LLOYD'S

MARKET BULLETIN

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Title	Claims Equalisation Reserves
Purpose	To explain the operation of Claims Equalisation Reserves and clarify the information which Lloyd's will provide
Type	Information
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Related links	

1. Background

Claims Equalisation Reserves (CERs) were introduced for Lloyd's by Finance Act 2009 to align the tax treatment of Lloyd's corporate members' reserves with the treatment for general insurers. For Lloyd's members, unlike for general insurers, this is a tax adjustment only and has no impact on reserving for accounts purposes or on capital setting. Neither does it require assets to be set aside in a separate trust fund or in any way ring-fenced.

The purpose of this Bulletin is to provide the following:

(i) a brief summary of the mechanics of the CER,
(ii) information about the data that Lloyd's will provide to assist members in the calculation of their CER, and
(iii) further details of how members compute the transfer in to their CER.

A separate Bulletin has been published (Y4340) to provide guidance to aligned corporate members who wish to calculate their own CER.

Please note that Lloyd's CER system is being designed to cater for the majority of Lloyd's members. For some members, the particular facts of their business may mean that their

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CER calculation needs to be adjusted. Unfortunately it is not feasible for the central system to deal with all known and unknown circumstances, therefore members there may be situations where members will need to calculate their own CER. Lloyd's will however provide them with their premiums and claims data to assist with this. One example of when a member might have to compute their own CER is if they have purchased member level insurance cover. Members who have entered into HASP or HARP2 arrangements should however refer to Section 6.

2. Application

CERs are applicable to corporate members of Lloyd's, including Scottish Limited Partnerships and Limited Liability Partnerships. Individual names cannot set up a CER but will continue to benefit from the Special Reserve Fund which provides similar benefits. The de minimis limit which applies to the requirement for general insurers to maintain a CER does not apply to the tax relief available to Lloyd's corporate members and therefore all corporate members will be able to benefit from the CER should they wish to do so.

3. Commencement date and timings

The CER regime will first apply to profits arising in the year ended 31 December 2008, i.e. the profits declared in relation to the 2005 year of account. Lloyd's is currently in the process of building the IT system which will provide the data which members need to calculate their CER. We are currently aiming to provide the 2005 and 2006 year of account data in March/April 2010 provided that the IT build can be completed within that timeframe. Those members who wish to include the CER adjustment in their 2008 tax return will need to re-file their return once the information is made available early in 2010. Unfortunately this is unavoidable for this first period due to the time required to collect and compute the necessary data and build the IT system. In future years the data will be provided with the CTA1 forms for the relevant year of account, so re-filing of returns will not be necessary.

Some corporate members may be able to calculate the figures themselves, e.g. those members who are fully aligned. If you choose to calculate your own figures, Lloyd's will not provide the data to you in order to avoid any confusion arising due to two sets of data being produced. Such members should however refer to Market Bulletin Y4340.

4. Basic principles of CER regime

The CER only applies to certain classes of business, which are:

Class A – Property
Class B – Consequential Loss
Class C – Aviation and Marine
Class D – Nuclear
Class E – Non-proportional treaty property and consequential loss

Members can make transfers into their CER, based on the volume of written premiums for these business classes. Transfers out of the CER are triggered when claims arising exceed certain limits. The CER is subject to a maximum limit which is computed by reference to average written premiums over a five year period (the current year and the previous 4 years). However, members will be treated as new insurance companies for the purpose of calculating the maximum reserve for the 2005 year of account i.e. only premiums written on the 2005 year of account will need to be taken into consideration. For the 2006 year of account the written premiums on the 2005 and 2006 years of account will be used and so on, until a full five year average is built up for the 2009 year of account.

The limits applicable to each class of business are as set out below:

Business Group	Transfer in % (applied to net written premiums)	Transfer out % (trigger claims ratio as a percentage of net written premiums)	Maximum Reserve % (applied to 5 year average of net written premiums)
Property	3	72.5	20
Consequential Loss	3	72.5	20
Marine and Aviation	6	95	40
Nuclear	75	25	600
Non Proportional Treaty	11	100	75

For further information on how this calculation is performed, please refer to Market Bulletin Y4340. However, most members will not have the information available to compute their own CER and therefore Lloyd's will provide each member with the necessary data, subject to the caveats mentioned in 1 and 3 above.

5. Information provided by Lloyd's

Lloyd's will provide each member with 3 figures:

A = Maximum total provision
B = Provisional transfer into the CER
C = Provisional transfer out of the CER

The figures above will be provided at aggregate level only and not by class of business or by syndicate.

The figures will be calculated using data obtained from the Solvency and Reserving Data held centrally by Lloyd's plus some additional information provided by syndicates. For further information on the data used, please refer to Market Bulletin Y4340.
Members will need to keep a record of their brought forward and carry forward CER from year to year. This is because members have a certain amount of choice about the adjustments they make in their returns and Lloyd's will therefore not have access to this information.

The CER adjustment for inclusion in the tax return is computed as follows:

Suppose the brought forward CER = D and the carried forward CER = E. The calculation works as follows:

Step 1: Calculate the potential reserve carried forward, E, which will be equal to D + B – C, where B and C are both positive numbers.

Step 2: If the carried forward reserve, E, is greater than A, calculate the additional transfer out required so that E does not exceed A. I.e. the additional transfer out will be E – A.

Step 3: Calculate the net transfer in/(out) overall.

For example, suppose:

Maximum total provision (A)	= £3,300,000
Provisional transfer in (B)	= £450,000
Provisional amount transfer out (C)	= £50,000
Brought forward reserve (D)	= £3,000,000

Step 1: The potential reserve carried forward is:

D + B – C = £3,000,000 + £450,000 – £50,000
= £3,400,000

Step 2: The potential carried forward reserve is greater than the maximum reserve (A) of £3,300,000. Therefore an additional transfer out is needed of £3,400,000 - £3,300,000 = £100,000.

Step 3: This means that the net transfer in is £450,000 – £50,000 – £100,000 = £300,000.

A transfer in is treated as a deduction from the member's trading (formerly referred to as Schedule D Case I) profit. Correspondingly a transfer out is treated as additional trading income. In the example above, the member would reflect a trading deduction of £300,000 in their tax return. Further numerical examples are given in Appendix 1.

It should be noted that the CER can never be negative. Therefore if the calculation gives a net transfer out in the first year, the CER remains at zero. For subsequent years where the member has already established a CER, transfers out can only be made to the extent that they reduce the CER to zero.

6. Member level reinsurance

For members who have member level reinsurance, Lloyd's will provide, upon request, the net written premium figures, net claims paid and net technical provisions figures by year of account, together with the cumulative average net written premiums where necessary. The member can adjust this data to reflect their reinsurance policy. Such members will then need to compute their own CER figures as Lloyd's will not be able to include this adjustment in the central system due to the complexity of building a system to cater for all possible adjustments.

However, for those members with HASP or HARP2 policies Lloyd's is aiming to incorporate the necessary adjustments within the central system and should therefore still be able to provide the CER data to such members.

7. Option to waive relief

Setting up a CER and claiming the tax reliefs are optional. Members can choose whether to set up a CER. However, if they do choose to do so, the CER must be calculated from year to year. Where a member has set up a CER, it is possible to waive the tax relief for all or part of a net transfer in for a particular period. There is a two year window in which to make an election to waive all or part of a tax deduction for a net transfer in and such an election must be made in writing to the officer of the Board of HMRC. A record must be kept of any net transfers in waived and the waived amount must be set against any future transfers out at the earliest opportunity. A numerical example is provided in Appendix 2.

For SLP and LLP members, the decision about whether to claim the CER must be made at partnership level. The resulting adjustments should then be apportioned to the members of the SLP or LLP in line with their share of the syndicate taxable profit or allowable loss.

8. Cessation

Where a member ceases to write business which qualifies for CERs, the average net written premiums will gradually decrease. Therefore the maximum provision will gradually wind down to zero, causing amounts to be transferred out of the CER until the balance is zero.

If a member's trade at Lloyd's ceases for tax purposes e.g. upon resignation, there will be a transfer out equal to the amount of the CER. This will be taxed as a trading receipt in the member's final year of trading.

If you have any questions on the content of this Market Bulletin, please contact Helen Harrison (email: helen.harrison@lloyds.com; telephone: 0207 327 6859) or Juliet Phillips (email: juliet.phillips@lloyds.com; telephone: 0207 327 6839).

Appendix 1

Example 1

Maximum total provision (A)	= £3,300,000
Provisional transfer in (B)	= £450,000
Provisional transfer out (C)	= £50,000
Brought forward reserve (D)	= £2,500,000

Step 1: The potential reserve carried forward is:

D + B – C = £2,500,000 + £450,000 – £50,000
= £2,900,000

Step 2: The potential carried forward reserve of £2,900,000 is not greater than the maximum reserve (A) of £3,300,000. Therefore no additional transfer out is needed.

Step 3: The net transfer in/(out) is £450,000 – £50,000 = £400,000.

Example 2

Maximum total provision (A)	= £3,300,000
Provisional transfer in (B)	= £50,000
Provisional transfer out (C)	= £450,000
Brought forward reserve (D)	= £2,500,000

Step 1: The potential reserve carried forward is:

D + B – C = £2,500,000 + £50,000 – £450,000
= £2,100,000

Step 2: The potential carried forward reserve of £2,100,000 is not greater than the maximum reserve (A) of £3,300,000. Therefore no additional transfer out is needed.

Step 3: The net transfer in/(out) is £50,000 – £450,000 = (£400,000).

Example 3

Maximum total provision (A)	= £300,000
Provisional transfer in (B)	= £40,000
Provisional transfer out (C)	= £200,000
Brought forward reserve (D)	= £100,000

Step 1: The potential reserve carried forward is:

D + B – C = £100,000 + £40,000 – £200,000
= (£60,000)

Step 2: The potential carried forward reserve of (£60,000) is negative. Hence the transfer out (C) must be restricted to £200,000 - £60,000 = £140,000, so that the CER does not become negative.

Step 3: The net transfer in/(out) is £40,000 – £140,000 = (£100,000).

Appendix 2 - Example showing effect of waiving a net transfer in

Case (i) – Waiver is made

Year of account	CER b/f	Max provision	Net of potential transfers in and out	Net transfer in waived	Offset of waived transfers in against transfers out	Actual transfer in/(out)	Waived transfers in c/f	CER c/f	Notes
2005	0	17,000	3,000	0	0	3,000	0	3,000	1
2006	3,000	30,000	7,000	7,000	0	0	7,000	3,000	2
2007	3,000	25,000	6,000	0	0	6,000	7,000	9,000	3
2008	9,000	28,000	(2,000)	0	2,000	0	5,000	9,000	4
2009	9,000	24,000	(7,000)	0	5,000	(2,000)	0	7,000	5
Total						7,000			

Notes:

1. Transfer in is made as normal.
2. Transfer in is waived so the CER does not change.
3. Transfer in is made as normal.
4. Calculation gives a net transfer out, so the waived transfer in has to be offset against this.
5. There is a further transfer out which uses up the remainder of the waived transfer in.

Case (ii) – No waiver is made

Year of account	CER b/f	Max provision	Net of potential transfers in and out	Net transfer in waived	Offset of waived transfers in against transfers out	Actual transfer in/(out)	Waived transfers in c/f	CER c/f
2005	0	17,000	3,000	0	0	3,000	0	3,000
2006	3,000	30,000	7,000	0	0	7,000	0	10,000
2007	10,000	25,000	6,000	0	0	6,000	0	16,000
2008	16,000	28,000	(2,000)	0	0	(2,000)	0	14,000
2009	14,000	24,000	(7,000)	0	0	(7,000)	0	7,000
Total						7,000		

Therefore the total transfers in and out over the period are the same in each case once the waived transfer in has been offset in full against transfers out.