

# STRATEGY – COMPETITIVE ENVIRONMENT AND FUTURE OUTLOOK

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## LLOYD'S PLAYS A SIGNIFICANT ROLE IN BOTH THE UK ECONOMY AND THE GLOBAL INSURANCE INDUSTRY. IT IS THE LARGEST SUBSCRIPTION MARKET, A RECOGNISED LEADER OF SPECIALIST UNDERWRITING AND THE WORLD'S THIRD LARGEST NON-LIFE REINSURER\*.

### Lloyd's competitive position

Lloyd's has a strong competitive position, derived from the capabilities of the businesses in the market and the benefits and services provided by the Corporation:

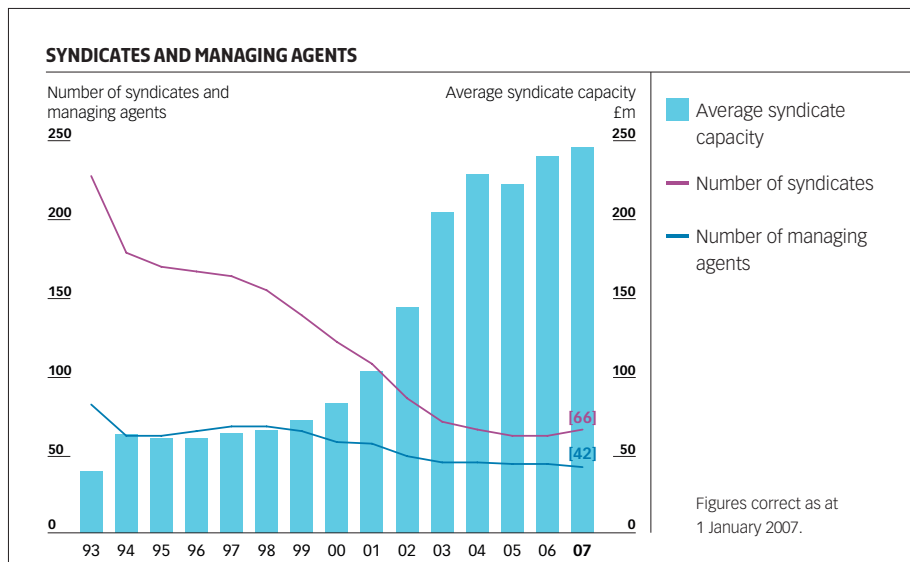
- Businesses trading at Lloyd's benefit from access to a worldwide licence network, a market-wide security rating and an established reputation and brand.
- Lloyd's is primarily a subscription market, and is unique in having a back office infrastructure to support this.
- Members at Lloyd's benefit from capital efficiency derived from a several and mutual capital framework.
- Lloyd's businesses bring an outstanding breadth and depth of specialist underwriting expertise.
- New businesses can start up with immediate access to business flows and the backing of a secure rating.

To develop and strengthen its competitive position, Lloyd's needs to address structural issues and trends both within the market and in the wider industry.

### Significant trends in the global insurance environment

- The insurance industry operates in an increasingly demanding regulatory environment which, while increasing transparency, adds to costs and workload.
- Consolidation and regulatory scrutiny are driving structural and business model changes in the broker market.
- There is an increasingly complex underwriting cycle, where loss trends and market forces are driving cycles with characteristics that differ by line of business and territory. At the same time, there are increasing demands from shareholders and rating agencies for an effectively diversified portfolio.
- Regional insurance markets are increasing in importance as less complex business is placed closer to home. Other markets for complex or international business are also growing. These trends are fuelled by the increasing mobility of global capital.
- There is an increasing interplay between insurance and the international capital markets (eg securitisation).

\* 'Lloyd's is the world's third largest non-life reinsurer', Standard & Poor's Global Reinsurance Highlights 2006.



### Trends in participation at Lloyd's

- The size and number of managing agents and syndicates operating at Lloyd's have changed markedly. Over 400 syndicates in 1980 have become 66 in 2007, with average capacity rising from £6m to £244m. The majority of managing agents are now owned by listed companies or backed by insurance-related capital.
- There have been major changes in the nature of capital backing with a significant reduction in private capital (from 45% to 16% of market capacity in the last ten years).
- Insurance businesses have more choice. Lloyd's is not the only market where large and specialist insurance business is transacted. 68% of Lloyd's capacity is now controlled by organisations with at least one underwriting platform outside Lloyd's.
- The managing agents operating at Lloyd's vary considerably (eg from subsidiaries of global, multi-platform insurers to specialist Lloyd's-only businesses). As such, our offer must be tailored to meet the differing needs of all users.

Our vision is aimed at meeting these challenges and is delivered through a rolling Three-Year Plan, reviewed and tested on an annual basis.



### IN CONTROL: RISK MANAGEMENT TOOLKIT

Risk is the business of Lloyd's. An in-depth understanding and control of risk is essential for keeping exposure within a set risk appetite. Yet, as every business at Lloyd's is unique, there is no one-size-fits-all answer to risk management in the market.

After consultation with the Lloyd's Market Association Risk Management Committee, in July 2006, Lloyd's launched a comprehensive Risk Management Toolkit (RMT), supporting and promoting best-practice risk management. Using tools, techniques and templates, worked examples and practical advice, the RMT is designed so each business can tailor it to its individual needs. By comparing current practice against the toolkit, businesses can undertake a gap analysis and can also use it as a training tool. It was one of only four non-FSA reference materials quoted in the FSA's recent briefing 'Risk Management in Insurers'.

It's not just for insurance risks: businesses face a variety of other risks as part of their day-to-day operations and the RMT is designed to help businesses manage these non-insurance risks as well. The toolkit will evolve alongside industry practices, allowing Lloyd's to provide market participants with ever more sophisticated tools to manage their risks. The RMT is available on [www.lloyds.com/rmtoolkit](http://www.lloyds.com/rmtoolkit)

# STRATEGY – LLOYD'S VISION

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## OUR VISION IS TO BE THE PLATFORM OF CHOICE FOR INSURANCE AND REINSURANCE BUYERS AND SELLERS TO ACCESS AND TRADE BOTH SPECIALIST AND LARGE PROPERTY AND CASUALTY RISKS.

### Key features

Supporting the vision, there are a number of key features of Lloyd's and the way we operate. These are detailed in full in the Three-Year Plan 2007-2009 at [www.lloyds.com/threeyearplan](http://www.lloyds.com/threeyearplan). They include:

- Lloyd's is a specialist property and casualty subscription market. Other types of business can be written but the subscription market is at Lloyd's core.
- Mutuality of capital will remain. It helps Lloyd's to be more capital efficient than many competitors while underpinning our licences and ratings.
- Lloyd's success will be seen in profitable cross-cycle growth. This does not necessarily translate into year-on-year growth as it may be necessary to contract at certain points in the underwriting cycle.
- Lloyd's is a disciplined marketplace where the standards of the best businesses will become those of the market as a whole.
- Lloyd's welcomes diversity of business types and diverse sources of capital.
- The Underwriting Room is central to the operation of an effective subscription market and will continue for the foreseeable future.
- Lloyd's distribution model consists of wholesale and retail brokers, coverholders, service companies and international, centrally-sponsored underwriting initiatives (eg Lloyd's Asia). While no fundamental changes are envisaged to the model, the supporting processes and operations are inadequate and will be reformed.
- The not-for-profit business model of the Corporation will remain. Its main function is to lead or support changes to ensure the market operates in the most commercially attractive and efficient manner.

### THE BENEFITS

Taken as a whole, the intended benefits of Lloyd's to market participants will be:

**For managing agents:** A central core of standards, security and market access, plus the provision of flexible tools and services which can be used as appropriate to execute individual strategies.

**For brokers:** A secure market with diverse participants with differing strategies and risk appetites, where policyholders benefit from Lloyd's reputation and service quality.

**For members:** An opportunity to participate, within a capital efficient framework, in businesses with the ability to maximise their performance in the specialist insurance market.



**The Three-Year Plan**

The rolling Three-Year Plan is aimed at delivering our vision. The current plan covers 2007-2009 and identifies the five key benefits of Lloyd’s as a place to do insurance business and the steps being taken to strengthen these attributes and improve Lloyd’s position in the global insurance market.



Each benefit is designed to be tailored by market participants to meet individual needs and characteristics. There is a central core to the offer comprising minimum standards, a mutual and several capital framework, licences, the market rating and some central services. Beyond this, we will offer additional services and infrastructure, which can be used as appropriate by individual managing agents (eg distribution channels, treasury services).



**A FAIR WIND: SCOTTISH POWER**

Climate change is challenging the world to find viable alternatives to fossil fuels. Wind power has huge potential but demands major effort and investment, which in turn depends on high-quality insurance cover. In 1999, a consortium of Lloyd’s syndicates anticipated the trend and began to offer cover for wind power operators. Today Lloyd’s has a 25% share of the global market in this specialist risk class.

One of our biggest clients in this class, Scottish Power, has invested in major wind energy projects around the world as it positions itself in the changing global energy market. Their portfolio of projects, including sites in the US, has a combined value of more than £1,000m.

For Scottish Power, Lloyd’s offers three major advantages. One is the breadth and scope of the cover. Another is the flexibility offered by licences all over the world – important when you are delivering projects in multiple locations. Finally, there is capacity: Lloyd’s can take on the largest individual risks. With its projects covered at Lloyd’s, Scottish Power is well placed to benefit from the trend towards green energy.

# STRATEGY – THE FIVE BENEFITS

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**The five benefits at the centre of our strategy are regularly tested and reviewed in the light of feedback from the market, progress and the evolving external environment. Each benefit is set out below in more detail. These descriptions outline the desired position for each benefit. We are close to this state for some benefits, such as Security and Ratings, whereas for others, notably Operations and Processes, much remains to be done.**

A detailed description of the workstreams to deliver each benefit and a progress update as at the end of 2006 can be found at [www.lloyds.com/threeyearplan](http://www.lloyds.com/threeyearplan) (see also pages 7 to 9 of the Chief Executive Officer's statement).

## 1. Performance framework

An overarching, consistent performance management framework across all key aspects of a managing agent's business, that supports the achievement of superior operating returns as part of an effective enterprise risk model.

- A performance framework that recognises, reacts to and rewards the relative performance of individual managing agents and raises standards across the market.
- The provision of differentiated levels of support and intervention by the Corporation, depending on the capabilities of each managing agent.
- Business planning tools that enable managing agents, their capital providers and the Corporation to better understand the risks and performance potential of individual businesses.
- The provision of relevant data and information which allows managing agents to benchmark, plan, measure and manage their business.
- A framework for the expert management of complex and subscription claims in order to further enhance the claims handling capability of the market.

## 2. Capital advantages

A capital framework in which the benefits of mutuality demonstrably outweigh the costs and which cannot easily be duplicated outside Lloyd's.

- A risk-adjusted capital-setting process, based on the FSA's ICAS regime, that reflects the level of exposure of the mutual assets to an individual business and 'commercially prices' this accordingly, taking into account the market's ratings requirements and each managing agent's enterprise risk management capability.
- Capital structures, including mutual assets, that can be tailored and give managing agents the opportunity to benefit from strong ratings and obtain increased returns for their capital providers, compared to trading on a stand-alone basis.
- The cost of maintaining Lloyd's mutual assets targeted to be on average less than 1% of gross written premiums across the insurance cycle.
- A capital framework that actively assists managing agents in accessing flexible sources of capital at a competitive cost.
- Managing agents able to increase their capital resources expeditiously to take advantage of business opportunities as they arise.
- Managing agents able to pay out excess funds through bi-annual release of profit from their syndicates and capital providers able to reduce their commitment where surplus capital exists.
- Asset admissibility criteria that allow flexibility in how capital is provided which enhances potential investment returns.

## OTHER SIGNIFICANT ACTIVITIES FOR 2007

The Three-Year Plan 2007-2009 also outlines a number of other significant issues outside the five benefits which are of major importance to the current and future attractiveness of Lloyd's. These include:

- Work to reduce the actual and perceived complexity of operating at Lloyd's, including:
  - Reviewing managing agents' reporting requirements.
  - Revising the Lloyd's/FSA oversight protocol.
  - Developing processes to allow syndicates to start mid-year.
  - Introducing a more streamlined business planning and capital timetable.
- Analysis to understand and address actual and perceived cost disadvantages of the Lloyd's platform.
- Developing relationship management and marketing strategies for both existing and potential new users of the Lloyd's platform.



### 3. Security and ratings

Stable insurer financial strength ratings (currently at least 'A') necessary to attract specialist and large property and casualty business.

- Within reasonable bounds of expectation, Lloyd's maintains its ratings across the insurance cycle.
- Lloyd's has the capability to survive a '1 in 200' industry-level event and enable managing agents to trade forward with a secure rating.

### 4. Market access

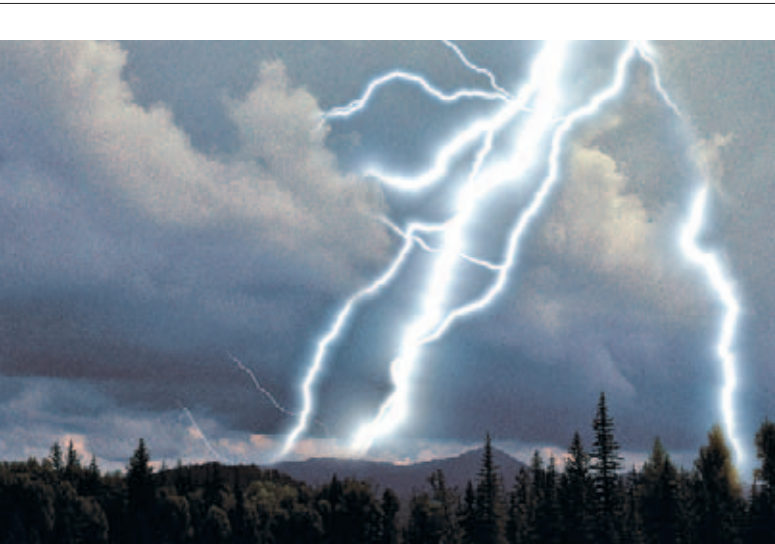
Cost-effective, easy access to the world's major markets supported by a global brand and licence network.

- A turnkey licence structure that offers access to the major markets in specialist and large property and casualty risks.
- International offices that provide business development and support services to managing agents.
- A leading global brand and reputation, which helps managing agents to win and retain preferred business.
- Access to multiple distribution channels capable of supporting acquisition costs that are commercially comparable with those of non-Lloyd's businesses.
- An attractive platform for brokers and other producers of business to place risks in the market in terms of cost and ease of access.
- Co-ordinated reporting by the Corporation to regulatory and tax authorities to protect the licences and reduce the burden on individual managing agents.
- Local underwriting operations in worldwide markets open to local capital providers as well as existing capital providers.
- Access, through the Lloyd's network, to a pool of insurance talent and a choice of service providers and professional firms with insurance knowledge and expertise.

### 5. Operations and processes

Integrated processes and technology, standards and value-added services that enable managing agents, brokers and other producers to trade, irrespective of location, cost-effectively and efficiently.

- Business processing standards and quality targets, aligned with the wider Performance Framework, that support the effective operation of the market.
- Simple and cost-effective processes that support multiple distribution channels.
- Brokers and other producers are able to place subscription business, dealing with Lloyd's underwriters as one market, using non-duplicative and non-repetitive processes.
- A market that operates primarily with electronic data capture, enabling data exchange between firms to international standards.
- Streamlined provision of relevant data to the Corporation, sourced once and used many times.
- Proven, resilient technology used to provide services and systems relevant to the needs of each managing agent and the Corporation.
- Where demand and cost efficiencies exist, centrally sponsored, value-added services which leverage Lloyd's collective strength.



### WIDENING CHOICE: THUNDERBIRD RE

The availability and affordability of reinsurance cover for US catastrophic risk is an important issue in the Lloyd's market. Syndicates at Lloyd's are now exploring new types of loss mitigation and looking at capital markets alternatives to supplement traditional sources of reinsurance.

Last year, Lloyd's widened the market's options further, with the establishment of Thunderbird Re, a new framework to provide Lloyd's syndicates with a cost-effective way to access capital markets through the issuance of catastrophe-linked bonds ('cat bonds'). Thunderbird Re is a special purpose reinsurer dedicated to the Lloyd's market. It has been uniquely designed to support Lloyd's syndicates either on a bespoke or collective basis.

A working party of managing agents is now meeting to determine the size and nature of syndicates' cat bond requirements. It's an example of Lloyd's exploring alternatives and providing options for the market to make optimum choices.