

SOLVENCY II

TECHNICAL PROVISIONS SUBMISSION TEMPLATE INSTRUCTIONS

HALF-YEAR 2011 TECHNICAL PROVISIONS AND
PROJECTED YEAR-END 2011 TECHNICAL PROVISIONS

JUNE 2011



INTRODUCTION

As set out in the Guidance Notes for the 2011 Dry Run Review Process, calculation of Technical Provisions on a Solvency II basis is required at various points during 2011. The first collection in 2011 was the calculation of Technical Provisions as at 31st December 2010 submitted to Lloyd's on 27th May 2011. The second collection is due to be submitted to Lloyd's by 30th September 2011 and cover Technical Provisions as at half-year 2011 and projected year-end 2011.

This document sets out further details on the requirements for the second exercise and instructions for the use of the Technical Provisions submission template.

Agents should note that there are still many areas of uncertainty around the calculation of Technical Provisions for Solvency II. As requirements from the EC, EIOPA and the FSA become clearer, and as current interpretation develops, Lloyd's will aim to issue additional guidance.

Agents should refer to the previous guidance on Technical Provisions issued by Lloyd's which was updated in March 2011. There have been few changes since the July 2010 document, and interpretations of the areas of major uncertainty have not developed significantly. However, agents should note the possibility that some of these areas (such as interpretation of contract boundaries for business written on binding authorities) may change over the coming months. In addition, agents should also refer to the May submission template instructions and associated FAQs.

The above guidance can be found in the Technical Provisions section of the Solvency II guidance area on lloyds.com.

Purpose

The purpose of the exercise is to confirm that all syndicates are able to provide Technical Provisions on a Solvency II basis at a point other than the year end and anticipated future amounts. As these calculations build on those performed for the submission made to Lloyd's in May, Lloyd's would expect the quality of submissions to naturally improve and the approaches and methodologies used to be further developed and become more robust.

In addition, the Technical Provision element of the qualitative Dry Run, which started in 2010, should be developing further to give more detail and documentation around the calculation process.

Following submission of syndicate results, Lloyd's will perform a number of high-level validations and sense checks to confirm results appear reasonable. Lloyd's will then analyse the results and provide feedback as per the May submission.

Participation in Technical Provision exercise

All syndicates participating in the Solvency II dry run will be required to complete this exercise. This includes life, RITC syndicates and those syndicates with business written during 2011.

Basis of calculation

Solvency II Technical Provisions as at two different valuation dates will be required to be submitted on the 30th September 2011:

- Half-year 2011 Technical Provisions as at 30th June 2011, and
- Projected year-end 2011 Technical Provisions as at 31st December 2011

Both bases are contained within the same template available on lloyds.com.

All figures should be reported in thousands and in converted Sterling. The exchange rates used should be consistent with the Lloyd's Q2 2011 exchange rates as per the "Q2 2011 QMR – major losses, exchange rates and other information" Market Bulletin.

The Solvency II Technical Provision best estimate must take account of the impact of discounting using the relevant risk-free interest rate term structure. Lloyd's will provide these risk-free interest rate term structures for each of the six significant currencies by the end of July 2011. Agents who require any additional currencies should request these via Solvency2@lloyds.com.

Scope of data collection

General

Though the calculations and processes required for this submission should be similar to those performed by agents for the submission in May, the level of granularity in the template has increased.

The Technical Provision Data (TPD) submission in November will collect the full detail required by Lloyd's going forwards. Details of the TPD specification and instructions are available in the Technical Provisions section of the Solvency II guidance area on lloyds.com.

Changes since May 2011 submission

The main changes to the template since the May submission are as follows:

- Segmentation by currency is now also required by the "six plus one" major currencies (GBP, USD, CAD, EUR, AUD, JPY, OTHER).
- Expense provisions are now also required at a line of business level by year of account. The number of categories has been reduced to four: ULAE, non-ULAE, gross acquisition costs, and reinsurance acquisition costs.
- Discounting credit is now also required at a year of account level (by line of business).
- Reinsurance bad debt provisions are now also required at a year of account level (by line of business).
- The risk margin is now required at a line of business level.

Contact for queries and support

Any generic or syndicate specific issues should be raised via Solvency2@lloyds.com or through Solvency II account managers. In addition, Lloyd's will set up FAQs for this exercise which will be updated with answers of use to other agents. 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_Q2Q42011_SYND.xls", where "SYND" represents an individual syndicate number (4 digits).

There will be 3 sheets within the excel file: "Solvency II TPs @ 30.6.2011", "Solvency II TPs @ 31.12.2011" and "Comments". **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 template 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.
- **Grey** cells do not need to be completed by agents.
- **White** cells are formula driven and must not be amended.

Submission of results

General

Completed submission templates should be submitted electronically by **30th September 2011** to Solvency2@lloyds.com. The results of the Technical Provision calculations must be submitted to Lloyd's using the Q2 and Q4 2011 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.**

Sense checks

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

- Are the net TPs in line with expectations? For example, compared to current held reserves and the May submission.
- Are all standard data items entered with positive values (including future premiums, discounting credit and reinsurance bad debt)?
- Are all future premiums gross of acquisition costs?
- Are gross TPs greater than net TPs? An exception to this may be on the unaccepted year for the premium provision.
- Have future premiums been completed?

- Have binary events been completed?
- Have all expense categories been completed?
- Do allocations seem reasonable? For example, allocation of reinsurance recoveries and allocation to currency.

In addition, Lloyd's will be checking the validity of the template to ensure no amendments have been made to the template structure. Agents must ensure that the template is submitted in the same format as the one published on lloyds.com.

Agents who fail to meet these requirements may be required to provide explanations and potentially a resubmission.

TECHNICAL PROVISION SUBMISSION TEMPLATE

Segmentation

Solvency II lines of business

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

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).

All figures should be reported in thousands and in converted Sterling. The exchange rates used should be consistent with the Lloyd's Q2 2011 exchange rates as per the "Q2 2011 QMR – major losses, exchange rates and other information" Market Bulletin.

Claims and premium provisions

Non-life best estimates should be calculated separately for claims and premium provisions. These will be reported separately on the Technical Provision submission template.

Life syndicates

As set out above, life syndicates are required to complete the Technical Provision submission template. For consistency, life syndicates should report all business within the claims provision section, with the exception of unaccepted business relating to the 2011 and 2012 underwriting years which should be reported in the premium provision section.

Data items collected at a whole account level

General

The syndicate number and managing agent name should be entered at the top of the Technical Provision submission template.

Data items collected at a line 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 workshop slides on lloyds.com.

Data items collected by underwriting year and currency (all excluding the Risk Margin)

The following section sets out details of the data items collected by the Technical Provision submission template.

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 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.
 - **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.

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 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.
- **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.

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 unaccepted contracts relating to the 2011 and 2012 underwriting years 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 2011 and 2012 years. Note that there may also be unaccepted 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 2011 technical provisions Lloyd's would not expect there to be any contractual obligations relating to the 2012 underwriting year as syndicate business plans will have not yet been approved for the 2012 year of account. This row in the half-year 2011 sheet in the template has therefore been greyed out.

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.
 - **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.

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 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.
 - **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.

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. The split of expenses is less granular than the May submission (**Undiscounted ULAE Provision, Undiscounted non-ULAE Provision, Undiscounted Gross Acquisition Costs Provision, Undiscounted RI Acquisition Costs Provision**) but is required at a line of business level, on an undiscounted basis.

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.

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)**

Comments

The Submission Template file includes a sheet where comments or notes can be made. Agents can use this to provide comments on methodology and to point out any peculiarities which Lloyd's would otherwise query.

UNCERTAINTIES

There are still areas of uncertainty relating to the calculation of Technical Provisions on a Solvency II basis. 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 ensure they regularly check the FAQ site for other information that may be of use.

Contract boundaries

There continues to be uncertainty around the inclusion of unaccepted business relating binding authorities. Current discussion in the market considers 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. As per the May submission and Lloyd's guidance, Agents should use a flexible approach and be able to come in to line with the requirements once these are finalised.

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 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.

FUTURE CALCULATIONS

Technical Provisions Data

By the end of November, full completion of the more granular Technical Provisions Data (TPD) return will be required. This submission will be based on data as at 31st December 2010.

Details of the TPD specification and instructions are available in the Technical Provisions section of the Solvency II guidance area on lloyds.com.

Although the TPD (forms 599 and 699) will form the basis of the year-end Solvency II Technical Provision reporting going forward, Lloyd's may require additional calculations in the future.