LLOYD'S

SOLVENCY II

QIS 5 STANDARD FORMULA RE-RUN SUBMISSION INSTRUCTIONS

JUNE 2011

INTRODUCTION

The fifth quantitative impact study (QIS5) was conducted throughout Europe in 2010 and coordinated by CEIOPS and the FSA in the UK. Within Lloyd's, managing agents were requested to complete the QIS5 exercise for each syndicate and submit this to Lloyd's as part of the Solvency II Dry Run. Lloyd's analysed these submissions and provided feedback towards the end of 2010. Lloyd's itself produced an aggregate QIS5 return which was submitted to the FSA in line with CEIOPS timelines.

As part of the 2011 Dry Run process Agents are required to rerun the standard formula and Solvency II balance sheet calculations as at year end 2010. This is to ensure:

- Managing Agents can demonstrate calculation of both the standard formula and Solvency II balance sheet to an appropriate standard;
- Lloyd's can provide feedback and guidance to Managing Agents on their derivation of the standard formula versus peers and the market as a whole;
- Managing Agents can assess the impact of the standard formula. For example, if needed for contingency planning;
- Lloyd's can continue to assess the overall impact of the standard formula on the market; and
- Where appropriate, Lloyd's can continue to lobby against certain areas of the standard formula using up to date results form this exercise.

This document is intended to give an overview of:

- submission requirements and timelines for the QIS5 rerun and Solvency II Balance Sheet;
- where Agents can find the information they need to complete the QIS5 rerun return;
- the basis on which Lloyd's expects completion to be made; and
- the changes to the CEIOPS template which Lloyd's has made.

This document is not intended to be exhaustive guidance on the completion of the rerun template but instead is to be used as an introduction and overview to the submission requirements and to provide information on where Agents may be able to find more information to assist in the completion of the template.

Participation in the QIS5 Standard Formula and Solvency II Balance Sheet Rerun

All syndicates participating in the Solvency II dry run will be required to complete this exercise. This includes life and RITC syndicates and those syndicates who have written business during 2010. This is the same requirement as the recent Technical Provision returns and the 2010 QIS5 exercise. As for the Solvency II dry run process, submissions are required at syndicate level and so special purpose syndicates must also complete a separate return.

Submission of Results

Completed submission templates should be submitted electronically by 29th July 2011 to Solvency2@lloyds.com. One submission template excel file should be submitted for each syndicate using the standard naming convention "**SYND_S2QIS5ReRun_V#.xls"**, where "SYND" represents an individual syndicate number (4 digits) and "V#" represents the version number of the spreadsheet downloaded from lloyds.com. Agents should ensure they are using the most up to date version of the template to avoid any errors in their submissions, please check lloyds.com regularly for any updates.

Contact for queries and support

In the first instance Agents should refer to the QIS5 guidance issued by CEIOPS and Lloyd's (including the QIS5 FAQs) as detailed below. Any questions which are not answered by these sources should be raised via Solvency2@lloyds.com or through Solvency II account managers.

In addition, Lloyd's will set up FAQs for the 2011 exercise which will be updated with answers of use to other agents; Managing Agents are encouraged to check these regularly for updates.

SUBMISSION TEMPLATE

General Requirements

The excel template provided on Lloyds.com should be completed as at 31st December 2010. This is to be taken as year-end 2010 where a syndicate may have earlier cut off dates.

The template is intentionally set out in a standard format to enable all data to be exported for the analysis performed by Lloyd's. **Please do not change the structure or the formula of the template; this will result in Lloyd's asking for a resubmission on the original unmodified template.**

Basis of Submission and Lloyd's Expectations

The template should be completed to **include Geographical Diversification but exclude USPs**; this is similar to the 'main' 2010 QIS5 submission. Managing Agents do not need complete the Qualitative Questionnaires or the Quantitative Return on any other basis other than the above. Lloyd's are therefore only expecting **one** completed template for each syndicate.

The 2011 rerun is on the **same basis as that of the 2010 submission**. This includes the areas of standard formula which Lloyd's considers to give disproportionately high capital loads (e.g. Non-Life Catastrophe Risk and Currency Risk). Lloyd's continues to lobby on these areas and are hopeful that these may change, however until finalised the re-run basis should be as the requirements stand. The results may support lobbying activities by re-emphasising the impact of not changing the bases.

One change compared to the 2010 QIS5 exercise is that Lloyd's will not be requiring Managing Agent's to incorporate Funds at Lloyd's (FAL) or Funds in Syndicate (FIS) in to their submission (balance sheet and SCR calculation), more detail on this can be found below.

The QIS5 spreadsheet contains the option to provide information in a number of reporting currencies and units. For consistency, agents are required to **report all figures in thousands and converted Sterling**. If items within the spreadsheets are calculated and converted from alternative bases, the Lloyd's 31st December 2010 period end rates as set out in market bulletin Y4459 should be used.

The QIS5 rerun return will not require formal managing agent sign-off and is not audited. However, the syndicate data disclosed therein should be consistent with data reported in the year-end annual return (QMA) and solvency reserving data (SRD).

Technical Provisions and Risk Margin

Lloyd's requires that the best estimate Technical Provisions entered in to the template are consistent with those calculated as at 31st December 2010 as submitted to Lloyd's on 27th May 2011 as part of the Solvency II Dry Run (including any corrections following queries from Lloyd's).

In addition to the best estimate, a risk margin on a Solvency II basis should be provided; this can either be derived from an Agent's own internal model SCR or from the standard formula SCR calculated in the template.

For the 2010 QIS5 submissions many agents used simplification 3 to estimate their risk margin (run-off the t=0 SCR proportionally to the reduction in best estimate and calculate the discounted cost of capital as the risk margin). Lloyd's are aware of numerous methods used to derive the SCR to be run-off for the Risk Margin and would encourage Managing Agents to carefully consider the approach taken for their Risk Margin calculation in this return, particularly the SCR being used.

The correct calculation of the risk margin should be derived based on the current and future SCR requirements of the current recognised obligations being transferred to a reference undertaking. This would exclude risks relating any policies not recognised as a current obligations.

The appropriate SCR for calculation of the risk margin will therefore cover risks which exist at the valuation date of t=0 (reserving risk, operational risk, and counterparty default risk) and these risks can be assumed to run off over time. In additional the SCR needs to consider risk relating to unexpired exposures at the valuation date for current obligations. This would include premium and catastrophe risk but would only will tend to cover the period t=0 to t=1 and therefore does not run off over the lifetime of the policies.

Agents should carefully consider the components of the SCR which go towards the calculation of the risk margin.

Negative risk margins (which may arise due to negative best estimate technical provisions) are not consistent with the concept of risk margins and should be adjusted such that they are positive or zero. If these do arise an Agent may have to revise their allocation to Solvency II classes of business.

Solvency II minimum lines of business

Since QIS5 was run in 2010 Lloyd's has reviewed the risk code mapping to Solvency II lines of business to now include transaction type as well as risk code. This revised risk code/transaction type mapping can be found on lloyds.com.

Changes to the CEIOPS 2010 QIS5 template made by Lloyd's

Lloyd's has used the original QIS5 spreadsheet issued by CEIOPS in 2010 as a basis for the QIS5 rerun return template but has made some changes.

Certain areas are **not being requested for the 2011 rerun** submission. These are as follows:

<u>Tabs removed from the original 2010 QIS5 template</u>

- 'Group' tabs and ''I.SCR Adjusted' tab – Agents are being requested to submit one return per syndicate as a solo entity and as such group submissions are not required. Similarly information in intra-group group transaction information will not be collected. Lloyd's has removed these from the template published on lloyds.com.
- 'I. Participations' tab – This tab previously collected information regarding investments in participations and related entities. Again, Lloyd's has removed this tab from the template published on lloyds.com.
- 'I.Own funds items details' tab – This tab was previously used to collect additional information regarding capital instruments in the valuation sheet. Lloyd's does not require this additional information.
- 'SF.RFF' tab – This tab provided information on ring fenced funds for the 2010 submission. Lloyd's will not require this for the 2011 rerun and as such has removed this tab from the template published on lloyds.com.
- 'IM. ' tabs – Lloyd's will not be collecting information on syndicate internal model output for the purposes of this return and has therefore removed this tab from the template published on lloyds.com. A separate Lloyd's Capital Return is being used for this purpose.

<u>Data not being requested on remaining tabs</u>

For the below areas only certain aspects of the sheets' inputs are being requested by Lloyd's. Lloyd's has hatched out the areas not being requested. In most cases these areas have been hidden in the Lloyd's template, Agents may unhide these cells but **please do not delete rows or columns.**

- 'I.Participant' tab – Country, First Level EEA Supervisor and Local Registration Number is not required (all hidden).
- 'I.Valuation' tab – Section 4 (Information on valuation methods applied to determine the Solvency II balance sheet) and Section 5 (Intragroup assets and liabilities, for undertakings belonging to a group) are not required (all hidden).
- 'I.Current Situation' tab – Lloyd's will not require agents to allocate their current basis technical provisions by Solvency II classes in this tab (sections 2 and 3) (all hidden). However, Agents should complete section 1 ("Current Solvency 1 position") and will be requested to split current basis gross and outwards reinsurance technical provisions into the high level groupings of Non-Life (excluding health), Health (similar to non-life), Health (similar to life), Life (excl health and unit-linked) and unit-linked funds for the purposes of the current basis balance sheet on the 'I.Valuation' tab.
- 'I.QIS5 insurance obligations' tab Section 3 (d) - Expected Profits in Future Premiums were collected as part of the full QIS5 submission in 2010 to allow CEIOPS to assess the impact of allowing these as tier 1 capital. These will not be collected.

- 'I.QIS5 insurance obligations' tab Section 4 – Illiquidity Premium allocations. Lloyd's is expecting all technical provisions to be allocated to the 50% bucket and is not testing this requirement in this rerun (all hidden).
- 'SF.SCR_G' tab Section 2 – Adjustments for loss absorbing effects of technical provisions and deferred taxes are not expected within Lloyd's and as such Lloyd's is not requesting these.
- 'SF.SCR_G' USPs – USP parameters for Non-Life and Non-SLT Health are not being tested for this submission. Agents are not expected to calculate these but may find it useful to do so.
- 'SF.SCR_G' Non-Life and Non-SLT Health Lapse Risk – This small SCR component is not being collected due to materiality.

In addition to the removal of certain tabs and the shading out of certain non-required areas Lloyd's has also attempted to correct errors previously identified in the original template.

- 'O.Overview' tab – this tab previously had several mistakes mainly due to picking up of data from incorrect sources. The main areas which have been corrected are the Solvency summary above the graphs (Available capital towards SCR now includes Letters of Credit) and the Technical Provisions section (which previously referred to incorrect cells when summarising the QIS5 basis).

If Agents are aware of any other errors or identify these in during the process of completing the submission then please let Lloyd's know via Solvency2@lloyds.com as soon as possible. We will endeavour to update the version of the template published on lloyds.com to account for these. Agents should check regularly that the template they are using and submitting is the most up to date one.

Lloyd's has also added a 'Comments' tab to allow agents to enter particular issues or notes on certain areas. Lloyd's would encourage the use of this sheet to facilitate the collection of methodology, areas of concern or difficulty across the market.

Where Helper tabs exist Managing Agents are free to use the 2010 QIS5 versions to assist in their completion of the template. Lloyd's has not attempted to adjust these in anyway or replicate them on lloyds.com, however these can still be downloaded from the EIOPA website (http://eiopa.europa.eu/).

Details of Overseas Trust Fund Deposits

For the 2010 QIS5 exercise Lloyd's provided agents with an indicative split of trust fund assets for use in their balance sheet and modelling of these for the derivation of the SCR. Managing Agents have since been provided with Syndicate security level information for the Overseas Trust Funds as at 31 December 2010 to be included within PTF asset submissions.

The overseas deposits should be included in the appropriate investment lines. For example, amount of government bonds in the overseas deposits should be in included in the "Bonds - Government and multilateral banks" line in the balance sheet.

All investment data should be based on capital values alone, with accrued interest being captured in "Any Other Assets".

Investment Funds

Investment funds, for example, money market funds that meet the definition of cash and cash equivalents as per International Accounting Standard 7 (IAS 7), Statement of Cash Flows should be included in the cash and cash equivalents line for QIS5 valuation principles.

Capital supporting syndicates

In a change to QIS 4 and the original 2010 QIS5 exercise, agents **must not include funds at Lloyd's (FAL) or funds in syndicate (FIS) supporting the syndicate in their submission.**

Standard Formula Calculation

For the purposes of the standard formula calculation Agents should only calculate their capital requirements based on their best estimate Solvency II liabilities and the assets which support these liabilities. This would exclude FAL, FIS and any surplus assets held to avoid overstating capital requirements under the standard formula.

Lloyd's will centrally calculate market risk and counterparty default risk on FAL and FIS as part of the aggregate calculation based on the Lloyd's Internal Model Asset Information Request Return also due to be submitted at the end of July.

Balance Sheet

For the purposes of completing the current basis and Solvency II balance sheets Agents should also exclude FAL and FIS. The current balance sheet submission should reconcile to the QMA 201 as submitted at year end 2010. A mapping of the elements in the QMA 201 was provided in the detailed QIS5 guidance issued by Lloyd's in August 2010. Lloyd's recognises that this may distort the surplus and solvency of syndicates as there will be no reporting of assets available to meet the Standard Formula SCR.

Lloyd's will produce the balance sheet on FAL, FIS and Central Fund assets as part of the aggregate Standard Formula modelling.

SOURCES OF INFORMATION AND ADVICE

For the full QIS5 submission in 2010 there were several sources of information available to Managing Agents all of which are still available. Lloyd's would encourage Agents to refer these sources initially to check if any queries they may have already been identified and answered. A separate set of FAQs will also be produced for the Lloyd's 2011 rerun which Lloyd's would also encourage agents to check regularly. If Agent's still have questions after referring to these sources then please email these to Solvency2@lloyds.com.

CEIOPS

https://eiopa.europa.eu/consultations/qis/quantitative-impact-study-5/index.html

As part of the exercise in 2010 CEIOPS produced full technical specifications, annexes, questions and answers and errata to accompany the spreadsheets. These are all still available on the EIOPA website.

FSA

http://www.fsa.gov.uk/Pages/About/What/International/solvency/qis/QIS5/index.shtml

The FSA website contains an overview of the submission requirements and several FAQs pertaining to QIS5.

Lloyd's

http://www.lloyds.com/The-Market/Operating-at-Lloyds/Solvency-II

As part of the full QIS5 exercise in 2010 Lloyd's issued several guidance notes and published FAQs throughout the process, these can be found on the Solvency II area of Lloyds.com under 'QIS5".

Market workshops

Lloyd's will continue to run Dry Run workshops in 2011 covering all areas of the Solvency II requirements. The Technical Provisions and Standard Formula workshops held on the 13th and 17th of June 2011 will introduce the standard formula 2011 rerun and cover any preliminary questions which may arise.