LLOYD'S

MARKET BULLETIN

REF: Y4301

Title	Coming into Line (CIL) November 2010
Purpose	To advise agents of the revised recognition of interim profits and basis for capitalising to meet CIL
Type	Scheduled
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Date	11 August 2009
Deadline	26 November 2009
Related links	

The purpose of this bulletin is to advise of changes to the quantum of the half year profit credit to be treated as capital agreed by the Franchise Board and provide more guidance on timing of recapitalisation, where members' free funds are eroded for any reason. The bulletin also sets out the timetable for the CIL process.

Summary

Interim profits will be recognised as capital up to the level of the 35% economic uplift applied to Individual Capital Assessments (ICAs) i.e. Half year profits may meet 25% (previously 10%) of members' Economic Capital Assessment (ECA).

Lloyd's will only adjust members' capital requirements, once set for CIL, where the aggregate market change is over £1bn (c10%)

Interim Profit Credit

The previous level of half year profit credit (up to 10% of ECA) was introduced when Lloyd's was evolving from the first Continuous Solvency Adjustments post 9/11. The syndicate reporting of interim results and Lloyd's central review process is now firmly established, thus allowing a more appropriate and timely level of credit within the capital setting process. The restriction to 10% of ECA was seen as too penal and presented a commercial disadvantage compared to the company market.

The half year credit has therefore been extended to meet the economic uplift in full. It is not considered that interim profits should be eligible to meet regulatory capital requirements (the ICA level), since the audit opinion is a review only and there is no requirement for an independent statement of actuarial opinion on reserves. The half year profit recognition for capital purposes has, therefore, been set at 25% of ECA (approximately equivalent to 35 part of 135 in an example where ECA is 135, the ICA is 100 and the uplift is 35). In practice, therefore, the restriction to the uplift alone would only apply to members achieving annualised returns on capital of over 50%.

Other restrictions for the half year credit remain ie. only active members will receive a credit / deficit. For this purpose active members include those ceased members who have made funds inter-available to an active member or where a ceased member is part of an ongoing corporate group and there is a cross deficit clause in place.

The condition that the profit could be disallowed across the market in the event of a major catastrophe has been discontinued. In its place, a risk based adjustment will be made for material changes to members' free funds caused by any reason, catastrophe experience or otherwise – see below

Enhancements to the basis for CIL requirements

Outside of the bi-annual June and November CIL dates, Lloyd's will only require a more rapid re-capitalisation where members' free funds fall below their regulatory minimum (Individual Capital Assessment (ICA)) or if, at market level, the level of shortfalls place an undue burden on the Central Fund. This reiterates the approach set out in the ICA guidance issued earlier this year.

The November capital tests draws on many data points finalised at different dates. Firstly, the capital available to meet requirements is determined by early September based on syndicate half year net profits / losses and funds at Lloyd's valued as at 30 June. Secondly, syndicate ICAs and derived member ECAs for the following year of account are finalised during late September and October. Thirdly, there could be late changes in risk profile or available assets through currency movements, asset fluctuations and major losses, where judgement is required on whether to adjust capital levels in November or to recapitalise later.

In recognition of this the Franchise Board has agreed that the process is tightened and that the November capital tests recognise the up to date risk profile for large exposures. In this regard firstly, once the future capital requirement (the 2010 ICA) is agreed, this will be adopted for both CIL and Release test purposes. This ensures that where risk is reducing, the member does not have capital trapped because of a superseded risk assessment.

Secondly, rather than use a market wide withdrawal of interim profit recognition following a Q3 catastrophe, a member level assessment of the impact will be made. This will draw on data from any major loss returns or requiring early submission of Q3 headline information for materially affected syndicates.

General recapitalisation outside of bi-annual exercise

In relation to our approach on timing of recapitalisation, where free funds are eroded across the market up to an aggregate level of approximately £1bn or 10% of the aggregate of members' ECA, this will be absorbed centrally until the following CIL date. This recognises the ability to be flexible given the current strength of central assets and would be subject to change at Lloyd's discretion if necessary.

By way of an example, a 15% movement in rates of exchange equates to a movement of c£1bn (or 10%) in members' capital requirements. At this level, central assets are more than sufficient to absorb that additional exposure and allow members up to a further six months to recapitalise i.e. adjust in mid year 2010. This is consistent with the approach set out in John Parry's email to managing agents of 13 July 2009.

Applying a similar approach for all changes in risk across the market would mean that major losses in excess of plans' allowance as "business as usual" (or any other cause) up to £1bn should not require rapid adjustments, thus avoiding potentially damaging short term difficulties for the market.

Where the change in risk affects a small number of members Lloyd's is satisfied that provided they demonstrate the ability and willingness to provide funds in the longer term, maintaining free funds equal to the ICA level for prudential purposes is sufficient until the following CIL date (30 June 2010 in this instance)

Timetable

The timetable for this year's CIL process will be as follows:-

30 June 2009	Valuation date of funds at Lloyd's
4 September 2009	Interim Profit data released
8 September 2009	Release Test calculations (as at 30 June 2009 incorporating half results issued)
30 September	Review of current exchange rates and impact at market level of movements since 30 June. Advise market of whether any change to ECA is required for CIL
Before 9 November 2009	Assessment made of Q3 results / major loss returns
26 November 2009	Latest date for Members to CIL

If you have any queries relating to the timetable please contact Malcolm Colesworthy ext. 2497 (Malcolm.colesworthy@lloyds.com). All other queries should be addressed to Kevin Nethersell ext. 6253 (Kevin.nethersell@lloyds.com) or Mike Steer ext. 5709 (mike.steer@lloyds.com). This bulletin has been sent to all members' agents, direct corporate members, recognised accountants and market associations for information.