of the Council and the Franchise Board.

∞ See page 15 for more detail on the governance of Lloyd's.

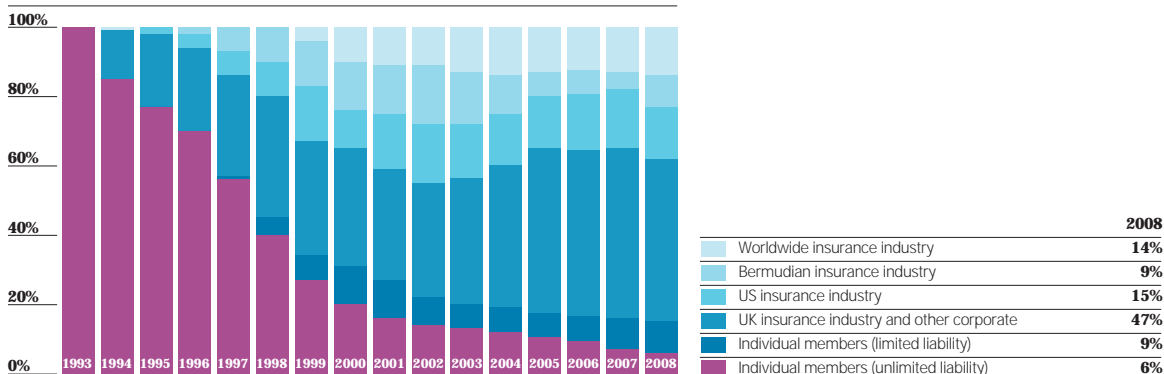
The Corporation (including its subsidiaries) had 851 employees worldwide, as at 31 December 2008.

∞ More information can be found in People Strategy on page 44.

As well as providing cost-effective services fundamental to the smooth running of the market, the Corporation strives to raise the standards and improve the performance of the market. The Corporation's work includes:

- > Setting the level of capital that Lloyd's members must provide to support their proposed underwriting.
- > Overseeing the market's business activities by operating a minimum standards framework and monitoring the performance of syndicates in areas such as exposure management, cycle management, claims management and operational risk management.
- > Working with the managing agents of underperforming syndicates to improve performance and intervening directly if stronger action is required.
- > Managing financial and regulatory reporting for the market, including the production of its results and Financial Services Authority (FSA) return.
- > Managing and developing Lloyd's global network of licences and the Lloyd's brand.

**Sources of capital by type and location**



# stability underpinned by a strong capital structure.

“ In these uncertain times worldwide, there is a concern as to any company's security, whether it be an insurer or otherwise. Lloyd's provides a more secure platform than many and remains a key participant within our insurance programme. ”

**Ken Williamson**

Insurance Manager, Kier Group plc

Kier Group is a leading construction, development and service group specialising in building and civil engineering, support services, private house building, property development and the Private Finance Initiative.

## Financial strength the chain of security

Lloyd's unique capital structure, often referred to as the 'chain of security', provides excellent financial security to policyholders and capital efficiency to members. The Corporation is responsible for setting both member and central capital levels to achieve a level of capitalisation that is robust and allows members the potential to earn superior returns. There are three 'links' in the chain: the funds in the first and second links are held in trust, primarily for the benefit of policyholders whose contracts are underwritten by the relevant member. Members underwrite for their own account and are not liable for other members' losses.

The third link contains mutual assets held by the Corporation which are available, subject to Council approval, to meet any member's insurance liabilities.



Further information on the security underlying policies at Lloyd's can be found on page 80.

## First link syndicate level assets

All premiums received by a syndicate are held in its premium trust funds, and are the first resource for paying policyholder claims from that syndicate. Funds are generally held in liquid assets to ensure that liabilities can be met as they fall due. Profits are not released until full provision has been made for future liabilities. The reserves for future liabilities of each syndicate are subject to annual independent audit and actuarial review.

## Second link members' funds at Lloyd's

Each member, whether corporate or individual, must provide capital to support its underwriting at Lloyd's. In accordance with the FSA regime, each syndicate produces an Individual Capital Assessment (ICA) stating how much capital it requires to cover its underlying business risks at a 99.5% confidence level.

The Corporation reviews each syndicate's ICA to assess the adequacy of the proposed capital level. When agreed, each ICA is then 'uplifted' (by 35% for 2008) to ensure extra capital is in place to support Lloyd's ratings and financial strength. This uplifted ICA, known as the syndicate's Economic Capital Assessment, is used to determine the level of capital required by the syndicate's members to support their underwriting. This capital is held in trust as readily realisable assets and can be used to meet any Lloyd's insurance liabilities of that member but not the liabilities of other members.

## Chain of security

|                |             |  |                      |
|----------------|-------------|--|----------------------|
| Several assets | First link  | Syndicate level assets<br>£38,306m             |                      |
|                | Second link | Members' funds at Lloyd's<br>£10,630m          |                      |
| Mutual assets  | Third link  | Central Fund £852m<br>Corporation assets £138m | Callable layer £495m |
|                |             | Subordinated debt/<br>securities £1,082m       |                      |

All figures as at 31 December 2008.

### Third link central assets

The Corporation's central assets are the third level of security. The Central Fund is funded by members' annual contributions, and subordinated debt issued by the Corporation in 2004 and 2007. In addition to the Central Fund and other assets of the Corporation, central assets may be supplemented by a 'callable layer' of up to 3% of members' overall premium limits. Through detailed analysis, the Corporation determines the optimum level of central assets, seeking to balance the need for robust financial security against members' desire for cost-effective mutuality of capital. In particular, the Corporation's sophisticated modelling tests each member's underwriting portfolio against a number of scenarios and a range of forecasts of market conditions. The Corporation's target for unencumbered central assets is a minimum of £1.7bn. Members' contributions to the Central Fund remain at 0.5% of gross written premiums for 2009. The Council of Lloyd's regularly reviews the central assets target and the level of contributions in light of the current financial position and forecast needs, and will adjust the contribution levels as required.

### Lloyd's ICA and solvency

The Corporation also prepares an ICA for Lloyd's overall, using the FSA's six risk categories to examine the risks that are not captured in each syndicate's ICA. The Corporation, for example, must consider the risks posed by a global pandemic or damage to the Lloyd's building. In addition, the Corporation calculates the statutory solvency position of the Society of Lloyd's and reports this to the FSA. As at 31 December 2008, the Society had an estimated solvency surplus of £2,475m.

### Lloyd's ratings

The world's three leading insurance rating agencies recognise Lloyd's strengths and robust capitalisation. The Lloyd's financial strength ratings apply to every policy issued by every syndicate at Lloyd's since 1993.

In 2008, all three rating agencies affirmed Lloyd's ratings, reinforcing our resilience and the financial strength of the market.

**Fitch ratings:** A+ (Strong), Stable Outlook  
**standard & Poor's:** A+ (Strong), Stable Outlook  
**A.M. best:** A (Excellent), Stable Outlook

"Lloyd's has a strong competitive position in the global insurance market and benefits from its reputation for innovative and flexible underwriting. Its competitive strength derives from its marketplace structure that fosters the development of strong specialist underwriting skills."

A.M. Best, July 2008



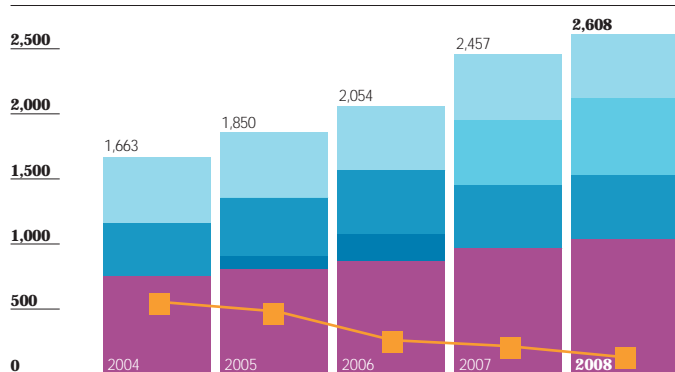
## Enhancing the market's performance and credit ratings

The strategic objective of working with managing agents to ensure they are effectively managing the insurance cycle across the market is a vital part of protecting Lloyd's Central Fund. To support this objective, the Franchise Performance Directorate (FPD) launched its Performance Management Data project in 2008. This enables FPD to collect underwriting data from managing agents at risk level, allowing for more accurate monitoring of syndicates' performance against their approved business plans. By collecting more robust and accurate information, FPD will be better positioned to take decisive action if there are performance concerns about particular syndicates or managing agents.

The project has been recognised as an important factor in Lloyd's future credit ratings. Standard & Poor's September 2008 assessment of the Lloyd's market reported: "A project is currently under way to improve the granularity of the underwriting data the FPD is able to access for monitoring purposes. If successfully implemented, Standard & Poor's believes this project will further enhance FPD's ability to oversee the market's underwriting performance, which will be a key focus over the rating horizon."

Managing agents make their first data submissions in April 2009.

### Corporation & Central Fund net assets† (£m)



† The aggregate value of central assets of the Corporation for solvency purposes at 31 December 2008, excluding the subordinated debt liabilities, including the callable layer.

| £m  | 2008  |
|---|-------|
| Corporation & Central Fund net assets         | 1,031 |
| Syndicate loans                               | -     |
| Callable layer                                | 495   |
| Subordinated debt issued 2004                 | 586   |
| Subordinated perpetual securities issued 2007 | 496   |
| Solvency deficits                             | 133   |

# a range of risk appetites, with each area of potential risk expertly assessed.

#### Managing insurance risk at LLOYD'S

As with all insurers, the largest risk facing Lloyd's is the inherent uncertainty of the size and timing of insurance liabilities. At Lloyd's, each managing agent develops a syndicate business plan, sets its own risk appetite, plans its reinsurance protection and manages its exposures and claims. Through the Franchise Performance Directorate, the Corporation regularly reviews syndicates' performance in each of these activities to ensure that the level of risk to the overall market and its mutual assets is acceptable. The Corporation uses various tools to control and monitor insurance risk, including:

- > Setting guidelines for catastrophe exposure and reinsurance usage.
- > Devising Realistic Disaster Scenarios to assist in the measurement and management of catastrophe exposures at syndicate and market level.
- > Reviewing business plans and determining appropriate capital requirements.
- > Establishing and monitoring underwriting standards, including claims and exposure management principles.
- > From April 2009, the Performance Management Data project will enhance monitoring of syndicates' performance against approved business plans.



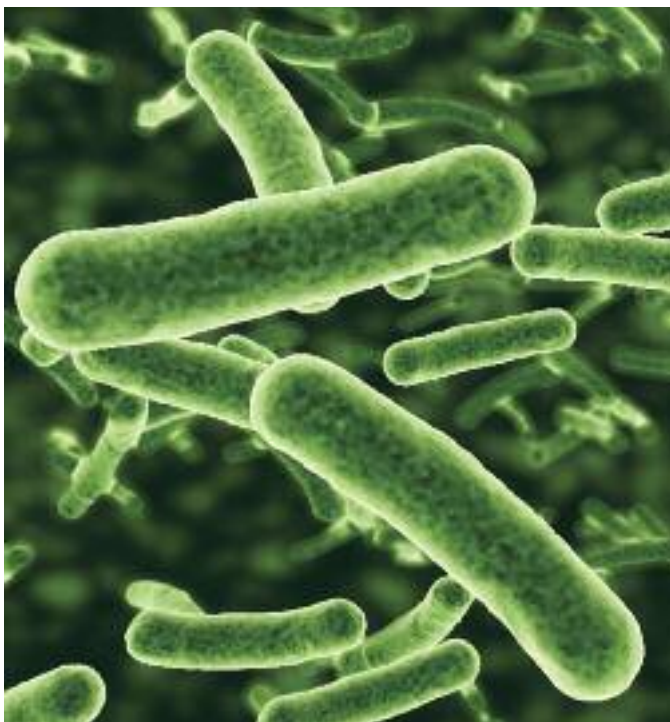
For more information on the Performance Management Data project please see the case study on page 13.

Each area of potential risk is carefully considered by expert teams within the Corporation. If a managing agent's operations pose an unacceptable risk, the Corporation will work with that agent to make appropriate changes. If the agent does not respond to this facilitative approach, the Corporation can withhold or withdraw approval of a syndicate business plan. In extreme cases it can disqualify a managing agent and its syndicate from trading in the market.

The process of setting required capital for syndicates and members also begins with the syndicate's assessment of its own risks.



For more detailed information on capital setting see page 12.



#### Pandemics: preparing for the next outbreak

Pandemics have tended to break out every 30-50 years. It's prudent to assume that the world will see another one – but it would be unwise to assume that this will necessarily repeat the patterns of the past.

In April 2008, the Corporation joined with XL Capital to host a conference on managing the threat of the next pandemic. Speakers from the Metropolitan Police, the Fire Service and the Department of Health came together to discuss their preparations for a pandemic outbreak, and provide guidance for the financial services and insurance world.

The Lloyd's Emerging Risks team followed-up with a report into the possible insurance impacts of a major pandemic. There are many reasons to hope that the world is better prepared, including the availability of new anti-viral drugs and global coordination by the World Health Organisation. But there are also reasons for concern, including the growth of urbanisation and global travel.

Economic impacts in today's interconnected world are likely to be severe and could have knock-on effects for insurers: in today's litigious world, legal actions against businesses shown to be unprepared could lead to claims against liability policies. This type of event, among others, could have a substantial impact on the (re)insurance industry. The conference provided a timely reminder of the importance of robust disaster planning including catastrophe and systemic risk management, and the Emerging Risks team's own close monitoring through its Realistic Disaster Scenario framework.

# A structured approach to governance and regulation.

## the council and franchise board

The Council of Lloyd's is the governing body of the Society of Lloyd's, with ultimate responsibility for the management of Lloyd's. For many of its functions, the Council now acts through the Franchise Board, whose members are appointed by the Council and are drawn from inside and outside the Lloyd's market.


- ∞ The members of the Council and Franchise Board are listed on pages 16 and 17.
- ∞ Further details on the roles of the Council, Franchise Board and their respective committees can be found on pages 86 to 88.

The day-to-day powers and functions of the Council and Franchise Board are exercised by the Corporation's Executive Team, consisting of the CEO and directors of the Corporation.

In November 2008, Parliament approved a Legislative Reform Order to amend the Lloyd's Act 1982.

- ∞ For more details of the Legislative Reform Order see page 86.

The FSA is responsible for regulating Lloyd's, including direct supervision of managing agents and monitoring capital and solvency. The Corporation plays an active role in managing risk within the market to ensure that Lloyd's central assets, brand, licences and reputation are protected.

-  Details of the Executive Team can be found at: [www.lloyds.com/managementteam](http://www.lloyds.com/managementteam)
- ∞ For more information on corporate governance see page 86 to 88.

## Principal committees of Lloyd's

