MARKET BULLETIN

REF: Y4600

Title	Franchise Guidelines - change to the catastrophe exposure guideline
Purpose	To inform the market the guideline has been changed and that it will come into effect for 2013 business plan approval process.
Type	Event
From	Trevor Maynard, Head of Exposure Management and Reinsurance Performance Management Directorate 020 7327 6141 trevor.maynard@lloyds.com
Date	19 June 2012
Deadline	The new guidelines should be considered as part of the 2013 planning process (during Q3/4 of 2012).
Related links	

Whilst this bulletin is directed at all underwriting directors / active underwriters, it will affect a wide range of functions within each Managing Agent. In the circumstances, it is strongly recommended that this change is widely communicated within each Managing Agent.

In particular this bulletin will be of interest to the following roles or to those carrying our similar duties:

- Heads of Exposure Management;
- Heads of Reinsurance;
- Compliance Officers;
- Those engaged in business planning for 2013.

HISTORY

The Chairman's Strategy Group (CSG) in 2002/3 proposed Franchise Guidelines to which Syndicates at Lloyd's are subject, including one that relates to Realistic Disaster Scenarios (RDSs). The guideline specified maximum RDS exposures expressed as a percentage of "Capacity". The percentage thresholds were 75% in respect of expected Gross losses and 20% in respect of Final Net Losses.

In 2011 the denominator was changed to "Gross Net Premium" (taking effect on 1 January 2012) to be more in line with other Lloyd's measures. We did not change the thresholds at that time pending a review in 2011/2012.

NEW GUIDELINE

With effect from 1 January 2013 the Franchise Guideline in respect of maximum RDS exposures will be changed to the following:

> *The maximum gross and final net exposures to a single Lloyd's specified Realistic Disaster Scenario (RDS) event for a Syndicate are subject to the following thresholds:*
>
> *(1) up to 80% and 30% of Gross Net Premium (GNP) respectively; and*
>
> *(2) up to 80% and 30% of Syndicate ECA respectively.*

The capital guideline (2) above is new; both tests must be met simultaneously.

REASON FOR CHANGE

The existing guideline (with a premium denominator) provides a guide to potential loss ratio volatility should a RDS occur. However the current test does not assess the impact of such an event on capital. We have carried out this comparison internally for some time, indeed it was one of the factors we consider when granting dispensations. We have decided it is appropriate to make this a formal test in future. In particular it highlights an important use of syndicate capital requirements.

The strengthening of the RDS test that occurred when we moved from Capacity to Premium will be unnecessary if an additional capital test is introduced; this is why we are raising the thresholds on the premium test.

The intention to carry out this change, subject to Franchise Board approval, was informally communicated at Tom Bolt's market presentation on 17 May 2012. The Lloyd's Syndicate Underwriting Performance team have been discussing implications with planning teams at Managing Agents since early May. This new Guideline was approved by the Franchise Board on 28 May 2012.

NATURE OF GUIDELINE

We would like to stress the "Guideline" nature of the above rule. Also, where a Syndicate plans to exceed one or more aspects of the guideline, a dispensation to exceed the guideline must be granted by the Business Plan Steering Group (BPSG). Please note that the granting of dispensations by the BPSG is based on a number of factors. These include, but are not limited to:

- The Managing Agent's:
  - Underwriting and management capabilities
  - Compliance record in relation to its planned levels of catastrophe exposure in previous business plans.
- The Syndicate's:
  - Track record in the underwriting catastrophe risk
  - Proposed catastrophe risk exposure profile
  - Planned level of profitability
  - Reinsurance arrangements

Please note that the list above is not exhaustive.

BUSINESS PLAN APPROVAL OF CATASTROPHE EXPOSURE

Managing Agents are also reminded that the planned levels of catastrophe exposure approved in the business plans should be treated as absolute limits. Where a Syndicate's catastrophe exposure from its "in-force" business is anticipated to exceed the approved levels at any time during the course of the year in question then the additional exposure needs to be approved by Lloyd's in advance. In cases where approval is not granted Managing Agents will be expected to take steps to bring their catastrophe exposures into line with their approved plan.

For the avoidance of doubt, the term "in-force" is defined as all unexpired exposures that could be subject to a claim should the RDS occur on the as-at date. As such they contain a mixture of several Years of Account (those that are running off from prior years of account and those that have been accepted in the latest year of account).

FURTHER INFORMATION

Should you have any further questions or require any additional information please contact your Exposure Management Executive below:

David Singh	020 7327 6496	david.singh@lloyds.com
Phil Holt	020 7327 5983	phil.holt@lloyds.com
Suzanne Laurent	020 7327 6402	suzanne.laurent@lloyds.com

Trevor Maynard
Head, Exposure Management and Reinsurance
Performance Management Directorate
020 7327 6141
trevor.maynard@lloyds.com