

## Beazley Furlonge Ltd. - Syndicate 0623/2623/3622/3623

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# Beazley Furlonge Ltd. - Syndicate 0623/2623/3622/3623

## Financial Strength Ratings And Lloyd's Syndicate Assessments

Standard & Poor's Ratings Services insurer financial strength rating on Lloyd's (the Market; A+/Stable) remains the primary indicator of the level of financial security that is afforded to a policyholder of any syndicate trading in the

Lloyd's Market. Lloyd's Syndicate Assessments (LSAs) evaluate, on a scale of '1' (very high dependency) to '5' (very low dependency), the extent of a given syndicate's dependence on the Lloyd's Market rating.

| Financial Strength Rating |
|---------------------------|
| None                      |

## Lloyd's Syndicate Assessment

4/Stable (low dependency)

## Major Assessment Factors

### Strengths:

- Strong competitive position.
- Strong and consistent operating performance track record.
- Strong enterprise risk management.

### Weaknesses:

- Increased catastrophe and investment risk tolerance adds volatility to capitalization.
- Potential execution risk of long-term growth strategy.

## Rationale

The assessment on Beazley Furlonge Ltd. - Syndicate 0623/2623/3622/3623 (collectively Beazley or the syndicates) reflects its strong competitive position, its long track record of strong operating performance, and strong enterprise risk management (ERM). However, these strengths are partially offset by increased catastrophe and investment risk tolerance, which adds volatility to capitalization, and by the potential execution risk of the long-term growth strategy.

Beazley's strong competitive position is derived from its long history of success within the Lloyd's Market (Lloyd's, A+/Stable/--), notably its leading position in medium-tail specialty business, which accounted for 43% of premium income in 2010. Furthermore, Beazley has a strong reputation in property (which accounts for 22% of its business), marine (15%), and treaty reinsurance (10%).

Strategic acquisitions have also supplemented the group's strong growth track record to some extent. Standard & Poor's Ratings Services believes the group will continue to look to acquire companies to enhance its offering, particularly in the U.S. We believe that this will bring with it execution risks, especially given the complexity and tail of the risks the syndicates typically write. That said, Beazley's strong underwriting and effective cycle management

controls mitigate these factors.

We view the syndicates' operating performance as strong. Over the past decade, Beazley has been consistently profitable and has demonstrated performance at least in line with their Lloyd's peers on a risk-adjusted basis. The syndicates' five-year average combined ratio is 87% (86% in 2010). Despite the record catastrophe losses in the first half of 2011, Beazley PLC (the group; BBB+/Stable/--; just over 80% of the group's premiums emanate from the syndicates) posted a combined ratio of 108%, which is better than most of its peers. Technical gains from noncatastrophe business and higher than usual reserve releases have largely offset the losses leading to a modest pretax loss of \$24.2 million. In our view, the syndicates' diversified earnings profile should enable it to benefit from any improvement in pricing within the wholesale segment, notably in loss-affected property (re)insurance segments.

We view the syndicates' capitalization as strong. We note that increased catastrophe risk and investment risk tolerance adds volatility to Beazley's capitalization. We expect that Beazley will appropriately manage its risk profile in such a way that its capitalization supports the assessment because of its strong ERM.

Our view of Beazley's capitalization is largely based on the risk-based capital adequacy of the group, measured using our model. The group provides about 80% of the syndicates' funding requirements at Lloyd's. At year-end 2009, the group's risk-based capital deteriorated to the upper end of the 'BBB' level. This was due to a combination of increased exposure to catastrophe losses relative to capital base, increased market risk, special dividend payout, and share repurchases.

We forecast that the group's risk-based capital is likely to improve to the lower end of the 'A' level at year-end 2011 through retained earnings. Beazley's investments in hedge funds following the revised investment strategy in 2009 (which accounted for 10.6% of the group's total invested assets as of June 2011) have increased its market risk. Under the new strategy, the proportion of this asset class could potentially increase to 14%, which could potentially place downward pressure on capitalization, in our opinion. The remaining assets are held in highly rated bonds, or cash and cash equivalents (57.7% and 31.7% in June 2011).

## Outlook

The stable outlook reflects our expectation that the group's risk-based capital adequacy will be at least at the lower end of the 'A' range over the next 24 months, and that Beazley will maintain its strong competitive position. We anticipate that gross premiums for 2011 will remain flat when compared with those for 2010, partly reflecting the soft market conditions in specialty lines. Unless there is major merger and acquisition (M&A) activity at the group level, we do not expect the syndicates' strong competitive position to change materially over the next 24 months.

As with most of its peers, we expect the syndicates' operating performance to deteriorate in 2011 because of the catastrophe losses in the first half of 2011 and low interest rates across the board. We forecast a combined ratio of about 95%-100% and a return on revenue of (ROR) of 5%-10%, which may put it ahead of its peers. In 2012, we anticipate the syndicates will return to strong operating results, achieving a combined ratio of 90% or below, assuming average historical levels of catastrophe losses and challenging pricing conditions in specialty business. We believe continued prior-year releases will support this result. We also forecast the accident-year combined ratio to be around a break-even level, reflecting the syndicates' conservative reserving strategy. We also anticipate that any growth--notably in catastrophe-exposed segments--will translate into strong earnings, which will be mostly retained.

Any further material deterioration in the group's risk-based capital to a level that does not support the assessment could result in negative assessment action. Positive assessment action is unlikely over the assessment horizon, given that the group's capitalization does not support a higher assessment level. Furthermore, the uncertainty surrounding the potential capital increase under Solvency II needs to be resolved satisfactorily. In addition, the challenging pricing conditions outside the loss-affected areas prevent the assessment from improving at this stage.

## Syndicate Profile: Specialist Insurance Provider, With Increasing Exposure To Property And Reinsurance

Following the creation of the Beazley group in 2002, the flagship syndicate 2623's capacity has grown from £830 million in 2008 to £860 million in 2010. Syndicate 0623 is backed by unaligned capital, while Syndicate 2623 is backed 100% by Beazley. As the syndicates write pro rata according to the relative capacities, we treat the syndicates as a single entity. Beazley funds syndicates 3622 (life) and 3623 (personal accident) entirely. This report applies to the above four Beazley-managed syndicates (0623/2623/3622/3623).

In 2010, Beazley established special-purpose syndicate 6107 to utilize third-party capital to write a quota share of syndicates 0623 and 2623's property treaty account. We have not assessed syndicate 6107, nor is it covered by this report.

In 2009, the Beazley group also acquired First State, a U.S.-based surplus lines property underwriting agency. In 2010, First State underwrote \$110 million of gross premiums.

The Beazley group also writes via its wholly owned U.S. subsidiary Beazley Insurance Company Inc. (not rated), giving the group access to the U.S.-admitted market. In 2009, the group redomiciled its ultimate holding company to Jersey (tax resident in Ireland) and revised its structure to optimize European access and reduce the company's tax burden.

The Beazley group has operations in the U.K., U.S., France, Norway, Germany, Ireland, Singapore, Hong Kong, and Australia. Most of its premium income comes from the U.S., which accounted for about 60% of premiums written in 2010, while 15% came from Europe, and 26% from other regions worldwide.

## Competitive Position: Strong, Reflecting Its Critical Mass And Specialty Focus

As one of the largest Lloyd's operations, with a respected track record, Beazley has established a strong competitive position in its core business lines, notably medium-tail specialty business, and is a market leader in many of its core lines. Furthermore, the syndicates' diversified risk profile allows it to manage its top line through the various cycles in each of its core lines. In addition, the syndicates are able to generate new and innovative products that provide greater profit potential than long-standing commoditized products. For example, it has various environmental and data protection insurance offerings.

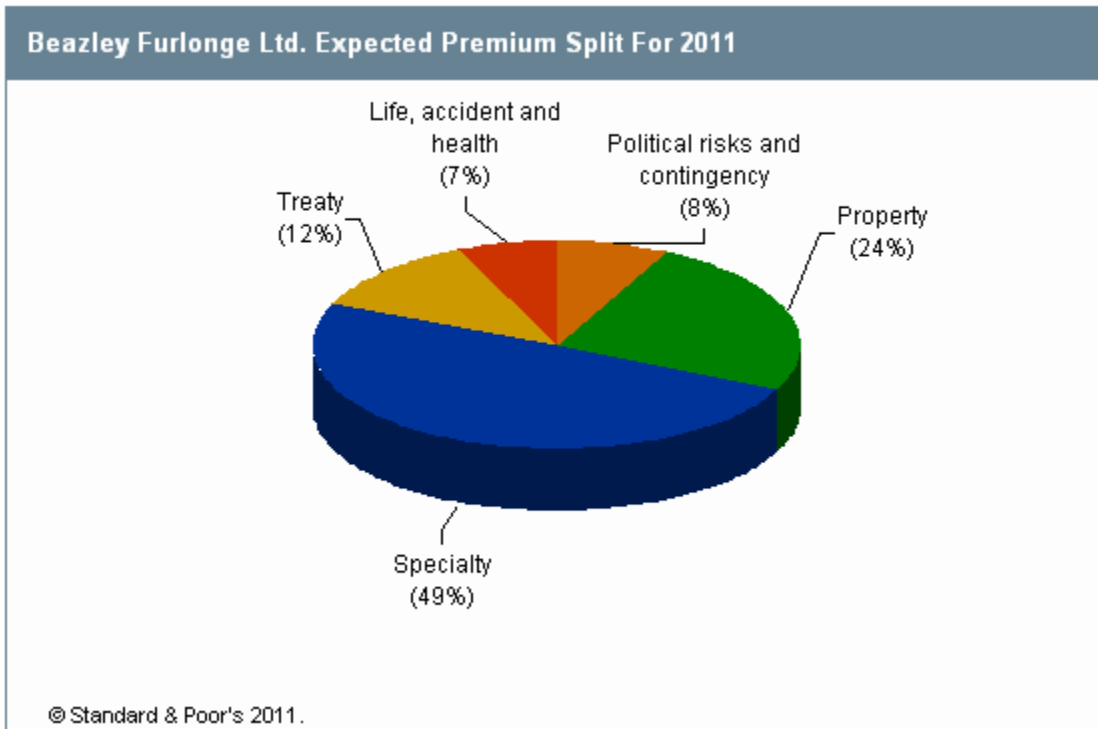
As a part of the London-based Lloyd's insurance market, the syndicates draw significant support from:

- Lloyd's strong competitive position, supported by its unique brand;
- Lloyd's position as the world's largest subscription market;
- London's continued position as a major international insurance/reinsurance market; and

- Policyholder loyalty.

The syndicate comprises six underwriting divisions, writing six sectors of business (see chart 1). Unlike many of its peers, the syndicate writes a significantly higher percentage of primary insurance business than reinsurance (in 2010, 84% insurance and 16% reinsurance, including specialty reinsurance). Beazley's specialty business is focused on professional and management liability. Life, accident, and health are new and still relatively small in premium terms. However, we expect them to grow and partly base our expectation on the acquisitions of the two Australian managing general agencies (MGA) in 2011 which will add to the group's life, accident and health business written via the group's Lloyd's platform. For 2011, we expect the premium split to be similar to 2010.

**Chart 1**



The group is willing to expand significantly when conditions are suitable (such as the past few years) and constrain growth, or reduce the top line, when it deems conditions not to be favorable. We consider that this demonstrates Beazley's effective cycle management. This was evident in the first quarter of 2011, when Beazley withdrew from the U.S. commercial property-admitted lines business, which accounted for a small proportion of the group's locally written business. It subsequently partly offset this premium reduction with rate increases in loss-affected areas during the second quarter. Furthermore, the overall premium rate remained flat despite the soft market conditions in specialty, political risks, and contingency segments. This is largely due to rate increases seen in property (re)insurance segments in the wake of the catastrophe losses at the beginning of 2011 and the release of Risk Management Solutions (RMS) updated model (version 11). Additionally, marine business saw a slight improvement in rates.

The group has been willing to use M&A as a mechanism for expanding its offering more quickly than would otherwise be possible through organic growth. It demonstrated this in 2010 by its approach to Hardy Underwriting

Ltd. (not rated), although it did not succeed. Another example of this occurred during 2009, when it acquired First State (subsequently named Beazley E&S), a managing general agency (MGA) writing surplus lines U.S. property risks, and Momentum Underwriting, an MGA providing accident & health cover with a focus on sports business. These businesses diversified the group, and in First State's case, provided the syndicates with a more-even split of U.S. catastrophe cover between wind and earthquake risks. It has, however, increased the syndicates' risk profile.

In our view, the syndicates' premium retention is high at about 80%, reflecting its strong reputation. The syndicates are heavily dependant on brokers, in common with its peers in the London Market.

### **Prospective**

In our opinion, the syndicates' competitive position will remain strong and well-diversified over the next five years. While rates are increasing in property (re)insurance segments, there is no broad hardening of the cycle yet and we expect Beazley to remain disciplined. The group will look to acquire additional underwriting resources in order to write classes new to the syndicates, such as the warranties business started in 2009, marine professional liability, and environmental risks. We anticipate that gross premiums for 2011 will remain flat when compared with 2010, partly reflecting the soft market conditions in specialty lines. In our view, should a hard market materialize, the syndicates are well positioned to grow rapidly, subject to capital availability.

Overall, we expect the group to continue to manage the cycle by contracting in segments where rates are soft, such as casualty business, while expanding where it sees opportunities, as in the continental European market. Unless it instigates a major M&A at the group level, we do not expect the syndicates' strong competitive position to change materially over the assessment horizon.

## **Management And Corporate Strategy: Focused Team With Rational Strategy**

Standard & Poor's considers that the syndicates' clear, rational strategy can be implemented by their experienced and focused management team appropriately.

### **Strategy**

The group's key strategic priorities are based on growth, attracting new business in the U.S., and cycle management. The management aims to grow a sustainable business of about \$1 billion in the U.S., focused around less-volatile admitted U.S. business (the share of group premiums written in the U.S. was about \$400 million in 2010). The group simultaneously intends to maximize profitable business written within the Lloyd's Market by seeking to expand line sizes in core products while selectively expanding into the European insurance market. In our view, the group's strategy is consistent with its organizational capabilities, as evidenced by its profitable track record while recording strong growth in premiums. In particular, we note that the group has gradually re-positioned its specialty business, which was sensitive to recession, to avoid a hike in claims size and frequency.

### **Operational management**

In our view, the syndicates benefit from the management's expertise and experience. We believe that the management has the ability to grasp and react to market conditions, financial conditions, and competitive challenges as demonstrated by its profitable track record over a long period.

Management operates a divisional structure, with the heads of each underwriting unit reporting to--and forming part of--the central management function. The senior management members at the syndicates demonstrate strong knowledge of their key franchises and remain focused on the business in which they have demonstrated competence.

As the group has grown, the management team has expanded through a combination of the recruitment of specialist, experienced staff and internal promotions.

The participation of third-party capital through Syndicate 0623 constrains management's freedom to implement strategy to some degree; good relations with capital providers mitigate this issue, as confirmed by their financial support of the First State acquisition. The acquisitions of First State and Momentum, as well as the hiring of underwriters to write new lines, have been managed appropriately.

### **Financial management**

Following group targets, the syndicates focus on return on capital for each class of business, and currently target an 18% pretax cross-cycle return overall. Given the low investment yield environment and soft market conditions in specialty lines, we believe that this will be difficult to achieve. Nonetheless, for lines of business where the return-on-capital target is not currently being achieved, management has actively adjusted the business plan and taken appropriate action to correct or reduce exposure to the business.

The group aims to maintain a buffer equivalent to 20% of its Lloyd's capital requirement (see capitalization section) and we expect the group to meet this target over the assessment horizon. In 2009, the group revised its investment strategy, which has increased the market risk in the group's balance sheet (see investment section).

The group has achieved a strong alignment of interest between underwriters and capital providers by giving staff incentives through the creation of Beazley Staff Underwriting Ltd., a corporate name participating on Syndicate 0623, in which a proportion of staff bonuses are invested.

### **Accounting: Pro Forma Numbers Used, Based On Combined Syndicates**

Syndicates 0623, 2623, 3622, and 3623 are all separate operations trading at Lloyd's. However, this structure is only in place due to the restrictions of operating at Lloyd's: All syndicates are considered core to each other. As such, our analysis is based on a pro forma consolidation of the syndicates' annual accounts. In our opinion, this represents a reasonable approximation of actual financial performance.

In assessing capital adequacy, we base our analysis on the financial data of the group and we recognize 25% of the reserve surplus is in excess of best estimate (the level to which our model is calibrated).

In our view, the group's performance is a good indicator for the syndicates' performance as just over 80% of the group's premium is made up of the syndicates' premium.

### **Operating Performance: Strong Over An Extended Period, Reflecting Effective Cycle Management**

The syndicates' extended track record of underwriting profitability is considered a key strength to the assessments. This performance reflects strong risk selection and a long-standing, effective focus on cycle management. The syndicates have been consistently profitable throughout the last decade, and have experienced volatility in operating performance below similarly assessed peers. The syndicates' low level of volatility compares favorably to its peers, reflecting successful cycle management, its conservative reserving philosophy, and lower exposure to catastrophic losses in the past. While exposure to catastrophic loss events has increased in the past two years, particularly as a

result of the First State acquisition, we expect operating performance to continue to be at least in line with peers.

Record catastrophe losses for the industry in the first half of 2011 caused the group to report a loss of \$24.2 million during this period. The group reported estimated net losses of \$200 million related to the New Zealand Christchurch earthquake (\$64 million), Australian floods (\$23 million), the Japanese earthquake and tsunami (\$67 million), and the U.S. tornados (\$23 million). In aggregate, this amount is well within the syndicates' tolerance. In addition, it incurred a loss of \$23 million in Libya in the political risk class. These reported amounts represent about 20% of total shareholder's equity at the end of 2010, which is broadly in line with the losses reported by most of Beazley's peers, bearing in mind the group's additional loss in Libya. These losses have added 30% to the combined ratio, while reserve releases have reduced the ratio by 13 percentage points. This led to an overall combined ratio of 108% for the first half of 2010, which is favorable bearing in mind the record catastrophe losses. The group reported an annualized investment return of 1.1%, which is adequate in our view, given the group's conservative investment strategy and the low interest rates.

Based on a pro forma consolidation of syndicate-published financials, the syndicates reported a five-year average combined ratio of 87% (86% in 2010). In 2009 and 2010, the syndicates' ROR was equal to 16%. Catastrophe losses in Chile during the first half of the year affected strong operating results in 2010.

The group has a larger weighting toward casualty classes than similarly assessed peers. The syndicates' track records attest to their ability to write these often-complicated classes profitably. That said, we note the risk of deterioration from the tail on this business. These issues are offset by the fact that the syndicates write casualty business only on a "claims made" basis (that is, claims must be notified during the period of cover), as well as by Beazley's reserving philosophy and strong underwriting risk controls. Although the syndicates do not write financial institutions business, a number of the casualty classes they write are potentially exposed to an increase in claims frequency and severity, resulting from deteriorating economic conditions; there is no indication to date that this potential trend has affected Beazley's underwriting.

Historically, Beazley's underwriting results benefitted notably from the strong performance of 2003-2006 underwriting years of specialty business, which has been subject to softer pricing conditions in recent years. That said, we believe that the group has maintained its underwriting discipline and the strong level of prudence in its reserving.

## Prospective

Standard & Poor's forecasts that Beazley is likely to post a reasonable net combined ratio of 95%-100% for 2011, largely due to the large losses in the first half of the year (mentioned above), which may put it ahead of its peers. For the second half of the year, we have assumed catastrophe losses of \$50 million, bearing in mind the group renewed its reinsurance program in April 2011. We anticipate that the underlying loss ratio (excluding catastrophe losses) is likely to remain strong, assuming premium rates remain flat across business lines that were not affected by recent losses. Given the low interest rates, we forecast that Beazley is likely to post a ROR of 5%-10% for 2011.

In 2012, we expect the syndicates to return to strong operating results, achieving a combined ratio at 90% or below, assuming average historical levels of catastrophe losses and tough pricing conditions in specialty business. We expect continued prior-year releases will support this result. We expect that the accident-year combined ratio will be around a break-even level, reflecting the syndicates' conservative reserving strategy.

## Enterprise Risk Management: Strong, With Market-Leading Cycle Management Practices

Beazley's ERM is assessed as strong overall. In our opinion, it is unlikely that Beazley will experience losses that exceed its risk tolerance. Beazley's strong strategic risk management, risk culture, and controls over the majority of its risks support this assessment. Given the risk profile and operation of the group, the ERM assessment is of moderate importance to the rating. Beazley was an early advocate of the benefits of ERM, and as such, its ERM is well seasoned. However, recent developments by peers have diminished Beazley's comparative advantage in this area.

The group's risk culture is assessed as strong and the continued involvement of senior management underpins this. The arrangements in place for governance and the size of the organization enable clear oversight of the risk management practices in place across the group. The updated risk management framework is now in use. The framework includes definitions of the control environment, business risk management, and assurance function. It provides a more robust and transparent delineation of roles and responsibilities and reporting lines.

An actuarial function responsible for risk capital modeling supports risk management and is independent of the underwriters. The overall risk appetite is predominately focused around catastrophe risk.

The group has strong controls over its insurance risks (underwriting, reserving, and catastrophe). The group also has a process for assessing the current state of the insurance cycle and incorporating this into its modeling processes, which in turn affects business planning. The group uses peer reviews when assessing the performance of underwriters. External reviews are also carried out at the portfolio level by industry experts. Technical rating tools are used for most business lines (exceptions generally occur where the risks are individual and so modeling is not particularly useful). These tools include the allocated capital and the required return on capital.

A number of models are used across the group to model the exposure to catastrophe risks. The group uses RMS version 9 in particular (because of software issues they did not move to version 10) for its nontreaty business and the latest version of AIR for its treaty business. The group adjusts the modeled results to reflect its perception of the risk. The group plans to use RMS version 11 by the beginning of 2012.

The investment risk controls are assessed as adequate. In our view, the change in the investment strategy has weakened investment risk management. The group aims to optimize its asset portfolio within the risk appetite limit. The optimization includes consideration of both capital measures (at a 99.5% one-year value-at-risk level) and the earnings at risk measures.

The controls around the use of reinsurance are assessed as strong. The reinsurance credit risk limits reflect not just credit ratings, but also other factors and differentiate between short-tail and long-tail lines. The group has a good process for considering the emerging risks of its specialty lines business. However, because this process is not implemented across the group, we assess the controls as adequate overall.

The group has developed a sophisticated set of modeling tools that have been used consistently throughout the business to assess the risk and return associated with major strategic decisions. This leads to a strong strategic risk management assessment. Diversification of the business is a key consideration for Beazley, especially when building business plans. Each line of business is assessed against return on economic capital measures. Poorly performing

lines are actively replaced by more profitable segments, or exposure is reduced until the cycle improves.

## Investments: Revised Investment Strategy Could Lead To High Market Risk

In 2009, the group changed the way its investments were managed and its general investment strategy. Falcon Money Management, established in 2009, has managed Beazley's funds exclusively for two years. The group has a 25% stake in Falcon, the remainder being owned by Falcon's management. The revised strategy targets absolute return with two key metrics at the expense of accurately matching the asset-liability profile, a target total portfolio return of 125 basis points (bps) above the risk-free rate, and a low probability of having a loss-making year.

The core portfolio allocation comprises up to 86% of total invested assets and it is primarily held in zero-to-three-year government, supra-national, and agency bonds from France, Germany, Italy, Japan, U.K., U.S., and Canada. Cash is matched to liabilities in terms of currency. The target return for the core portfolio is approximately 90 bps over Treasury bills. The remainder is held in hedge funds and the target return is the risk-free rate plus 400 bps. In June 2011, bonds accounted for 57.7% of the group's total invested assets, with 31.7% in cash and cash equivalents, and 10.6% of hedge funds, which is in line with its targeted asset allocation.

The group's investments in hedge funds have increased the market risk in the group's balance sheet and we consider that this could result in increased earnings volatility. However, the volatility of this portfolio has been low since its inception (with an annualized standard deviation of 2.54%). The inherent volatility over the long term remains to be seen. We view the overall market risk to be moderate, partly reflecting the very strong credit quality of the bond portfolio (see Credit risk). Under the new strategy, however, the proportion of the hedge funds could potentially increase to 14%, which could lead to high market risk. We expect the return on investments for 2011 will likely be modestly positive, but below group targets. Furthermore, we believe that the group will find it difficult to achieve an overall return of 125 bps above risk free in a low interest rate environment, while maintaining low credit and duration risk.

### Credit risk

The credit quality of Beazley's fixed-income portfolio is very strong; about 28% of this asset class was held in 'AAA' rated bonds at Aug. 31, 2011, and 50% in 'AA' rated bonds. Bonds rated 'A' or higher represented 99%, while the remainder were held in 'BBB', 'BB', and 'B' rated bonds. The group is exposed to asset-backed securities within the bond portfolio, although these are generally highly rated.

### Asset-liability management

Beazley matches liabilities by currency. The average duration of the bond portfolio, of about one year at June 2011, is kept shorter than the company's estimate of the mean term of the technical liabilities (4.3 years) to protect against a sudden rise in interest rates.

## Liquidity: Strong, With Positive Cash Flows Expected

The Beazley group continues to generate strong cash flows to support its highly liquid investment portfolio with a low duration (see Investment) bond portfolio, which has very strong credit quality. Although the hedge funds invested in have relatively short redemption schedules, we believe that these investments will have limited liquidity in a stressed environment. In recognition of potential growth in premium, which could increase the funding requirement, the group has recently increased its letter of credit (LOC) facility to \$225 million (from \$150 million)

and extended it to the 2013 underwriting year. Currently, this facility has not been drawn.

## Capitalization: Increased Market Risk And Catastrophe Exposure Add Volatility

We view the syndicates' capitalization as strong. Our view of the capitalization is largely based on risk-based capital adequacy of the group, which provides about 80% of the syndicates' funding requirements at Lloyd's. Syndicate 0623 is backed by private limited and unlimited Names, including directors of Beazley directly and the Beazley staff underwriting fund, and by limited-liability corporate backers. Increased exposure to catastrophe losses, notably to U.S. earthquake risk as a result of acquiring First State Management Group Inc. in 2009, increased market risk (see Investment), a special dividend payout, and share repurchase have all contributed to the group's capital adequacy deteriorating to the upper end of 'BBB' level at year-end 2010 (when compared to 'A' level in 2009). We consider this to be below the current assessment. We expect the group's risk-based capital to improve to the lower-end of 'A' level at year-end 2011 largely through retained earnings. This would be more supportive of the assessment.

Beazley's strong enterprise risk management leads us to expect that it will be able to appropriately manage its risk profile in such a way that its capitalization supports the assessment. Furthermore, the Individual Capital Assessment (ICA) regime and Lloyd's requirement to maintain capital above this contributes positively to our view of the syndicates' capitalization. In 2010, the group indicated that its medium-term intention is to retain a buffer of 20% over Lloyd's capital requirements, at least until the implications of Solvency II become clearer. In the absence of any further major catastrophes in 2011, the group will be holding at--or about--its targeted surplus capital. Given the large losses so far in 2011, we do not anticipate any share repurchase over the next year.

### Reinsurance

The syndicates' reinsurance utilization ratio has been around 20% in recent years, excluding 2009, which was higher than prior years due to the distortion caused by the acquisition of First State. However, the reinsurance program for 2010 was rationalized to account for this.

Exposure to individual reinsurers is actively managed, although there is significant exposure to a single counterparty. However, the very strong credit characteristics of this reinsurer, which is rated 'AA-/Stable', ameliorates this exposure. Although we have some concerns with the ongoing reliance on this counterparty to support the group's underwriting (in particular on the specialty account), there are no other significant concentrations and reinsurance counterparties are highly rated. Bad debt provisions against reinsurers are not significant.

### Reserves

We note that the level of reserves held by the syndicates is conservative and materially higher than actuarial best estimate on an ongoing basis. Beazley has provided significant transparency surrounding its reserves and has stated it is targeting a margin in held reserves between 5% and 10% above actuarial best estimate, currently 6.4% in the first half of 2011. The track record of reserve releases demonstrates the syndicates' conservative reserving. The lack of business written on an occurrence basis supports its accurate and conservative reserving history.

Beazley undertakes a full peer review of reserves quarterly, with separate underwriting and actuarial reviews, as well as an annual external review. The claims reserving, pricing, and ICA processes are integrated by the reserving group, with actuaries operating within the underwriting divisions.

## Financial Flexibility: Strong, Supported By Strong Earnings

The syndicates' financial flexibility (defined as the ability to source capital relative to capital requirements) is tied to that of the group, and we view it as strong. Given the deterioration in the group's risk-based capital (see capitalization), it could need additional capital to exploit growth opportunities in loss-affected areas. The group has increased its LOC facility in recognition of this.

In our view, a strong level of financial flexibility was once again evident when the group successfully completed a fully underwritten £150 million rights issue and placing in April 2009, predominantly to support increased underwriting and to fund the acquisition of First State. In October 2006, the group successfully issued £150 million of Tier II capital (rated 'BBB-') to replace its short-term borrowing facilities and secure a more permanent capital base to support the syndicate.

The syndicate potentially has access to other types of financial support through reinsurance, or arrangements for special-purpose reinsurers established to provide underwriting capacity to a specific reinsurer ("sidecar" arrangements).

**Table 1**

| <b>Beazley Furlonge Ltd. Key Financial Data</b> |                               |             |             |
|---|-------------------------------|-------------|-------------|
|   | <b>--Year ended Dec. 31--</b> |             |             |
|   | <b>2010</b>                   | <b>2009</b> | <b>2008</b> |
| <b>Analysis of underwriting (£000s)</b>         |                               |             |             |
| Gross premium written                           | 1,329.5                       | 1,253.3     | 1,034.3     |
| Net premium written                             | 1,070.4                       | 984.2       | 888.6       |
| <b>Operating performance (%)</b>                |                               |             |             |
| Combined ratio                                  | 86.1                          | 88.3        | 88.7        |
| Loss ratio                                      | 51.3                          | 54.4        | 55.9        |
| Expense ratio                                   | 34.8                          | 33.9        | 32.8        |
| Return on revenue                               | 16.0                          | 15.5        | 16.4        |
| <b>Reinsurance ceded</b>                        |                               |             |             |
| Premium retention ratio                         | 80.5                          | 78.5        | 85.9        |

| <b>Ratings Detail (As Of October 4, 2011)*</b>               |                    |
|--|--------------------|
| <b>Beazley Furlonge Ltd. - Syndicate 0623/2623/3622/3623</b> |                    |
| <b>Related Entities</b>                                      |                    |
| <b>Beazley Group Ltd.</b>                                    |                    |
| Issuer Credit Rating   | BBB+/Stable/--     |
| Subordinated (1 Issue)                                       | BBB-               |
| <b>Beazley PLC</b>   |                    |
| Issuer Credit Rating   |                    |
| Local Currency   | BBB+/Stable/--     |
| <b>Holding Company</b>                                       | Beazley Group Ltd. |
| <b>Domicile</b>  | United Kingdom     |

\*Unless otherwise noted, all ratings in this report are global scale ratings. Standard & Poor's credit ratings on the global scale are comparable across countries. Standard

**Ratings Detail** (As Of October 4, 2011)\*(cont.)

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