

FROM: Head, Market Reporting EXTN: 5129  
DATE: 29 July 2005 REF: Y3607  
SUBJECT: **2005 YEAR END RETURNS**  
SUBJECT AREA(S): Final forms for the 2005 year end returns and revised timetable for their completion, and draft Valuation of Liabilities rules  
ATTACHMENTS: Appendix 1 – timetable  
Appendix 2 – draft Valuation of Liabilities rules  
Appendix 3 – draft Statement of Actuarial Opinion

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ACTION POINTS: **To note final forms for use in the 2005 year end returns and revised timetable for their completion, and draft 2005 Valuation of Liabilities rules.**  
DEADLINE(S): **See Appendix 1**

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The purpose of this market bulletin is to provide the final forms for the annual return (AR), solvency and reserving data (SRD) and FSA return as at 31 December 2005, and formally advise the market of the revised and final timetable for the submission of the 2005 year end returns. This follows up the presentation made at the LMA Finance Directors' Open Meeting on 23 June 2005. This bulletin also includes the draft Valuation of Liabilities rules. We are finalising these rules in conjunction with the Institute of Actuaries and the FSA.

### *Forms*

The final forms for the AR, SRD and FSA returns as at 31 December 2005 are available for download from the MSU market returns website.

The main changes from the draft forms provided in February 2005 are summarised below:

#### AR:

- A new form (AR102) is provided to collect cumulative information by reporting year of account only, in converted sterling. This form is required for control and reconciliation purposes.
- A new form (AR103) provides a reconciliation from the calendar year result on an annual accounting basis to the cumulative result reported on AR102.
- A revised AR104 collects a segmental analysis for all reporting years combined for use in the Lloyd's Market Report.
- The previous AR104 is renumbered AR106 and collects segmental analysis by reporting year, for use in the central corporate member accounting facility. This form is only required to be completed where the syndicate year in question is participated on by corporate members subscribing to this facility.
- A number of additional forms are provided to collect comparative information for calendar year 2004 (on an annual accounting basis) and a reconciliation from the calendar year 2004 information previously collected in the 31 December 2004 supplementary syndicate

return. These forms are required for the central corporate member accounting facility. These forms are denoted ARxxxc for comparative data and ARxxxr for reconciliations. These forms only need to be completed where the syndicate year in question is participated on by corporate members subscribing to this facility.

- A new form (AR109) is provided to collect an analysis of RITC. This form, which is similar to SSR1A as at 31 December 2004, is also required for the central corporate member accounting facility.
- The segmental analysis collected on AR104 and AR106 requires a breakdown of gross written premiums between 'United Kingdom', 'Other EU member states' and 'Rest of the world'. It is considered likely that, in most cases, following consideration of this matter with your auditors, that all premiums will be reported as 'United Kingdom' business.
- AR223 is slightly revised and includes provision for solvency loadings.
- AR282 is revised to reflect the new format of the equivalent form to be reported in the Lloyd's Return provided to the Financial Services Authority. For this year end only, comparative data is also required.
- AR320 and AR330 have been slightly revised to bring them into line with the equivalent forms in the 30 June 2005 interim return.

#### SRD:

Where the SRD is not to be used to pre-populate the AR and FSA return (see 'Timetable' below), then analysis by method of placement is not required, and certain lines do not need to be completed. The relevant lines which are not required to be completed in this circumstance are identified on the forms.

#### FSA return:

No changes to the previously provided drafts have been made.

Although these forms are intended as final, it is possible that, as a result of further development and testing work to be performed both centrally and by managing agents, and in order to ensure that the data collected meets Lloyd's requirements, further minor revisions may be required.

The managing agent's and auditor's reports will be distributed at the time of the distribution of final instructions for the year end returns, in early October. Please note that there will be two audit reports required for the annual return: a report addressed to the Council of Lloyd's on the whole return and a separate report addressed to the corporate members of the syndicate and their auditors, in relation to the information submitted in respect of the central corporate member accounting facility only.

#### *Timetable*

The final timetable for provision of the forms, instructions and software to the market, and the submission of the returns to Lloyd's is attached at Appendix 1. In response to our consultation with the market, the following amendments have been made to the timetable and basis of submission:

- The choice will now be provided to managing agents as to whether they wish to use the SRD to pre-populate parts of the AR and FSA returns, or alternatively complete the AR and FSA returns using an alternative methodology.

- The deadline for submission of the SRD return has been put back from 2 March 2006 to 13 April 2006.
- The deadline for the submission of the FSA return has been put back from 23 March 2006 to 13 April 2006.

#### *Valuation of Liabilities rules*

Attached at Appendix 2 are the draft Valuation of Liabilities rules for 31 December 2005. Please note, among other things, that a requirement for the actuary to consider a disclosure relating to material cross subsidy between components of the solvency provision, is set out in paragraph 10. The draft Statement of Actuarial Opinion is attached at Appendix 3. These rules are being finalised in conjunction with the Institute of Actuaries and the FSA. The final rules will be issued by the end of October.

Please contact Henry Johnson ([henry.johnson@lloyds.com](mailto:henry.johnson@lloyds.com)) if you have any queries or comments on the draft Valuation of Liabilities rules. Any queries on the rest of this bulletin and the forms should be e-mailed to [lloyds-mrd-returnqueries@lloyds.com](mailto:lloyds-mrd-returnqueries@lloyds.com).

This bulletin is being sent to the compliance officers of all underwriting agents, and also to recognised accountants and market associations.

John Parry

## Appendix 1

### Timetable – 31.12.2005 reporting season (excludes overseas reporting)

Activity	2005 deadline	2004 deadline	Comment
Final forms and instructions provided to market for year end returns	Fri 7 Oct 2005	Fri 8 Oct 2004	
Software available for market-wide user acceptance testing – SRD	Fri 7 Oct 2005	-	
Software available for market-wide user acceptance testing – AR	Mon 7 Nov 2005	-	
Software available for market-wide user acceptance testing – FSA	Fri 11 Nov 2005	-	
Final software available for download – SRD	Fri 2 Dec 2005	Fri 12 Nov 2004	
Final software available for download – AR	Fri 9 Dec 2005	Fri 12 Nov 2004	
Final software available for download – FSA	Fri 23 Dec 2005	Fri 12 Nov 2004	
Annual return workshops	6, 7, 12 Dec 2005	3, 10, 13 Dec 2004	Combined AR, SRD and FSA return workshops
Agents to submit 31.12.2005 AR	Thur 2 Mar 2006	Thur 24 Feb/ Thur 3 Mar 2005	Succeeds SR, SSR and AAR. Audited
Agents to submit 31.12.2005 QMR	Thur 9 Mar 2006	Thur 24 Mar 2005	Will be largely pre populated from AR. Unaudited
Agents to submit 31.12.2005 syndicate report and accounts	Thur 23 Mar 2006	Thur 24 Mar 2005	Audited
Agents to submit 31.12.2005 SRD	Thur 13 Apr 2006	Thur 14 Apr 2005	May be used to pre populate AR and FSA return for class of business analysis. Unaudited.
Agents to submit 31.12.2005 FSA return	Thur 13 Apr 2006	Thur 21 Apr 2005	Audited

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VALUATION OF LIABILITIES RULES  
FOR LLOYD'S SOLVENCY PURPOSES

31 DECEMBER 2005

## DRAFT

# VALUATION OF LIABILITIES

## INTRODUCTION

These rules are made by the Council of Lloyd's under paragraph 9 of the Solvency & Reporting Byelaw (No.13 of 1990) for the valuation of members' underwriting (general and life business) liabilities. Lloyd's has consulted the Financial Services Authority on these rules. A syndicate's general business liabilities must be calculated in compliance with sections 18.3.1 and 24.3 of the Financial Services Authority's Lloyd's Sourcebook (LLD) (which apply PRU 1.3R and PRU 7.2 R to PRU 7.2.19G (except PRU 7.2.13R(1)) to managing agents).

Members' underwriting liabilities are determined by reference to the liabilities of the syndicates on which they participate. The attribution of those liabilities to members for the purposes of the annual solvency test is undertaken by Lloyd's centrally. These rules therefore focus only on the determination of syndicate underwriting liabilities.

## GENERAL INSURANCE BUSINESS

Equitas Reinsurance Ltd has reinsured all 1992 and prior general business liabilities with effect from 31 December 1995. The rules therefore relate only to the 1993 and subsequent years of account.

The main principles are as follows:

- managing agents must determine adequate technical provisions for solvency purposes in accordance with the rules set out below;
- managing agents must appoint an actuary (the Syndicate Actuary), who is in possession of a current Lloyd's Practising Certificate issued by the Institute of Actuaries or Faculty of Actuaries, to provide an opinion on those technical provisions, for each syndicate; and
- where an unqualified actuarial opinion will or may not be available, the managing agent concerned must report to the Lloyd's Director of Finance and Risk Management. Technical provisions for solvency in such a case will be determined by the Lloyd's Actuary who, after consultation with the Syndicate Actuary, will take the relevant facts of the syndicate's business and reinsurance arrangements into account when forming his opinion.

Any managing agent which is not able to secure an unqualified actuarial opinion on its technical provisions for solvency for a particular syndicate will normally be subject to a monitoring review by Lloyd's Risk Management Department.

Where it becomes apparent that there may be any difficulties in obtaining an unqualified actuarial opinion, or that the "Additional Comments" section of the

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opinion is likely to contain material issues, the Lloyd's Actuary must be informed as soon as is practicable.

LLD 19.2 requires the minimum capital requirement (MCR) for each member to be calculated. The method for determining the member's MCR is similar to that used for EC required minimum margin calculations, as adapted for the circumstances of members of Lloyd's. Those calculations are performed by Lloyd's centrally, and are outside the scope of these rules.

### **DETERMINING THE TECHNICAL PROVISIONS FOR SOLVENCY– GENERAL BUSINESS**

1. The managing agent must, in respect of each syndicate managed by it, establish adequate technical provisions for solvency for each year of account which became closed or remained open as at the solvency test date. Both gross and net of reinsurance technical provisions must be established: the net of reinsurance technical provision shall be the technical provision for solvency.
2. For the purposes of determining the technical provisions for solvency for any year of account which has accepted a reinsurance to close, account must be taken of the liabilities associated with earlier underwriting years which have been reinsured into that year, and thus the technical provisions for solvency will be the aggregate of all these years taken together. This technical provision for solvency will also include a reserve specifically for that latest year itself.
3. The technical provision for solvency in respect of any year of account which is being closed by reinsurance to close must be at least equal to the reinsurance to close premium.
4. The appropriate method of deriving the net of reinsurance technical provision is by subtracting reinsurers' share from the gross technical provision. The rules for determining the gross technical provisions and reinsurers' share are set out below.
5. The technical provisions established by managing agents must be consistent with the provisions reported in syndicate annual accounts, prepared in accordance with the Insurance Accounts Directive (Lloyd's Syndicate and Aggregate Accounts) Regulations 2004. The actuarial opinion must continue to be on the basis that the technical provisions for solvency purposes are no less than the best estimate of future liabilities.

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### ACTUARIAL OPINIONS

6. As referred to above, the technical provisions determined for each year of account are required to be subject to an actuarial opinion in the form prescribed. This assessment is to be performed in accordance with GN20. Account should also be taken of relevant advisory notes issued by the Institute and Faculty of Actuaries and the Code of Practice “Management Of Reserving Risk” issued by Lloyd’s, even where these are not mandatory. GN20 is being reviewed and actuaries must refer to the Institute and Faculty of Actuaries to confirm that they have the latest version. The current version is available from [www.actuaries.org.uk](http://www.actuaries.org.uk).
7. Provisions for future unallocated loss adjustment expenses, provisions for reinsurance bad debts, and unexpired risk provisions and unearned premiums provisions, fall within the scope of the actuarial opinion.
8. Acceptable signatories to the actuarial opinion are:
  - fellows of the Institute of Actuaries;
  - fellows of the Faculty of Actuaries; and
  - fellows of the US Casualty Actuarial Society who are also members of the Institute of Actuaries or Faculty of Actuaries.
9. Signatories must hold a current practising certificate issued by the Institute of Actuaries or Faculty of Actuaries and may be either external consulting actuaries or employees of the managing agent.
10. The actuarial opinion includes a section entitled “Additional Comments” which allows the actuary to highlight material issues for the Council of Lloyd’s attention. Such comments are intended to enhance the disclosures made in the opinion and do not constitute a qualification. Any matters which materially increase the degree of uncertainty underlying the opinion beyond that which would reasonably be expected [which relate to material cross subsidy between components of the solvency provision] or which involve a material deviation from accepted actuarial methodologies would normally justify a reference in this section.
11. The actuarial opinion covers the total of the technical provisions for solvency but the actuary is not required to report separately on each component element of the technical provisions.

### GROSS TECHNICAL PROVISIONS

12. The gross technical provisions must not be less than the expected ultimate cost of settlement of all claims incurred in respect of events up to the balance sheet date, whether reported or not, together with all loss adjustment expenses, less amounts already paid and before taking



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reinsurers' share into account (LLD 18.3.1 and 24.3.1 applying PRU 1.3.5 and PRU 7.2.13 respectively). Provision should also be made for claims events which have occurred but have not yet been reported, using appropriate statistical and other techniques to address any uncertainty arising.

The gross technical provisions must include gross reported claims, incurred but not reported claims and provisions for future allocated and unallocated loss adjustment costs including the expenses of managing the run-off of the business. They must take account of inflation, currency exposure and any other factors which may influence the final monetary cost of settlement including any costs of borrowing that may arise. When assessing the cost of borrowing prudent allowance may be made for cash calls planned but not actually made at the valuation date.

Credit must be taken for anticipated salvage and subrogation rights, net of any related bad debts.

An unearned premium provision must be established which represents that proportion of gross premiums written which relate to periods of risk after the balance sheet date. Premiums are deemed to be earned over the period of cover under each policy having regard to the nature of the business written and the related spread of risk.

An unexpired risk provision must be provided where the expected value of claims and claims management expenses attributable to the unexpired periods of policies in force at the balance sheet date exceeds the unearned premiums provision in relation to such policies after deduction of any acquisition costs deferred. An assessment of whether an unexpired risk provision is necessary must be made for each grouping of business which is managed together with any unexpired risk surpluses and deficits within that grouping being offset. Further guidance on the definition of 'managed together' is given in paragraph 117 of the ABI SORP. The potential requirement for an unexpired risk provision must be assessed on the basis of information available at the balance sheet date. Claims events occurring after the balance sheet date in relation to the unexpired period of policies in force at that time must not therefore be taken into account in assessing the need for an unexpired risk provision if they were not capable of prediction at the balance sheet date. Please also refer to paragraph 119 of the ABI SORP.

The total gross technical provisions thus comprise outstanding claims (including reported and IBNR claims), unearned premium provisions, unexpired risk provisions and any other technical provisions. Lloyd's does not expect managing agents to hold any 'other technical provisions' and

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- any agent intending to do so must contact the Lloyd's Actuary as soon as possible.
13. For practical reasons, it should be assumed that the costs of handling gross claims and reinsurance recoveries are included in the gross provision for unallocated loss handling expenses. Where it is reasonable and prudent to do so, the provision for unallocated future claims handling should be calculated on the practical assumption that each syndicate is a going concern. Otherwise, provision must be made on the basis that the syndicate has ceased or will cease trading, in whole or in part, as appropriate.
  14. The level of claims provisions must be set such that no adverse run-off deviation is expected. This is consistent with the requirement of paragraph 43 of Part I of Schedule 9A to the Companies Act 1985 that technical provisions must be sufficient at all times to cover any liabilities arising out of insurance contracts so far as can reasonably be foreseen. Please refer to paragraph 88 of the ABI SORP for further guidance.
  15. Discounting is not permitted when calculating technical provisions for solvency (LLD 19.3.1 applying PRU 2.2.79). Accordingly, any credit for discounting within syndicate technical provisions determined under UK GAAP, must be added back in full.
  16. The gross technical provisions must take into account the particular circumstances of the syndicate, any relevant statistical evidence and the judgement of the Board of the managing agent as to the eventual outcome of each year in question. Historical statistics may not, however, satisfactorily reflect a syndicate's exposure to significant losses. Accordingly, the provision for incurred but not reported claims must provide for circumstances where a syndicate is exposed to losses arising from one or more known major catastrophes or a known potential cause of loss.
  17. Careful consideration must be given to ultimate exposures (irrespective of currently reported losses/current technical provisions) in respect of known catastrophes on any year of account. Furthermore, if there is likely to be a greater than usual incidence of attritional losses, then appropriate technical provisions must be established.
  18. If there are circumstances or an event that materially increases the uncertainty and makes estimation of the technical provisions particularly difficult for any year of account, then alternative approaches will need to be considered. Syndicates must have a clearly documented methodology and must be able to demonstrate reasoned judgements for the estimation

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of such liabilities. Claims reported or precautionary advices received to date must be monitored and reserved for in the usual way.

### REINSURERS' SHARE

19. The deduction in respect of reinsurers' share of technical provisions must be the net monetary amounts which are expected ultimately to be recovered in relation to the total gross technical reserves. Such amounts must include any costs of borrowing necessary to cope with delays in reinsurance recoveries. An appropriate provision must be made for potential reinsurance bad debts.
20. Since the technical provisions for solvency cover all relevant liabilities at the year end, the managing agent must take account of the need to provide for the reinsurance premium cost of the protection of the liabilities covered by the technical provisions for solvency.
21. With respect to the unexpired risk provision, additional reinsurance premiums required must be taken into account.
22. Where a syndicate is a going concern and the following year of account has commenced trading, the provision for future reinsurance costs, to be considered within the unexpired risk provision, should be made on the basis of allocation of costs according to each year of account's share of earned premiums being protected by the future reinsurance. This is irrespective of the year of account in which the relevant reinsurance premiums will be charged. Care must be taken where a syndicate has contracts that provide protection over several years to ensure all future costs of reinsurance are properly allocated to the year of account they are protecting so that the technical provisions for solvency are not underestimated.
23. Where a multi-year reinsurance contract is entered into, the reinsurance premiums contracted for must be included in reinsurers' share of unearned premiums. Where the syndicate is a going concern, the unexpired risk provisions may take into account expected future gross premiums, which the multi-year reinsurance contract is expected to cover.
24. The reinsurance bad debt provision must take into account appropriate amounts in respect of reinsurer insolvency only. Provisions in respect of disputes with reinsurers must be deducted from reinsurers' share of claims, not included within reinsurers' bad debt provisions. There is potential for these amounts to increase significantly, as well as gaps occurring in the reinsurance cover when the circumstances or an event as

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- envisaged in paragraphs 17 or 18 occur. The reinsurance bad debt provision must also cover all stop loss reinsurance contracts.
25. Lloyd's security must be treated as 100% recoverable. However, provision must be made within the reinsurers share of claims where considered appropriate for reinsurance disputes between different Lloyd's syndicates which must not be confined to identified disputes.
26. Reinsurances must be assessed in accordance with the principles of Financial Reporting Standard 5. That is, if the contract is in the nature of an investment it must be treated as an asset and valued for solvency purposes at its net present value; alternatively, if it is a contract of reinsurance, it must be treated as such. Some reinsurance contracts have large profit sharing elements attaching to them, which are clearly financial elements. For these contracts the profit commission must be treated as a financial element and therefore as an asset and valued for solvency purposes at its net present value.

### **NO ACTUARIAL OPINION**

27. Where an unqualified actuarial opinion is not available for any particular year of account, including any year which has earlier underwriting years reinsured into it, the managing agent concerned will need to seek further instructions from the Lloyd's Director of Finance and Risk Management. In particular, the Lloyd's Actuary, after consultation with the Syndicate Actuary, will determine the technical provisions for solvency for each year of account in respect of which an unqualified opinion is not available.

### **US & CANADIAN DOLLAR, EURO AND OTHER SETTLEMENT CURRENCY BUSINESS**

28. The estimated liabilities on United States dollar, Canadian dollar, Euro and other settlement currencies (where material) must be calculated in these currencies, in accordance with the rules set out above.
29. The pre-1 August 1995 LATF is not specifically covered by any of these opinions, at least not in isolation.

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30. The [UK] actuarial opinion addresses the breakdown of the net reserves for each year of account, so as to identify separately amounts attributable to the pre-1 August 1995 LATF.
31. Liabilities in US dollars, Canadian dollars, Euro and any other relevant settlement currencies must be converted into sterling at the rates of exchange prevailing at the close of business on the effective date of calculation. Recommended closing rates of exchange will be determined and notified to the market early in the following year.

### **RESPONSIBILITIES OF SYNDICATE AUDITOR AND SYNDICATE ACTUARY**

32. The syndicate auditor's responsibility with respect to the determination of the solvency position of each syndicate is unchanged, notwithstanding the requirement for an actuarial opinion on the technical provisions for solvency. In other words, the syndicate auditor is required to submit the prescribed audit report on the annual return in the usual way.
33. The auditor will, however, be able to place reliance on the actuary's opinion, in accordance with the appropriate professional guidance.
34. Where no unqualified actuarial opinion is available, this may have implications for the syndicate auditor's report and accordingly, the actuary and auditor will need to liaise closely and report to Lloyd's as soon as any difficulties are identified.
35. Where it becomes apparent that there may be any difficulties in obtaining an unqualified actuarial opinion, or that the "Additional Comments" section of the opinion is likely to contain material issues, Lloyd's must be informed as soon as is practicable once advisers will have discussed matters with their client.

### **LIFE BUSINESS**

36. A syndicate with long term insurance liabilities must comply with LLD 18.3.1 and 24.3, which apply PRU 1.3 and 7.2 respectively. The managing agent must appoint a Syndicate Actuary to certify the technical provisions for solvency for life business using the form of opinion approved for this purpose.

**Opinion on Solvency Reserves**

To: Council of Lloyd's / International Insurers Department

Statement of Actuarial Opinion – Syndicate KLM

**Identification**

I, ABC, am an actuary employed by XYZ [the Managing Agent.]

Or

I, ABC, am associated with the Firm of GHI Consulting Actuaries who have been retained by XYZ [the Managing Agent.]

**Qualification**

I am a Fellow of the [Casualty Actuarial Society and an Affiliate of the] Faculty/ Institute of Actuaries and possess a certificate valid as at the date of this Opinion to provide UK Actuarial Opinions for Lloyd's Syndicates, issued by the Institute /Faculty of Actuaries.

**Scope**

I have examined the technical provisions listed below for the underwriting years 1993 to [current year] of Syndicate KLM as at 31<sup>st</sup> December [current year], as reported in Form(s) AR223 "Summary of Technical Provisions" submitted by the Managing Agent. I have reviewed the technical provisions shown in column 1 of lines 5 and 18, for each relevant year of account. [The form references may need to be changed, if the relevant forms are altered. The actuary should refer to any relevant instructions issued by Lloyd's.]

The technical provisions are the responsibility of the Managing Agent; my responsibility is to express an opinion on those reserves based on my review.

	<b>[current year]</b>	<b>[current year -1]</b>	<b>[current year -2]</b>
Total gross technical provisions (Conv £000's)			
Total technical provisions net of reinsurers' share (Conv £000's)			
LATF (US\$000's)			

NB: "Conv £" figures above are converted at [£1 = US\$ a.aa = C\$ b.bb = Euro c.cc]

[NB: The table may need to be amended if, for example, there are old open years of account]

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The preceding technical provisions are for indemnity amounts and claims handling expenses (both allocated and unallocated) and include provision for future claims arising from unexpired periods of risk. They are net of salvage and subrogation, on past and current business. They are not discounted for the time value of money. The net technical provisions and the LATF technical provisions include a provision for reinsurance bad debts, where appropriate.

I have relied upon data prepared by the responsible employees of the Managing Agent. These data have not been checked by me, although the Managing Agent has confirmed that the data supplied to me are accurate and I have reviewed all key data for reasonableness. In other respects my examination included the use of such actuarial assumptions and methods and such tests of the calculations as I considered necessary.

[If the actuary did not carry out independent calculations for the purposes of providing the SAO, but rather reviewed the methods and assumptions used by the Managing Agent in determining the technical provisions, then wording similar to the following may be used (in place of the final sentence of the previous paragraph):

***“In other respects my examination included such review of the methods and assumptions used and such tests of the calculations made as I considered necessary.”***

[Additional Comments

Other comments at the discretion of the Actuary.

These additional comments do not constitute a qualification of my opinion.]

### **Variability**

In evaluating whether the technical provisions make a reasonable provision for unpaid claims and claims expenses, it is necessary to project future premium, claim and claim handling expense payments. Actual future premiums, claims and claim handling expenses will not develop exactly as projected and may, in fact, vary significantly from the projections. Further, in most classes of business, the scope for adverse development exceeds the scope for favourable development. In particular, although I have made what I believe to be a reasonable allowance for the risk of adverse development, I have not anticipated the emergence of major new types of classes of claims, nor the emergence of any major new reinsurance disputes.