Article Title: ARCHIVE | Criteria | Insurance | Specialty: Criteria For Lloyd's Syndicate Assessments Data: (EDITOR'S NOTE: —This article is no longer current. It has been superseded by "Insurance Criteria: Lloyd's Syndicate Assessment Methodology Revised In Light Of Lloyd's Market's Move To Annual Accounting," published June 28, 2006.) Summary Lloyd's Syndicate Assessments (LSAs) evaluate on a scale of '1pi' (very high dependency) to '5pi' (very low dependency) the degree to which a Lloyd's syndicate's financial strength is dependent on Lloyd's Central Fund, brand, international licensing agreements, and infrastructure. Standard & Poor's insurer financial strength rating on Lloyd's is currently, and will remain for the foreseeable future, the principal measure of financial strength to be applied to all syndicates underwriting in the Lloyd's Market. LSAs have been introduced as a result of the changes that have taken place in the Lloyd's Market over the past few years and a greater demand for syndicate-level information from Market users. LSAs differ somewhat in origin and analytical approach from Standard & Poor's Lloyd's Syndicate Performance Measures (LSPMs). Due to the overlap of LSAs and LSPMs for the user, Standard & Poor's has concurrently withdrawn LSPMs. LSAs are determined using both qualitative and quantitative assessment, and will initially be based entirely on publicly available information, and therefore carry a 'pi' subscript. Unlike LSPMs, which ranked a syndicate relative to other Lloyd's syndicates around a statistical mean, LSAs are an absolute measure. It is expected that full reviews of LSAs will be undertaken annually, with brief interim reviews shortly after each Lloyd's syndicate quarterly return (SQR) date. Standard & Poor's may also change an LSA in response to emerging publicly available information. Standard & Poor's Current Coverage of the Lloyd's Market Before the launch of LSAs, Standard & Poor's provided two products related to the Lloyd's Market: the insurer financial strength rating on Lloyd's; and LSPMs or 'bells'. The insurer financial strength rating on Lloyd's, which applies currently and prospectively to each policy issued by Lloyd's from the 1993 year of accounting onward, was first assigned to the Lloyd's Market in October 1997, and is currently 'A' (strong). The rating is, in effect, an aggregation of all the constituents of the Market, and this approach is facilitated by a common set of practices and partial mutualization through the Central Fund. The rating on Lloyd's is currently, and will remain for the foreseeable future, the principal measure of financial strength to be applied to the syndicates underwriting in the Lloyd's Market. Since 1991, Standard & Poor's has also provided opinions on individual syndicates, latterly via the LSPMs. LSPMs derived a ranking of all active syndicates at Lloyd's based on the syndicates' relative performance in the Market. Each syndicate was assigned a ranking, from one bell (well below Market expectations) to five bells (well above Market expectations). The analysis was strictly statistical, and contained no qualitative assessment. An LSPM was not a credit rating, and should not have been used to compare syndicates with insurance entities outside of the Lloyd's syndicate market. Background Over the past few years, the structure of the Lloyd's Market has changed significantly, particularly in terms of the pattern of capital provision. Traditionally, Lloyd's was a market backed by individuals trading on an unlimited-liability basis. Following the losses of the 1989-1992 underwriting years, and as part of the reconstruction and renewal process, Lloyd's opened membership to limited-liability capital with effect from the 1994 underwriting year. Initially, this took the form of spread vehicles (some of which were quoted on the London Stock Exchange), which were passive investors providing capital to a range of syndicates. Following ownership changes in 1996 and 1997, however, capital has become increasingly aligned to underwriting. This has given rise to Integrated Lloyd's Vehicles (ILVs), nascent insurance vehicles operating under the Lloyd's umbrella, where the underwriting member and managing agent are owned by the same parent. At the same time, the number of individual names has fallen sharply, from 12,798 in 1996 to 2,466 in 2002. To improve efficiency, the ILV owners have also instigated a consolidation of syndicates, with the result that the number of syndicates has fallen from 164 in 1997 to 86 in 2002. In addition, the losses incurred in the marketplace from 1997-2001 have brought into sharper focus the disparities in syndicate performance. It is the combination of alignment (with the industry investor often cobranding their Lloyd's operations) and the losses experienced during 1997-2001 that have focused the attention of policyholders, particularly buyers of reinsurance in the U.S., on the continuity of individual syndicates and their managing agents within the Lloyd's Market umbrella. Rationale for Lloyd's Syndicate Assessments The insurer financial strength rating on the Lloyd's Market applies to all syndicates at Lloyd's, regardless of their individual performance relative to other syndicates and market aggregates. Yet, it is understood that better-performing syndicates contribute positively, and poorer-performing syndicates contribute negatively, to the rating. LSPMs partly captured these disparities through the measurement of past operating performance. Nevertheless, Standard & Poor's recognizes that the changes in the Lloyd's Market over the past few years call for an approach that both takes into account some of the qualitative factors (rather than the purely quantitative approach of the LSPM) and is more forward looking in its analysis. LSAs are therefore designed to measure the extent to which each syndicate relies on Lloyd's, both in terms of financial support (including the potential for recourse to the Central Fund) and nonfinancial support (including brand and international licensing agreements). Although analytically this is a somewhat different approach to LSPMs, Standard & Poor's has concurrently withdrawn LSPMs because of the overlap of LSAs and LSPMs for the user. Like LSPMs, LSAs are not ratings per se, and the insurer financial strength rating on Lloyd's will remain the main measure of the financial strength of the Market for the foreseeable future. Therefore, all syndicates at Lloyd's will continue to carry the uniform insurer financial strength rating as a measure of financial strength. At the same time, each syndicate will carry an LSA as a measure of its dependence on Lloyd's. Origin of Lloyd's Syndicate Assessments As with LSPMs before them, LSAs will initially be determined solely using information that is currently in the public domain. They will not use confidential information provided by the syndicates' management, as would typically be the case when assigning an interactive insurer financial strength rating. Unlike LSPMs, however, LSAs do take into account qualitative factors in the overall assessment, and therefore Standard & Poor's does apply a certain amount of subjective judgement in determinging an LSA. Due to reliance on public information, some minimum requirements need to be fulfilled before an LSA can be assigned. The most important of these is a minimum of three closed underwriting years. Nevertheless, if there have been recent major changes at a syndicate, so that its past history has no bearing on its future performance (for example, major changes in the business portfolio, change of management), Standard & Poor's will not, under normal circumstances, publish an assessment. Syndicates writing in parallel are considered to be a single entity, and therefore carry the same LSA. In determining an LSA, Standard & Poor's considers six analytical categories: business position; operating performance; capital and ownership; outward reinsurance; reserves; and investments and liquidity. In total, 22 qualitative and quantitative factors are analyzed, with each factor carrying a fixed weighting depending on its relative importance. A score assigned for each factor and an overall score is therefore mathematically derived for each syndicate. These scores are presented in five bands, with a score of '1pi' indicating that the syndicate has very high dependency, and '5pi' indicating that the syndicate has very low dependency on the Lloyd's Central Fund, brand, international licensing agreements, and infrastructure. The factors and weightings used have been determined by Standard & Poor's using both its analysis of Lloyd's past syndicate continuity and factors that, in Standard & Poor's opinion, contribute to overall insurer financial strength. Some examples of factors that Standard & Poor's considers when assigning an LSA that were not considered in LSPMs are: The nature of the membership providing capacity to the syndicate concerned. An LSA score will benefit from a strong committed corporate capital provider where that member provides all or a significant proportion of the capacity and, in particular, where such corporate capital members are part of a group that carries an insurer financial strength rating. At the same time, the score also gives credit for the ability of a syndicate to draw capital from a diverse range of members underwriting on an unlimited basis, particularly where the syndicate has good past and prospective operating performance. Syndicate return on capacity forecasts for the open years provided by the managing agents. The most recent forecasts contribute to the operating performance component of the LSA, as does the historical accuracy of managing agents' forecasts. Risk-based analysis of the capital supporting a syndicate and the potential performance volatility of the syndicate's business mix. It is expected that full reviews of LSAs will be undertaken annually, with brief interim reviews being published shortly after each SQR date. Standard & Poor's may also change an LSA in response to emerging publicly available information. Analytical E-Mail Addresses kevin_willis@standardandpoors.com rob_jones@standardandpoors.com marcus_rivaldi@standardandpoors.com stephen_searby@standardandpoors.com InsuranceInteractive_Europe@standardandpoors.com