

A.M. Best's Rating Methodology For Lloyd's Syndicates: Frequently Asked Questions

Q: What is the relationship between syndicate ratings and A.M. Best's Lloyd's market rating?

A: It is important to stress that syndicate ratings should only be considered in the context of the Lloyd's market rating. A.M. Best's financial strength rating on Lloyd's represents our opinion of the "floor" of security for all policies written at Lloyd's. The existence of the market rating reflects the "chain of security" and, in particular, the role of the Central Fund. The market rating level reflects the overall financial strength of the market. However, A.M. Best believes that some individual syndicates have capital strength characteristics in their own right that could support a rating at, or above, the level of the market rating. Syndicate ratings are differentiated via an "s" modifier, e.g. A+s. See the report, "A.M. Best's Rating Methodology for Lloyd's Syndicates," for more information.

Q: Does the fact that the Lloyd's rating represents the minimum "floor" of security imply that all syndicates would achieve a rating equal to or above that of the market?

A: Financial strength ratings provide A.M. Best's view as to the ability of a rated organisation to meet policyholder obligations. The Lloyd's market rating represents the floor or minimum level of security offered to all policyholders. Consequently, a policyholder exposed to a syndicate with a financial strength profile weaker than the market would still have market-level security, given the guaranty fund role of the Central Fund. Therefore, any financial strength rating published on a syndicate would be equal to or above that of the market.

However, some key attributes considered by A.M. Best in forming a view as to long-term financial strength could differ substantially among syndicates (e.g. business position and market profile), and therefore some syndicates are unlikely to have a profile consistent with a

rating at the market level. In the case of a syndicate that falls into this category and also wishes to see the result of its interactive rating published, A.M. Best will clearly state in its rationale the issues identified, and the fact that the rating is largely based on the "wrap" offered by the Lloyd's rating. As with any other rated entity, syndicates are free to accept or reject the publication of an A.M. Best interactive rating opinion.

Q: How will A.M. Best be able to rate syndicates that derive capital from a mix of capital providers?

A: Theoretically, any syndicate, regardless of its capital-backing structure, could achieve a rating at the same level as that of the market by reason of its stand-alone operating performance and business profile, both of which are viewed as leading indicators of long-term financial strength by A.M. Best.

A. M. Best envisages two potential scenarios—described more fully in A.M. Best's Rating Methodology for Lloyd's Syndicates—that could lead to a syndicate rating higher than the market rating:

The first scenario would be any syndicate where all of the members—capital backers—are able and willing to provide additional capital support consistent with a syndicate-specific rating above the market level. In practice, if the capital behind a syndicate is provided significantly or entirely by one member, there is the potential for A.M. Best to make a judgment on both the syndicate's value to that capital provider and the ability to offer additional support. However, clearly such a judgment would be much more difficult to make on a syndicate where capital was provided by a diverse membership, particularly as members' liability is several but not joint.

The second scenario would be one in which the business profile and/or operating performance of a syndicate are better than that required for a rating at the market level. In this

scenario, the specific nature of the capital backing the syndicate—spread or dedicated—would not be a factor.

Q: What would happen if the market rating were to change?

A: If the market rating were to be amended, this would automatically trigger a review of all syndicate ratings, as these cannot be viewed in isolation from the market as a whole. However, this would not necessarily mean that any given rating would change. That would depend on the nature of the basis for the change in the Lloyd's rating and the syndicate-specific characteristics that support the syndicate's rating.

Q: What qualifies A.M. Best to provide an interactive rating opinion on syndicates?

A: A.M. Best currently offers a comprehensive set of services on the Lloyd's sector through our interactive market rating and Marksman* database. Additionally, A.M. Best reviews all Lloyd's market operations related to insurance companies undergoing our interactive rating process. In particular, we believe that, with the current structure of Lloyd's, an assessment at the syndicate level is only analytically meaningful alongside the provision of an interactive rating of the market as a whole.

Q: What sort of involvement is required from a syndicate in order to achieve a rating?

A: Syndicate ratings are assigned through A.M. Best's interactive rating process, which applies a set of specific criteria designed for Lloyd's syndicates. This is a voluntary rating process undertaken at the request of a syndicate. It involves formal meetings with management and underwriting teams with the objective of assessing non-public information. This is combined with public information to

enable A.M. Best to perform a qualitative and quantitative analysis of the syndicate.

Q: Who could benefit from using syndicate ratings?

A: A.M. Best envisions that syndicate ratings will be utilised by insurers and reinsurers with an existing or potential exposure to Lloyd's syndicates, as well as brokers and other intermediaries, risk managers and market advisers or consultants.

* Marksman 4 is a comprehensive database containing syndicate annual financial statements and syndicate quarterly returns.

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