LLOYD'S

SOLVENCY II

TECHNICAL PROVISIONS AS AT 30 JUNE 2012
DUE 28 SEPTEMBER 2012

TEMPLATE INSTRUCTIONS

JULY 2012

INTRODUCTION

As set out in the Guidance Notes for the 2012 Dry Run Review Process, calculation of technical provisions on a Solvency II basis is required at various points and valuation dates during 2012. These are summarised below:

- 1 June 2012 – Technical Provisions Data (TPD) return submitted to Lloyd's via Core Market Returns (CMR) as at 31 December 2011. The key forms on this return are the TPD 199 (P&L items), 299 (UK GAAP technical provision balance sheet items), 599 (Solvency II technical provision balance sheet items) and 699 (Solvency II risk margin). This is the business as usual annual return to Lloyd's and collects data at the granular level required by Lloyd's to perform market level analysis.
- 28 September 2012 – Technical provisions return submitted to Lloyd's on a spreadsheet template similar to the Solvency II technical provision submissions in 2011. The technical provisions submitted on this return should have a valuation date of 30 June 2012 and be consistent with the Solvency II balance sheet submitted to Lloyd's on 13 September 2012. This return collects data by Solvency II class of business, "six plus one" currencies and pure year of account.
- 19 July & 20 September 2012 – The Lloyd's Capital Return (LCR) submitted to Lloyd's via CMR includes form 312 which collects projected year-end Solvency II basis technical provisions as the starting balance sheet position on which to base capital calculations. This is collected at syndicate level split by pure year of account.

This guidance relates to the second of the three submissions above including the provided template. Guidance and instructions regarding the TPD and LCR submissions are available elsewhere on lloyds.com or the Core Market Returns system.

Purpose and Scope

This exercise is a continuation of the Lloyd's Solvency II dry run process and facilitates this transition to business as usual for the Lloyd's market. Mid-year 2012 Solvency II basis technical provisions will be collected at a high level on the Solvency II balance sheet reported to Lloyd's on 13 September 2012. This balance sheet will have had an audit review opinion to confirm that the amounts shown are not unreasonable and technical provisions are calculated in line with Solvency II requirements and Lloyd's Technical Provisions Guidance. The half-year 2012 Solvency II technical provision return will not be in scope for the audit review of the balance sheet however the amounts provided, at a high level, should be consistent across both submissions. A mapping to the balance sheet amounts is shown below.

This exercise assists the Lloyd's review of syndicate capital setting between July and November 2012 by providing more granular detail of the Solvency II technical provisions on which the coming-into-line process will be based.

Due to the tight timescales between receiving these returns on 28 September and approving syndicate capital in early November 2012 Lloyd's will only be able to conduct a limited validation exercise on these submissions. Lloyd's will reconcile the amounts provided in the template to the Solvency II balance sheet but will otherwise largely rely on agents' own internal quality control and review process to ensure amounts provided are accurate, appropriate and complete.

As with earlier returns, it should be clear who is taking responsibility for the September 2012 TP return.

Participation in Half-Year 2012 Technical Provision Exercise

All syndicates submitting a half-year 2012 Solvency II basis balance sheet on 13 September 2012 will be required to complete this exercise. This includes non-life, life and RITC syndicates.

Basis of calculation

Solvency II technical provisions as at 30 June 2012 will be required to be submitted to Lloyd's on the 28 September 2012. The template workbook provided on the Technical Provisions and Standard Formula section of the Solvency II area of lloyds.com should be used to complete this return. This workbook consists of two sheets. The 'Information' Tab collects and provides high level submission information. 'Solvency II TPs @ 30.06.2012' Tab collects all technical provisions amounts in respect of this submission. Details of these tabs and sections are provided below.

All figures should be reported in thousands and in converted Sterling. The exchange rates used should be consistent with those used for the half-year 2012 Solvency II basis balance sheet (such that the amounts reconcile). These could either be consistent with those provided on Lloyd's the "Q2 2012 QMR – major losses, exchange rates and other information" Market Bulletin or any other reasonable rates of exchange used to produce the returns within the managing agent.

The Solvency II technical provision best estimate must take account of the impact of discounting using the relevant risk-free interest rate term structure, illiquidity premiums are not required to be added to the risk-free rate to discount the best estimate provisions. As per the 2013 SCR guidance notes Lloyd's will provide these risk-free interest rate term structures for all material currencies as at 30 June 2012 by 6 July 2012. Agents who require any additional currencies should request these via solvency2@lloyds.com.

Scope of data collection

General

Calculations and processes required for this submission should be similar to those performed by agents for previous Solvency II technical provision submissions to Lloyd's. The template is similar to the half-year 2011 submission collected in September 2011; however please note that the template now distinguishes between incepted and unincepted obligations on the current underwriting year.

Contact for queries and support

Any generic or syndicate specific issues should be raised via solvency2@lloyds.com or through account managers. In addition, Lloyd's will add any relevant FAQs for this exercise to the Technical Provisions FAQs available on the Technical Provisions and Standard Formula workstream section of the Solvency II area of lloyds.com. We would also advise agents to check the FAQs regularly for any updates and prior to sending any queries to solvency2@lloyds.com as your question may have already been covered.

Naming convention

One submission template excel file should be submitted for each syndicate using the standard naming convention "**S2TPs_Q22012_SYND.xlsx"**, where "SYND" represents an individual syndicate number (4 digits), please overwrite this.

There will be 2 sheets within the excel file: "Information" and "Solvency II TPs @ 30.6.2012". **The sheet naming conventions must not be amended.**

Signs of figures reported

All standard data should be entered with **positive values**. This includes, for example, claims amounts, future premiums, discounting credit, reinsurance bad debt and expenses.

The exception to this would be in situations where future premiums are so large that premium provisions are actually negative or where future premiums represent solely profit commissions which are due to be paid out. Please ensure that discounting credit is consistent with the items being discounted. For example, unless clearly reasoned, negative technical provisions with a positive discounting credit in the template is inconsistent as this will result in technical provisions becoming more negative.

Colour coding

The cells within the "Solvency II TPs @ 30.06.2012" sheet have been colour coded to aid completion:

- **Yellow** cells require input agents (where applicable). These values are then used within the template for various calculations.
- **Turquoise** cells also require input by agents (where applicable). These values are for information purposes only and are not used within the template for calculations.
- **White** cells are formula driven and must not be amended.

All yellow cells within the "Information" sheet can be filled in by agents. The 'Summary Details' and 'Sign-off and declaration' sections should be completed in full.

Submission of results

General

Completed submission templates should be submitted electronically by **28 September 2012** to solvency2@lloyds.com. The results of the technical provision calculations must be submitted to Lloyd's using the Q2 2012 technical provision submission template, available with these instructions on lloyds.com.

This template is set out in a standard format to enable all data to be exported for the analysis performed by Lloyd's. The template has been left unprotected to allow agents to group unused lines of business using the grouping buttons on the rows in the spreadsheet. **However, the submitted template must not have rows or columns inserted, removed or moved. In addition, please do not amend or remove the formulae. All external links should be broken prior to submission.**

Sense checks

As highlighted above Lloyd's will have a limited timeframe in which to put these submissions to full use and as such a full validation exercise by Lloyd's is not possible. Lloyd's sense checks will ensure that the template structure is as supplied and that high level amounts reconcile to the Solvency II balance sheet provided on 13 September. Lloyd's may, if deemed necessary, conduct other appropriate validations. The following reconciliations will be made:

- Gross Best Estimate Technical Provisions (excluding risk margin) – cell D17 on "Solvency II TPs @ 30.06.2012" equals D35 on the Solvency II balance sheet return
- Reinsurance Best Estimate Technical Provisions (excluding risk margin) – cell E17 on "Solvency II TPs @ 30.06.2012" equals D24 on the Solvency II balance sheet return
- Risk Margin – cell F18 on Solvency II TPs @ 30.06.2012" equals D36 on the Solvency II balance sheet return.

For reference the balance sheet template can be found here.

Before submitting the technical provisions template, Lloyd's would advise agents to carry out a number of high level sense checks and be able to explain anomalies in the Notes and Comments section of the Information tab. This will avoid the need for Lloyd's to contact agents with queries. Lloyd's would suggest the following sense checks:

- Is the most recent version of the submission template being used?
- Are the net TPs in line with expectations? For example, compared to current held reserves and the June TPD submission.
- Are all standard data items entered with positive values (including future premiums, discounting credit and reinsurance bad debt)?
- Have future premiums been completed? Are all future premiums gross of acquisition costs?
- Are gross TPs greater than net TPs? An exception to this may be on the unincepted portion of business for the premium provision.
- Have binary events been completed? What percentage are these of the non-binary insurance losses or best estimates?
- Have all expense categories been completed?
- Do allocations seem reasonable? For example, allocation of reinsurance recoveries and allocation to currency.
- Is the risk margin completed and magnitude explainable?

TECHNICAL PROVISION SUBMISSION TEMPLATE

This section provides detail of each tab on the submission template.

Information Tab

Summary Details

Agents should provide the details of two key personnel which Lloyd's may wish to contact with queries on the submission. These contacts will also receive the feedback results produced by Lloyd's.

Scope and Purpose

This provides high level information on the reasons for the exercise and template.

Sign-off and Declaration

This section requires a key representative to declare that the return has been reviewed and is deemed an accurate representation of the position of the syndicate at 30 June 2012. This could generally be the head of the actuarial function or a relevant board member.

Version History

This section details the version history of the template and provides information on changes from previous versions.

Key

As described above this section provides an overview of the colour coding used in the template.

Notes and Comments

This is a free-form section which allows agents to input comments and notes on the data provided. Agents can use this to provide comments on methodology and to point out any peculiarities which Lloyd's would otherwise query. Lloyd's requests that agents use this section fully.

Solvency II Technical Provisions Reporting Tab

Segmentation

Solvency II lines of business

Figures must be reported for each of the Solvency II lines of business. The required lines of business have not changed since the September 2011 submission. Please refer to previous Lloyd's guidance for further details.

To assist agents with mapping to Solvency II class of business Lloyd's has produced a risk code, transaction type and non-life annuity flag mapping. Please note however that this is only to assist agents, knowledge of their own business should be the primary source of mapping to Solvency II classes.

Currency

Calculated cashflows need to be allocated by currency to ensure that they are discounted using an appropriate risk-free interest rate term structure.

For this exercise, Lloyd's requires reporting of all significant currencies (GBP, USD, CAD, EUR, AUD, JPY and OTHER). Lloyd's will accept submissions where proposals have been submitted and approved by Lloyd's to report in fewer than 'six plus other' currencies, please provide a comment in the 'Information' tab where this is the case.

All figures should be reported in thousands and in converted Sterling. The exchange rates used should be consistent with those used for the half-year 2012 Solvency II basis balance sheet (such that the amounts reconcile). These could either be consistent with those provided on Lloyd's the "Q2 2012 QMR – major losses, exchange rates and other information" Market Bulletin or any other reasonable rates of exchange used to produce the returns within the managing agent.

Claims and premium provisions

Best estimates should be calculated separately for claims and premium provisions. These will be reported separately on the technical provision submission template.

Data items collected at a Class of Business Level

Risk Margin

The risk margin must be provided at a line of business level but there is currently no requirement to split by currency.

The risk margin shall be such as to ensure that the value of the technical provisions is equivalent to the amount insurance and reinsurance undertakings would be expected to require in order to take over and meet the insurance and reinsurance obligations over and above the pure best estimate.

Technical provisions for non-life business written at Lloyd's should be calculated as the sum of an explicit best estimate and an explicit risk margin. Risk margins should be calculated using a cost of capital approach.

For further guidance on how to calculate the risk margin please refer to the Detailed Lloyd's Technical Provisions Guidance and June 2011 workshop slides on lloyds.com.

Data items collected by class of business, pure year and currency (all excluding the Risk Margin)

Claims Provisions

Provisions for claims outstanding relate to the cashflows in respect of claims events occurring before or at the valuation date (i.e. earned business).

Gross best estimate claims provisions

- **Undiscounted Gross Best Estimate excl Expenses -** This should exclude discounting and all expenses, but should incorporate all other elements including future premiums and binary event loadings. Further detail on amounts for these included within the best estimate are captured separately, as noted below.
  - **Undiscounted Gross Gross Future Premiums included in Gross Best Estimate -** This is the allowance for future premiums included within the best estimate. This should incorporate future premiums expected on this (earned) business excluding discounting. Future premiums should be entered gross of acquisition costs to avoid any double counting of acquisition costs. These values are for information purposes only and are not used within the template for calculations as they should be incorporated in the 'Undiscounted Gross Best Estimate excl Expenses' already.
  - **Undiscounted Binary Event included in Gross Best Estimate excl Expenses -** This is the allowance for binary events within the best estimate, excluding expenses and discounting. These values are for information purposes only and are not used within the template for calculations as they should be incorporated in the 'Undiscounted Gross Best Estimate excl Expenses' already.

(Outwards) Reinsurance best estimate claims provisions

- **Undiscounted RI Best Estimate excl Bad Debt Provision excl Expenses -** This should exclude discounting and all expenses. This should also exclude the adjustment made for reinsurance counterparty default, which is captured separately. It should incorporate all other elements including future premiums and binary event loadings. Further detail on amounts for these included within the best estimate are captured separately, as noted below.
  - **Undiscounted RI Gross Future Premiums included in RI Best Estimate -** This is the allowance for future premiums included within the best estimate. This should incorporate future premiums expected on this (earned) business excluding discounting. Future premiums should be entered gross of RI acquisition costs to avoid any double counting of acquisition costs. These values are for information purposes only and are not used within the template for calculations as they should be incorporated in the 'Undiscounted RI Best Estimate excl Bad Debt Provision excl Expenses' already.
  - **Undiscounted Binary Event included in RI Best Estimate excl Expenses -** This is the allowance for binary events within the best estimate, excluding expenses and discounting. These values are for information purposes only and are not used within the template for calculations as they should be incorporated in the 'Undiscounted RI Best Estimate excl Bad Debt Provision excl Expenses' already.

Net best estimate claims provisions

- **Undiscounted Net Best Estimate excl Bad Debt Provision excl Expenses** - This is a calculated field, which excludes discounting, expenses and the allowance for reinsurance counterparty default.

Premiums provisions

Premium provisions relate to cashflows in respect of claims events occurring after the valuation date and during the remaining in-force coverage period of policies (i.e. unearned business).

Unearned exposure amounts should also include unincepted contracts relating to the 2012 underwriting year which are contractual obligations as at the relevant valuation date. The expected claims, future premiums and other elements of the best estimate should be reported within the respective rows for the 2012 underwriting year that relate to incepted and unincepted business. Note that there may also be unincepted contracts that relate to earlier underwriting years (via binding authorities) which will be included within the premium provision amounts for these years.

For the calculation of half-year 2012 technical provisions Lloyd's would not expect there to be any contractual obligations relating to the 2013 underwriting year as syndicate business plans will have not yet been approved for the 2013 year of account. Subsequently, no allowance has been made for the 2013 year of account in the template.

Gross best estimate premium provisions

- **Undiscounted Gross Best Estimate excl Expenses -** This should exclude discounting and all expenses, but should incorporate all other elements including future premiums and binary event loadings. Further detail on amounts for these included within the best estimate are captured separately, as noted below.
    - **Undiscounted Gross Gross Future Premiums included in Gross Best Estimate -** This is the allowance for future premiums included within the best estimate. This should incorporate future premiums expected on this (unearned) business excluding discounting. Future premiums should be entered gross of acquisition costs to avoid any double counting of acquisition costs. These values are for information purposes only and are not used within the template for calculations as they should be incorporated in the 'Undiscounted Gross Best Estimate excl Expenses' already.
    - **Undiscounted Binary Event included in Gross Best Estimate excl Expenses -** This is the allowance for binary events within the best estimate, excluding expenses and discounting. These values are for information purposes only and are not used within the template for calculations as they should be incorporated in the 'Undiscounted Gross Best Estimate excl Expenses' already.

(Outwards) Reinsurance best estimate premium provisions

- **Undiscounted RI Best Estimate excl Expenses -** This should exclude discounting and all expenses. This should also exclude the adjustment made for reinsurance counterparty default, which is captured separately. It should incorporate all other elements including future premiums and binary event loadings. Further detail on amounts for these included within the best estimate are captured separately, as noted below.
    - **Undiscounted RI Gross Future Premiums included in RI Best Estimate -** This is the allowance for future premiums included within the best estimate. This should incorporate future premiums expected on this (unearned) business excluding discounting. Future premiums should be entered gross of RI acquisition costs to avoid any double counting of acquisition costs. These values are for information purposes only and are not used within the template for calculations as they should be incorporated in the 'Undiscounted RI Best Estimate excl Bad Debt Provision excl Expenses' already.
    - **Undiscounted Binary Event included in RI Best Estimate excl Expenses -** This is the allowance for binary events within the best estimate, excluding expenses and discounting. These values are for information purposes only and are not used within the template for

calculations as they should be incorporated in the 'Undiscounted RI Best Estimate excl Bad Debt Provision excl Expenses' already.

Net best estimate premium provisions

- **Undiscounted Net Best Estimate excl Bad Debt Provision excl Expenses** - This is a calculated field, which excludes discounting, expenses and the allowance for reinsurance counterparty default.

Expenses

Though allocated loss adjustment expenses may be incorporated within the claims best estimates, other expenses should be reported separately. Expenses are to be split the same as the TPD, that is **Undiscounted ULAE Provision, Undiscounted non-ULAE Provision, Undiscounted Gross Acquisition Costs Provision and Undiscounted RI Acquisition Costs Provision**.

Please note that we have defined **reinsurance acquisition costs** to be the sum of:

(1) Acquisition costs paid to brokers for acquiring reinsurance on the agent's behalf; and

(2) Reinsurer's share of acquisition costs paid to the agent.

Where both of these costs arise the summation would be expected to offset each other as (1) is generally outgo and (2) is income.

Reinsurance acquisition costs are for information purposes only and are not used within the template for calculations to avoid double counting with outwards reinsurance premium. Agents should refer to the technical provision FAQs and worked example provided on the TP&SF section on the Solvency II area of lloyds.com if there are any questions on this.

Adjustment for discounting

Discounting credit - The adjustment made for discounting should be reported for each line of business at a year of account level for the claims and premium provisions separately. This is required for the gross and reinsurance best estimates (all including expenses). A reduction in provisions due to discounting should be entered as a positive amount.

Adjustment to reinsurance for counterparty default

Undiscounted RI Bad Debt Provision - The adjustment made to the reinsurance best estimate for counterparty default should be reported for each line of business at a year of account level and for the claims and premium provisions separately. The reduction in best estimate reinsurance recoveries due to the allowance for counterparty default should be entered as a positive amount. The effect on the net best estimate is a calculated field.

Calculated fields

The remaining fields are formula driven:

- **Total Undiscounted Gross Best Estimate TPs (excl Risk Margin)**
- **Total Discounted Gross Best Estimate TPs (excl Risk Margin)**
- **Total Undiscounted RI Best Estimate TPs (excl Risk Margin)**
- **Total Discounted RI Best Estimate TPs (excl Risk Margin)**
- **Total Undiscounted Net Best Estimate TPs (excl Risk Margin)**
- **Total Net Discounting Credit**
- **Total Discounted Net Best Estimate TPs (excl Risk Margin)**

UNCERTAINTIES

Lloyd's has previously highlighted a number of Solvency II requirements which are still open to interpretation. While these uncertainties remain Lloyd's has taken a view as to how they should be derived in the Solvency II calculations. When there is additional guidance available for these areas, Lloyd's will ensure that this is communicated to the market. However, in the absence of such guidance, Lloyd's suggests that agents take a reasonable approach which they can justify. Agents should try to remain flexible in their approach and ensure they regularly check the FAQs provided on lloyds.com for other information that may be of use.

Contract boundaries

There continues to be uncertainty around the inclusion of unincepted business relating binding authorities. Current approaches in the market consider including either all expected attachments to the binder, only those contractually obliged by the valuation date, or the contracts which would be expected to attach to the binder before it could be cancelled.

Lloyd's view is that the contracts with delegated underwriters (potentially through a binding authority) are not contract of insurance and it is the underlying process of binding contracts with policyholders that create the legal obligations on an ongoing basis. The key principle is that the underlying policies should be treated like any other policies an undertaking could underwrite. On this basis agents may need to estimate or approximate the amount of business under the binder which would expect to be bound at the valuation date.

Reinsurance allocation

Similar to the issue of contract boundaries, uncertainty also exists for the treatment of reinsurance that would cover both existing (on a contractual obligation basis) business and also future (non-contractually obliged) business. Lloyd's recommends that a correspondence approach is taken, whereby the valuation only makes allowance for the portion of reinsurance recoveries and costs that relate to existing inwards business included within the technical provision calculation.

Lloyd's also recommends that a best estimate correspondence approach is used to deal with reinsurance that would be purchased in the future (but which is not contractually certain by the date of the valuation) to cover existing business included within the technical provision calculation. The assumptions made here would need to be considered alongside the requirements for assumed future management actions. Treatment will differ whether the reinsurance contracts are on a risk attaching or losses occurring basis.

FUTURE CALCULATIONS

Lloyd's Capital Return

As mentioned in the introduction, technical provisions on a Solvency II basis will be collected in July and September to assess the starting balance sheet position at 2012 year-end for capital setting in 2013. Details of the LCR specifications and the SCR process are available on lloyds.com and the Core Market Returns system.

Technical Provisions Data (TPD) Return

The TPD has now been collected as at year-end 2010 (November 2011) and year-end 2011 (June 2012) alongside the Solvency Reserving Data (SRD) return. In 2013 the TPD will replace the SRD completely and reporting for the TPD will move to early April to be in line with the historic SRD reporting timetable.

Specifications, instructions and FAQs for the 2012 TPD are available on the Core Market Returns system.

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