LLOYD'S

MARKET BULLETIN

From	John Parry, Chairman, ICA Steering Group (extn 5129)
Date	26 July 2006
Reference	Y3854
Subject	**Economic Capital Uplift for 2007 Year of Account**
Subject areas	Advise level of Economic Capital Uplift to be applied to 2007 ICAs
Attachments	
Action points	**Information only - no action required**
Deadlines	**N/A**

Level of Uplift to be applied to 2007 ICAs

The purpose of this bulletin is to advise all agents and members that a proportional Economic Capital Uplift (ECU) of 35% will apply to syndicate ICAs for the 2007 year of account. This is the same uplift as applied for the 2006 year of account.

As advised previously, the uplifted ICAs will be subject to a 20% corridor around RBC.

Economic Capital

The Lloyd's standard Economic Capital is higher than the minimum regulatory requirement of the FSA. This is achieved from two components: the Economic Capital held by members, based upon an Economic Capital level for syndicates, and the Central Fund.

Each syndicate must produce an Individual Capital Assessment (ICA). To bring the level of capital up from the ICA standard to Lloyd's required level, ICAs are uplifted before being used as an input to the member capital setting process. For the 2006 Year of Account it was decided that an increase of 35% would apply to all syndicates. It was agreed that for 2007 a variable uplift would be considered and Lloyd's has investigated a method that aimed to capture the differences in risk beyond the ICA level that is in the 0.5% tail of the range of possible outcomes.

Background on proposed Differential Uplift

A variable uplift would seek to introduce a higher ECU for those syndicates whose books posed higher than average "high severity/low frequency" risk and correspondingly a lower

ECU for those syndicates for whom the ICA is already closer to the highest loss they could have.

The methodology considered was based on syndicates' estimates of the risk at a higher percentile than that required by the ICA. Lloyd's carried out detailed investigations and also analysed the responses of managing agents who had submitted results of their analysis, covering 51% of 2006 market capacity.

On close examination, neither the central estimates nor those of the managing agents were sufficiently stable to be used in setting capital.

Conclusion

Lloyd's has concluded that in practice an ECU based on this approach would be unstable and would lack transparency. Furthermore, it would be difficult to monitor the legitimacy of an individual syndicate's calculations given the level of spurious accuracy. This result was discussed with LMACC and that group agreed with the conclusion.

The proportional 35% uplift does produce higher uplifts for syndicates that have higher risk at the ICA level, so is to a degree risk sensitive. Also, the Lloyd's central model which drives the Society ICA does take account of the risk beyond the uplifted level, so the risk is captured.

It is proposed that Lloyd's will continue to investigate methods for capturing the differences in risks between syndicates that are outside the scope of the ICA calculations, for implementation in the future if a method can be found. Agents will be given due notice of any change in the method away from the current 35% proportional uplift.

This bulletin is being sent to all managing agents, members' agents, direct corporate participants and for information to all market associations.

John Parry
Chairman
ICA Steering Group