Lloyd's 24th March 2009

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Presenters

- Richard Ward
- Luke Savage

Richard Ward: Welcome to our annual results presentation. As always this presentation is being webcast, so if you could get the Blackberry's and mobile phones off, I'd appreciate it greatly. I'm joined as usual by Luke Savage, FD at Lloyd's and Rolf Tolle, Franchise Performance Director at Lloyd's, hopefully two very familiar figures to you. I will do a brief introduction to our results then hand over to Luke for the finances and then we'll have a wrap up session and of course we will have Q&A afterwards.

2008, well I was standing here this time last year; I certainly couldn't have forecast what has happened in 2008. I don't think anyone could have forecast the financial turmoil, financial crisis we've faced, the banking failures, economic recession, government bailouts, collapse of AIG, the list is absolutely endless and I think the most important thing for us in Lloyd's is that 2008 has been particularly testing but our results have shown that we've been pretty resilient throughout that period. We've maintained market discipline. That's been a key element of our mantra for the last few years, market discipline, underwriting discipline, focussing on risk management, focussing on writing risks at the right price; so market discipline, underwriting discipline is absolutely essential and been maintained throughout the period.

Our financial position; we continue to build on our financial position and again, as you will see from our results that the central fund now sits at its highest level, ever, well in excess of £2 billion. During these testing times we've continued to expand our global reach. We've obtained new licences in Brazil. We became the first admitted reinsurer, we've got establishment licences in places such as Poland and Austria and we're continuing to reposition our overseas networks to deliver value for our managing agents. We're building on our global reach.

Again, during these testing times we've continued to improve business processes and as I am sure many of you're aware this has been the real focus for Lloyd's over the past three years, things such as contract certainty back in 2006, moving through to electronic claims files and accounting settlement repositories. These initiatives have all been rolled out over the past couple of years and now we're seeing some real value from them in terms of improving the efficiency of the market. Very importantly giving the market a central repository of information, one source that everyone can access.

Through 2008, we updated the Lloyd's Act of 1982. That was know as the Legislative Reform Order. It's brought some our governance arrangements into line with best practice and it's also changed some of our business arrangements to the extent that for instance now non-Lloyd's brokers can access Lloyd's market directly if they meet the standards that the Lloyd's brokers meet.

Finally even during these testing times and the turmoil, we've been able to maintain our rating. A+ from S&P and Fitch, and an A from AM Best and both with a stable outlook. Against the backdrop of extraordinary turmoil in the financial markets, against the backdrop of an economic recession that we're now in, Lloyd's really has proved its resilience in its ability to deliver a strong performance.

What was that performance like in 2008? Just give you the highlight numbers, Luke as I've said will go through the detail. Gross written premiums sitting at nearly £18 billion, that's 10% up on last year. The 10% has two components; 5% coming from exchange rate and Luke will talk about that exchange rate movements during the year and the other 5% coming from the new entrants that we've had over the past three years. As I said, gross written premium number of £18 billion, 10% up.

Looking at the underwriting performance; a good result in terms of combined ratio, 91% compared to 2007 of 84%. Let's not forget 2007 was a record year for Lloyd's in the absence of any catastrophes. 2008 has been the third worst year for us in terms of catastrophes and payouts on claim; and again Luke will cover that; but even against that backdrop of pretty large catastrophe season, we've been able to deliver a combined ratio of 91% and that's in terms of actual underwriting profit is about £1.2 billion. On the investment side, that has been particularly challenging. For any business to be able to show a positive return on investments is a good result. Yes, our investment returns are down from the 2007 highs of 2 billion. We've just under a billion for 2008; but that does reflect a conservative approach that we've adopted in Lloyd's over the past few years to our investments. We're roughly third in cash, a third in government bonds and a third in corporate bonds. Through that conservative investment strategy and limited exposure to equities, we've been able to deliver a positive investment return of just under a billion or 2.5% on the investments that we've had. Taking those numbers together, that gives us a profit before tax number of £1.9 billion compared to the £3.8 billion of 2007; but as I said, given the economic turmoil, given the collapse in investment income across many markets and given the catastrophes that we had to deal with in 2008, this is a strong result for us, delivering a profit of £1.9 billion. And looking at return on capital, obviously a pre-tax number, that gives us return on capital of over 13%, which again is a good performance for the market.

Just moving on to the combined ratio. This is a chart that we've shown every year since about 2001 when we started annual accounting. Just comparing the Lloyd's performance to our peers; these are the peers that we always use. We haven't changed the mix so it's very consistent if you look against year on year. Our combined ratio of 91% for 2008 compares pretty favourably to the rest of our peer group. The Bermuda is getting closest with 92% but they're moving from right to left and you can see the European reinsurers at 97%, US at 102% and US P&C industry at 101%. Again, with our combined ratio we have managed to outperform our peer group which is a positive result for the Lloyd's market.

That's all I'd like to say in terms of highlights for the figures. I will hand over to Luke for the financial results and then as I said, pick up. Luke.

Luke Savage: Thank you, Richard and good morning ladies and gentlemen. To look at some our P&L in a little more detail. As Richard mentioned, gross premiums up nearly 10% of which about half of that is foreign exchange. We're looking an average rate in 2008 is about 1.85 versus an average rate of about 2 the prior year and the other 5% coming from new business. On the incurred claims line, you can see claims up

29%. Again there is and FX element in that number as indeed they are in all of our figures this year, but the real driver there is Gustav and Ike and indeed a number of other significant catastrophes, I'll come back to in a moment. Net operating expense is actually down year on year. Reason for that is that this is the line where we benefit from the weakening of the pound. A lot of our business is written in Dollars, Euros, many currencies other than Sterling and with a weaker Pound, we've been seeing some considerable FX gains coming through that I'll come back to; and then as Richard said investment return, still a positive £1 billion an extraordinary good outcome under the circumstances. Let's drill into the underwriting performance in a little more detail.

First of all the normal waterfall chart that we use, you can see in the blue bars in the left hand side, that the accident year excluding major losses had drifted out slightly from 86.7% to 87.8%. That increase of about 1.1% is actually the net of two compensating factors. On the one hand we've seen an increase in claims frequency, and certainly during the first half or 2008 claims inflation off the back of record high commodity prices, but then again that's been partly mitigated by the FX impact.

Moving across, major losses; 3.8% last year up to 12.7% this year. I'll come back to this is a second and show you just how severe the catastrophe year 2008 was, but for us within there, the major drivers were hurricane Ike at about £1.2 billion in net claims, Gustav at about £0.2 million and then a number of other smaller claims adding another £0.3-0.4 million to the total; so about £1.75 billion in catastrophe claims in total.

Moving across you can see prior year reserve developments up from 6.5% to 9.2%. Again within there, there's an FX component and if you were to strip that out then the year on year number would've been very similar to 2007. The actual figure for this year is about 1.2 compared to about 0.8 last year. Put all that together and you end up with the combined ratio, still very respectable of 91.3%. Let's just look at the moment at those catastrophe losses. What we've done on this chart is in the blue bars we've shown the industry losses going back over the past 15 years and they're scaled against the left hand scale. And then in the purple line, we'd shown Lloyd's catastrophe losses over the same period and that's scaled against the right hand scale. And you can see if look at the far right hand orange bar, that we've adjusted the calibration so that the two averages for the industry and for Lloyd's are one and the same. So you can see those years where Lloyd's picks up a higher than average share and those that pick up a lower than nett average share; and you can see that index up to count values 2008 was actually the third worst industry year for catastrophe losses on record and for Lloyd's the same thing, our third worst year. We normally pick up more than average in the bad years as we did in this case.

We turn to looking at by class. You can see that with the exception of energy where hurricane Ike saw us incurring large offshore energy losses in the Gulf, that all classes have remained profitable, or I think it's fair to say that if one is to back out the benefit of FX and prior year reserve releases, these numbers would be a lot more marginal with a lot more than looking as though they are about break even.

Can't touch on underwriting without talking about the current turmoil in the financial markets and the implications that may have for us in terms of D&O claims and so coming through. It's fair to say that at the beginning of this decade, Lloyd's saw considerable claims coming through from Enron and Worldcom and laddering and so on and off the back of those experiences as a market we now write far less of this business than we used to. Whilst we have seen claims coming through from subprime and the credit crunch more generally, it is fair to say they are an order of magnitude smaller than we experienced at the beginning of the decade and we do expect them to be absorbed in the ordinary course of business and that includes some of the more high profile cases that you may be reading about in the press recently such as Madoff and more recently Stanford. In both cases our exposure to them is very limited.

Let's turn for a moment to look at prior year reserves and the open years. In the bars on the left hand side, you can see the number of open years tracking back over the past five years and you can see that it's come down from a peak of 104 back in 2004 to now there being just 37 down and that includes two that have gone into run off this year. We had 19 new closures this year and in the right hand set of bars, you can see that our reserves from the gross of £7 billion are now down to £2.5 billion. Now you may look at 2007 versus 2008 and say why isn't that reduction bigger? Only £200 million. Again, it's the FX impact. The fact that the £2.7 billion would have come down significantly because of open years closing but then for those years that have remained open, you revalue their reserves against 1.44 to the pound and that pushes the number back up. Now that trend is a trend that we would expect to see continuing over the next year or two. There are now some 11 providers of RITC within the Lloyd's market. A number of open years came close to closing this year but didn't quite get across the line. At the end of '09 and into 2010 we'd expect to see that trending down further.

On our operating expenses, you can see overall our operating expenses moved 9%. Within that you can see acquisition cost up 8%, roughly in line with premium changes, admin expenses up a little more than that. The driver there being that that is the line in which we include profit commissions payable to managing agents. If you want to do true like for like comparison with a company market, you'll need to add profit commissions back into the number because in the company market they don't arbitrarily split their profits between those that are going to the capital providers and those that are going to the underwriters. And then the big story on this slide is the gain on FX; some £853 million. Now I will point out that within that there is a sizable amount, about £370 million that relate to non-monetary items which for those of you aren't familiar with the vagaries of international accounting standards, is effectively a timing difference which will see a credit in our P&L at the end of 2008 which will reverse back out in 2009.

The rest of it is genuine FX gains on the long currency positions which the market naturally tends to hold.

If we then try and summarise where that leaves us on underwriting, you can see on the five bars on the left here that the current accident year excluding the major windstorms in the US has actually held up pretty well, generating almost £1.4 billion but then moving across to the bars in the middle where we've got a conspicuous gap for 2006 and '07, 2008 those cats have come back with a vengeance with a £1.4 billion loss on those. So, current underwriting year more or less breaking even.

Moving across you can see the strength in reserve releases £1,265 million versus £856 million which as I mentioned if you stripped out FX would have been much closer to last year. It's fair to say that we would not expect to see that level of reserve releases continuing going forwards. And then finally on the right hand side of the contribution from investment returns which whilst down significantly is nonetheless still a strong return.

Let's look at that in a little more detail. The assets within the rights market fall into three broad buckets. We have the Premium Trust Funds in which premium is received and it's the working capital they then use to pay claims. We have the Members' Capital we refer to as Funds at Lloyd's or FAL and we have Central Assets. As you can see from this bar chart, all three of those asset pools have had positive returns in 2008, some 1 billion in total, 2.5% overall and in marked contrast to a lot of our peers.

How have we achieved that? It's through our conservative asset mix and if you look at this chart where we've shown the income quarter by quarter, you can see that after a modest start to the year, through the turmoil of quarter 2 and quarter 3, we just about broke even over those periods and then it was in quarter 4 that we saw a big pick up in income. If we were to break that down more granularly between quarters, what we would've seen was that the first half of quarter 4 was pretty disastrous and it was really in the last five or six weeks of the year when we simultaneously saw the equity markets start to rally, you saw credit spreads start to tighten and importantly we saw interest rates being cut and therefore government bond prices were rising. It was in the last few weeks of the year that the investment income really picked back up to generate the billion for the year. Fair to say that the first few months of this year has been equally tough. We've seen despite the rally in the past few days, equity markets are still down year to date. We've seen the gains in credit spreads being given back and the only thing that somewhat helped us has been this relentless downward march of interest rates.

So, how is it that our asset mix has helped throw off a good return? In this slide we've taken the overall assets of the entire market and on the basis that to us letters of credit are as good as cash, you can see that in the two blue areas we've gov about one third of our assets in cash. We've got about one third in governments; we've got about a third in corporate bonds and across the market as a whole we have a very small proportion, about 4%, in equities and alternative asset classes, and those alternative asset classes are things like hedge funds. It is fair to say that at the beginning of the year that 4% would've been 5 or 6% and it's losses in those classes that's reduced it to 4%, but because they are such a small proportion of the overall total it hasn't severely impacted the overall terms of the market. Nonetheless, corporate bonds at a third of our portfolio and could be hiding a whole range of things. If we split that out a little further, you can see that within those corporate bonds, over three quarters of them are rated AAA or AA, 16% are A and where we have 7% below A, that's actually not quite true, there's actually 7% including those where we don't know the rating because for some of the market assets we don't have sufficient detail to know what it's rated, so it will probably end up being that some of that will actually have a rating or be better than the graph implies. Within the mix of assets here, as a market we have generally shied away from the likes of subprime and CDO's and so on. Not exclusively but the vast majority of this portfolio is just vanilla debt.

If you look at the central fund in particular which is at the end of the day, the fund of last resort, it's an even more conservative picture. You can see within the central fund we have almost two thirds of our assets invested in governments; 16% in corporate and then given the longer term nature of the central fund name it is the fund of last resort, not surprising we have a high proportion of our assets in more esoteric assets classes such as equities and hedge funds and so on. Our equity funds have struggled like everybody else's. Rather pleasingly, our hedge funds more or less broke even for the year.

How does all that ripple through into the balance sheet?

First thing to notice if you look at the percentage changes in the right hand column because of the FX rate movement there is a built-in 20% increase across almost every line in the balance sheet. The weighted impact of the weak Pound against both the Dollar and the Euro and the proportion of our business that's written in those currencies means that everything gets uplifted by 20% before you do anything else. If you look down you can see the reinsurers' share of technical provisions up more than that at 40%. That is again off the back of Gustav and Ike and our reinsurance receivables from those windstorms. Underlying that increase we continue to have a strong record of collection of reinsurance receivables and within it over 95% of that balance is rated A- or better. Moving down you can see a similar increase in other liabilities against the claims off the back of those windstorms.

A net increase in assets of 5.6% represented by members' assets up 5.5% and that increased from 12.5% to 13.2% is after paying out in the order of £2.3 billion in profits due in 2008; a combination of early years that have closed together with the early profit release that we now have within the market.

Finally, central assets once again up are breaking through the £2 billion mark excluding the callable layer and how have we achieved that? Well, first of all, you can see that we've continued to receive contributions from members but are £84 million down from £168 million last year. We've actually halved the contribution rate. We now charge members 50 basis points which is the lowest contribution rate that has been certainly since R&R.

Moving down, we don't have the payment to Equitas, to remind people that last year there was the Equitas deal to which we contributed £90 million. Phase I was completed last year. Phase II is due to complete later this year and we're confident that will go ahead. And then under the lines 'claims and provisions credit', this is the line under which we record the undertakings given by Counsel to meet the liabilities of insolvent members and for a second year on the trot we've actually got a credit on this line. Earlier in the decade after the troubles of the soft market and 9/11 we had a number of members became insolvent. The central fund paid out significant amounts of money to meet their liabilities but now we're seeing those years run off more profitably than we had expected, so we're actually releasing monies back into the central fund.

You can see our subordinated debt in there, has benefited from the revaluation on the Euro tranche against Sterling; helped take us through the £2 billion barrier, which together with the callable layer brings us to a total of assets for solvency purposes of £2.6 billion.

You can see on this chart how that solvency surplus has grown over time. So £1.6 billion five years ago increasing to £2.6 billion now and against it in the blue line you can see our solvency deficits. These are the solvency shortfalls of insolvent members together with a margin that we add on for solvency purposes, and you can see as our assets go up and our deficits have gone down they're in combination it means that our solvency, our excess assets has just continued to grow.

In summary, £1.9 billion, a very good year despite the record catastrophe claims and despite very tough conditions in the investment market; a result that we're pleased with and on that note I'll hand you back to Richard.

Richard Ward: As you said, despite the very tough conditions that we had to operate in 2008, we've delivered a strong result. 2009 I don't think anyone knows what 2009 will hold for us but I imagine it will be no different to 2008 and it will be full of surprises – financial, economic and whatever – and so against that backdrop of a very uncertain environment we, as a business, as a market absolutely have to focus on maintaining underwriting discipline which is our key priority, preserving capital which means being conservative around our investment strategy and ensuring we're able to preserve our capital in this very difficult financial environment we find ourselves in; but recognising that it's around underwriting discipline preserving capital, there will be opportunities in 2009 and it's important that we are positioned to capitalise on those market opportunities as and when they arise.

Just to remind you, our vision has been and continues to be the platform of choice for specialist insurance and reinsurance. I do believe we're absolutely delivering on that through our three-year plan through the attractiveness that the Lloyd's market is seen as attractive by new entrants coming into the market and capital coming into the market, but 2009 will be challenging. Let's not forget underwriting discipline and capital preservation throughout the year.

Our disclaimer and our happily it's in the pack. You can all read it. I'm sure you will. Open up for a Q&A both from the webcast and from the floor. When we take questions, if you could just give us your name and affiliation and use the microphone so that people on the webcast can hear you. Thank you, any questions?

Nick Johnson: Morning all, it's Nick Johnson from Numis Securities. Just picking up on your closing comments, the outlook for 2009, I think you said in one of the interviews actually this morning was tough. I was wondering if you could just elaborate on where those challenges come from because it doesn't necessarily chime with the sentence of some of the market participants who have been commenting that the underwriting environment is quite positive. Where are the challenges coming from?

Richard Ward: I think it does chime with the market participants but let's just reflect on what 2009 holds for us at the moment. We're in possibly the worst recession any of us can remember. We're in an environment where here in the UK interest rates are down half a percent and the opportunity to make investment returns will be very challenging. What that means for all market participants they will absolutely have to focus on underwriting and underwriting discipline and writing the right risks at the right price.

Now, yes, there is a lot of talk in the market and we've received it as well here but with the market hardening, creating more favourable environment for underwriting. Frankly that has to happen given the lack of investment opportunities and the requirement that all businesses in insurance make a profit so that you there to pay the claims when they come through and as you've seen from Luke's presentation we've paid out a lot of money in claims in 2008 and that is our business to pay claims when they come through. Recognising that, it is going to be a challenging year because of the economic recession. The impact that has on buyers is uncertain at the moment but there is an expectation that the underwriting environment will improve to compensate for the lack of investment opportunities and also recognising that we paid out an extraordinary high number of claims in 2008.

Joanna Parsons: Joanna Parsons from RBS. I've got four questions if I may? Firstly, on the reserve releases that the market's recognised this year, you commented that they were high and you would expect them to continue on that basis. Could you comment a little bit on your perception of the reserving of the market? There's always a concern from having seen in the past people tend to raid reserves a bit in difficult years to deliver the result of what the market wants and how comfortable you are on that.

Secondly on AIG, don't supposed you're surprised to get this question, but any signs of the turmoil that's affecting AIG having any positive impact on Lloyd's particulary; for example, the excess and surplus lines market. Capital requirements, obviously we've seen changes to capital requirements for the Lloyd's players because of the FX but going forward do you think there's going to be more pressure to hold more capital? You know in the past we've seen Lloyd's in fact adjust the capital requirements because of the underwriting profitability, that margin coming through; will that happen again do you think, or do you think it will be the reverse because regulators want more money?

Finally, tax...

Richard Ward: That's five questions then.

Joanna Parsons: Four.

Richard Ward: capital…

Luke Savage: Reserve releases…

Richard Ward: Rolled into one.

Joanna Parsons: Obviously there are people moving their domiciles and I know there has been talk about Lloyd's and your issues with tax havens; could you give us any guidance on where you are in terms of conversations with the Government on this?

Luke Savage: Shall I start with reserve releases?

Richard Ward: Reserve releases and the capital requirements and the FX and the pressure to hold more capital.

Luke Savage: Fine, I'll start with those. On the reserve releases one of the things that we do here at the centre, after the dust has settled on the year-end is we go through everybody's reserving across every syndicate so that we can form a fairly good idea as to whether the market and the individual syndicates are adequately or under or over-reserved. From the review that we undertook last year and from the size of the releases that we've seen that does not give us any cause for concern, but as I said in my presentation I don't believe there's as much coming out going forward as had come out in recent years.

On the capital requirements, I think with the weaker Pound it's fair to say that the peak exposures that we are exposed to have gone up and we've been asking members to look at their business plan and the capital they needed to support that, with a couple of exceptions, I think most members either already have the increased capital that they need or they have gone out and raised it and there are two or three where we talked about potentially scaling back their activity to fit the amount of capital they've got as for whatever reason they don't want to raise more, but that is marginal and that scaling back will be absorbed by other players within the market.

In terms of the pressure going forward for more capital, we already imposed an uplift than the regulatory minimum, so we ask people to put up

35% more on the regulatory minimum and at the current time we're very comfortable with that level of uplift, although we do recognise that with a very strong, central fund, the strongest it's ever been; that does give us the flexibility to consider varying that uplift if we should choose to at some point.

As for the regulators requiring more capital, I think at the moment the regulatory focus around capital levels, at least in the insurance industry, is centred on Solvency II and all eyes seem to be on looking at what Solvency II will do for capitalisation and trying to make sure that gets calibrated appropriately, so I wouldn't expect to see any kneejerk reaction requiring more capital from the FSA.

Richard Ward: Thanks Luke. Rolf, do you want to take the AIG?

Rolf Tolle: I don't want to comment really on what AIG is doing, but I think the important thing to see here is that what has happened is a change in the attitude of policy holders. Policy holders will no longer place as much as they did in big slugs into one carrier. I think subscription is much more *en vogue* now and I think that's where we will gain, because people see Lloyd's as an alternative, particularly as we are seen to be very secure due to our ratings and our performance, so we see more business not from the basis that we have to compete for from a pricing perspective; it is really just the redistribution and we see that on the E&S side in the US and we see those big clients coming to AIG, now coming to Lloyd's. A lot of people have come back even to Lloyd's and/or want to increase their placement with Lloyd's; it's an advantage for them.

Richard Ward: On the tax issue, yes, we continue to see Lloyd's businesses considering re-domiciling and there have been one or two announcements recently about re-domiciling headquarters overseas to optimise tax positions. I think the important thing from our perspective is irrespective of where these businesses are domiciled they're absolutely committed to Lloyd's in the Lloyd's marketplace and they quite often reaffirm that commitment when making these announcements about re-domiciling. Our focus here in Lloyd's is ensuring that we offer the most efficient place for those businesses to place risks and we do that through optimising the capital position, we do that through underwriting and risk management, we do that through business process efficiencies and market access and that's where our focus would be, so irrespective of where these businesses have their headquarters we ensure that they continue to place their business through Lloyd's. Yes, at the back.

Floyd MacDonald: Floyd MacDonald, ANZ. A slight follow-up question to that then; how do you see the performance of your Asian platform?

Richard Ward: You're referring to the Lloyd's Asia and Singapore I assume. Pleased with the number of managing agents who are operating out of there now; it's round about 14 managing agents who have syndicates there. The premium written for 2008 was round about £160 million if I got the number right, so we continue to see that grow. I think frankly it is still early days for that platform in terms of establishing a presence out in the Far East. I'm encouraged by the brokers who are now locating in Singapore, because Lloyd's are there. I've been out recently doing the rounds in the Asia Pacific region and quite a few of them commented on the strength of the Lloyd's Asia platform and the fact that they would now put their Asia Pacific headquarters in Singapore, because of the Lloyd's presence, so we're pleased with the interest we had from the market and pleased to see the premium income grow, but it is early days for that business still.

Whilst you're getting the mic are there any questions from the webcast at all?

Richard Ward: We'll come to that next then.

Barry Cornes: Morning, Barry Cornes from Panmure Gordon; a couple of questions if I may. First of all, really picking up on Nick's point about capital raisings and the outlook for the market. I just wondered how appropriate you thought it was to raise capital ahead of raising increases in an improving market simply on the basis companies may or may not be able to apply that capital, they're not too sure where to put it at this point in time. I guess the question is directed towards Rolf and whether or not he's actually looked at these capital raising trends ahead of the announcements; do you want to do that one first?

Richard Ward: Rolf, do you want to take that?

Rolf Tolle: I think it's fair to say that the people who have established capacity to take advantage of market changes is really done on the basis that we all expect terms and conditions to improve; however, so far it's been so slow that I don't think these facilities will be used fully. I think it's one of the vagaries of what will happen in 2009. If we get another hurricane year of things may change dramatically overnight and then you have to have instruments in place in order to take advantage; that's the whole purpose of it. What we will not do is to say having established, if you will, the facilities you're off to the races; we will still want to see is it really possible to use it in a good way and therefore it has to be a process reiteration with the managing agents if and when these opportunities arise that the facilities that can be used.

Barry Cornes: Just following up on that one then; if you don't think the additional capital raise is going to get used is it not simply going to dilute ROEs of these businesses?

Rolf Tolle: That's their decision if they want to do that. I personally think it's a good thing to do, because otherwise it may become very difficult to raise that capital when you need it, so I think it's their decision and I have to say personally I think it's the right decision to be prepared for things to happen, because we're in a very, very volatile and a very…in a situation where things really can develop quite dramatically.

Barry Cornes: The other question I had was, I guess, towards Luke. Corporate bond levels of default provisioning; could you tell me what default positioning there is for the corporate bonds and also you've given a flavour of the percentage in AAA and AA, but are people reserving on the basis of a 1930s Depression as they are in the life sector?

Luke Savage: I think we've looked at the level of bond provisioning versus the rating agency default probabilities, which I realise that some people may question the validity of those in current times, and we're comfortable across the market the level is significantly in excess of what the rating agencies would suggest is necessary. Whether that takes it back to 1930 levels I don't know, but we're pretty comfortable with the way we've provisioned both on the bonds and also on our insurance portfolio as well.

Richard Ward: A question from the webcast.

Question: There are two questions for Luke from John Francis from Hampden Capital referring to the slide 16 on the FAL investment return; do you include an illustrative return for LOC bank guarantees? Also, in corporate bonds have you broken out non-agency, MBS and CMBS exposure?

Luke Savage: In terms of the market return, yes, we do infer a notional return on the letters of credit. We don't know what assets underlie each of those letters of credit, so we take a mix in proportion to other FAL and the methodology behind that is detailed in the report and accounts. In terms of the breakdown of the asset mix between things like mortgage-backed securities and so on, if I heard the question correctly, we don't have transparency into all of the syndicate assets, so we can't give those figures accurately. We do know from the transparency that we do have discussions with the managing agents that we have very, very little in the way of mortgage-backed securities and CDOs and so on, and I think that's evidenced in the fact that we've been able to generate good returns despite what's been happening in those particular markets.

Siddharth Parmaeswaran: Siddharth Parmaeswaran from J.P. Morgan. I've got a question just on the claims experience in 2009. You mentioned that you were worried about the possibility of claims rising in classes such as D&O and presumably PI and other long term classes; are there actually any signs of claims reporting increasing so far this year given that we're already in tougher economic conditions?

Rolf Tolle: What we have done for the last couple of years on a quarter-to-quarter basis have followed the number of claims advice to the market and there is a trend, which is quite interesting which really shows '06, or '05, or '07 over '06, '08 over '07, it's an increasing trend and it goes through all classes of business, it's not just the casualty lines, it's all lines, marine casualty. An increased frequency drives normally also potentially higher severity and at the same time higher payouts. If you then combine that with the recessionary effect, which we really first will see, we have started it, but I think not even everybody agrees today that we're in a deep recession, but in my opinion we are, that you will then get on top of that, fraudulent claims, arson claims, again it will hit all lines. You just have to see what is happening to insured values. If you take a very simple example of a vessel, which had a value of let's say $150 million by the middle of last year, the value's now $75 million, but you took a mortgage to buy this vessel for $150 million and you can't deploy it longer, I think there is a big temptation to see if you can realise that potential problem and that are the issues we are facing as an industry. I think in all recessions you will find that arson and fraudulent terms increase on top of the normal increase of claims.

Question: So to just be clear, you're saying that there's been a trend of frequency increasing over the last couple of years. You're expecting it to continue to…

Rolf Tolle: Yes, the fourth quarter 2008 was already up on the fourth quarter of the other years.

Tim Doyle: Tim Doyle from Canada Life; just a question really on risk management. Obviously you have a well developed risk management framework, but I'm wondering how you first stepped up or increased your monitoring of your members over the last six months in light of the economic environment.

Richard Ward: Rolf, do you want to take that from underwriting? I don't know if you want to comment, Luke, from an enterprise risk management…

Rolf Tolle: There's nothing which we have increased over the last six months. As you know, we have introduced a system of underwriting standards, claim standards, risk management for quite some time and what we have done is really improved those standards and I think one of the reasons why we are sitting here and can show a very [exemplary] result is that people have bought into these disciplines, which drive then, if you will, a much soberer approach to underwriting. I haven't seen over the last six months any deviation from that trend which we have seen and we will stay on top of it and we will try to encourage and keep people on that path, because I think from an underwriting perspective to go through this challenge of 2009 on one side, as Richard mentioned earlier, a fall in demand you have increased claims, you have a very slow burn on increasing rates, you have to stay very, very disciplined and that is what we have now, I would say, worked with the market to instil into the market for the last couple of years. There's nothing we have done over the last six months. It is really the result of years of work with the market and market's efforts to bring us where we are today.

Luke Savage: I think if you look at what drives risk in the market and if you use, for example, the overall market ICAs as a judge of that, by far the majority of our risk sits in the underwriting world. I think the next biggest area in terms of it is our asset risk and I think you only need to look at the mix of assets and the returns that we generated to realise that there is discipline. That said, within the individual syndicates, the outcomes of gains and losses and how they fared, there's been quite a wide variety, but you would expect that across 70 or odd different investment strategies and what we haven't seen is anything where those gains or losses are out of line with the risk appetite that those managing agents had defined through their ICAs, so comfortable with that.

Richard Ward: Any other questions?

Question: There's one more question from the web from John Francis for Rolf. How do you see the impact of deflation or a return to inflation on Lloyd's?

Rolf Tolle: I think it is quite natural that when you come out of a phase where a lot of debt has been created that the time concept, the debt has to be paid, if you make the assumption that repayment will get supported by printing more money then that will create an inflationary effect. I think we can easily see in a year or two years' time that we see inflation picking up. Inflation has really two impacts. One on the claims side that quite often social inflation is higher than economical inflation and that drives just simply amounts to be paid out of claims up, so we will have a challenge to make sure that we reserve properly in our books for that to happen or when that happens. Secondly, on the underwriting side there has been normally inflationary periods and tendency suddenly to turn onto cash flow underwriting despite the fact that maybe the real interest rates is comparatively low, because you have inflation at the same amount as maybe the interest rate, but it has forced, in the past historically people have then looked and said let's write the business, because the investment income will carry us through and that is something we then have to address quite carefully to make sure that that doesn't happen in the Lloyd's market. That's the challenge ahead of us.

Richard Ward: Any other questions? If there are no further questions thank all very much indeed for your time this morning.