LLOYD'S

SOLVENCY II

TECHNICAL PROVISIONS VALUATION AS AT 31ST DECEMBER 2010

SUBMISSION TEMPLATE INSTRUCTIONS

INTRODUCTION

As set out in the Guidance Notes for the 2011 Dry Run Review Process, calculation of Technical Provisions on a Solvency II basis will be required at various points during 2011. The first collection in 2011 will be the calculation of Technical Provisions as at 31st December 2010. The results of this calculation must be entered to the technical provision submission template and submitted to Lloyd's by 27th May 2011.

This document sets out further details on the requirements for this 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 in July 2010 and based on CEIOPS Level 2 advice to the EC. Lloyd's will be providing an update to this guidance by the end of 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.

The July 2010 version of the technical provision 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. As these calculations build on those performed for the QIS5 exercise, which was the first real test of Solvency II Technical Provisions, Lloyd's would expect the approaches and methodologies used to be further developed and 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 to confirm results appear reasonable. Lloyd's will then analyse the results and provide feedback before the end of August 2011.

Participation in technical provision exercise

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 with business to be written during 2010.

Basis of calculation

All calculations should use a valuation date of 31st December 2010.

All figures should be reported in thousands and in converted Sterling. The exchange rates used should be consistent with the year end returns, the basis for which is discussed in Lloyd's Market Bulletin Y4459.

The Solvency II technical provision best estimate must take account of the impact of discounting using the relevant risk-free interest rate term structure. EIOPA will be deriving and publishing these risk-free interest rate term structures for each relevant currency.

It is not yet clear whether any risk-free rates will be available in advance and in time for this technical provision valuation exercise. If, by the middle of April, it is clear that these rates will not be available, Lloyd's will derive and publish to the market a set of risk-free rates to use for the most significant currencies.

Scope of data collection

Though the calculations and processes required for this submission should be similar to those performed by agents for QIS5, Lloyd's recognises that the exercise will pose significant resource issues. To help with this, Lloyd's has cut down on the granularity of items required for this valuation.

The level of granularity will need to increase for the next technical provision exercise in September, with the Technical Provision Data (TPD) submission in November collecting 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.

Submission of results

Completed submission templates should be submitted electronically by 27th May 2011 to Solvency2@lloyds.com.

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.

TECHNICAL PROVISION SUBMISSION TEMPLATE

The results of the technical provision calculations must be submitted to Lloyd's using the Q42010 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 up unused classes using the grouping buttons on the rows in the spreadsheet. **However, the submitted template must not have rows or columns inserted, removed or moved.**

Naming convention

One submission template excel file should be submitted for each syndicate using the standard naming convention "**S2TPs_Q42010_SYND.xls"**, where "SYND" represents an individual syndicate number (4 digits).

Signs of figures reported

All standard data should be entered with positive values. This includes, for example, claims amounts, future premiums and amounts for adjustment (including discounting and reinsurance bad debt). The exception to this would be in situations where future premiums are so large that premium provisions are actually negative.

Segmentation

Solvency II lines of business

Figures must be reported for each of the Solvency II lines of business. These include the 28 non-life and health classes of business which match those used within QIS5.

In addition to these classes, there will be some technical provisions, including those related to Periodic Payment Orders, which will need to be reported separately in the non-life and health annuity lines of business. Note that this change from QIS5 (which used one class for annuities) is to bring the classes in line with our current interpretation of segmentation under the level 2 draft implementing measures.

Lloyd's expects that of the 16 lines of business for life business, life syndicates would only need to use the insurance and reinsurance lines within the "Other" grouping (and are likely to require only some of these). Again, the naming of these classes has been amended from those used in QIS5 to reflect our current interpretation of segmentation under the level 2 draft implementing measures.

The breakdown of classes to be used is set out below, with further details in Appendix 1:

- 12 direct classes (non-life and health)
- 12 proportional classes (non-life and health, corresponding to those above)
- 4 non-proportional (non-life and health)
- 4 "Other" life insurance classes covering death, health or miscellaneous
- 1 class for annuities stemming from non-life contracts relating to health obligations
- 1 class for annuities stemming from non-life contracts relating to other than health
- 4 "Other" life reinsurance classes covering reinsurance of death, health or miscellaneous

Solvency II requires calculation of technical provisions using homogeneous risk groups. Subsequent reporting of obligations by the Solvency II minimum lines of business may then require allocation. Lloyd's expects agents to use a reasonable basis to allocate business to the Solvency II minimum lines of business.

Lloyd's has provided a risk code mapping for QIS5 to **assist** agents in the allocation process. **This mapping does not give sufficient information to split out all data** to the required level for Solvency II. Further separation of data may be required such as between direct and proportional business, often modelled together, or to separate facultative non-proportional reinsurance, sometimes modelled with direct business. Additional data sources or assumptions may be needed to be able to allocate and report to the required level.

Agents should note that, in most cases, facultative reinsurance would be classed as non-proportional business.

Currency

As noted above, homogeneous risk groups should form the basis for the calculation of Technical Provisions under Solvency II. These groupings may include separation of obligations of different currencies where these are not considered to be part of the same homogeneous risk group.

Calculated cashflows would then 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 results in two currencies only, US Dollars and Other. This is an area where the full requirements have been simplified. The number of currencies to be reported will increase for future exercises.

All figures should be reported in thousands and in converted Sterling. The exchange rates used should be consistent with the year end returns, the basis for which is discussed in Lloyd's Market Bulletin Y4459.

Claims and premium provisions

As for QIS5 and our current interpretation of the draft level 2 implementing measures, non-life best estimates should be calculated separately for claims and premium provisions. These will be reported separately on the technical provision submission template.

In a change to previous guidance issued, it now seems likely that future premiums relating to claims provisions will be included within the claims provisions, rather than having all future premiums (from earned or unearned business) grouped into the premium provisions.

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 unincepted business relating to the 2011 underwriting year, 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.

Expenses

Though allocated loss adjustment expenses may be incorporated within the claims best estimates, other expenses should be reported separately. These are requested at a whole account level, on a discounted and undiscounted basis.

Note that this is an area where requirements have been simplified. For future exercises, expenses may need to be allocated to a more granular level.

Data items collected at a class level

Adjustment for discounting

The total adjustment made for discounting should be reported for each line of business for the claims and premium provisions separately. This is required for the gross, reinsurance and net best estimates (all excluding expenses). A reduction in provisions due to discounting should be entered as a positive amount.

Adjustment to reinsurance for counterparty default

The total adjustment made to the reinsurance best estimate for counterparty default should be reported for each line of business 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.

Data items collected by underwriting year

The following section sets out details of the data items collected by the technical provision submission template.

Current position (Gross)

- Claims paid and incurred
- Premiums received, net of acquisition costs

Gross best estimate claims provisions

- Gross best estimate claims provision. These should exclude discounting and 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.
- Future premiums within the gross best estimate, excluding expenses and discounting. Further to our current interpretation of the draft level 2 implementing measures, claims provisions should also incorporate future premiums expected on this (earned) business. This is a change to the position within the technical provision guidance released in July 2010 and which were based on the advice to the EC available at the time.
- Allowance for binary events within the best estimate, excluding expenses and discounting.

Reinsurance best estimate claims provisions

- Reinsurance best estimate claims provisions, excluding discounting and expenses. This should also exclude the adjustment made for reinsurance counterparty default, which is captured separately at a total level for each line of business. The reinsurance best estimates should incorporate all other elements including future premiums and binary event loadings, further detail on which is captured separately, as noted below.
- Reinsurance future premiums within the reinsurance best estimate, excluding expenses and discounting.
- Allowance for reinsurance on binary events included within the reinsurance best estimate, excluding expenses and discounting.

Net best estimate claims provisions

- This is a calculated field, which excludes discounting, expenses and the allowance for reinsurance counterparty default.

Gross premiums provisions

Unincepted contracts relating to the 2011 underwriting year, but which are a contractual obligation as at 31st December 2010, should be included within the valuation. The expected claims, future premiums and other elements of the best estimate should be reported within the row for the 2011 year. 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.

- Gross best estimate premiums provision. These should exclude discounting and 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 below.

- Future premiums within the gross best estimate, excluding expenses and discounting. Further to our current interpretation of the draft level 2 implementing measures, premiums provisions should only incorporate future premiums expected on this (unearned) business. This is a change to the position within the technical provision guidance released in July 2010 and which were based on the advice to the EC available at the time.
- Allowance for binary events within the best estimate, excluding expenses and discounting.

Reinsurance best estimate premiums provisions

- Reinsurance best estimate premium provisions, excluding discounting and expenses. This should also exclude the allowance made for reinsurance counterparty default, which is captured separately at a total level for each line of business. The reinsurance best estimates should incorporate all other elements including future premiums and binary event loadings, further detail on which is captured separately, as noted below.
- Reinsurance future premiums within the reinsurance best estimate, excluding expenses and discounting.
- Allowance for binary events reinsurance recoveries within the reinsurance best estimate premium provisions, excluding expenses and discounting.

Net best estimate claims provisions

- This is a calculated field, which excludes discounting, expenses and the allowance for reinsurance counterparty default.

Comments

The Submission Template file includes a sheet where comments or notes can be made.

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

It is not clear what approach should be taken for the inclusion of unincepted business written via binding authority. Current discussion in the market includes 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.

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

As set out in the guidance notes for the 2011 Dry Run process, there will be additional exercises to test the calculation of Technical Provisions throughout 2011. It is expected that calculations will also be required in 2012.

The following section gives further details on the expected requirements for 2011.

Half-year update

A half-year update of the Technical Provisions, including the projected Technical Provisions as at 31st December 2011, will be required by 30th September.

Lloyd’s expects to expand requirements from this cut-down version for subsequent calculations. This is likely to include:

- Reporting of risk margins and associated discounting, by Solvency II line of business.
- Reporting under the seven currency groupings as will be required for the TPD.

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.

APPENDIX 1:

CURRENT INTERPRETATION OF SEGMENTATION

The list below reflects Lloyd's current understanding of the classes of business to be used within the calculation of Technical Provisions on a Solvency II basis. Note that these are based on Lloyd's understanding and may change as implementing measures are finalised.

Non-life insurance - direct

1. Medical expense insurance

Medical expense insurance obligations as referred to below where the underlying business is not pursued on a similar technical basis to that of life insurance, other than obligations included in the line of business 3.

Medical expense insurance obligation means an insurance obligation that covers the provision of preventive or curative medical treatment or care including medical treatment or care due to illness, accident, disability and infirmity, or financial compensation for such treatment or care.

2. Income protection insurance

Income protection insurance obligations as referred to below where the underlying business is not pursued on a similar technical basis to that of life insurance, other than obligations included in the line of business 3.

Income protection insurance obligation means an insurance obligation that covers financial compensation in consequence of illness, accident, disability or infirmity other than the financial compensation referred to in line of business 1.

3. Workers' compensation insurance

Health insurance obligations as referred to below which relate to accidents at work, industrial injury and occupational diseases and where the underlying business is not pursued on a similar technical basis to that of life insurance.

Workers' compensation insurance obligation means an insurance obligation that covers the provision or financial compensation referred to in lines of business 1 and 2 and which relates to accidents at work, industrial injury and occupational diseases.

4. Motor vehicle liability insurance

Insurance obligations which cover all liabilities arising out of the use of motor vehicles operating on land (including carrier's liability).

5. Other motor insurance

Insurance obligations which cover all damage to or loss of land vehicles (including railway rolling stock).

6. Marine, aviation and transport insurance

Insurance obligations which cover all damage or loss to sea, lake, river and canal vessels, aircraft, and damage to or loss of goods in transit or baggage irrespective of the form of transport. Insurance obligations which cover liabilities arising out of the use of aircraft, ships, vessels or boats on the sea, lakes, rivers or canals (including carrier's liability).

7. Fire and other damage to property insurance

Insurance obligations which cover all damage to or loss of property other than those included in the lines of business 5 and 6 due to fire, explosion, natural forces including storm, hail or frost, nuclear energy, land subsidence and any event such as theft.

8. General liability insurance

Insurance obligations which cover all liabilities other than those in the lines of business 4 and 6.

9. Credit and suretyship insurance

Insurance obligations which cover insolvency, export credit, instalment credit, mortgages, agricultural credit and direct and indirect suretyship.

10. Legal expenses insurance

Insurance obligations which cover legal expenses and cost of litigation.

11. Assistance

Insurance obligations which cover assistance for persons who get into difficulties while travelling, while away from home or while away from their habitual residence.

12. Miscellaneous financial loss

Insurance obligations which cover employment risk, insufficiency of income, bad weather, loss of benefit, continuing general expenses, unforeseen trading expenses, loss of market value, loss of rent or revenue, indirect trading losses other than those mentioned above, other financial loss (non-trading) as well as any other risk of non-life insurance not covered by the lines of business 1 to 11.

Proportional non-life reinsurance

The lines of business 13 to 24 shall include proportional reinsurance obligations which relate to the obligations included in lines of business 1 to 12 respectively.

Non-proportional non-life reinsurance

25. Non-proportional health reinsurance

Non-proportional reinsurance obligations relating to insurance obligations included in lines of business 1 to 3.

26. Non-proportional casualty reinsurance

Non-proportional reinsurance obligations relating to insurance obligations included in lines of business 4 and 8.

27. Non-proportional marine, aviation and transport reinsurance

Non-proportional reinsurance obligations relating to insurance obligations included in line of business 6.

28. Non-proportional property reinsurance

Non-proportional reinsurance obligations relating to insurance obligations included in lines of business 5, 7 and 9 to 12.

Life insurance (excluding lines not relevant for Lloyd's)

29. Other life insurance – contracts which mainly cover death

30. Other life insurance – contracts which mainly cover survival

Other life insurance obligations which mainly cover survival other than obligations included in with-profit and index/unit-linked lines of business (not included in list) and line of business 33.

31. Other life insurance – health insurance contracts

Other life insurance obligations which mainly cover the financial compensation referred to in lines of business 1 to 3 but pursued on a similar technical basis to that of life insurance.

32. Other life insurance – miscellaneous contracts

Insurance obligations of other life insurance contracts, other than those included in lines of business 29 to 31.

33. Annuities stemming from non-life insurance contracts and relating to health insurance obligations

34. Annuities stemming from non-life insurance contracts and relating to insurance obligations other than health insurance obligations

E. Life reinsurance

35. Reinsurance where the underlying insurance contracts mainly cover death

36. Reinsurance where the underlying insurance contracts mainly cover survival

37. Reinsurance of health insurance contracts

Reinsurance obligations where the underlying insurance contracts mainly cover the financial compensation referred to in lines of business 1 to 3 but pursued on a similar technical basis to that of life insurance.

38. Reinsurance of miscellaneous contracts

Reinsurance obligations other than those included in lines of business 35 to 37.