Reserving Tests of Uncertainty:
2023 Business Planning and Capital Approval

May 2022

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 2022 YE Capital Approval process to the 2023 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 2023 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 2023 Reserving Tests of Uncertainty.

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Introduction and purpose

The purpose of this pack is to provide market participants with details on the Reserving tests of Uncertainty framework for the 2023 capital and business planning approval process along with key dates.

The Reserving tests of Uncertainty were introduced in 2019 to assess key areas, from a reserving perspective, that are inputs to the capital model and could lead to under capitalisation if inappropriate. The expectation is that these inputs are appropriate in respect of adequately reflecting uncertainty. 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.

Since 2019 there has been year on year reduction in the number of Lloyd's loadings applied to Syndicates in respect of these tests. In direct response to this market improvement, the testing framework for the 2023 capital and business planning approval process has been reassessed and updated.

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.

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Reserving Tests of Uncertainty: 2023 Capital Setting

High level framework for each Reserving Test of Uncertainty

Test	2023 Testing Framework	Key Dates
Prospective year Modelled Loss Ratio	• **No market-wide testing** • Individual syndicates monitored using simple metrics from data already available • For syndicates flagged through this process, review of prospective year modelled loss ratio methodology and assumptions for key classes • High risk Syndicates reviewed in July/August, prior to YE Capital Approval • Low risk Syndicates considered for review within Annual Reserve Meetings • Continued checks on LCR Form 561 e.g. on Modelled Loss Ratio Floor	• Syndicates selected for either High risk or Low risk review notified via email including next steps during June 2022 • LCR 561 checks continued as per phasing for Capital and Planning Approval process
TP Roll Forward	• **No market-wide testing** • 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 2022
Solvency Tests	• **Testing for Mid-Year Capital Approval only**, based on YE SAO and Q4 ASR	• March 2023 next testing
Best Estimate Review	• **No changes vs 2022 testing framework** • Specific agents notified due to ongoing concerns including any material deficiencies against the Rio framework • 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 H1 July 2022

Prospective Year Modelled Loss Ratio

Details of Testing Framework for 2023 Capital and Business Planning Approval process

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Prospective Year Modelled Loss Ratio oversight - summary

Individual Syndicates monitored for the need for additional oversight on modelled loss ratio assumptions

- Given the recent shift in market behaviour and improved market conditions, less market-wide oversight is required.
- However we will still perform some testing of successful plan execution as part of our oversight.
- This will not be through our existing Actual vs Plan testing framework
- Instead we will use metrics from historical TPD, QMB, LCR and SBF data to highlight Syndicates showing systemic inability to meet plan and modelled loss ratios.

Data from existing returns used to identify syndicates of concern

Syndicates flagged from this will be triaged into Low Risk and High risk.

Syndicates will be informed of their categorisation and next steps during June 2022.

FAIL

PASS

High Risk Syndicates

- Reviewed in July/August, ahead of the upcoming CPG season
- May result in a controls loading for the Year-End 2023 Capital process

Low Risk Syndicates

- Review of prospective year modelled loss ratio may be included as an agenda item in the 2022/2023 Annual Reserve Meeting
- May result in a controls loading for the Mid-Year 2023 capital approval process (rather than Year-End 2023)

Syndicates not flagged

- No interaction required except minimum checks detailed below

Checks on the LCR Form 561 integrated into wider capital review during CPG season, specifically:

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

Metrics used in selecting syndicates for review

We will use a combination of a shorter term and longer term view

- The following **two quantitative metrics** will be used:

Weighted average (by GNP) difference between actual and modelled loss ratio on the 2019 to 2021 YOAs

- *Actuals based on the 2022 Q1 QMB return*
- *Requirement for reporting modelled loss ratio through LCR 561 was first introduced for the 2019 YOA*

Number of times a syndicate has missed plan over a rolling 10 year basis (or since inception)

- *Based on the 2012 to 2021 YOAs for 2023 Capital Approval*
- *Based on a comparison of SBF and TPD loss ratios*
- *Years with immaterial premiums (< 5% of premiums over the 10 year period) will be excluded*

- Both metrics will be considered:
  - On a gross of reinsurance, net of acquisition costs basis
  - Including Catastrophes except COVID-19

- We will primarily consider syndicates for review where they are performing adversely on both metrics. However we may also consider syndicates that are flagging as very adverse on a single metric.

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Qualitative review considerations

A qualitative assessment will support the quantitative metrics used to select and triage syndicates for review

When selecting syndicates for a Low Risk or High Risk review, we may take the following into consideration. This list is not exhaustive, but to give examples of the types of considerations.

Have we reviewed the modelled loss ratio setting process for the Syndicate recently?

If so, an in-depth review this year may not add much value.

What is the magnitude of the historical deviance to plan?

Syndicates who have missed plan by a larger margin many be of greater concern.

Have we reviewed any recent changes to the Syndicate's planning process via our AvP testing in previous years?

If so, it may be less appropriate to rely on metrics based on historical data.

How has historical deviance to plan trended over time?

If there is an upwards trend in the miss to plan over time, the syndicate may be of greater concern.

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Illustration of syndicate selection process

The examples go through how we might select a syndicate for a High Risk or Low Risk review

Syndicate ABCD

Weighted average (by GNP) difference between actual and modelled loss ratio on the 2019 to 2021 YOAs

UWY	GNP	QMB - LCR
2021	100	9%
2020	40	7%
2019	50	1%
Wghtd av.		**6%**

On average, Syndicate ABCD has missed its modelled loss ratio by 6% over the most recent 3 year period.

Syndicate ABCD has been writing premiums since 2015. It has missed plan for 6 out of 7 years. Generally an upwards trend in the magnitude of miss to plan.

No. of times missed plan from 2012 to 2021 YOAs (or since inception)

UWY	TPD - SBF
2021	10%
2020	7%
2019	3%
2018	5%
2017	4%
2016	0%
2015	2%
2014	N/A
2013	N/A
2012	N/A

OUTCOME

HIGH RISK REVIEW

Syndicate PQRS

Weighted average (by GNP) difference between actual and modelled loss ratio on the 2019 to 2021 YOAs

UWY	GNP	QMB - LCR
2021	50	0%
2020	70	2%
2019	80	3%
Wghtd av.		**2%**

On average, Syndicate PQRS has missed its modelled loss ratio by 2% over the most recent 3 year period.

Syndicate PQRS has missed plan for 6 out of 10 years.

Improvements were made to the planning process for 2021 planning, these were discussed and reviewed within last year's AvP review.

Miss to plan on the 2016 and 2017 YOAs was as a result of HIM losses. Excluding these years, the margin by which plan has been missed is relatively small.

No. of times missed plan from 2012 to 2021 YOAs (or since inception)

UWY	TPD - SBF
2021	-1%
2020	2%
2019	3%
2018	0%
2017	10%
2016	9%
2015	1%
2014	-3%
2013	2%
2012	0%

OUTCOME

LOW RISK REVIEW

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Illustration of review process

Selected syndicates required to justify their modelled loss ratio assumption for key classes deviating from plan

For both Syndicates ABCD and PQRS, Lloyd's identifies that the historical miss to plan loss ratio is primarily driven by the Syndicate's D&O, A&H and Marine Cargo classes (in order of materiality of impact).

Syndicate ABCD **HIGH RISK REVIEW**

Syndicate ABCD is required to justify the appropriateness of the prospective year modelled loss ratio for all three of the D&O, A&H and Marine Cargo classes, referring to the areas below, where relevant:

Drivers of poor historical performance against modelled loss ratio	Changes made to modelled loss ratio setting process as a result of poor past experience	Historical loss ratio performance of the class	Number of years of history used, including years excluded
Rate change or exposure change	Credit(s) for re-underwriting	Changes in T&C / legal environment of business written	Claims inflation allowance and/or other trends

Lloyd's expects to see underlying quantitative / summary analysis (as well as qualitative information) to support the justification of the selected prospective year modelled loss ratio.

Lloyd's review is conducted in July/August 2022.

Syndicate PQRS **LOW RISK REVIEW**

A review of Syndicate PQRS's prospective year modelled loss ratios is considered as an agenda item for the 2022/2023 Annual Reserve Meeting (ARM), which takes place in November 2022.

However there are multiple agenda items to cover in the ARM, some of which are higher risk and more material than the modelled loss ratio review.

As such, Syndicate Reserving decides to question/review the general process for setting the modelled loss ratio, and picks the D&O class only to review in more detail.

We note that the number of classes reviewed and level of evidence required for Low Risk syndicates may differ between Syndicates and will be decided on a case-by-case basis.

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Class selection and loading processes

Reviews will be conducted at Syndicate class level, and loadings will be determined on a case by case basis

How will Lloyd's select the classes that we want to review for a syndicate?

- Lloyd's will identify the Lloyd's Generic Classes that drive historical deviances to plan for a particular Syndicate using TPD vs SBF data.
  - In doing so we will take into account any material changes to the mix in business. For example, if a particular Lloyd's Generic class has historically missed plan but has since been materially reduced in terms of income as a result of remediation activity, it is unlikely that this class will be flagged.
- For those Lloyd's Generic Classes that we identify, we will ask the Syndicate to map these to its own modelled classes (in line with the classes reported in the LCR 561)
- ***Lloyd's review will focus on the Syndicate modelled classes that materially map to the Lloyd's Generic classes we identify. This will allow these discussions to be more meaningful than in previous years.***

How will we load syndicates where we have identified a deficiency from our review?

- This will be on a *case by case* basis.
- A *controls loading* may be applied if we identify a material concern around the prospective year modelled loss ratio, or if our review highlights a material concern in respect to governance and controls or inadequate risk management.

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Technical Provisions Roll Forward

Details of Testing Framework for 2023 Capital and Business Planning Approval process

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Technical Provisions Roll Forward test updates

Market-wide testing will be dropped and replaced by risk-based selection

Syndicates selected for review based on historical ability to accurately project Q4 Balance Sheet at Q2

- 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 (2019-2021)
  and
  number of year-ends where projection of Q4 TPs was understated
- Catastrophes included in selection of syndicates
- Legal obligations excluded, risk margin included, undiscounted basis

Selected syndicates will be informed by Lloyd's via email during June 2022

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 August 2022***
- Back-testing template and loading calculation will remain the same as prior year
- In particular, back-testing template will concentrate on non-cat
- "Self-loading" is explicitly not permitted again; 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 2022 process:

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

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Solvency Tests

Details of Testing Framework for 2023 Capital and Business Planning Approval process

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Solvency Tests updates

Earned Margin and Unearned Profit will not be tested on the Q2 QSR return

Previously, testing was conducted for both:

- Mid Year Capital (based on the Q4 ASR)
- Year End Capital (based on Q2 QSR)

- Capital is no longer being collected at YE, instead being replaced by QCT
- Q2 QSR is no longer required to be audited

- <u>Going forwards, test only at Mid Year (based on Q4 ASR), i.e. March assessments</u>
- For Mid Year, expectation is still for Syndicates to address deficiencies vs Signing Actuaries as part of the ASR submission, as such this is likely to result in Lloyd's requesting ASR resubmission if not satisfied

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Appendix

1. Key Timelines by Test
2. Key differences between 2022 and 2023 testing framework

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Timeline for interaction with the market

Expected interaction between Lloyd's and the market for the 2023 Reserving tests

	June	Jul	Aug	Sep	Oct	Nov	Dec-Feb	Mar
Prospective year modelled loss ratio	*During June* - Syndicates selected for review informed, with next steps	"Higher risk" syndicate reviews		Loadings for "higher risk" syndicates applied at YE 2023 Capital Approval Minimum checks on LCR 561		"Lower risk" syndicate reviews as part of Annual Reserve Meetings		Loadings for "lower risk" syndicates applied at Mid-Year
Technical Provisions Roll Forward	*During June* Syndicates selected for review informed, back-testing template released		Back- testing template submission	Review of back-testing template and communication of outcome to Syndicates				
Solvency Tests								Testing based on Q4 2022 ASR
Best Estimate Reviews		*During H1 July* Syndicates selected informed Main period for review completion		Conclusion of review and communication of outcome to Syndicates				

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Recap of 2022 testing and 2023 updates

High level framework for each Reserving Test of Uncertainty

Test	2022 Testing Framework	2023 Testing Framework
Prospective year Modelled Loss Ratio	• **Market-wide testing** • Triage process resulting in light scope, detailed scope and detailed plus scope reviews • Compliance with Modelled Loss Ratio Floor guidance required • Investigation of material decreases in self-uplifts	• **No market-wide testing** • Individual syndicates monitored using simple metrics from data already available • For syndicates flagged through this process, review of prospective year modelled loss ratio methodology and assumptions for key classes • High risk Syndicates reviewed in July/August, prior to YE Capital Approval • Low risk Syndicates considered for review within Annual Reserve Meetings • Continued checks on LCR Form 561 e.g. on Modelled Loss Ratio Floor
TP Roll Forward	• Testing on a risk-based sample for 2022, with **market-wide testing due for 2023** • Back testing template required and for 2023 cycle all Syndicates would have been required to complete template on old framework	• **No market-wide testing** • Individual syndicates monitored using simple metrics from data already available • Back testing template required for flagged syndicates only
Solvency Tests	• **Testing for YE and Mid-Year Capital Approval** • Formulaic tests (earned margin and unearned profit) based on prescribed formula • Syndicates expected to address deficiency versus Signing Actuary as part of the QSR/ASR submission	• **Testing for Mid-Year Capital Approval only**, based on YE SAO and Q4 ASR • No other changes
Best Estimate Review	• Specific agents notified due to ongoing concerns • 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	• **No changes**

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