Reserving Tests of Uncertainty:
2025 Business Planning and Capital Approval

July 2024

Reliance and Limitations

Content contained within is wholly for discussion purposes only

References

References to “YE Capital Approval” and “Mid Year Capital Approval” throughout the presentation refer to the year end and mid year business planning and capital approval process at Lloyd’s respectively.
References to “CPG” refer to the Capital Planning Group at Lloyd’s.

Purpose & Scope

The purpose of the information contained within is for discussion on changes/updates to the Reserving Tests of Uncertainty performed as part of YE Capital Approval. The scope of this is limited to changes/updates to testing from the 2024 YE Capital Approval process to the 2025 YE Approval process.

Reliance and Limitations

The information contained within is an overall summary of changes. Lloyd’s will send Syndicate specific communication where indicated in the pack in respect of the 2025 Reserving Tests of Uncertainty.

As such, this pack should not be used for business decision making purposes.

This publication supersedes any previous packs supplied by Lloyd’s (including drafts and for discussion only documents) in respect of the 2025 Reserving Tests of Uncertainty.

Contents

Introduction and purpose

The purpose of this pack is to provide market participants with details on the Reserving tests of Uncertainty framework for the 2025 capital and business planning approval process along with key dates.

The Reserving tests of Uncertainty were introduced to assess key areas, from a reserving perspective, that are inputs to the capital model and could lead to under capitalisation. The Lloyd's testing framework primarily used data from returns readily available to Lloyd's to flag Syndicates for oversight and (where required) capital loadings were applied to address deficiencies identified by the testing.

This year there is increased focus on strengthening syndicate's framework for validating the model loss ratio for the prospective year of account. There have been no changes to the other reserving tests that are discussed in this pack.

These updates are designed to support our risk-based oversight which focuses on material risks, and to drive meaningful discussions with Syndicates in the lead up to the Capital setting process.

Reserving Tests of Uncertainty: 2025 Coming Into Line Capital Setting

High level framework for each Reserving Test of Uncertainty

Test	2025 Testing Framework	Key Milestones

Prospective year Modelled Loss Ratio	• Lloyd’s assessment of appropriateness of modelled loss ratios will be based on review of the **Focus Area Returns, validation reports and the Retrospective Loss Ratio test**
	• **All syndicates** will be subject to Focus Area Return review
	  ◦ 2 questions are in line with last year’s return, i.e. related to Modelled Loss Ratio Floor Test and Change in Self-Uplift
	  ◦ 3 new questions are included this year. Further details are provided in the next section of this pack
	• **Risk-based sample of syndicates** will be subject to validation report review
	• Retrospective Loss Ratio test will be performed as per last year, with no changes to the process
		• Review of Focus Area Returns and Validation report during September - October 2024
		• Retrospective Loss Ratio test in November 2024 and March 2025

TP Roll Forward	• **No changes vs 2024 YE Capital Approval testing framework** • No market-wide testing (in line with previous year) • Individual syndicates monitored using simple metrics from data already available • Back testing template required for flagged syndicates only	• Syndicates selected for completion of back testing template notified via email during June 2024 • Reviews during August - October 2024
Solvency Tests	• **No changes vs 2024 YE Capital Approval testing framework** • Testing for Mid-Year Capital Approval only, based on YE SAO and Q4 ASR	• Review conducted in March 2025
Best Estimate Review	• **No changes vs 2024 YE Capital Approval testing framework** • Specific agents notified due to ongoing concerns including any material deficiencies against the Reserving Principle. • Agents expected to demonstrate, via evidence, material progress against highlighted concerns to alleviate loading requirement • Any loading amount based on expert judgement and discussions with agent	• Syndicates selected for review notified via email including next steps during July 2024 • Review during August - November 2024

For more details on key milestones and review periods of each reserving test, please refer slide 15.

Prospective year Modelled Loss Ratio: Minimum Tests, Validation Review & Retrospective Loss Ratio Test

Details of Testing Framework for 2025 Capital and Business Planning Approval process

Focus Area Return based review – impacting all syndicates

Two questions related to Minimum Tests are unchanged from last year

Review of the LCR Form 561 and Focus Area return during CPG season, specifically to assess:

- Adherence to Modelled Loss Ratio Floor guidance
- Investigation of material decreases in the Plan to Modelled loss ratios self-uplift.

Modelled Loss Ratio Floor guidance

- It is required that the prospective year loss ratio for capital setting should not be below the SBF loss ratio.
- On a gross net (gross of reinsurance, net of acquisition cost) basis, this guidance applies at class of business and at syndicate level.
- On a net net basis, this guidance applies at the overall syndicate level.

Plan to Modelled Self-Uplift

- ‘Self-uplift’ is defined as difference between modelled and plan loss ratios from LCR form 561.
- For any syndicates where the total ‘self-uplift’ has decreased by more than 1% since the prior year, Lloyd’s will require rationale as to why the syndicate considers this to be appropriate.

The review of these two questions will be consistent to last year.

Inadequate responses to these questions may lead to a capital load being applied.

Focus Area Return based review – impacting all syndicates

Three new questions are included this year

<u>Modelled Loss Ratio Analysis of Change Guidance</u>

- Syndicates are required to provide an analysis of change of the modelled loss ratio (change between modelled loss ratio approved as part of the 2024 YE Capital Approval process and the modelled loss ratio submitted as part of the 2025 YE Capital Approval process) in the FA return.
- Where the modelled loss ratio has changed by more than 1%ppt (either on a gross of RI or net of RI basis) at syndicate level, syndicates need to explain the drivers of the change.
- An example response has been included in the LCR Instructions (section 6.4) to help understand the level of detail Lloyd’s expects in responses to this question.
- Inadequate responses to this question may lead to capital loadings being applied.

<u>Consideration of Reserving Cycle For Setting Modelled Loss Ratio Guidance</u>

- Syndicates are required to describe how they consider the reserving cycle while setting the modelled loss ratio.

<u>Signpost to the Modelled Loss Ratio section of the Validation Report Guidance</u>

- There is now an explicit requirement for syndicates to include a separate section for the Modelled Loss Ratios related validation within the validation reports.
- References to this section should be appropriately signposted in the Focus Area Return to enable Lloyd’s to efficiently review the relevant section of the validation reports for a risk-based sample of syndicates.

Validation Report review

A risk-based sample of syndicates will be subject to this review

There is an explicit requirement for validation reports to include a separate section on the prospective year modelled loss ratios.

Beyond the high-level guidance provided below, further guidance is included in section 6.4 of the LCR Instructions, which the reader should refer to.

Modelled Loss Ratio Validation Guidance

- The modelled loss ratio section in the Validation report should
    - Identify the key assumptions / areas of expert judgements used to derive the modelled loss ratio
    - Explain the validation undertaken for the modelled loss ratios, which may be broadly classified as
        - Top-down validation of the derived modelled loss ratios
        - Bottom-up validation of the key assumptions / expert judgements used to estimate the modelled loss ratios
- Articulation of key assumptions / areas of expert judgement may be provided via some form of bridging analysis. An example of a possible analysis is included in the following slide.
- Should we consider the validation to be incomplete or inadequate, it may result in a capital load being applied.

Example of bridging analysis - Modelled loss ratio

As per the LCR Instructions, Lloyd’s expectation is that validation of model loss ratios is performed both from a top-down and bottom-up perspective. Within the guidance for the bottom-up, the LCR Instructions refers to a bridging analysis that can be included in the validation report to illustrate the material assumptions and areas of expert judgements that are used to estimate the modelled loss ratio. The table below is an example of such a bridge, which illustrates the aggregate impact of each of the key assumptions / areas of expert judgement that drive the prospective modelled loss ratio.

Lloyd’s expectation is that each assumption is validated at an appropriate level of granularity. For example, if one of the validation tests for rate assumptions is an actual versus expected analysis, this would be expected to be performed at class of business and underwriting year level. The table below is intended to be a summary of the aggregate impacts.

The bridge below assumes that the starting point for setting prospective modelled loss ratios is an average of historical ultimate loss ratios over years of account deemed relevant and appropriate.

	Average ULR based on relevant prior years of account	Rate change	Claims inflation	Remediation action: Risk mix	Remediation action: Changes in exposure	Other adjustments	2025 YOA Modelled LR
Net net (%)	67%	-10%	4%	-3%	-2%	1%	57%
Validation status (Y/N)	Y	Y	Y	Y	Y	N	Y
Validation signpost (if applicable)							
Rationale for validation status 'N' (if applicable)							

In line with the expectations set out in the LCR Instructions, the table above enables clear articulation of the key assumptions and areas of expert judgement that have a material impact on the resulting modelled loss ratio. In addition, it includes signposting of where further details on the relevant validation tests can be found in the validation report(s), as well as rationale for why no validation tests were performed, where applicable.

Examples of validation of modelled loss ratio assumptions

- In the LCR Instructions, there is reference to high-level examples of top-down and bottom-up validation relating to modelled loss ratios.
- This slide provides further detail around some of those examples for illustration purposes.
- For ease of reference, high-level definition of what is meant be top-down and bottom-up validation is provided below.
- Top-down validation:
  - Needs to focus on validating the selected model LR at appropriate level of granularity e.g. at syndicate level, or at class level, or by claim type.
- Bottom-up validation:
  - Needs to focus on the assumptions that underlie the model loss ratio such as rate change, RI, risk mix, inflation etc.
  - Needs to evidence appropriateness of assumptions given historical experience, deviation from plan, reserve cycles and stressed market conditions.

Assumption	Type of Validation	Test Description	Pass criteria	Observation	Test Result	Comment
Self uplift	**Top - down**	The gross self uplift for the model loss ratio has reduced from 5%ppt last year to 1.5%ppt this year. To validate whether the new level of self-uplift is appropriate, compare actual vs model LR for the past 5 years to assess if the reduction in self-uplift while determining model LR is appropriate.	At least 3 out of last 5 years should have actual LR lower than model LR by 3.5%ppt.	4 out of last 5 years had actual LR lower than model LR by 3.5%ppt.	Pass	There is no change in planning basis.
Model LR	**Top - down**	The Net Net Model LR selected should reside at a reasonable confidence interval based on the reserve risk distribution for the syndicate.	The Net Net Model LR is within 50-65th percentile, based on the reserve risk distribution.	The Net Net Model LR is at 58th percentile based on the reserve risk distribution	Pass	
Inflation	**Bottom - up**	Double excess inflation load assumption for Model LR and assess whether impact on capital is in line with expectations.	1 in 200 Ult Premium Risk increases between 0 to 5%	Movement in Ultimate Premium Risk : 2%	Pass	Excess inflation is the inflation over and above general inflation experienced by the insurer. Pass criteria based on what is considered reasonable based on risk profile.
RI XoL	**Bottom - up**	Reduce limit of each XoL contract by 10% multiplicative while estimating the Model LR and assess whether impact on capital is in line with expectations.	1 in 200 Ult Premium Risk increases between 0 to 10%	Movement in Ultimate Premium Risk : 6%	Pass	Pass criteria based on what is considered reasonable based on risk profile

Retrospective Modelled Loss Ratio Appropriateness test

We will continue to retrospectively apply capital loads to syndicates that have a trend of missing their capitalised loss ratio on a normalised basis as part of the Mid-Year Capital Approval process

Identification of syndicates who fail the test

The current framework flags syndicates if at least any 3 of the recent 5 YOAs (including the current YOA) show adverse loss ratio performance relative to capitalised loss ratio.

2025 Capital process

- Lloyd's will perform this test based upon the data submitted to us as part of your QMB, SBF and LCR returns for the 2019 - 2024 YOAs.

- Lloyd's will run this test indicatively using 2024 Q3 data and will notify syndicates that are triggering a loading under this assessment at the time.

- The full assessment will be undertaken using 2024 Q4 data and all Syndicates triggering a loading will be informed w/c 26th February 2025

- Syndicates will be informed on whether further capital is required via the CPG process.

Further details of the testing framework will be provided during 2024 Q4 via the Actuarial Oversight email communication.

Technical Provisions Roll Forward

Details of Testing Framework for 2025 Capital and Business Planning Approval process

Technical Provisions Roll Forward test updates

As per last year, risk-based selection of syndicates in scope of the test

Syndicates are selected for review based on how inaccurately they have projected their Q4 Balance Sheet at Q2 historically.

- Projected Q4 TPs (LCR 312) compared to Actual Q4 TPs (ASR 002 / 210) over the past 3 year-end submissions
- Consideration of both:
  average understatement over 3 year period (2021-2023)
  and
  number of year-ends where projection of Q4 TPs was understated
- Technical provisions considered including catastrophes
- Legal obligations excluded, risk margin included, undiscounted basis

Selected syndicates have been informed by Lloyd's via email during June 2024

Only the selected syndicates will go through a review process which is the same review process as last year

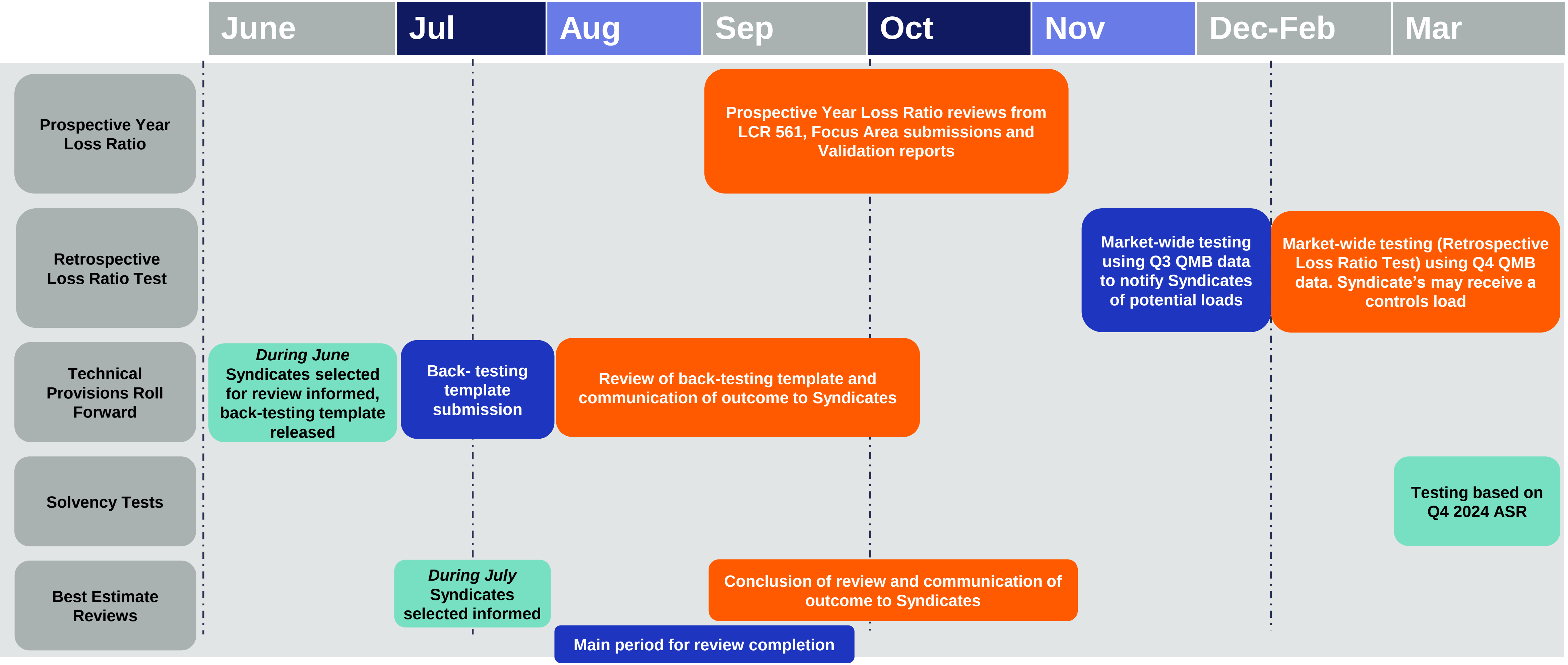
- ***Submission of back-testing template required by 31 July 2024***
- Back-testing template and loading calculation will remain the same as prior year
- Back-testing template will concentrate on non-cat
- "Self-loading" is not permitted; either a Lloyd's loading will be applied or the expectation is that a Syndicate would update the roll forward process to eliminate historical deficiencies

The loading calculation will remain unchanged from the prior year process:

(Percentage Mis-statement x Post Diversified Reserve Risk x 2) rounded to nearest £1m

Timeline for interaction with the market

Expected interaction between Lloyd's and the market for the 2025 Reserving tests



This information is not intended for distribution to, or use by, any person or entity in any jurisdiction or country where such distribution or use would be contrary to local law or regulation. It is the responsibility of any person publishing or communicating the contents of this document or communication, or any part thereof, to ensure compliance with all applicable legal and regulatory requirements.

The content of this presentation does not represent a prospectus or invitation in connection with any solicitation of capital. Nor does it constitute an offer to sell securities or insurance, a solicitation or an offer to buy securities or insurance, or a distribution of securities in the United States or to a U.S. person, or in any other jurisdiction where it is contrary to local law. Such persons should inform themselves about and observe any applicable legal requirement.

LLOYD'S