

New Syndicate Capital Guidance

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1 Introduction

1.1 Purpose

The purpose of this document is to set out the capital setting process for new entrants and syndicates moving from one managing agent to another. In particular, it outlines the process for:

- the initial approval of the new entrant by Lloyd's from a capital perspective as part of the "Making it Happen" process
- the process to obtain approval to set capital using the syndicate's own internal model
- demonstrating compliance with Lloyd's 'Principles for Doing Business' Principle 7.

1.2 Related Guidance

This document is intended to be read in conjunction with the following documents:

- Lloyd's Capital Guidance. The latest version of this can be found on the [Internal Model SCR](#) page on Lloyds.com,
- The 'Principles for Doing Business' at Lloyd's ("[The Principles](#)"), and
- LCR Instructions that are in force at the time of LSM submission. These can be found alongside the Capital Guidance.
- [Guides for New Entrant Application](#) section on Lloyds.com

2 Overview of the Process

New entrants go through the "Making it Happen" process once a detailed plan has been presented at the Business Opportunities Committee (BOC) and Lloyd's Council has given an agreement "in principle" to the application to set up a new syndicate or managing agent. More information on the wider Making it Happen process can be found in the Guides for New Entrant Application section on Lloyds.com.

In general, this requires new entrants to show that they are fulfilling The Principles. However, the capital principle requires a Solvency II compliant internal model, which needs longer timeframes and significant resource to build. Therefore, new syndicates will set capital using Lloyd's Standard Model (LSM) until they have had their internal model approved and are compliant with Principle 7 of The Principles.

Syndicates are usually required to have applied for and been granted internal model approval within 3 years of account of underwriting – this can be extended in some circumstances, e.g. if the first year of account was a partial year. For Syndicates in a Box (SIAB), this is extended to 4 years so that the internal model application can be made after approval has been given for the SIAB to transfer to full syndicate status. Syndicates cannot normally apply for internal model approval within less than one year of account since the evolving nature of the risk profile of new syndicates usually means frequent major model change ("MMC") submissions are required to ensure the internal model continues to reflect the syndicate's risk profile.

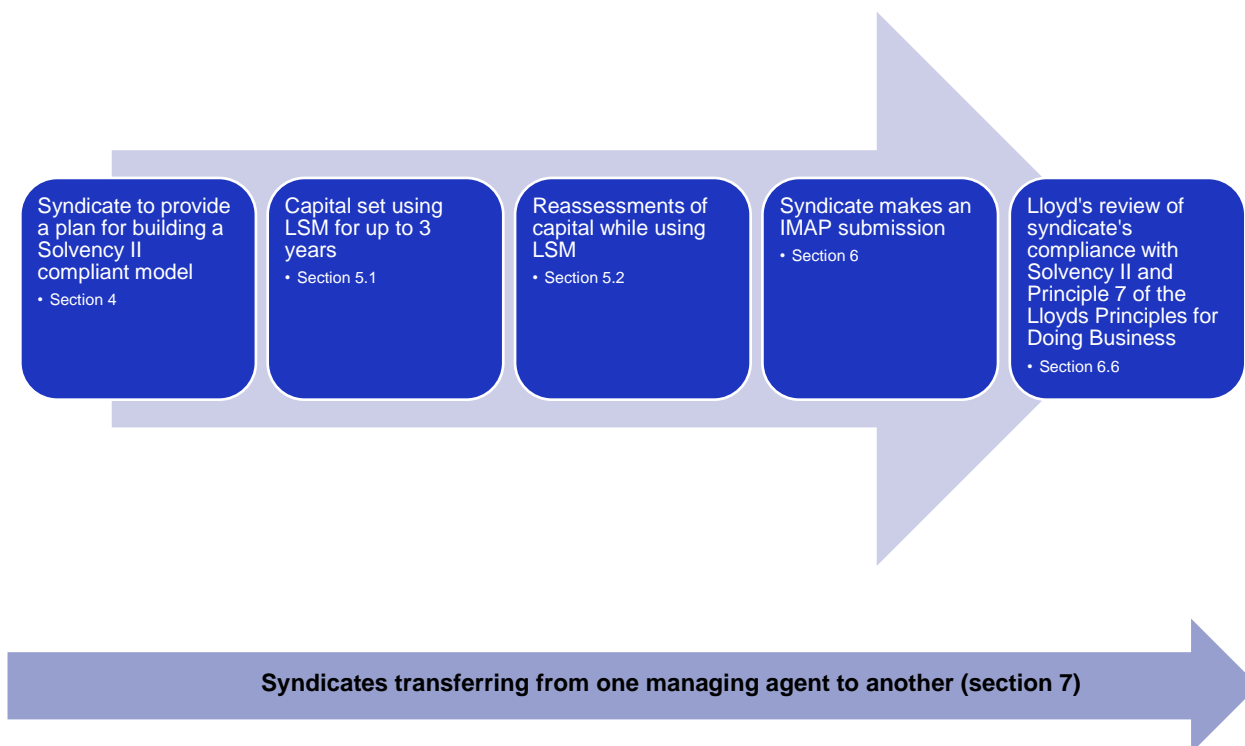
The timeframes set out below mean that syndicates setting capital using their own internal model in their second year of account effectively have to apply for model approval relatively shortly after starting to write business and syndicates should discuss timings as early as possible with Lloyd's.

More information about the LSM and the processes around submission, approval and updating the LSM is set out in [section 5](#).

[Section 6](#) outlines the process for new syndicates to obtain internal model approval.

For syndicates transferring from one managing agent to another a review similar to the 'Making it Happen' review for new entrants will be conducted to consider whether the syndicate continues to meet expectations with regard to The Principles. [Section 7](#) sets out the internal model considerations specific to such syndicates.

The diagram below gives an overview of the process for setting capital for new syndicates.



3 Lloyd's 'Principles for Doing Business' for New Syndicates

The main capital-related principle in The Principles is Principle 7 'Capital' which outlines the following:

- 1 Maintain an internal model which captures all material risks that the syndicate is exposed to.
- 2 Use modelling assumptions which are realistic and justifiable, methodology which is adequate, and all material limitations are understood.
- 3 Have strong feedback loops joining the business and the model.
- 4 Demonstrate robust governance and understanding of the model. This includes adequate understanding and challenge at senior management level.
- 5 Implement changes to the model which are reasonable and justified and their impact on the SCR adequately explained.
- 6 Conduct objective challenge of the internal model through independent validation.

When a syndicate begins operating, it will be given an Overall Rating of "New" for The Principles, with no rating assigned for Principle 7 while capital is set on the LSM. This is a temporary status and is equivalent to a neutral rating.

4 Plan for Compliance with Solvency II and Principle 7

As part of the Making it Happen process, managing agents will be required to submit a plan to Lloyd's setting out how they will achieve compliance with Solvency II and Principle 7 of The Principles (see [section 6.6](#) of this document for how that is assessed at the time of the IMAP submission). Lloyd's will review that plan and will work with the syndicate to ensure it is reasonable.

The plan should cover areas such as:

- When the syndicate plans to set capital using its own internal model for the first time and when it plans to submit the internal model application to Lloyd's.
- The planned resource for the capital and validation teams, covering areas such as the expected number of people in the team, the level of experience and a hiring plan. The syndicate should also set out contingency plans if hiring takes longer than expected and resource is not available according to the initial plan. Any agreements or discussions with consultancies should also be outlined.
- The capital modelling platform, cat risk vendor model and economic scenario generator (ESG) vendor model the syndicate intends to use and why. It should outline how market risk/catastrophe risk are going to be modelled if no external vendor models are planned to be licenced. This should also include if any software has been licenced already or when licences are expected to be in place.
- The data systems that will be in place.
- Outline the planned governance of the capital model, in particular which committees will be responsible for signing off capital and major model changes, and the make-up of those committees. This should also include a high-level timeline of when policies affecting the internal model are expected to be adopted and approved.
- The plans for internal model validation (e.g. using external or internal validators and resourcing around this), in particular setting out how the syndicate will ensure that the validation is independent, any challenges and contingency plans.
- The feedback loops planned to be in place between the capital model team and validators, governance, and the business.

5 Lloyd's Standard Model (LSM)

The Lloyd's Standard Model is a spreadsheet model which calculates the capital requirement for the syndicate. The model calculates the ultimate and one-year Solvency Capital Requirement (SCR) – explanations for these terms can be found in section 4.4 in the Lloyd's Capital Guidance. The spreadsheet model and instructions on how to complete the data inputs can be found on Lloyds.com in the Requirements for New Entrants section. Managing agents should not, however, simply rely on completing the inputs correctly and assume that the resulting capital is automatically appropriate. Syndicate Boards are ultimately responsible for confirming that their capital requirements are appropriate. Lloyd's expectations on this requirement are outlined in more detail in section 5.2.

The LSM uses an insurance risk calculation based using Lloyd's 60 class level granularity. Syndicates are required to input gross and net premiums and claims (earned and unearned with regards to prior, current and prospective years of account) and Lloyd's has parameterised class volatilities, between year and between class correlations to arrive at an insurance risk number excluding natural catastrophes. Additionally, syndicates need to input their aggregate natural catastrophe risk to be aggregated into the total insurance risk calculation. Market and credit risk calculations are based on the Solvency II Standard Formula and operational risk is added as a charge which depends on the age of the syndicates, with extra risk charges for new managing agents, captives and existing governance and risk management concerns for the Managing Agent. Please note that the operational risk calculation replaces the "New Syndicate Load" applied in the past.

After the calculations above, there are some adjustments in the LSM to arrive at the final capital requirement – these are the same in the LSM as for standard internal model syndicates: A reinsurance contract boundary (RICB) adjustment is applied to the ultimate solvency capital requirement (uSCR) as per the calculations in the LCR and an uplift of 1.35 is applied to arrive at the ECA – the economic capital requirement used in setting member capital requirement.

Lloyd's does not expect to update parameters of the LSM every year, however, the appropriateness of the structure and parameters will be regularly assessed and syndicates will be notified about any changes. However, the LSM template will be published twice a year (once at the beginning and once before CPG) in order to take into account of current economic conditions including exchange rates, yield curves etc.

Please note that additionally to the LSM syndicates are required to also submit the standard formula calculation to Lloyd's (except for SIABs). Guidance can be found on [Lloyds.com](https://lloyds.com).

5.1 Submission Requirements for the LSM

For syndicates submitting for the very first time, there is no fixed submission timetable – however, capital submissions and review will be aligned with the quarterly corridor test (QCT) timetable as far as possible (the dates are outlined in section 5.5 of the Lloyd's Capital Guidance).

For syndicates which have gone live and are submitting plans and capital requirements for the next year of account, business plan and capital submissions follow a phased approach. Each syndicate is given a specified return submission date based on its capital structure and Lloyd's risk-based approach. Syndicates will follow one of four submission phases, which has been confirmed by the Account Managers. Non-aligned syndicates will submit their plan and capital information in the first phase. Further details will be published annually in a market bulletin – LSM templates should be submitted in line with the LCR deadline for a given phase. Deadlines are at 1pm on the submission day. The LSM model should be uploaded to the "MRC Syndicate Capital Setting" folder on SecureShare. If you require access to SecureShare please speak to your devolved administrator in the first instance, or visit the SecureShare link on Lloyds.com for further information and an example on setting up SecureShare as a new agent. Agents are requested to also directly notify their capital point of contact to confirm whenever an LSM template is submitted on SecureShare.

In general, for capital setting purposes syndicates only need to submit the LSM template plus any additional documentation as noted below. Other requirements for syndicates that have a full model are not required e.g. the focus area return, an analysis of change, validation report or model change template. For the focus area return Lloyd's may request information from individual syndicates where the area of focus is relevant – so for example the syndicate might have to provide some additional information for major losses it has experienced (if not in its first year).

Syndicates are required to submit documentation outlining the following:

- Approval: The final SCR submitted to Lloyd's must be approved by the Board or an appropriately authorised committee, depending on the syndicate's governance arrangements, and in line with the Governance, Risk Management and Reporting Principles ([Principle 10](#)). Approval here is not related to the appropriateness of the model (as per the LCR), as the LSM parameters are not set by the syndicate. However, approval relates to the accuracy of the data inputs to the model and their consistency with other returns as well as the appropriateness of any bespoke calculations (e.g. the reinsurance benefit).
- Confirmation of appropriateness: The board should also confirm that there are no features in the risk profile which make this model inappropriate for use for the syndicate (see 5.2). Furthermore, the managing agent should, for any key inputs that materially impact the LSM capital requirement, outline why these are considered appropriate. For example, this could include:
 - The risk codes/Lloyd's classes that the exposures have been allocated to.
 - Counterparty default inputs e.g., split of exposures across the assumed RI panel and their credit ratings.
- Details on any areas where the LSM has bespoke inputs, in particular if overrides to the risk margin have been used, any risk mitigation and how that has been derived, or the calculation of any management adjustments.
- Validation of the loss ratios used as performed by the actuarial function.
- Confirmation that the ULO profit from the opening balance sheet (actual or projected) has been reviewed and any potential double-count has been eliminated from the prospective year insurance risk profit item.
- Details behind the workings of any profit claimed in the "Current and prior year's profit not already reflected in TPs" item.

The data input to the LSM needs to be in sterling. Submissions made up to February in a given year must use the published prior 30th June rates, which are set out in the QMR Bulletins that are published every quarter. Submissions made from March must use the 31 December rates.

5.2 Appropriateness of the LSM for the risk profile of the syndicate

Managing agents are required to bring any features of the risk profile to Lloyd's attention, where the limitations of the LSM could render it inappropriate and lead to a material misstatement in capital. The limitations are set out below. If the LSM is inappropriate for use then other mechanisms for setting capital will have to be discussed. Furthermore, in the case where Lloyd's believe that a syndicate has certain aspects of its book that make the LSM inappropriate, Lloyd's will contact the syndicates on a case by case basis.

As with any model, the LSM has limitations and might not be appropriate for the specific risk profile of the syndicate. There are limitations due to this being a spreadsheet model, as opposed to a monte-carlo simulation model that calculates the 99.5th percentile using stochastic simulations. The model is parameterised based on net market averages from the Lloyd's Internal Model (LIM) – however, this might not be appropriate for every syndicate. The managing agent is required to discuss with Lloyd's if the following clearly is not valid:

- The model is calibrated for "small" syndicates – as a guideline typically this means syndicates with a uSCR below £100m.
- The net volatilities are calibrated based on the average market portfolio – i.e. the line size risk profile and outwards reinsurance are averages. If syndicates are writing much larger (or smaller) line sizes than other writers in the market, the model might not be appropriate to use.
- There is no separate non-natural catastrophe modelling component– these are included in the parameterisation of the volatilities. Therefore you should flag to Lloyd's if you have material exposure to non-natural catastrophes and this is an important driver of risk as this might make the model inappropriate to use.

- The LSM is parameterised based on historical experience in the Lloyd's market with expert judgement overlay, for example to allow for potential downside deteriorations beyond any prior experience. However, if the risk profile of the syndicate includes business that has not previously been written at Lloyd's, the model may not be appropriate to use without adjustment.
- Given that volatilities and correlations are calibrated based on market averages, these might not be appropriate for monoline syndicates or syndicates writing very few lines of business.

Generally, the above not being valid does not automatically mean that the LSM cannot be used, as the model does have guardrails to ensure capital is not understated. The overall level of capital set might also still be appropriate, despite the limitations – this will be decided on a case-by-case basis. There might be other options to set capital:

- Firstly, managing agents should actively consider whether there are any limitations (which at a minimum should include consideration of limitations identified within this guidance) that mean they consider the LSM may materially misstate capital, and, where possible, calculate a management adjustment that would adequately cover the limitation(s) identified.
- If a syndicate is growing and becoming too large in its second or third year, then an early internal model application might be considered. Capital could also be set on a model that has not been approved yet, but then a controls loading might be applied due to risk management and governance concerns.
- A high-level adjustment to the SCR to exposure ratio could be considered.
- Loss ratios could be adjusted for capital setting purposes.

In addition to the above, Lloyd's have also introduced a minimum insurance risk vs. exposure requirement in the model to ensure that the capital requirement is not inappropriately low due to limitations in the model.

Syndicates are required to assess exposure to Realistic Disaster Scenarios (RDS) as well as developing their own aggregation scenarios and reporting them to Lloyd's. Franchise Guidelines are in place for RDS: "A syndicate's projected and in-force loss estimates for Realistic Disaster Scenarios shall not exceed 80% of ECA plus Profit for Gross Losses and 30% of ECA plus Profit for Final Net Losses" (more detail can be found in [Market Bulletin Y5375](#)). For syndicates with their own internal models, the Franchise Guidelines are only in place for the scenarios defined by Lloyd's – and syndicates are expected to parameterise their model using scenarios, and stress and scenario testing is an important part of the internal model validation. However, syndicates are also required to submit two scenarios that they have developed themselves (Alternatives A and B) as part of the new entrants process, to demonstrate the syndicate's understanding of where the main accumulations lie. Given the limitations of the LSM with regards to non-natural catastrophes, the Franchise Guidelines above will also be applied to the syndicate's own scenarios submitted to Lloyd's. If the Guidelines are breached by any scenario, then the syndicate can limit its exposure (e.g. by purchasing additional outwards reinsurance) or a capital loading can be applied. This should be discussed with the Exposure Management team at Lloyd's. There is a worksheet within the LSM where agents can check whether Franchise Guidelines may be breached.

The Cat Risk Appetite (CRA) ratio will be calculated as the LCM5 1:200 AEP FNL / (ECA + SBF Profit), and any proposed syndicates with a provisional/forecast ratio >37.5% will need to discuss this with Lloyd's Exposure Management and be able to demonstrate a highly-sophisticated approach to natural catastrophe risk and exposure management prior to approval.

5.3 Consistency with other returns

The methodology and assumptions used for completing the LSM, SBF, LCM, the assets and liabilities on the Solvency II balance sheet and the technical provisions including the contract boundary definitions must be consistent. Any inconsistencies should be identified and justified with the potential impact understood.

The premium volume for the prospective year within the LSM submission should be consistent with the accompanying SBF. However, loss ratio assumptions for the prospective year need not be the same as those in the business plan, albeit the gross loss ratio assumptions should not be lower than those in the business plan – see

below. Additionally, consistency here means that syndicates should be able to articulate the differences between model and plan loss ratios clearly and bridge between the assumptions if there is a difference.

Any reinsurance mitigation claimed in the LSM and included in the LCM should be consistent with the reinsurance assumptions in the SBF.

The assets in the opening balance sheet in the model should be consistent with the projected balance sheet as at the year-end. If agents expect to make changes to their investment profile, they should allow for this in projected balance sheet and therefore the opening balance sheet at t0 in the model as well.

Managing agents must have in place a process by which the consistency of data used, methodologies and assumptions can be verified.

5.3.1 Prospective Loss Ratios

Section 4.10.1 in the Lloyd's Capital Guidance outlines requirements for prospective loss ratios in capital models – these do also hold for the LSM, i.e. that the capital setting loss ratio should not incorporate improvements in performance. However, for new syndicates there is obviously no track record of performing to plan (or not). Lloyd's expect the actuarial function to validate and challenge the loss ratios in the SBF for new syndicates as for other syndicates.

Consideration of assumptions underlying the SBF loss ratios should be made at the level they are input into the model, for example it would not be adequate to demonstrate performance to plan in total by year if certain classes consistently do not perform to plan. Lloyd's would expect the managing agent to support the view taken by performing their own analysis showing the classes where they believe the SBF loss ratios to be too low given the track record and the increase required to achieve a best-estimate value.

The Actuarial Function opinion on underwriting policy should challenge the assumptions underlying the SBF loss ratios. Loss ratios should be increased to achieve a best-estimate value for any classes where they believe that the SBF loss ratio is too low given history (at market level or other data that might be available), benchmarking and expert judgement. The loss ratios in the LSM cannot be below the SBF by class of business. Details on the tests that Lloyd's conducts for the prospective year loss ratios used as part of capital setting are outlined in the reserving tests of uncertainty instructions provided annually. This includes an expectation that the gross prospective loss ratio for capital setting should not be below the gross SBF loss ratio by class of business.

5.3.2 Opening Balance Sheet

The assets in the opening balance sheet in the model must be consistent with the projected balance sheet at the year end. The opening model balance sheet projection (T0) should be prepared on the basis of net nil basic own funds on a Solvency II basis. Section 4.10.2 in the Lloyd's Capital Guidance contains more detail on this.

September LSM submissions made in line with the CPG process for setting capital for the following year are based on a balance sheet projected to year-end, to determine the starting claims for volatility assumptions as well as the opening assets for market risk calculations (for March reassessments, the actual year-end balance sheet is used).

Syndicates are also permitted to allow for profit to offset ultimate capital from three sources: risk margin, prospective year insurance risk profit, and 'current and prior year's profit not already reflected in TPs'. In the case of the prospective year profit there is a potential for profit to be double-counted via both ULOs in the technical provisions as well as this component of the LSM. Therefore, it is a requirement that syndicates must review their ULO profit and ensure that they eliminate any such potential profit double-count.

Any profit (with a floor of 0) the syndicate is projecting to claim on the opening balance sheet ULOs should be subtracted from the profit claimed in the LSM. If the ULO profit is negative, syndicates cannot add this to the prospective insurance risk profit claimed in the LSM.

5.3.3 Natural Catastrophe inputs

As noted at the start of this section, the LSM calculates an ultimate and one year SCR. One of the key inputs into the LSM is natural catastrophe losses - both for LCM5 perils and ROW perils. The current structure of the LSM directly generates an ultimate SCR and then derives a one-year SCR via an emergence factor. In this current structure, the natural catastrophe inputs should therefore be on an ultimate basis. As the accompanying LCM forecast returns represent a calendar year view of risk, agents should not use these figures directly (unless they have also been submitted on an ultimate basis). They should instead use figures which represent the ultimate view of risk on all unexpired and prospective year natural catastrophe exposures *consistent* with the figures reported within any LCM submissions.

The net stress (1:200 minus mean) on any ultimate natural catastrophe losses should not be lower than the net stress included within any accompanying LCM submissions. If this does not hold true the agent should include an explanation within the LSM to justify this. Lloyd's may make an adjustment to capital to uplift the net natural catastrophe stress within the LSM to be at least as high as the LCM basis if this is the case.

5.4 Review process for the LSM

Lloyd's will carry out initial completeness checks to highlight to the managing agent early on if the submission does not meet Lloyd's requirements. The result of the initial completeness checks will be communicated within 10 working days of the LSM submission. It will cover:

- Any missing information from the submission against the list above ([Section 5.1](#)).
- Data inconsistencies between the LSM and other returns, for example the consistency of risk margin and RICB between LCR and QSR, as well as the consistency of premium, claims and profit between LCR and SBF and the catastrophe risk inputs in the LSM against the LCM.

The review process including the loadings process for syndicates on the LSM will mirror the process for syndicates submitting a Lloyd's Capital Return and is outlined in the LCR Instructions. The reserving tests of uncertainty do not apply to new syndicates given the lack of history, however, syndicates could receive capital loadings due to issues with their LSM submission, loadings by Exposure Management (as outlined in the LCR Instructions) and controls loadings if there are wider issues with governance and controls processes (unrelated to a capital model). In particular, a loading for tail risk could be applied if the syndicate takes on undue natural catastrophe tail risk as outlined in the LCR instructions.

Results of the capital review will be presented to and discussed at the Actuarial Oversight Review Group (AORG) and a recommendation regarding the syndicate's capital will be presented to the relevant governance committee at Lloyd's, currently the Capital and Planning Group (CPG). The decision will be communicated by Account Managers verbally and followed up with a letter shortly after the CPG meeting. CPG decisions can be appealed; syndicates should contact their Account Managers regarding procedures. There will be no separate feedback issued to syndicates by the syndicate capital team (unlike for LCR submissions) unless there have been capital loadings.

5.5 SBF Resubmissions

If an SBF resubmission is required during the September/October review process, the managing agent must assess the capital impact of this change. A resubmission of the LSM may be required depending on the circumstances – the resubmission will generally only consist of the LSM template with no accompanying documents:

Downwards capital movement:

- If the managing agent would like to take credit of the downward capital movement, a resubmission of the LSM is required. For any movements of greater than 10% a resubmission of the LSM is mandatory.

Upwards capital movement:

- Less than 5%: No update required.
- Greater than 5%: Resubmission required.

5.6 Resubmissions throughout the year

All managing agents are required to consider the impact of emerging information on the syndicate capital requirement and notify Lloyd's if this causes a capital movement of greater than 10% (measured before the impact of foreign exchange and Reinsurance Contract Boundary). This requirement is in place for all syndicates, regardless of whether capital is set via an internal model or via the LSM. The 10% is measured from the point of the last submission. Note that the measurement previously also accounted for the risk margin movement, but due to the change in cost of capital in the risk margin from 6% to 4% at 2023 year-end, this is no longer factored into this measurement. Previously, an adjustment to the capital was made through the QCT process to adjust the risk margin in the ECA calculation to be consistent with that included in the Technical Provisions. This year, Lloyd's will no longer be making this adjustment. As such, the change in risk margin should contribute to the uSCR 10% movement analysis when assessing if any LSM resubmissions are required – in the past, it did not contribute.

Following year-end, all syndicates are required to re-assess their capital based on actual positions at year-end. Managing agents should update the LSM to include the actual technical provisions within the unaudited QSRs and make allowance for any changes in business plans, risk profile and rates of exchange. Syndicates with their own internal model are required to rerun the model and then submit a template with the impact to Lloyd's. However, for syndicates on the LSM;

- The March reassessment template (as referenced in section 5.6 of the Capital Guidance) is not required.
- If the uSCR (including management adjustment) moves by less than 10%, syndicates should provide positive confirmation of this to Lloyd's via email to their Capital Point of Contact..

If at any point there is a capital movement greater than 10%, a LSM submission (with all appropriate supporting documents) is required.

Due to the requirement to keep the risk margin value constant in their QSR and ASR submissions for a year of account (as per section 5.7 below – notwithstanding the change in cost of capital from 6% to 4%), when reassessing capital in the LSM agents may choose to overwrite the default risk margin calculation in their reassessment calculation with the previously calculated risk margin used in the most recently approved LSM submission.

See the Capital Guidance for more detail on resubmissions.

5.7 Quarterly Corridor Test (QCT)

All members are subject to Coming-into-Line annually in June, which is when members are required to ensure their capital meets the required level. Member level assets and liabilities are compared each quarter to their latest ECA requirement as part of the of the QCT. Where a member's assets, as defined in the Membership and Underwriting Rules (M&URs), is below the required level of 90% of ECA, further FAL will be required in adherence to the M&URs. Members will also be permitted to release surplus FAL above 110% of ECA.

Underwriting restrictions or other measures may be imposed to mitigate the risks until capital is lodged at Lloyd's.

The final agreed SCR (per the latest CPG letter) will be adjusted for FX and balance sheet movements in quarterly corridor tests and mid-year CIL. The introduction of the QCT process means that Lloyd's will, in general, consider changes in capital four times a year – and in particular any changes in SBFs and resubmissions will be considered within this timetable.

See the Capital Guidance for more detail on the wider QCT process and the timetable.

As stated above, Lloyd's centrally adjust the agreed SCR capital requirements to ensure consistency with the solvency valuations – in particular using consistent exchange rates and adjusting the RICB reported in the LCR to be consistent with the latest Solvency II balance sheet, i.e. the QSR and ASR submissions.

For syndicates on the LSM some adjustments are made in the same way as for syndicates with their own internal model – in particular adjustments for foreign exchange rate movements and the reinsurance contract boundary. The treatment of any loadings and adjustments is also the same. These are outlined in more detail in the capital guidance.

Given that a new syndicate does not have an internal model, the calculation of the risk margin is more difficult. Generally, the LSM sets the risk margin to zero for syndicates in the first year – as the risk margin is expected to be immaterial (as it is based on the run-off SCR). Syndicates should set the risk margin to zero in their QSR and ASR submissions as well to ensure consistency in the capital stack and keep it at zero for the first year of account. In the second year of account and beyond, the risk margin is calculated in the LSM as 10% of the total current and prior years of account exposure. Syndicates have the option to overwrite the risk margin in the LSM if these simplifications are deemed material.

Following the HMT change to reduce the cost of capital from 6% to 4%, Lloyd's has changed how agents should calculate the risk margin for capital submissions compared to the risk margin that they report in their technical provisions. The default risk margin calculation in the LSM is set to be equivalent to a 6% cost of capital approach and this should not be changed for capital submissions. However, syndicates should overwrite the default from 10% to either 6% or 7% for their technical provision calculations, i.e. ASR/QSR submission. Note that we have updated this since publishing the ASR guidance (where section 3.4 references a requirement to use 7% only). This figure

should be kept constant for all QSR and the ASR submissions for that year of account. Syndicates have the option to overwrite the risk margin in the LSM if these simplifications are deemed material.

5.8 New Legacy RI Providers

A new legacy RI provider is any syndicate which does not have an approved capital model and is seeking to write one or more legacy RI transaction(s).

5.8.1 Capital Setting First Transaction

The capital requirement for a first transaction of a new legacy RI provider will be set using the partial LCR from a ceding syndicate (if appropriate). The ceding syndicate SCR is calculated from their approved internal model and is therefore the most appropriate reflection of the risk available. Any operational risk included in the partial LCR will be removed and replaced by the operational risk calculation from the Lloyd's Standard Model (LSM). The resulting operational risk percentage will be applied to the remaining SCR from the partial LCR.

5.8.2 Capital Setting for Additional Transaction(s)

In the event of multiple transactions being signed in the 2025 modelling year, MRC will model the impact of the additional transactions to allow for diversification (if appropriate) using the SBM. Again, the operational risk will be included in the calculation based on the LSM methodology.

5.8.3 Capital Setting for 2025 Modelling Year

The LSM is currently not appropriate to be used for syndicates writing legacy reinsurance who do not have an internal model – mainly since the prior year reserves are modelled in bulk at the moment which is unlikely to appropriately reflect the risk profile.

Therefore, legacy RI providers without an approved model for the 2025 modelling year and existing transactions from the 2024 modelling year will have the capital set via the Syndicate Benchmark Model (SBM) with an additional operational risk amount added using the LSM methodology, which will replace the new syndicate load applied in the past.

If you are involved in the bidding process for further transactions and wish to obtain an indication of the capital implications, you should contact your MRC point of contact as soon as possible. Providing all the relevant information has been provided by the ceding syndicate an indicative capital value should be made available within 4-6 weeks of the request.

5.8.4 Syndicates in 2nd & 3rd Years without an Approved Model

In order to apply the appropriate level of reserving risk within the SBM, syndicates entering their 2nd or 3rd years of account must supply their projected technical provisions and claims via a partial LCR on MDC. A csv upload template has been supplied in the MDC Help Section of the LCR on MDC which can be used to complete the required fields of the LCR and pass the minimum validation requirements.

5.8.5 Treatment of Outwards Reinsurance

Any ORI arrangements being considered for a legacy RI transaction must be agreed in advance with the Lloyd's ORI team. It should be noted that, to give Lloyd's additional comfort in the capital levels, prudence has been built into the allowances for syndicates without an approved model, by reducing the capital credit for the ORI to allow for credit risk, dispute risk and uncertainty in the modelling. Further information is available in the Legacy RI guidance document.

6 Internal Model Approval Process (IMAP)

Syndicates will need to go through an internal model approval process before they are permitted to begin setting capital using their internal model. The IMAP will involve a draft LCR submission review, a model walkthrough, a validation review, a Solvency II compliance review and an assessment of the syndicate against the expected maturity for Principle 7 of The Principles.

6.1 Timings

Syndicates should start the internal model approval process in the year before they plan to use their model for capital setting. Syndicates can only set capital using the internal model for the first time during a September/October capital submission, not a March resubmission.

The internal model approval process should start with a draft LCR submission **no later than 31 March** prior to the first anticipated use of the internal model for capital setting purposes. So, if a syndicate aims to set capital on their internal model for the first time in September 2024 (for the 2025 year of account), a draft submission of the LCR should be made by 31 March 2024. Syndicates should contact the capital point of contact to discuss the exact timings.

Syndicates should be mindful that the further in advance of their first full submission an IMAP is submitted, the more time they will have to address any resulting Lloyd's feedback – however, the submission should be of a quality that is suitable for Lloyd's to review.

Please note that syndicates undergoing an internal model approval process are expected to submit a self-assessment against Principle 7 as standard (which is generally due just after the draft LCR submission).

6.2 Initial Completeness Checks

Lloyd's will carry out initial completeness checks to highlight to the managing agent early on if the submission does not meet Lloyd's requirements. The result of the initial completeness checks will be communicated within 10 working days of the draft LCR submission.

6.3 Draft Submission

The draft submission should be of sufficient quality to allow a full and detailed review by Lloyd's. Syndicates will be required to provide all documents listed in the Submission Requirements section of the LCR Instructions, except the Analysis of Change and Model Change Template.

Lloyd's will undertake a detailed review of these documents in order to confirm that the model is in line with Lloyd's guidance and calculates an appropriate capital requirement for the syndicate. Lloyd's targets to provide feedback to syndicates 10 weeks after a complete IMAP submission is made to Lloyd's, to allow time for any material feedback that could result in loadings to be addressed prior to the September submission. Please note that this is an indicative timeframe only and any additional queries might lead to delays.

In addition to the key metrics set out within Form 600, Lloyd's review will focus on a number of areas, including but not limited to:

- All risk types are expected to make a meaningful contribution to capital. If this is not the case, the syndicate should carefully explain the justification for this.
- Syndicates should pay particular attention to the contribution of operational risk as Lloyd's considers this to be a key risk for new syndicates.
- Lloyd's will require detailed information on the parametrisation process and outputs for key classes, including the data relied on, where the syndicate does not have a history of writing such business.
- The dependency structure and level of dependency – both within risk types and between different risk categories. Syndicates should pay particular attention to the tail dependencies.

- The steps that the managing agent has undertaken to ensure that the internal model appropriately represents the risk profile of the syndicate, including appropriate governance, challenge and validation on key aspects of the internal model, including for example parameterisation, model limitations, expert judgements etc. The agent should also outline whether there are any material modelling changes expected to arise in future – for example with the build-up of reserves in a new, growing syndicate requiring a more sophisticated approach for reserve risk – and how they anticipate acting in these scenarios.

Syndicates should ensure that the documentation supplied with the IMAP submission covers the above points. Syndicates should also refer to the Capital Guidance (section 9.3.11) for guidance related to modelling new classes of business, as 'The Principles' there are likely to be relevant here.

Other requirements for internal model approval include:

- Model walkthrough – In the model walkthrough Lloyd's will step through examples of how model processes are applied in practice (e.g. parameterisation for a class of business and / or areas of the dependency structure). Lloyd's will assess the example areas against the sub-principles that underpin the capital dimension of the 'The Principles'. This would include, for example, a look at use of data and methods, selection of assumptions, limitations, expert judgments, capital team resourcing, application of governance policies and the validation process.
- Syndicates will be required to complete a template to provide syndicate-specific modelling information (the SSI Template), which can be found in the Internal Model SCR page on Lloyds.com.
- Solvency II compliance assessment/Principle 7 of 'The Principles' review (see [section 6.6](#)).

In addition to the documents outlined in Appendix 1, the following documents should be provided to accompany an Internal Model Application:

- Board pack and minutes for the sign-off of the draft LCR submission
- Limitations Log
- Model development plan

6.4 Model Walkthrough Process

The examples chosen for the walkthrough will be based on material model/risk profile areas such as the dependency structure and/or parameterisation of key classes of business.

To this end, a detailed agenda will be sent to managing agents by week three of the review for a walkthrough to happen by week six. This gives Lloyd's time to have an initial review of the draft submission and identify the most useful areas to step through with managing agent staff. The detailed agenda will highlight the specific example areas to be covered and any features of these areas that Lloyd's may wish to discuss in detail (e.g. for a model area example Lloyd's may choose to focus on treatment of data while for another there may be a focus on assumption setting and the governance process).

By the end of week four Lloyd's will share queries with the agent that should also be covered in the model walkthrough. These queries will be based on review that has happened to that point and would be appropriate to cover in person with the agent. At the same time Lloyd's may make other final updates to the detailed agenda.

The walkthrough should happen by week six in the form of a two to three hour in-person (or virtual) meeting between Lloyd's and managing agent staff. After the walkthrough Lloyd's will summarise the meeting and draw conclusions to be presented and discussed at the Actuarial Oversight Review Group ("AORG"), which is the committee that will approve IMAPs, unless escalation to CPG is required. This may indicate areas to investigate further in the IMAP, or for feedback and review in the future.

6.5 Validation

At the time of the draft submission, syndicates are required to submit full model validation. Please see the [Validation Guidance](#) for information on what should be considered in the validation process and report, including development of a targeted plan for performing tests in line with a 3-year validation cycle. A full validation in this context means

carrying out the full scope of the validation of the internal model and not just the calculation kernel. The Validation Guidance (section 2.7) has more detail on what is included in the scope of full validation.

A validation report should be submitted illustrating that validation has been carried out in line with 'The Principles' and Validation Guidance. The 3-year validation cycle does not need apply to the first validation report submission because, as previously mentioned, all areas of the model should be validated for the draft submission. For areas where the syndicate has applied a simplification and is planning further refinement, the validation process should assess that capital reflects the uncertainty around the simplification adequately and include a summary of this work in the report.

It is appreciated that syndicates may not be able to apply certain tests or validation tools by the time of the draft submission, due to lack of underwriting experience or otherwise.

- Validators will not be able to complete an analysis of change or review how the model strength has changed over time for the draft submission. However, this testing should be provided with the first official LCR submission to compare against the draft LCR submission.
- Where a syndicate is in its first or second underwriting year, there may be limitations in the extent of testing against experience that can be performed. In this case syndicates should consider any relevant internal and external data that could be used for backtesting and extend the usual range of testing that is applied to the affected model areas.
- Syndicates will not have prepared a Profit and Loss (P&L) Attribution Report by the time of the draft LCR submission if they had not parameterised the model for the prior underwriting year, therefore we do not require syndicates to provide one with either the draft submission or the first official LCR submission. However, syndicates must submit this report by 1 April in the year after the first official LCR submission. For example, a syndicate that makes an official submission for the 2023 year of account, a P&L attribution should be submitted by 1 April 2024, comparing the actual 2023 P&L versus the P&L forecast in the 2023 model. The submission to Lloyd's should include the report itself and a summary of the review carried out by the validation team, if the validation team did not produce the original analyses. The PRA is considering amending the Solvency II requirements for P&L attribution. If these requirements are amended then Lloyd's will consider how this should affect the requirements for syndicates and will communicate any changes by means of an Actuarial Oversight Update.

Given a full validation report is expected to be provided for the IMAP, it is not expected that this is repeated for the first full submission. As it states in the validation guidance, the onus is on the validator to ensure that any appropriate updates are made and tests are re-run if necessary. The validation report for the first full submission should include appropriate information to demonstrate that validation applied to earlier versions of the model remains sufficient to validate the current model and provide bridges between versions where appropriate.

6.6 Compliance with Solvency II and Lloyd's 'Principles for Doing Business'

Based on the detailed information reviewed as part of the IMAP review, Lloyd's will assess the syndicate against their expected maturity for Principle 7 of The Principles.

Compliance with Solvency II will also be reviewed and Syndicates are required to submit additional documents for this part of the review - the list of required documents is included in Appendix 1 of this Guidance.

All of the items in that list should be submitted to Lloyd's by 31 March in the year the syndicate would like to use their own internal model for capital setting for the first time – i.e. if the syndicate intends to set capital using their own model for the first time for the 2023 year of account, then all items in that list should be provided by 31 March 2022.

The assessment against the principles for capital might not be available for the CPG categorisation letters – however, the capital principle rating will be included in the feedback Lloyd's send and if this has an impact on the overall syndicate categorisation then this will be communicated to the syndicate.

6.7 Conclusion of the IMAP

Following completion of the IMAP a conclusion will be reached by the AORG. The conclusion is to either approve the internal model, approve it with conditions or reject the internal model. Here a rejection means that the syndicate

cannot use its own internal model in the next capital setting process. An approval with conditions means that the syndicate has to fulfil certain conditions before a full internal model capital submission is accepted (without capital loadings). This conclusion along with more detailed feedback will be sent to capital contacts by the Lloyd's capital point of contact. The feedback will be split into a RAG rating in order to help prioritise the feedback for agents.

7 Syndicates transferring Managing Agents

When syndicates transfer from one managing agent to another, Lloyd's will need to confirm that the new managing agent continues to set capital in a Lloyd's approved and Solvency II compliant internal model. The process will vary depending on whether the new managing agent will continue to use the internal model used by the previous managing agent or if the syndicate will be using a new internal model. It is possible for the syndicate's capital to be set temporarily by the LSM during the transition, i.e. while a new model is built if required. Timeframes and transitions will be assessed on a case by case basis with the managing agents.

7.1 Syndicates Switching to Using a New Internal Model

When a syndicate changes to using a new internal model, they will be required to provide a plan for compliance with the Solvency II and Principle 7 of The Principles (as outlined in [section 4](#)) and go through the full IMAP process (as outlined in [section 6](#)). This requirement applies whether the syndicate will be using a newly built model or a model that already exists (and has been approved by Lloyd's) at the new managing agent.

While the syndicate is seeking internal model approval, their capital will be set on the LSM. All timings for getting internal model approval are as per the new syndicate guidance outlined in [section 2](#) and [section 6](#).

7.2 Syndicates Continuing to Use the Existing Internal Model

When syndicates continue to use the previously approved internal model after they have transferred to the new managing agent, they will be able to follow a partial-IMAP process, rather than the full IMAP process (outlined in [section 6](#)). It is noted that the syndicate and new managing agent are required to arrange agreement with the previous managing agent to continue using the same internal model – which means they will need visibility of the inputs and the modelling code.

Since the syndicate is continuing to use the same internal model, any feedback (capital, validation or other) given to the syndicate under the previous managing agent will continue to apply and will be required to be addressed. If a change in process means that the prior feedback points are no longer relevant the syndicate should make that clear and justify why that is the case.

As this situation involves the use of an internal model that has already been approved by Lloyd's, the partial-IMAP will focus on ensuring the capital team at the new managing agent has the required skills to use the internal model appropriately and that suitable governance processes are in place.

The steps of the full IMAP process that are also required for the partial-IMAP process are as follows:

- Model walkthrough – in line with the model walkthrough outlined in [section 6.4](#), the model walkthrough will be used to consider examples against each of the sub-principles that underpin Principle 7 of The Principles. This would include, for example, a look at use of data and methods; selection of assumptions; limitations; expert judgments; capital team resourcing; application of governance policies; and the validation process.
- Confirm compliance with Solvency II and Principle 7 of The Principles, as outlined in [section 6.6](#)
- Detailed Validation review – this will be carried out after the 1st LCR submission that the syndicate submits. Syndicates will be required to submit a full signposting template to aid this review. The full signposting template may differ from that published on Lloyds.com and will be provided by Lloyd's as required. The versions differ following feedback from the market on the increasing reporting requirements for regular submissions.

8 Requirements for First Full Submission

Once a syndicate has their internal model approved, they should use this for subsequent capital setting submissions. The requirements for this are set out in the Capital Guidance and LCR instructions in force at that time. This includes the requirement to submit a Model Change Template (MCT) and Analysis of Change, covering changes and movements between the draft and full submission.

It is not expected that a full validation report is repeated for the first full submission. As it states in the validation guidance, the onus is on the validator to ensure that any appropriate updates are made and tests are re-run if necessary. The validation report for the first full submission should include appropriate information to demonstrate that validation applied to earlier versions of the model remains sufficient to validate the current model and provide bridges between versions where appropriate.

9 Appendix 1: Documents Required for the review of compliance with Solvency II and Principle 7 of The Principles

In order to demonstrate compliance with Solvency II and to aid the assessment of performance against expected maturity for Principle 7 of The Principles, syndicates are required to provide a number of documents as outlined below. These should be submitted to the capital point of contact via SecureShare.

In addition to the documents listed below, the syndicate is also required to complete a self-assessment for Principle 7 of The Principles. More information about the self-assessment can be found on [Lloyds.com](https://www.loyds.com).

The list of documents required to be provided at the same time as the draft LCR is as follows:

- Responsibilities Map, Team Structure charts, and Model governance structure
- Any evidence of prior reviews that the syndicate conducted to assess SII compliance (if applicable)
- Risk Management Policy
- Risk Register
- ORSA report
- Model Change Policy
- Model Use Policy
- Documentation policy
- Any evidence that demonstrates how the Board and Senior Management understand the model uses or just confirmation by the Chair that the Board and Senior Management are comfortable with the model uses
- Any documentation around how the internal model is integrated in the risk management system (if not already within the Model Change Policy)
- Internal Model Scope Policy (or this might be part of an overarching Internal Model Policy)
- External Model Policy (if separate to the IM Scope Policy)
- Expert Judgement Log and examples of expert judgment / documentation
- Any SCR Methodology or parameterisation documents not already sent previously with LCR submissions that provide relevant information on the appropriateness of methodology or assumptions.
- Standardised syndicate information template
- Documentation explaining how techniques, methods and assumptions used in the model are considered to be adequate, up-to-date, and generally accepted market practice (if not already covered in other documents requested)
- Documentation addressing how future management actions are considered to be reflected appropriately in the internal model
- If the submission includes management adjustments any details/justification of those
- Internal Model Data Policy and Data Directory
- Internal Model Validation Policy
- Internal Audit reports on Model Governance/Board effectiveness
- Internal audit report on data quality
- Records of internal model training for Board members and other key personnel involved in model governance

10 Appendix 2: Changes made to Guidance from previous edition

The list below summarises the substantive changes in this guidance from the previous version, which was published in September 2022:

- Section 5, introduction. An update to reflect that the original document was released at the same time that the LSM was first released. The current guidance now notes Lloyd's expectations with respect to ongoing updates to the LSM more generally, rather than referencing any specific year.
- Section 5, introduction: An update to reflect the requirement that the Syndicate Boards are responsible for confirming that the LSM is appropriate.,
- Section 5.1. Expressly clarifying that agents should notify their capital point of contact whenever an LSM template has been submitted to SecureShare.
- Section 5.1. An update to the confirmation of appropriateness, related to key inputs that materially impact the LSM capital requirement.
- Section 5.1. Extending the documentation requirement to accompany an LSM submission to include information on management adjustments, assessment of ULO profit, and details for any profit claimed in the 'Current and prior year's profit not already reflected in TPs' item.
- Section 5.2. An update to state that the volatilities used to calibrate the LSM are net volatilities.
- Section 5.2. Including an additional point for managing agents to consider about the appropriateness of the LSM with respect to whether the planned business is similar or different to business that has been written at Lloyd's previously.
- Section 5.2. An additional point to reflect that managing agents should consider potential limitations that would mean that the LSM could misstate capital, and where possible calculate a management adjustment.
- Section 5.2. Removing the reference to the option to set capital using the syndicate benchmark model.
- Section 5.3.2. Inclusion of new requirements (previously advised to agents using the LSM for 2024 via email) to consider ULO profit when inputting prospective year insurance risk profit
- Section 5.3.3. A new section clarifying the expected reporting basis for natural catastrophes within the LSM.
- Sections 5.6 and 5.7. Updates to the treatment of risk margin following HMT reducing the cost of capital from 6% to 4%.
- Section 5.6. Updates to the requirements for syndicates to only submit an LSM following the year-end reassessment process where the movement in capital is more than 10%, and to otherwise provide positive confirmation to their capital point of contact that the reassessment has been performed.
- Section 6.3. Inclusion of a requirement to outline how the managing agent has ensured that the internal model being submitted with an IMAP appropriate represents the risk profile of the syndicate
- Section 6.3. Additional documents required to be submitted with IMAP (first document previously existed in Appendix 1)
- Appendix 1. Update to the document list that should be submitted to Lloyd's when a review for compliance with Solvency II and Principle 7 of The Principles is scheduled.
- Most hyperlinks to documents intended to be read in conjunction with this guidance have been removed, to avoid the need to continually update these links in successive editions. Instead, a link to the webpage where the relevant documents can be found is included at the first mention of the relevant document in this guidance.