LLOYD'S

Market Bulletin

Ref: Y5198

Title	Economic Capital Assessment (ECA) Process for 2019 Underwriting Year of Account
Purpose	To set out the ECA process for the 2019 underwriting year, including basis of calculation, and arrangements for distribution of the Member Modelling Software ('Member Modeller')
Type	Scheduled
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Date	10 July 2018
Deadline	See business timetable on Lloyds.com for all capital return submission dates
Related links	SCR Guidance Update 2018 (access via: Lloyds.com > Market Resources > Regulatory >Solvency II > Market Tools and Resources > /syndicate Workstreams > Internal Model SCR > Guidance Issued) ECA Guidance Manual (access via: Lloyds.com > Tools and Systems > Member Modelling Software)

Introduction

This Bulletin confirms the key process points to note for the setting and modelling of member capital for the 2019 underwriting year, during calendar years 2018/19. In addition, details of modelling enhancements are provided in the appendices and the business timetable has been updated on Lloyds.com.

Readers of this Bulletin should also ensure that they are familiar with the fundamental process points set out in the ECA Guidance manual linked above.

Key Points to Note:

- *The SBF and LCR submission timetable is staggered between Group 1 and Group 2 syndicates, falling in September and October respectively. All active syndicates are required to submit a High Level Plan (HLP) in July.*
- *The initial indicative Member Modeller release is in August based on rolled forward 2018 data, scaled to reflect proposed changes in aggregate premiums (from HLP).*
- *There has been modest development to the Member Modeller since last year and those enhancements are outlined in Appendix 1.*
- *The LCR and SBF will be submitted via the Core Market Return (CMR) platform*.
- Managing agents' prior year performance against plan will be taken into account in assessing the proposed year loss ratios for capital setting. Where SBF loss ratios include assumptions that are not in line with regulatory requirements then a different LCR loss ratio should be used.
- The appropriateness of the LCR opening balance sheet position will be included in the scope of validation for the 2019 SCR.
- From full year coming into line, in November 2018, there will be a phased introduction of a limit on the proportion of Tier 2 capital allowed by members within FAL. Full details on the implementation of these measures and those relating to covering solvency deficits were provided in Market Bulletin Y5177, dated 12 April 2018.

Market Data Collection (MDC) Platform

As explained in Market Bulletin Y5194, the Lloyd's Capital Return (LCR) will not now be collected via the new Market Data Collection (MDC) platform, and should be submitted via CMR as in previous years.

The Supplementary Questionnaire (SuppQ) and Analysis of Change (AoC) documents will, therefore, continue to be collected as attachments to the LCR (form 990); new templates to be issued in July.

Submission Requirements

The Solvency Capital Requirement to ultimate (uSCR) and the one-year Solvency Capital Requirement (SCR1) must be submitted via the LCR by 1pm on the 13 September for Group 1 syndicates and 1pm on 4 October for Group 2 syndicates. The categorisation of Group 1 and 2 syndicates is set out in market bulletin Y5083.

The latest LCR submission must always be based on the same planned premium and reinsurance as the latest SBF submission. Although managing agents are not required to submit a full July SBF submission, they must submit HLP data and this will be used to estimate the rollover position, which will be reflected in the August Member Modeller release.

The SCR Guidance provides information on the basis of reporting and principles, plus the requirements for managing agents to submit:

- an LCR pro-forma (via CMR);
- an AoC document, attached via form 990 in the LCR (but can be submitted via SCRReturns@lloyds.com up to 2 working days following the appropriate LCR submission deadline);
- the SuppQ (attach via form 990 in the LCR);
- a model methodology document for 2019 (attach via form 990 in the LCR); and
- a full validation report in support of their SCRs, via SCRReturns@lloyds.com, up to 1 week following the appropriate LCR submission deadline.

Major Model Changes

Managing agents applying for approval of 'Major Model Changes', at any time during the year, should contact their MRC Analyst and provide the appropriate documentation to enable an assessment of the changes. Formal submission of Major Model Changes should be made, in line with current Lloyd's guidance, to GSII@lloyds.com with accompanying documentation to support the change. Managing agents are required, in any case, to submit a year on year analysis of change in the SCR with the LCR submission.

The Capital Setting Process for the 2019 Year of Account

The ECA Member Modelling Software ('Member Modeller') will be made available to registered users from 24 August. The Member Modeller will be updated in accordance with the business capital timetable, recognising SBF and uSCR submissions, Capacity Auctions and Coming into Line (CIL) deadlines.

Capacity

We would like to remind managing agents of their responsibilities in respect of submitting a Capacity number on SBF form 420, and ensure there is a uniform understanding of what this should represent. The key function of Capacity is in respect of allocating results and capital to members, and forms the basis for buying and selling rights of syndicate tenure in the Lloyd's auctions. It is 'Stamp Capacity' that is used as the denominator in these calculations, which is calculated as total capacity (row 6, SBF Form 420) less SPA Capacity (row 5, SBF form 420).

Stamp Capacity is, naturally, most important for non-aligned syndicates, particularly those trading in the Lloyd's Capacity auctions, although managing agents of aligned syndicates should also recognise that the matching of stamp capacity with the aligned member's premium limit is important if you are reliant on the Member Modelling software for determining member capital.

It is important to establish a stable Stamp Capacity number at the earliest point possible, to avoid any potential mismatch between members' premium limit and the syndicate capacity, which could lead to the incorrect member share being calculated.

We would therefore ask agents to follow these guidelines, in addition to the rules relating to pre-emptions and de-emptions set out in Market Bulletin Y5186, dated 5 June 2018:

i. Stamp Capacity should be set based on Gross Net Premium (GNP), net of SPA cession, as has been the custom, although this is currently under review and revised guidance may be issued in the future.
ii. Syndicate Capacity should normally include headroom to allow for possible increases in GNP, without necessitating a change to Capacity.
iii. As a general rule, we would not expect Capacity to be increased or reduced simply because of a change in GNP from the original plan, unless GNP exceeds Capacity. In applying this principle, however, managing agents of non-aligned syndicates should have regard to the impact on member fees, as Capacity decisions should <u>not</u> normally change the fees charged.
iv. Managing agents operating Special Purpose Arrangements (SPAs) are also advised that the 'Total Capacity' of the SPA reported on row 6 of SBF form 420 should always match 'SPA Capacity' reported on row 5 of SBF form 420 in the return of the host syndicate.

Syndicate SCR Review Process

Areas of Focus

The Lloyd's review will look for evidence that the following areas have been considered and included in the managing agent's internal model where appropriate:

<u>Non-Modelled Natural Catastrophe Risk</u>

Lloyd's expect managing agents to consider and take into account non-modelled risks, where relevant, in their internal models. This will continue to be an area of focus for Lloyd's for the 2019 review process.

<u>Climate Change</u>

The rise in greenhouse gasses is causing the planet to warm, affecting both the atmosphere and oceans. Sea levels are rising year on year, affecting storm surges, and sea surface temperatures, whilst subject to fluctuations from other cycles, are also rising inexorably on average. The extra energy in the climate system is fuel for hurricanes, and other windstorms. A warmer atmosphere traps more water, fuelling flood risk. Whilst the impact is slow year on year, the possibility of an overall worsening of risk levels compared to historic experience should be taken into consideration; managing agents are expected to recognise any potential impacts on peril frequency and severity in their risk models.

<u>Cyber</u>

Lloyd's will continue its focus on the modelling of cyber risk. Whilst most managing agents take into account the risk associated with direct and incidental cyber in their modelling of insurance risk, it is important that managing agents consider the risk of cyber-attacks in their own operational risk assessments. This will be an area of focus for the 2019 YOA.

Data Integrity

<u>Consistency of Data</u>

Managing agents should ensure that all data submitted to Lloyd's is internally consistent, i.e. between various forms. Often, certain items are submitted on different bases, as they are produced by separate teams within a managing agency or under separate processes.

Lloyd's, naturally expects consistency and agents will be notified of any discrepancies discovered within their submissions. Examples include, but are not limited to:

- Reinsurance Contract Boundary (RICB) impact on Technical Provisions (TPs) as submitted in the Quarterly Solvency Return (QSR) and the Supplementary Questionnaire section of the LCR.
- Premiums and reinsurance in the LCR and SBF.
- TPs in LCR and QSR (including risk margin).

SBF Loss Ratios and LCR opening balance sheet

Inconsistency between actual and planned loss ratios has been observed in previous years, and will be an area of focus for the 2019 review process. It is expected that the rationale for any optimism in planning loss ratios should be explained adequately. Managing agents should also ensure when bridging from previously used loss ratios, that the start point is appropriate and is not already carrying a level of optimism. Any trends showing unexplained and unreasonable differences between historical and planned loss ratios are likely to lead to further investigation, with a potential capital adjustment, to ensure capital adequacy.

In accordance with Article 77 of the Solvency II Directive, the LCR requires the use of "realistic assumption and adequate methods". It is not realistic for this basis to include improved underwriting results unless the measures planned to achieve these have been proven to be effective[1]. The appropriateness of the basis of the opening balance sheet should be subject to validation for the 2019 SCR.

The above may mean divergence between the SBF claims figures and LCR opening balance sheet. This should continue to be reported in the relevant tab of the SuppQ by syndicate class of business.

TPs

LCR submissions for November coming-into-line include projections for year-end reserves. Lloyd's intends to compare historically projected reserves to the actual Q4 reserves from the QSR submissions. Any observations that might suggest a trend of underestimation of projected reserves are likely to lead to further investigation, with a potential capital adjustment, to ensure capital adequacy.

Adjustments & Data Changes

Year End Adjustments

Syndicates are required to ensure that their business plan and uSCR, agreed for year-end CIL, are kept under continuous review. If circumstances change, leading to a material change in SBF and/or uSCR, by the end of February 2019, then a resubmission of relevant returns must be made by 1pm on 1 March 2019. As a guide Lloyd's would require a resubmission of the LCR if a syndicate modelled a 10% absolute movement in the uSCR, prior to any adjustment for latest risk margin, foreign exchange and RICB. Further details are included in the ECA Guidance manual on Lloyds.com.

[1] See PRA SS5/14

During Q1, Lloyd's will discuss developments with managing agents and informally gather projected uSCR movements. Whilst recognising the discretionary 10% threshold, Lloyd's reserves the right to request a capital resubmission, for the mid-year coming-into-line exercise, where having regard to all relevant circumstances it deems it appropriate.

Reinsurance Contract Boundary Adjustments

All agents are now required to model the RICB within their internal model and report the required adjustment to the uSCR on form 309 of the LCR, which should match the SuppQ and be consistent with the Quarterly Solvency Return (QSR).

Economic Capital Uplift (ECU)

Lloyd's will continue to apply an uplift to the minimum regulatory capital requirements to derive ECAs at member level. The uplift of 35% will continue for 2019, subject to confirmation by the Franchise Board on 26 July 2018, taking into account current circumstances.

Lloyd's Internal Model Parameter Changes

Lloyd's parameters have been reviewed and updated based on historic data as usual.

Exchange Rates

LCR submissions should be based on 2019 SBF exchange rates (set as at 30 June 2018 and detailed in Market Bulletin Y5192). However, March 2019 LCR resubmissions should be based on 31 December 2018 year-end rates of exchange. Movement in exchange rates will be kept under review and Lloyd's will consult and advise of any proposed action due to material changes.

Member Modeller

Use of the Member Modeller

All requirements and registration forms for prospective new users are set out in the ECA Guidance manual. Existing users will not need to do anything unless you are an agent that changes its name or authorising Director.

Data Protection

Prior to the commencement of the capital setting cycle, we will be conducting a review of third party firms who act on behalf of members (excluding Member Agents) to ensure we have explicit consent from each member for that firm to have access to their data. Failure to lodge consent for any member would result in removal of access to that member for the firm via the member modeller.

Lloyd's carries out an annual review of all users of the Member Modeller to ensure that individuals that no longer have a valid need to access the software have their access rights removed. Members' agents and managing agents are asked to advise Lloyd's, via the MRC helpdesk, of staff that have left their organisation or no longer need to access the software due to a change in responsibilities.

The Member Modeller only includes members that have active open year participations in the relevant modelling year, so does not retain any details relating to members that no longer have the need to calculate a capital requirement.

New Developments

The relatively minor changes for this year are detailed in Appendix 1. Users will notice a slight change in the homepage to improve the readability of messages. We have also introduced the ability to centrally override the Unlimited Back Year Liabilities (ULBY) requirement in a corporate consolidation, where there is a need to carry out a manual calculation, so all corporate consolidations will be able to rely on the results in the Member Modeller.

Members' Agent 'Publish' Requirement

All Members' agents will be required to publish their final member underwriting and capital requirements, and to electronically confirm that this is indeed the final CIL position

Training and Support

An e-mail help mailbox will be in operation to deal with queries on the ECA process and software, and for other ECA related questions; please direct all queries to:

Lloyds-MRC-Help@lloyds.com

If you require any more information regarding the capital setting process and Member Modeller, please review the ECA Guidance Manual or contact one of the following:

Neil Wells (ext. 6034) neil.wells@lloyds.com

Kevin Barnes (ext. 5683) kevin.barnes@lloyds.com

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Appendix 1

Software updates

Below we have detailed the two functionality and usability changes that will be apparent to users prior to the new business planning cycle. There will also be other minor changes behind the scenes, but these will not affect the user's experience:

Subject	Description
Home Page Message Box	The size of the Home Page message box has been increased to make it visually clearer. This will also mean that messages can be seen in full, reducing the need to scroll down each time.
ECA ULBY and ULBY Credit	The ability to override the member ULBY calculation for corporate consolidations has been introduced. This means that in certain circumstances, where the automated calculation is not able to produce the correct number, the Member Modeller will be able to present the correct requirement to users.