2023 LCR Instructions

Instructions for Submission of the 2023 YoA Lloyd’s Capital Return and Supporting Documentation

July 2022

Contents

1 Purpose

This document provides instructions for the submission of the 2023 Lloyd's Capital Return (LCR) and any supporting documents required. It also provides information in respect of the structure and timing of Lloyd's review and any specific focus areas for Lloyd's in 2022.

These instructions should be considered in conjunction with the Lloyd's Capital Guidance and the Capital Principle (Principle 7) under Principles for Doing Business at Lloyd's ("Principles"), which sets out the fundamental expectations of syndicates related to internal modelling, with differentiated expectations for syndicates based on their expected maturity. This guidance should also be considered in conjunction with Lloyd's Validation and Model Change guidance.

2 Submission Requirements and Deadlines

2.1 Overview

The LCR captures quantitative information that, alongside the qualitative validation and documentation, allows managing agents to demonstrate that they have systems enabling them to identify, measure, manage and report risk and calculate SCRs.

A full submission is required for all syndicates with a business plan or any open year of account at the time of submission, including those in run-off or underwriting RITC business only. The exception are syndicates who do not have an internal model. The process for these syndicates is changing this year and further guidance around this will be released in due course. Syndicates that are impacted have been contacted by Lloyd's. Syndicates planning to close all years of account at the balance sheet date and cease existence do not need to submit an LCR, as long as the receiving syndicate includes any ceded business in its LCR submission (see Section 5.8 of the Lloyd's Capital Guidance). This also holds for syndicates ceding certain years of account or classes – more details are contained in the RITC process guidance (available on request).

The phased approach for business plan and capital submissions will continue for 2023. Each syndicate has been 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 can be found in Market Bulletin Y5373.

The table below provides the requirements for each element of capital reporting. Deadlines are 1pm on the day each item is due. Please note that resubmissions of documents might be required if syndicates do not adhere to the naming conventions. The reason is that Lloyd's relies on automatic downloads from SecureShare for documents for data protection reasons - exceptions in the naming conventions will require manual intervention, which Lloyd's is seeking to minimise. Uploads to SecureShare should go into the Syndicate Capital Setting folder. The "free text" part of the name can be used to differentiate different types or versions of files.

Item	Description	Submission	Deadline	Naming Convention
LCR	Quantitative capital return	All forms complete on MDC	Phased submission deadline	N/A
Methodology document	Qualitative document supporting the LCR submission	Attachment in MDC	Phased submission deadline	Methodology2023_0000_free text (0000 representing the syndicate number)
Analysis of change	Document supporting the LCR submission	Attachment in MDC	Phased submission deadline	AoC2023_0000_free text (0000 representing the syndicate number)
Focus Areas	Spreadsheet return on Lloyds.com	Attachment in MDC	Phased submission deadline except certain questions	FocusAreas2023_0000_free text (0000 representing the syndicate number)

Item	Description	Submission	Deadline	Naming Convention
			(1st November 2022 for these)	
Model Change Template	Spreadsheet return on Lloyds.com	Upload to SecureShare	Phased submission deadline	MCT2023_0000_free text (0000 representing the syndicate number)
Validation	Documentation providing model validation	Upload to SecureShare	One week after LCR deadline	ValidationReport2023_0000_free text (0000 representing the syndicate number)

In certain circumstances, syndicates should fill in the Sum of Squares Template (available on Lloyds.com), and submit this with their LCR submission as an attachment in MDC. Further details can be found in Section 4.1.9.

Please note that the template for negative contributions of market risk has been removed and replaced by a model test this year.

The previous requirement for a validation signposting template has also been removed for this year's submission given feedback from the market on the increasing reporting requirements. Syndicates only need to provide a validation signposting template if they are specifically requested to provide one. These are expected to only be for a handful of syndicates where Lloyd's plans to complete a review of the validation report and process in December and they will be contacted at least four weeks prior to the requested submission deadline (and in all cases we will aim to give more notice).

Information on the documents/returns above can be found in Sections 5.2 and 5.9 of the Lloyd's Capital Guidance. The September/October return should be submitted on the basis of the expected business outcome at 1st January 2023. More information about the basis of reporting of the LCR return can also be found in Section 4.2 of the Lloyd's Capital Guidance.

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 11) under the Principles. Board members should ensure they are aware of all issues raised during the review process and recognise that following Lloyd's review of the SCR loadings might be applied.

2.2 Lloyd's Capital Guidance

The Lloyd's Capital Guidance for 2023 YOA (issued in January 2022), alongside these 2023 LCR Instructions, are the requirements in force for the 2023 LCR submissions.

2.3 Focus Areas

Lloyd's will continue to use the Focus Areas return to provide advance notice to managing agents of specific areas of review focus. Lloyd's has published this Focus Areas return in the Templates and Scoring Sheets section of the Internal Model SCR page on Lloyds.com.

Syndicates will need to download an Excel version of their submitted LCR and link this to their Focus Areas return, as several of the questions in the Focus Areas return rely on latest figures in the LCR. Agents will be able to do this using the "Data – Edit Links" functionality in Excel to ensure that the correct reporting figures in the LCR are pulled through into the Focus Areas return.

The 2023 YOA Focus Areas return requests responses across several areas, including:

- Minimum tests: these are described in more detail in Sections 4.1 and 4.2
- Ukraine crisis: these are described in more detail in Section 5.2
- Inflation: these are described in more detail in Sections 5.3 and 5.4
- Non-natural catastrophe risk: these are described in more detail in Section 5.5.
- General queries: these are described in more detail in Section 5.6.

2.4 Foreign Exchange

The LCR must be reported in converted sterling. Submissions made prior to year-end must use the published prior 30th June rates, set out in Market Bulletin Y5376. Submissions made post year-end must use the 31 December rates. As part of the new capital setting process the final agreed SCRs will then be converted to the latest quarter rates for the quarterly corridor tests and June 2023 CIL. This means that the SCR that agents submit in September and their approved SCR in the CPG letter might be different due to the FX conversion. The Quarterly Corridor Test (QCT) process is described in Section 5.5 of the Lloyd's Capital Guidance.

The managing agent may prepare its underlying model in any currency and present figures in the methodology document in US dollars where that is the dominant currency of exposure. All figures in the LCR submission must be reported in converted sterling. The syndicate should make clear what currency and units are used in its reporting at any point. executive summary in their analysis of change document, report on key movements from the previous submission in pound sterling. This should include at least headline figures of high-level risk category figures that reconcile to figures reported in LCR form 309, plus any other key material metrics appropriate for that submission.

2.5 Analysis of Change

The analysis of change (LCR Form 600 in MDC) remains unchanged this year from the version in the 2022 YOA LCR. Syndicates should ensure that their documentation explains the movement in these figures. Lloyd's expects syndicates to provide commentary on how the model represents the risk profile, with reference to recent experience and any emerging features of the risk profile. Movements will not be accepted by virtue of being the consequence of input updates and must be analysed in full to ensure they are clearly understood for both one-year and ultimate capital. Further detail can be found in Section 16 of the Lloyd's Capital Guidance.

A new requirement for the analysis of change this year is to include a description of movements by risk category in £GBP, at least at an executive summary level. Many syndicates model and complete this document on a $USD basis. When Lloyd's reviews this compared to movements in the model change template and between LCRs in £GBP, it can be difficult to bridge between the two due to the impact of changes in currency exchange rates over the year. A high-level £GBP summary will allow Lloyd's to unpick FX impacts and reduces the scope for follow-up with syndicates.

2.6 Resubmissions

If an SBF resubmission is required during the review process, the managing agent must assess the capital impact of this change. A resubmission of the LCR return may be required depending on impact, as set out in Section 5.3 of the Lloyd's Capital Guidance:

- Downwards capital movement:
    - Less than 10%: not required, the managing agent has the option to resubmit an LCR return. Lloyd's will not adjust capital downwards without a full resubmission.
    - Greater than 10%: Resubmission required.
- Upwards capital movement:
    - Less than 5%: No update required.
    - 5-10%: Managing agents can resubmit, or a high-level adjustment can be applied by Lloyd's instead.
    - Greater than 10%: Resubmission required.

Please note that Lloyd's may have to restrict capital resubmissions if the timing of an SBF resubmission does not allow for review of the capital resubmission within the regulatory timeframes. Constraints on resources might mean that agents will have to delay their resubmissions until January 2023. This will be considered on a case-by-case basis.

2.7 LCR Form Changes

2.7.1 LCR form 313

There are changes made to LCR Form 313 as follows:

Table 1

Premium in this section must exclude any element relating to a Special Purpose Arrangement (SPA) i.e. the host syndicate will enter the gross premium value net of any SPA data and should exclude the gross element of the SPA premium which will be shown on the SPA's LCR submission. The host's RI premium should also be netted down by the same amount. This means the net amount is unchanged from previous reporting which included the premium related to the SPA and hence the reconciliation checks in Form 550 that link to this table are unaffected.

Table 3

Table 3 will now collect non-natural catastrophe claims information as well as natural catastrophe claims, such that the total catastrophe claims reported in line 1 includes LCM natural catastrophe claims, non-LCM natural catastrophe claims, and non-natural catastrophe claims. The accompanying notes are also updated to outline the new reporting requirements for this table.

As noted in section 5.5 of these Instructions, agents are requested to provide their definition of non-natural catastrophes in the Focus Areas return; the figures that agents report in the new lines in LCR Form 313 should be aligned with the agent’s own definition.

Please note that the definition of catastrophe risk (vs. non-catastrophe risk) in other forms has not changed - i.e. catastrophe risk refers to natural catastrophes only going forward in the LCR in line with previous years. The Notes have been updated to reflect this; this is relevant for forms 500, 502, 520, and 561.

2.7.2 Other Changes

There are minor changes to LCR forms 309-314; all references to ‘Notes’ are removed from these forms; the notes themselves remain in place. The Notes have also been updated for the changes to Form 313 noted in section 2.7.1.

The description of how to complete forms 500-571 have been moved from the questions within these forms to a new LCR notes 500-571 section.

3 Lloyd's Review Process

3.1 Syndicate Capital

The first step of the syndicate capital team review process after LCR submission is to triage syndicates into review categories. Syndicates will either enter the "fast track" route with a light review or be subject to a more detailed review. All review levels will consider:

- Model tests mentioned in Section 4.1;
- Responses to the Focus Areas return – in particular the Ukraine and Inflation responses; and
- Responses to previous loadings and feedback – in particular for syndicates not 'Meeting Expectations' for the Capital Principle under the Principles, any material issues which led to this classification will be reviewed regardless of Fast Track status.

Fast Track reviews focus mainly on high-level movements in risk type and risk vs exposure metrics. In general, requests for further information from the syndicate will be limited.

The more detailed reviews focus on understanding the full scale of movements in capital, as well as risk-to-exposure metrics across all risk types and classes. There will usually be requests for further information for these reviews.

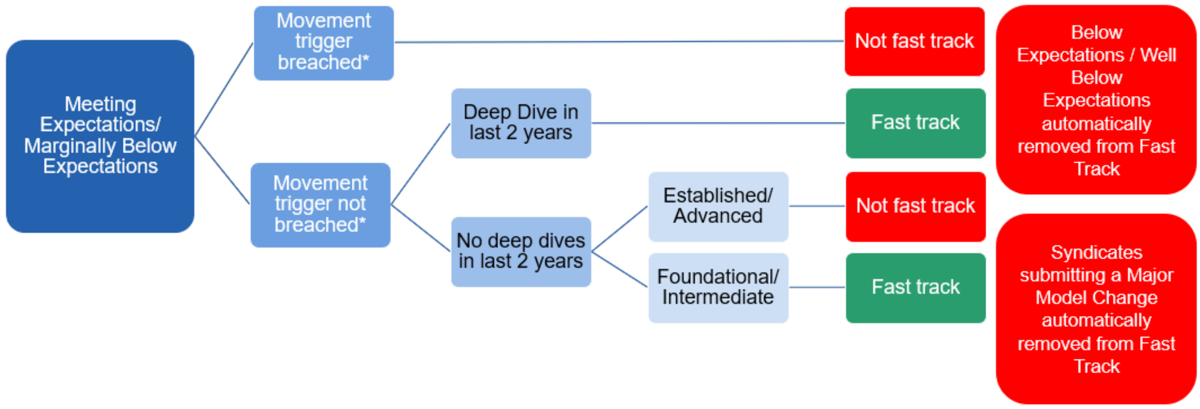
Syndicates will qualify for a Fast Track review based on the following criteria:

a. Lloyd's assessed maturity level against the syndicate's expected maturity rating for the Capital Principle under the Principles. Syndicates that are rated as 'Meeting Expectations' or 'Marginally Below Expectations' are eligible for Fast Track.
b. Whether a Major Model Change has been submitted with the LCR. Syndicates submitting a MMC will automatically be removed from Fast Track, although if a significant number of MMCs are submitted across the market, Lloyd's may defer review for small syndicates (Foundational rating under the Principles) until after September/October, and thus keep these syndicates eligible for Fast Track.
c. Key Risk-to-exposure metrics. If these metrics have not changed materially in the 2023 YOA LCR submission since the previous LCR submission the syndicate is eligible for Fast Track. The metrics and allowable movements are noted further in this section.

If the criteria above are satisfied, a syndicate will remain eligible for Fast Track based on the combination of two factors; recent reviews performed by Lloyd's, and materiality, as follows:

d. If the syndicate has been subject to a Deep Dive or an Internal Model Approval Process (IMAP) review (from coming off the syndicate benchmark model) in the last two years, the syndicate enters the Fast Track process, regardless of materiality, or:
e. Where syndicates that have not been subjected to a Deep Dive or IMAP in the last two years, the syndicate enters Fast Track if the syndicate's expected maturity is Foundational or Intermediate under the Capital Principle in the new Principles. Syndicates with higher maturities (i.e. larger uSCRs) that haven't have a deep dive or IMAP review in the last two years will not enter Fast Track.

This can be represented by the following flow diagram:



*Movement triggers for key risk-to-exposure ratios are noted in the table below.

Lloyd's will also consider any other available information when determining Fast Track status for syndicates, which may result in a qualitative override to a syndicate's Fast Track status. In general, Lloyd's will aim to keep syndicate's Fast Track status unchanged based on the above criteria.

Risk-to-exposure metrics used

MRC will carry out an initial assessment of movements in key risk-to-exposure metrics since the most recent LCR submission (which could be a MMC/Deep Dive/IMAP submission or the last LCR review) to determine whether these exceed certain pre-defined thresholds.

The principles used in determining the most appropriate metrics are:

- The stress amount (i.e. 99.5th percentile – mean) is the most appropriate risk measure to represent change in view of risk.
- Measures involving claims (rather than premium) are most appropriate to measure change in view of underlying risk.

Risk-to-exposure metrics are laid out below. Exact definitions from items on LCRs are contained in Appendix 1.

#	Metric	Eligibility requirement for Fast Track
S1	SCR(U) stress-to-exposure measure	This ratio must not reduce by more than 10%
S2	Premium Risk (U) stress to exposure measure	This ratio must not reduce by more than 20%
S3	Reserve Risk (U) stress-to-exposure measure	This ratio must not reduce by more than 20%
S4	SCR(1) stress to SCR(U) stress	This ratio must not reduce by more than 20%

For Fast Track status, the key risk-to-exposure metrics will be reviewed with the initial LCR submission and with any subsequent LCR submission triggered by an SBF resubmission. If a syndicate qualified for Fast Track with the initial LCR submission, but the subsequent LCR resubmission led to the key metrics changing materially, the syndicate may be removed from Fast Track review. The exact circumstances of the SBF/LCR resubmission will be considered by Lloyd's when determining whether a syndicate remains on Fast Track, but the starting position in this case is that the syndicate no longer qualifies for Fast Track.

Initial completeness checks

After the triaging process, 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 LCR submission. It will cover:

- Any missing documents from the submission against the list above in Section 2.1.
- Data inconsistencies between 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.
- Agents will also be informed if their submission will be fast tracked or otherwise.

3.2 Syndicate Reserving

The Syndicate Reserving team review the following, with further detail provided in Section 4.2:

- Model loss ratio assumptions
- Model opening reserves (balance sheet projection)
- Best estimate reserves

Model loss ratio assumptions

For the 2023 process, rather than conducting market-wide testing, Lloyd's has selected individual syndicates for additional oversight on prospective year modelled loss ratio setting based on quantitative and qualitative syndicate-level information. Selected syndicates have been triaged into High Risk and Low Risk.

Lloyd's oversight of High Risk syndicates will primarily take place in July and August 2022, with any resulting loadings applied for the year-end 2023 capital approval process. The expectation is that prior to commencement of CPG all High Risk reviews will be concluded. If any High Risk reviews require additional time, these will be prioritised based on their CPG phase.

Oversight of Low Risk syndicates will be integrated into the regular oversight activities, such as the 2022/2023 Annual Reserve Meetings, which are likely to take place from Q3 2022 to Q1 2023. Any resulting loadings would be applied for the mid-year 2023 capital approval process.

Model opening reserves

For the 2023 process Lloyd's has selected the syndicates for review based on historical ability to accurately project the Q4 balance sheet at Q2, over a 3-year period. Lloyd's has provided an updated template to complete for the Model Opening Reserves Test to be submitted to Lloyd's by these syndicates only.

Best estimate reserves

The best estimate reserve reviews are specific to the deficiency that has been highlighted and that needs resolution. Lloyd's will engage with the reserving team at the syndicate for queries/meetings and provide timely feedback and raise any additional queries. Where there appears to be deficiencies in the process or the reserves underpinning the model opening reserves, a loading may be proposed.

Please note that for the 2023 process Lloyd's will only perform the Earned margin and Unearned Profit tests for mid-year capital approval, based on the Q4 audited ASR. These tests will no longer be carried out during the September/October CPG process.

3.3 Co-ordination with other Teams

The capital review process involves a number of different teams in Lloyd's. The overall review is conducted by the Syndicate Capital team with input from other teams such as Treasury, Exposure Management and Outwards Reinsurance. However:

- Loadings regarding the prospective loss ratios, the technical provisions roll-forward process and mean best estimate reserve loadings are proposed by the Syndicate Reserving team.
- Loadings regarding the Catastrophe Risk Appetite, model completeness and other catastrophe risk related loadings are proposed by the Exposure Management team.

Questions regarding these loadings should be directed to your Syndicate Reserving/Exposure Management point of contact respectively. Account Managers can provide additional information on the process.

The Exposure Management review process involves reviewing the LCR/ECA along with the Syndicate Business Forecast and natural catastrophe risk (LCM) forecast returns. The LCM forecast returns include simulations for the following year's catastrophe losses, a sensitivity test to calculate the impact on SCR of an increase in catastrophe risk and a bridging analysis of the catastrophe losses provided to Exposure Management and those recorded in LCR Form 313. Further details on these returns will be released in July. The Exposure Management process will also take into account the outcome of their review of syndicates' Model Completeness Questionnaires.

3.4 Communication of Loadings

All loading proposals applied by Syndicate Capital / Syndicate Reserving follow the process outlined below, except where loads are below a minimum materiality threshold, as outlined in section 3.5.

The reviewer might ask clarifying questions throughout the review, although these will be kept to a minimum due to the short turnaround time. Results of the review will be presented to and discussed at the Actuarial Oversight Review Group (AORG), which replaces and combines the previous Capital Technical Review Group (CTRG) and the Reserving Technical Review Group (RTRG). Any proposed loadings will be sent to the Capital/Reserving team at the syndicate. Account Managers will also communicate potential loadings to the executive of the syndicate.

When communicating loads to syndicates, Lloyd's will advise the following:

- The amount of the loading to the ultimate and one-year SCRs
- The area of the model or model test to which the loadings are applied
- A description of the loading and how it has been derived unless it is a formulaic loading from a model test.

For Syndicate Reserving loadings there will not be an additional opportunity for the syndicate to challenge the loading before CPG, given that the syndicate provided information for the tests at earlier stages of the process.

For Syndicate Capital loadings are of an indicative nature and are designed to address the uncertainty surrounding the capital numbers if certain questions cannot be resolved satisfactorily. Lloyd's will communicate the proposed measures to address the loadings and there are areas where Lloyd's expects that syndicates could address the uncertainty in the timescales provided. Responses from syndicates will be reviewed before a recommendation is presented to the Capital Planning Group (CPG).

A recommendation regarding the syndicate's capital will then be presented to the Capital Planning Group. CPG's 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.

More detailed feedback will be sent to capital contacts by the Syndicate Capital team. This will include detailed information about loadings (capital and/or reserving, where relevant), how these can be addressed, and timeframes. Feedback will be sent out by end of November 2022 at the latest. Feedback will also include any changes to the status of the Principle ratings (Capital and Reserving – Principle 6).

Please note that the above process largely follows the review process established over the last three years, with no material changes to the process in place for reviewing the 2023 LCR submissions from last year.

3.5 Waived Loadings

In line with Lloyd's principles-based approach, a minimum threshold will be applied to the aggregate capital loading for a syndicate. Total loadings below the minimum threshold will be waived. The minimum threshold is set at 5% of the syndicate's submitted ultimate SCR as default – it is subject to review on a case-by-case basis.

Some loadings are exempt from this minimum threshold – i.e. they will be applied at any level. These non-waived loads are:

- Catastrophe Risk Appetite (CRA) loadings applied by Exposure Management. These are covered in section 4.3.1.
- Thematic loads. Presently, this includes:
    a. Non-modelled natural catastrophe / Model Completeness loadings. These are covered in section 4.3.2.
    b. Q1 2023 reserving model loss ratio loadings (retrospective loadings) that may be applied for performance below plan over 2022.
    c. Inadequate allowance for the current economic environment (in particular inflation).
    d. Inadequate allowance for the Ukraine crisis.

Waived loadings will be communicated to the syndicate as part of the capital feedback at the end of the CPG process and feedback will be provided on the areas where loads were waived. Waived loadings will be taken into account in March when the LCR reassessments are due. Large syndicates (with a uSCR over £250m) will be contacted if their waived loadings and SCR movement in aggregate exceeds +10%. The syndicate will then be asked to either provide information that addresses the loading or to resubmit their LCR in March. This is restricted to large syndicates and enables Lloyd's to manage the risk of significant market movements in capital. Waived TP roll-forward loads will not be taken into account in March, as these will become irrelevant for year-end reassessments. Agents are also required to continually monitor their capital requirements throughout the year and notify Lloyd's when SCR moves by more than 10%; the calculation of movement in capital should include waived loadings for syndicates with a uSCR over £250m.

Where further information has not been requested for waived loadings, Lloyd's expects that agents will address Lloyd's feedback on waived loadings with the next LCR submission, either through appropriate model adjustments or by providing information that addresses the loading.

Here are three examples of how the minimum threshold will work in practice:

Example 1: For a syndicate with a uSCR over £250m a potential 3% load to uSCR is identified. No other loads identified. Lloyd's chooses to waive the load and no loads are communicated to the syndicate during the review. The syndicate is notified of the waived load after CPG approval. Syndicates may provide further information to MRC Syndicate Capital ahead of March resubmission to address the area of concern identified, if their adjusted uSCR movement exceeds 7%. If information is considered sufficient to address the area of concern, feedback will be reissued. If that is not the case and the March reassessment template shows an adjusted uSCR movement of over +7% the syndicate will have to resubmit their LCR in March.

Example 2: Syndicate Capital identify a potential load to uSCR, and Syndicate Reserving identify an additional potential load to uSCR. The total of the two loads is greater than the minimum threshold, and therefore the loadings are both pursued and are communicated to the syndicate in accordance with Section 3.4.

Example 3: Syndicate Reserving identify a potential Model Loss ratio assumptions load to uSCR which is below the minimum threshold. The syndicate is also subject to a CRA load. As the syndicate reserving load is below the minimum threshold, Syndicate reserving will waive the load but the CRA load is still applied regardless of its size, as CRA loads are not additive with other loadings. The same process as per Example 1 holds.

The waived loadings process was first introduced in 2021 for the 2022 LCR submissions. Syndicates who were given a waived loading at this time were also given a deadline to provide a response to Lloyd's to address the concerns leading to the loading. In many cases this deadline was the 2023 LCR submission.

Syndicates are expected to prioritise model development work required, including consideration of emerging risks and the current and future external environment conditions (e.g. economic, regulatory etc). There have been two new major areas of focus in 2022 - inflation and Ukraine – and further information on these areas is requested from the market in the 2023 YOA Focus Areas return, as noted in in section 5. We acknowledge that this has significantly increased the workload for syndicates and that model development on waived loadings may have been deprioritised. In this case, syndicates must provide justification that the deprioritisation was reasonable. Syndicates who do not attempt to address prior waived loadings or provide reasonable justification for doing so may be subject to a Controls loading.

3.6 Controls loadings

Controls loadings were introduced for the first time in 2021 with the 2022 LCR submissions as Lloyd's moved to a principles-based approach. This process remains in place for the 2023 LCR submission, and has been further formalised in the new Principles framework. Controls loadings are applied as an intervention for concerns about the governance and controls that are in place at a syndicate. These are applied by CPG and will be applied for issues identified in one or more of the Principles, where the issue or aggregation of issues is considered to be material. As the loading is not in place to address a specific modelling issue, it is calculated as a simple % of ultimate SCR, with the % to be determined by CPG based on the severity of the issue(s) identified. It is expected that the starting point for a controls loading would be 10% of uSCR, as they are deemed to be less significant than failings to meet minimum Solvency II requirements, which is usually a 20% capital load.

3.7 Principles for Doing Business at Lloyd's

The syndicate capital team will assess the maturity of each syndicate's Capital principle under the new Principles for Doing Business at Lloyd's with each capital review. Syndicates that are on the Fast Track are, by definition, syndicates that are rated as either Meeting Expectations or Marginally Below Expectations. As outlined in section

3.1 above, the level of review for syndicates on Fast Track is limited, and thus it is unlikely that these ratings will be changed. Syndicates who are not on Fast Track will receive a more detailed review, and therefore as a result the assessed maturity may be changed (in either direction).

The assessed maturity of each syndicate will be communicated to each syndicate following the CPG review process.

4 Lloyd's Model Tests

Lloyd's will run a number of minimum tests which flag areas to question with the syndicate. If any of the tests are failed, Lloyd's expects to see robust justification to support the model output. Loadings will be applied if the justification is deemed insufficient. Please note that passing the minimum test does not necessarily mean that Lloyd's has no further questions on the area in question, as these only constitute a baseline. Some tests are relatively simple automated tests that will be run as a matter of course – other tests like the Model Loss Ratio tests have been agreed on with the market in advance of the submissions.

4.1 Syndicate Capital Model Tests

As noted in Section 2.3, these tests will be flagged in the 2023 Focus Areas return. Justification for failed minimum tests must be provided together with the Focus Areas return. Syndicates will not receive a further opportunity to address any loadings associated with failed minimum tests.

4.1.1 Insurance Risk – Modelled Class Volatility

The ratio of losses to mean premium should be greater than 100% for the standalone premium risk for each modelled class of business at the 99.5th percentile, i.e. each class should make a loss at a 1 in 200 return period relative to the expected premium.

This test checks that the 99.5th Net Claim percentile for Premium Risk including Catastrophes is greater than the Net Premium, for each modelled class. These correspond to LCR form 502 Q1 Col I and LCR form 502 Q1 Col A. The ratio is also automatically calculated in LCR form 503 Q1 99.5th ULR including Catastrophes, and it must be greater than 100%.

4.1.2 Diversification – within Premium Risk

Contributions from premium risk by modelled class of business to the 99.5th percentile of premium risk should be greater than the mean for the class. This test is designed to ensure that a minimum level of correlation is applied between all classes for premium risk.

This test checks that the 99.5th Post Diversified claims for Premium Risk including Catastrophes is greater than the Mean Net claims for each modelled class. These correspond to LCR form 502 Q1 Col I(i) and LCR form 502 Q1 Col B. The ratio is also automatically calculated in LCR form 503 Q2 Post diversified claims, and it must be greater than 100%.

Managing agents should note that while the minimum test is applied to Premium risk including Catastrophes (LCR forms 502 and 503), the same minimum criteria apply for the Premium risk excluding Catastrophes (LCR forms 500 and 501).

Of course, this test does not directly check the level of correlations applied. Lloyd's might use other information (e.g. the output correlations between classes supplied in the IMO returns) to check correlation levels. Syndicates should be prepared to provide the minimum modelled level of correlation between classes and years (output and input) to Lloyd's on request.

4.1.3 Diversification – within Reserve Risk

Contributions from reserve risk by modelled class of business to the 99.5th percentile of reserve risk should be greater than the mean for the class. This test is designed to ensure that a minimum level of correlation is applied between all classes for reserve risk.

This test checks that the 99.5th Post Diversified claims for Reserve Risk is greater than the Mean Net claims for each modelled class. These correspond to LCR form 510 Q1 Col F(i) and LCR form 510 Q1 Col A. The ratio is also automatically calculated in LCR form 511 Q1 Post diversified claims, and it must be greater than 100%.

Of course, this test does not directly check the level of correlations applied. Lloyd's might use other information (e.g. the output correlations between classes supplied in the IMO returns) to check correlation levels. Syndicates should be prepared to provide the minimum modelled level of correlation between classes and years (output and input) to Lloyd's on request.

4.1.4 Impact of Reinsurance

The level of reinsurance credit risk modelled should be considered in the context of the materiality of reinsurance to the SCR. The relatively binary nature of reinsurance default means that this risk can appear low (especially on a one-year basis) and/or well diversified. It is expected that any limitations associated with modelling this risk (e.g. including exhaustion) are clearly understood and quantified and stress/scenario tests are used to validate the level of risk.

The test checks that the movement in the benefit from reinsurance reported in LCR form 530 Q2 Row 3 is consistent with the movement in contribution to capital from credit risk (LCR form 541 Q2, reinsurance credit risk) as a percentage of capital (LCR form 309, Table 1, B1).

4.1.5 RI Credit Risk – Loss Given Default

Lloyd's expects managing agents to apply a loss given default probability of at least 50%. This is in line with the standard formula. However, when assigning the loss given default ratios, Lloyd's expects syndicates to also consider:

- Positive and negative risk features of the syndicate's reinsurers (e.g. financial strength rating, current aged debts or regulatory action)
- Positive and negative risk features of the syndicate's reinsurance contracts (e.g. contract clarity, current disagreements or disputes)
- The probability that loss given default ratios would increase under stressed scenarios, including with the scale of the unpaid recovery.

It should be noted that the loss given default probability should be applied to the unpaid recovery at the point of default. Collateral can be taken into account, but only if the collateral has not already been used as a positive risk offset when considering default/impairment probabilities. Syndicates must be able to justify the assumptions in this area, in particular when the 50% loss given default probability is lowered for some simulations, noting the lack of data in this area.

The minimum test applied by Lloyd's checks that the ratio of the 99.5th RI Credit Risk loss on RI Recovery (LCR form 530 Q1 F1) over the 99.5th RI Recovery (Gross) from defaulting counterparties (LCR form 530 Q1 F3) is equal to or greater than 50%. The ratio is also automatically calculated in LCR form 531 Q1 99.5th RI credit risk loss vs. RI recovery (Gross) - defaulting counterparties.

4.1.6 Negative Market Risk Contribution to Capital

In general, additional risk should add additional capital to the capital requirement. However, in the case of market risk, the contribution to capital might be negative (i.e. market risk reduces capital) under limited circumstances. This requires investment returns to outweigh the risk from liquidity, FX and credit risk. Lloyd's does not expect a negative contribution from market risk on an ultimate basis. On a one-year basis, the impact of the unwind of discount credit is accepted as part of the reason for a negative contribution from one-year market risk.

Given that interest rates are expected to rise in the near future, expected returns might have increased in the asset models in comparison to past years. Hence Lloyd's is expanding the test with regards to the market risk contribution in the Focus Area Return in order to facilitate a pragmatic approach to the review of this. Based on the submitted information, Lloyd's will assess whether or not a capital loading will be applied.

Ultimate basis

If there is a negative ultimate contribution, syndicates are required to input from the previous LCR submission and from the new submission:

- Expected return in market risk (as reported in LCR form 314).
- The market risk versus insurance risk JEPs (as reported in LCR form 520).

If the change (increase) in expected return exceeds the change in amount of contribution (in absolute terms) then no further action is required. If this test does not pass, syndicates are required to provide the following information:

- An analysis of change which describes how the components of market risk have moved since the previous submission.

    - On both a mean and stress level; and
    - Broken down into the components of market risk in question 2 of LCR form 314

- An explanation of how the model is appropriately capturing volatility in the current economic environment - in general terms, if expected returns have increased we would expect standalone market risk volatility to increase as syndicates should be allowing for higher credit spreads and a larger gap to the interest rate floor.
- An explanation of how the insurance risk versus market risk JEPs have moved since the previous submission - there should be an appropriate level of dependency being modelled between insurance risk and market risk so that higher standalone market risk volatility translates into an increase in capital contribution.
- Explain what is driving the contribution of market risk to capital in terms of the sub-risks of market risk and why this is appropriate. Syndicates should be clear with reference to the insurance risk losses that contribute to capital about the expected behaviour for market risk and whether the capital setting scenarios demonstrate this behaviour.

One-year basis

For the one-year SCR, as with previous iterations of the minimum tests, if the negative contribution is smaller than the amount of discounting benefit on the one-year TPs, no further action is required.

If there is a negative contribution beyond this level then syndicates are required to provide the change (increase) in expected market risk returns on a one-year basis between capital submissions and compare this to the change in amount of contribution on a one-year basis. If the change in contribution exceeds the change in expected return, please provide the information outlined in the ultimate section but on a one-year basis.

4.1.7 Foreign Exchange Risk Mean Profit

Lloyd's will only allow a maximum profit of £1m on Mean FX risk regardless of the contribution from Market risk. This rule will apply to all syndicates, including those with positive Market risk contributions to Ultimate and One-Year SCR.

This test will simply check that the FX Risk ultimate mean (LCR form 314 Table 2 D5) is greater than -£1m. If the syndicate capital level is such that £1m is material to the result, agents should take appropriate action to minimise this profit.

4.1.8 Contributions to Capital

Contributions to capital from all risk types should be positive (except for market risk under certain circumstances as discussed above).

This test simply checks that post-diversified capital contributions from all risk types (LCR form 541 Q2) are positive.

4.1.9 Diversification: The Sum of Squares Test (SST)

It is well understood that the level of dependencies included in syndicates' internal models is a material driver of capital, both on an ultimate and one-year basis.

There are many methods of introducing dependencies between classes of business and risk categories, e.g. copulas, common drivers, tail drivers. Lloyd's does not prescribe the use of any particular dependency structure and considers the individual dependency structure used in an internal model in the SCR review. However, Lloyd's does require consideration to be made of the potential for dependency effects to be greater within the tail of distributions than in the body. The impact of any tail drivers on capital should be considered as part of representing their appropriateness, rather than relying solely on their presence in the modelling.

The unique and complex nature of many dependency structures means that it is often difficult to consistently assess from a bottom-up analysis whether any particular approach is appropriate. As a result, Lloyd's also examines the output of internal models to ensure that sufficient dependency has been introduced.

A working group of Lloyd's and market representatives concluded in 2019 that the Sum of Squares Test is a useful high-level indicator, but further information can be considered if it indicates an issue with diversification.

There are 5 areas where the SST is applied by Lloyd's:

i) Overall ultimate SCR: The modelled SCR adjusted 99.5th percentile must be greater than the SST SCR adjusted 99.5th percentile (both in LCR form 521 Q6).

ii) Insurance Risk including Catastrophes: The modelled Insurance risk adjusted 99.5th percentile must be greater than the SST Insurance risk adjusted 99.5th percentile (both in LCR form 521 Q5).

iii) Insurance Risk excluding Catastrophes: The modelled Insurance risk excluding catastrophes adjusted 99.5^{th} percentile must be greater than the SST Insurance risk excluding catastrophes adjusted 99.5^{th} percentile (both in LCR form 521 Q7).

iv) Premium Risk excluding Catastrophes: The modelled Total Net claims 99.5th percentile (LCR form 500 Q1 Col I Total) must be greater than the SST Total Net claims 99.5th percentile (LCR form 501 Q3 99.5th Net Claim percentile Total Claims SST).

v) Reserve Risk: The modelled Total Net claims 99.5th percentile (LCR form 510 Q1 Col F Total) must be greater than the SST Total Net claims 99.5th percentile (LCR form 511 Q2 99.5th Net Claim percentile Total Claims SST).

The Sum of Squares Test Template focuses on the first three of these tests (on a one-year basis and an ultimate basis). It requests high-level model output to determine a pass/fail at a total level, and requests additional information that is required to assess the appropriateness of the dependency structure if the test was failed. Where tests i), ii), or iii) fail, agents are asked to fill in the Sum of Squares Test Template (available on Lloyds.com) and submit this with their LCR submission as an attachment in MDC. For failures in test iv) and v) the Diversification – within Premium / Reserve Risk tests will be reviewed, but agents should be prepared to provide more information on dependencies within premium risk and/or reserve risk in order to show that a minimum dependency exists between classes and years.

The additional evidence consists of:

- The use of randomised simulations for premium, reserving and insurance risk in order to assess model output against "true" independence ("scrambled sims")
- Spearman's rank correlation of model output
- Using an alternative measure, the APC (Average Percentile Contribution), on both randomised and modelled sims to assess contributions to the tail

Average Percentile Contribution examines Premium/Reserve risk contributions in the 99.5^{th} percentile tail of insurance risk and expresses these as a percentile of the standalone Premium/Reserve risk distribution. Randomised simulations are required to provide a baseline to measure dependency.

The additional evidence will be collected on a one-year basis and an ultimate basis. For the aggregation of Premium Risk and Reserve Risk to Insurance Risk, it will also be collected net and gross of reinsurance, including and excluding natural catastrophes.

The above will allow Lloyd's to assess dependency within internal models using different metrics against truly independent distributions. However, Lloyd's considers this level of dependency to be an absolute minimum rather than a test of adequacy.

4.1.10 New Franchise Guidelines relevant to Capital

For 2023 LCR submissions, new Franchise Guidelines will be in place to restrict excessive risk that syndicates may pose to the Central Fund (i.e. beyond their 1 in 200 uSCR requirements), as noted in Market Bulletin Y5375. These requirements will apply to all syndicates, including SPAs. There is a guideline on the maximum net line size which will be monitored by Exposure Management, and the guideline on tail risk will be monitored by Syndicate Capital. These two new guidelines are:

1. A new net line size requirement has been introduced specifying that the maximum net line size that a syndicate may have on an individual risk cannot exceed 30% of ECA plus profit, where profit is defined as 'Profit/Loss for the period' on an Ultimate basis in the approved Year of Account SBF (Item 16 of SBF Form 100s).

2. A new requirement has been introduced to restrict the amount of tail risk that a syndicate can be exposed to. This operates as follows (depending on whether a syndicate has an internal model and submits an LCR to Lloyd's or not):

- For syndicates with an internal model that submit an LCR, the 99.8th percentile (1-in-500) of the insurance claims shall not exceed 135% of the 99.5th percentile (1-in-200) of insurance claims. Both measures refer to the total modelled insurance claims net of reinsurance on an ultimate basis as reported to Lloyd's in the LCR submission (Form 311).

- For syndicates that do not have an internal model or submit an LCR, the 99.8th percentile of Final Net LCM WWAP losses shall not exceed 135% of the 99.5th percentile of Final Net LCM WWAP losses and the 99.8th percentile of Final Net LCM WWAP claims shall not exceed ECA plus Profit.

The second part for syndicates who do not have an internal model or submit an LCR will be monitored by Exposure Management.

As with other Franchise Guidelines, syndicates that do not meet these requirements will either be required to apply for a dispensation or make appropriate changes to remove the need for a dispensation request. These changes could include, for example, adding a management adjustment into their LCR submission, or adjusting their business plan to purchase tail risk RI cover and resubmitting their SBF/LCR. Any dispensation requests should be discussed with the Exposure Management/Syndicate Capital contacts before the submission.

A request to exceed Franchise Guidelines, i.e. a request for dispensation, may result in a capital loading if that request is not agreed by CPG.

4.2 Syndicate Reserving Model Tests

4.2.1 Model Loss Ratios

Prospective year modelled loss ratios

In line with previous SCR guidance, assumptions used for the model should be on a Solvency II best estimate basis. The basis of loss ratio assumptions for the LCR is required to be a best estimate, based on realistic and appropriate assumptions. As highlighted in the PRA's Supervisory Statement (SS5/14), this is not expected to incorporate improvements in performance unless the measures taken have been shown to be effective. Lloyd's considers that only syndicates with a consistent track record of performing to plan can justify the use of SBF assumptions for capital setting purposes, as Lloyd's has historically observed adverse performance compared to plan in the market's actual experience. Individual syndicates are required to assess the appropriateness of the internal model assumptions, including the realism and appropriateness of prospective year loss ratios.

For the 2023 process, Lloyd's will select individual syndicates for additional oversight on prospective year modelled loss ratio setting based on quantitative and qualitative syndicate-level information. Syndicates selected will be categorised into High Risk and Low Risk.

The quantitative metrics used in the selection and categorisation process are (1) a 3-year metric comparing historical actual performance to the modelled loss ratio; and (2) a 10-year metric comparing historical actual performance to the plan loss ratio. These metrics will be considered on a gross of reinsurance, net of acquisition costs basis. The metrics will include catastrophes except COVID-19.

High Risk Syndicates

Lloyd's oversight of High Risk syndicates will primarily take place in July and August. Syndicates will be required to provide quantitative and qualitative information justifying the appropriateness of the prospective year modelled loss ratio, for modelled classes that primarily drive historical miss to plan. Lloyd's will review this information. Any resulting loadings would be applied for the year-end 2023 capital approval process.

Low Risk Syndicates

Lloyd's oversight of Low Risk syndicates will be integrated into the regular oversight activities, such as the 2022/2023 Annual Reserve Meetings, which are likely to take place from Q3 2022 to Q1 2023. For Low Risk syndicates, the materiality/importance of the prospective year modelled loss ratio review will be considered in the context of other agenda items to be discussed in the Annual Reserve Meeting (or other means of regular oversight). This will dictate what classes or particular areas Lloyd's chooses to review. Any resulting loadings would be applied for the mid-year 2023 capital approval process.

Determination of loading

The level of the loading will be determined on a case-by-case basis, based on an assessment of the agent's responses. For example:

- If a more qualitative deficiency is determined this may drive concerns over the governance, risk management and internal controls processes or even concerns around the Solvency II compliance of the syndicate. If this is the case a Controls or Solvency II loading may be applied.
- In other cases, the quantum of a loading may be driven by data e.g. by asking the agent for a sensitivity to change in method/assumptions to allow for any deficiency identified in the process. However, some reliance may also be placed on Lloyd's expertise and judgement.

For the 2023 YOA LCR reviews, there continues to be an expectation that the prospective 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 should apply by class of business. On a net net basis, this should apply at the overall Syndicate level. This is tested in the Focus Areas return, and agents are required to provide robust justification in any circumstance where this test is failed, or a loading will be applied.

Additionally, Lloyd's will query any syndicates where the total 'self-uplift' has decreased by more than 1% since the prior year. 'Self-uplift' is defined as difference between modelled and plan loss ratios from LCR form 561. A loading may be applied if justification is considered to be inadequate by Lloyd's.

Further details on the 2023 process are provided in the "Reserving Tests of Uncertainty – 2023 Process" pack, which can be found on the Lloyd's Reserving Guidance and Support Materials page.

Retrospective capital loading

There is likely to be continued focus this year on the performance of the current underwriting year and the appropriateness of the capital as submitted. Where there is a material deviation of the actual experience as reported at year-end 2022 compared to the modelled loss ratio this may receive greater oversight from Lloyd's and may result in a retrospective adjustment to capital (an increase or a decrease). Further details of this process for 2023 will be provided in due course.

4.2.2 Model Opening Reserves

Lloyd's expects that managing agents will have robust processes in place for performing the roll-forward of their latest audited technical provisions data when obtaining the T0 balance sheet. In particular, managing agents are expected to consider the Actual vs Expected balance sheet positions and to correct their methodology where systematic under-/over-statement is identified, particularly where this is found to be material.

As part of the 2023 SCR, Lloyd's will be asking a subset of the market to fill in the roll-forward template for their syndicate for the last 3 roll-forward exercises. This will be based on a Syndicate's historical ability to accurately project Q4 Balance Sheet at Q2, over a 3-year period.

If methodology changes are being made to the roll-forward process, the managing agent is expected to clearly highlight the changes made within their modelling documentation submitted to Lloyd's. The managing agent is also expected to back-test (reforecast) any changes in methodology against the last 3 years of historical QSR returns to evidence the process improvements being made. The "impact" column within the roll-forward template gives managing agents the opportunity to explain any gaps in historical Actual vs Expected that they believe should be credited as part of the test. These will be reviewed on a case-by-case basis by the Syndicate Reserving team.

Any remaining under-statement that falls outside of the thresholds set for this test will be loaded to avoid understating the LCR. The percentage load is calculated using the average residual for the last 3 roll-forward exercises.

Syndicates are expected to provide the validation conducted on the opening balance sheet at an overall level as well as on the following component parts: reserves, future premiums and expenses. The objective in this case is to provide a summary of the analysis undertaken/testing performed to ensure appropriateness of opening balance sheet e.g. back-testing - actual versus expected opening balance sheet of historical years overall balance sheet (or by component part). The validator should consider whether the approach used to roll forward the balance sheet to the year-end is reasonable and where a change in approach has been taken consider the appropriateness of that change.

Additionally, all Syndicates will be asked to respond on how they made allowances for the Ukraine crisis and general economic developments (including inflation) as part of their roll-forward technical provisions. This will be included as part of the Focus Area Return. This will be a qualitative review and is outside of scope of the technical provisions loading calculation as stated above. Any deemed deficiency upon qualitative review could be subject to either further follow up work with the syndicate or an operational load.

4.2.3 Best Estimate Reserve Reviews

The best estimate reserving process of syndicates is reviewed by the Lloyd's Syndicate Reserving team throughout the year based on various metrics/KPIs used by Lloyd's to monitor the market, including Lloyd's assessment of syndicates for the Reserving Principle of the Principles for Doing Business at Lloyd's. The best estimate reserving reviews are specific in nature, dependent on the specific deficiency that has been highlighted and needs resolution. Syndicates in scope of a best estimate review ahead of YE Capital Approval will be informed in July 2022. Any potential loads will be determined on a case-by-case basis. Where judged to be necessary, loadings will be recommended to the Lloyd's Capital Planning Group (CPG).

4.2.4 Earned Margin and Profit in Unearned Premium

For the 2023 process, Lloyd's will only perform the Earned margin and Unearned Profit tests for mid-year capital approval, based on the Q4 audited SCR. These tests will no longer be carried out for year-end capital approval. Details of these tests are provided below:

Earned margin: If the earned margin being claimed in the ASR submission is greater than that calculated by the Signing Actuary as part of the year-end SAO, the Reserve Risk within the LCR submission may be understated.

Profit from unearned premium: If the associated profit from unearned premium (as derived from the loss ratio on unearned premium) being claimed within the QSR submission is greater than that calculated by the Signing Actuary as part of the year-end SAO, the Premium Risk within the LCR submission may be understated.

If the above cannot be adequately explained for either the Earned Margin or Profit from Unearned Premium, the ASR is expected to be re-submitted to correct for any shortfall. In such cases, consideration should also be given to any other adjustments required to the SCR, for example additional reserve risk related to a change in the earned margin.

Further guidance on this is available as part of the ASR/QSR submission and review process.

4.3 Exposure Management Model Tests

There are four principle types of Exposure Management-related capital loadings:

- Catastrophe Risk Appetite (CRA)
- Model Completeness
- Internal Model sensitivity
- Franchise Guidelines.

4.3.1 Catastrophe Risk Appetite (CRA)

The CRA is defined as the ratio of the LCM5 1:200 Aggregate Exceedance Probability (AEP) Final Net Loss (FNL) to ECA plus profit. Any increase in the LCM5 1:200 AEP FNL will need to be at a maximum ratio agreed by Lloyd's; where this is not met, Lloyd's Exposure Management will recommend a loading in order to achieve the required ratio.

4.3.2 Model Completeness

In May 2022 Lloyd's Exposure Management issued an updated Model Completeness Questionnaire, covering non-LCM5 ("Rest of World") peril-regions and additional natural catastrophe model completeness topics This return will be evaluated by Exposure Management over the summer, working with syndicates to explore any areas of uncertainty. Any material deficiencies may result in a capital loading in line with the guidance issued on 27th May.

Please note that syndicates are required to ensure that the addition of previously non-modelled risks is additive to capital, in line with the general principle that additional risk adds to capital.

4.3.3 Internal Model Sensitivity

Syndicates submit a sensitivity test to Lloyd's Exposure Management that assesses the impact of parameter error on the SCR. Any unusually high result will be reviewed in depth and the syndicate may attract a capital loading in extreme or unexplained cases.

4.3.4 Franchise Guidelines

Within SBF Form 452, syndicates provide projections for future Realistic Disaster Scenarios (RDSs). These are compared against ECA plus profit, and the result must fall within Franchise Guidelines (these are outlined in the guidance found here). A request to exceed Franchise Guidelines, i.e. a request for dispensation, may result in a capital loading if that request is not agreed by CPG.

5 Focus Areas

5.1 General comments

Throughout the Focus Area return, Lloyd's collects 'syndicate comments' and 'references to relevant documentation/validation'. In the comments section we are asking for clear explanations of syndicate approaches and what has been considered as well as justification for why this is reasonable for the syndicate risk profile. More detail to cover these points as well as what has been performed for validation should be signposted in the 'references to relevant documentation/validation'.

5.2 Ukraine Crisis

5.2.1 Background

The humanitarian crisis that is unfolding in Ukraine has caused major financial losses, as well as uncertainty about future insurance outcomes. Lloyd's requires syndicates to ensure that their models reflect this experience and uncertainty appropriately – as for any other event.

The Focus Areas return sets out topics that Lloyd's is focussing on in the capital review. Lloyd's has prioritised the list to areas considered material to the market and therefore the list is not exhaustive.

There are significant uncertainties in estimating potential loss outcomes:

- Ongoing nature of the crisis means that the duration, severity and geographical impacts are unknown.
- Establishing reserves for incurred claims are difficult due to a lack of data.
- There is the potential for coverage disputes and lengthy litigations.
- There is potential for new direct losses to emerge.
- For reinsurance there may be heightened risk of dispute due to interpretation of coverage terms and recoveries may be lower than expected due to erosion of limits.

Syndicates must ensure that their capital reflects these uncertainties. Capital adjustments must be made for the stressed state of the syndicate and the industry – whether those adjustments take place within or outside of the model.

Lloyd's acknowledges that the situation is still developing and that the ultimate outcome of the Ukraine crisis is very uncertain at this point. As such, it might not be possible to implement model changes now which take the full impact of events into account. We do not require syndicates to immediately implement any model changes which will be difficult to complete in the available timeframe, however we do require syndicates to identify areas where change needs to be made to appropriately reflect the experience, quantify the impact of the changes and include management adjustments where necessary. It is crucial that syndicates validate and document how they have reacted to the experience and clearly signpost this to Lloyd's. Implicit allowance for the uncertainty will not be accepted as it cannot be assessed/validated.

The following sets out our requirements with regards to questions in the Focus Area return. In all areas, syndicates are expected to take an approach that is proportionate in the context of their risk profile and be able to justify this approach. If the justification is not clear and robust, then a loading will be applied to allow for the area of uncertainty.

5.2.2 Basis for Completing the Ukraine Queries in the Focus Area Return

Lloyd's recognises there is a high degree of uncertainty in the external environment right now, partially due to the Ukraine crisis and its disruptive impact on international trade and economic factors, but also due to other economic developments like the heightened levels of economic inflation.

It may be challenging to isolate how much individual external factors have influenced development of the model and its parameterisation. Therefore. queries in the "Ukraine queries" tab should be completed in relation to losses from the Ukraine crisis only. For avoidance of doubt, this is in relation to losses reported under and *considered* for the UKRA and UKCL Lloyd's catastrophe risk codes, which are defined in the guidance for the Lloyd's QMA return:

- UKRA: Losses directly arising from Russia's invasion of Ukraine commencing February 2022 (i.e. a physical damage loss on a factory located in Ukraine)
- UKCL: Losses indirectly arising from or in consequence of Russia's invasion of Ukraine commencing February 2022 (including losses caused by the impact of sanctions).

The impact of all other external factors, including heightened inflation risk and potential for other global and macroeconomic impacts which have not been attributed to the Ukraine crisis or included for consideration in the UKCL catastrophe code (like e.g. a potential recession), should be captured in responses to queries in the "Inflation - Capital" queries.

Where there is difficulty to split modelling impacts and updates into these buckets, as there is still an overlap between the two, syndicates should apply a pragmatic approach to do so. This approach and its limitations should be described in the comment boxes with signposting to relevant documentation and validation.

Syndicates are only required to complete the "Ukraine queries" tab if:

- The net ultimate claims for the Ukraine crisis loss exceeds 2% of the overall net claims reserves;
- The net ultimate claims for the Ukraine crisis loss exceeds £20m or
- A syndicate is exposed to material downside losses which have only been partially reserved for or not at all (e.g. because the likelihood of the loss is very low or there is an implicit allowance within the general IBNR held by the syndicate). Extreme outcomes being considered for reserving must be captured in the capital model.

The overall net claims reserve is defined as gross claims reserves from QMA 205: Line 07 Total, less the reinsurance claims reserves from QMA 201: Line 26 Total (reinsurers' share of technical provisions).

Net ultimate claims for the Ukraine crisis are defined as the total estimated ultimate claims, net of reinsurer's share from QMA 800u Column F (which is split out for Ukraine in the QMA Additional Information return).

Lloyd's understands that comparing ultimate claims to claims reserves is not a consistent measure, however this approach has been chosen for simplicity and the limitations have been noted. Syndicates should contact Lloyd's about this if it creates an issue.

Back-testingBack-t-Testing

As a starting point, syndicates should back-test the event experience against the model, to establish which areas of modelling to focus on, regarding any model or parameterisation changes as well as validation, and prioritise accordingly.

The Focus Areas return prescribes a market-wide back-test with the intention of achieving consistency across the market – however, capital modelling teams and validators should not necessarily restrict their work to the tests requested. Other scenarios/bases might be considered more appropriate for the specific risk profile and setup of the business. It is the responsibility of the syndicate to ensure that the experience is reflected appropriately – hence it is important to carefully assess which type/basis of back-test is the most suitable test to establish this.

For the Lloyd's Focus Areas test, syndicates should back-test the Q2 2022 net best estimate loss from the event at both an aggregate and class of business level. For avoidance of doubt, the Ukraine net best estimate ultimate claims for the back-testing analysis should be the total estimated ultimate claims, net of reinsurer's share in the QMA Return 800u Column F, less the total ultimate reserve margin, net of reinsurer's share, which is also reported in the QMA 800u form (and split out for Ukraine potential losses in the QMA Additional Information return).

If the syndicate is aware that the estimated loss has changed materially since Q2 2022 reporting to Lloyd's, the most up to date estimate should be used. The submission should include a reconciliation to bridge between the Q2 2022 reported loss and the revised loss estimate. The losses should be back--tested against either:

- The losses generated by a specific event modelled by the syndicate (if applicable); or
- Non-catastrophe premium risk stress for the class(es) affected. This should exclude natural catastrophe losses and other specific man-made catastrophe losses which don't relate to this type of event.

For the back-test against the 2023 YoA model, syndicates should endeavour to provide a back-test of the 2022 experience against a model that is as much like for like in comparison to the 2022 YoA model as possible. If business plans have changed materially then the back-test might not be appropriate any more and the syndicate should comment. The aim of the back-test is to show how the return period has changed due to model changes that have been made in the 2023 model in response to Ukraine crisis experience. Please note that syndicates are NOT expected to consider any potential losses from business written in 2023 and beyond in the back-testing.

For the overall back-test, the losses should be tested against the distribution of the sum of classes affected (not against all classes), on top of other expected claims for the year, i.e. against the stress of the distribution. Where class level information is not readily available for the one-year SCR, this should be estimated on a best-efforts basis.

For the class back-test, the first row is for a specific class combination. Syndicates should determine which of their classes of business best fit the description given and sum the appropriate losses and distributions (allowing for dependencies as appropriate) to provide results for this. For the individual class back-tests, Lloyd's have included classes we would like to be tested. Syndicates should map these to their own model class (at LCR form 500 level) to conduct the test, rather than adjust their models to produce results at the Lloyd's class level. If a single model class covers more than one Lloyd's class, explain this detail in the comments section. We have left space for syndicates to add up to ten additional model classes should they be needed. These can be used when a syndicate uses more than one model class for a Lloyd's class (e.g. Marine insurance and Marine XL).

For any model class (excluding the class combination) where back-testing of the Ukraine crisis (against the 2022 YoA model) of the ultimate best estimate resulted in losses worse than a 1 in 20 return period, syndicates are required to outline actions taken to incorporate this experience into the model.

Syndicates are only required to complete the class back-testing for classes which are specific to them, i.e. if there are no relevant model classes to compare against a Lloyd's class, there is no requirement to provide data against it.

5.2.3 Ukraine Crisis Related Model Changes

Provide the approximate impact of model changes made in relation to potential losses from the Ukraine crisis, using the drop-down menu. You should consider the impact of changes to parameters and methods used to model:

- Premium and reserve risks;
- Dependencies within insurance risk;
- Other risk categories and dependency structures in the model; and
- If the syndicate has added a management adjustment, this should be included for consideration here.

Where it is difficult to estimate the impact (e.g. parameterisation changes related to the event are implicit in general parameterisation updates for a class), then it should be estimated on a best efforts basis. If the impact is difficult to isolate or is expected to be immaterial syndicates can report the change as being within simulation error. If no model changes have been made or the impact is within simulation error, outline the justification for this in the comments box.

Please note that the impact of changes to the business plan or including best estimate Ukraine reserves in the model should be excluded from this assessment, i.e. the model changes considered should relate to volatility updates only.

5.2.4 Volatility of Reserves

Lloyd's requires syndicates to reflect the uncertainty around Ukraine crisis reserves appropriately. Syndicates should compare (by class) the volatility applied for these reserves with the volatility applied for other reserves held for the accident year 2022, and the volatility applied to the reserves held for the accident year 2021 in last year's model and ensure that the relative volatilities are deemed appropriate. Syndicates should document their process and be able to demonstrate how they have taken the uncertainty related to Ukraine reserves into account.

5.2.5 Stress and Scenario Testing

Syndicates are required to carry out stress and scenario testing regarding the key uncertainties affecting the current estimated loss. Syndicates should provide two scenarios that have been used to validate how the internal model is capturing the ongoing development of the Ukraine crisis. The scenarios provided can be those currently being used throughout the agency, for example by Risk and Validation teams, to communicate uncertainty to senior management and validate the capital model.

The potential loss values should be split by risk category and back-tested against the relevant distribution in the model (e.g. the total loss should be back-tested against the overall capital requirement, while risk category losses can be back-tested against the relevant risk category distributions). The total loss should be the sum of the losses by risk category.

The basis of this scenario should be defined and described by the syndicate. Some of the considerations Lloyd's expects are:

- Gross policy level exposure where there is uncertainty around potential losses attaching i.e. how policy terms, conditions and limits of cover could respond.
- Reinsurance recoveries, including the potential for exhaustion of cover and failure to collect where the terms of coverage are uncertain and/or disputed.
- The crisis extending beyond the current geographical areas or beyond 2022 as well as emerging losses associated with this.
- Potential losses arising from international sanctions.

Lloyd's is not prescribing the scenario definitions, but will accept the definitions being used within your organisation. It is up to syndicates to provide scenarios which are deemed to be appropriate.

Syndicates are expected to clearly articulate the scenario assumptions and associated potential losses, as well as justify the model return periods. Providing clarity in explanation of the scenarios, return periods and validation of them will reduce the amount of follow-up with Lloyd's during the capital review period.

5.3 Inflation - Capital

A definition of what we mean by claims inflation is included in the appendices. Please refer to this definition in order to complete all inflation related queries.

5.3.1 ESG Usage

Lloyd's requires syndicates to reflect the recent economic conditions in their capital models, in particular the significant increase in economic inflation observed since Q4 2020 as well as recognising rising interest rates, elevated credit spreads among certain credit sectors and the increase in equity volatility.

If the model uses an Economic Scenario Generator, Lloyd's requires syndicates to consider what the most appropriate version to use would be. This could be to use a Q2 2022 version of the ESG. If an older version is being used, syndicates should demonstrate that the impact of doing so does not lead to underestimating uncertainty in the current economic environment. This may require that overrides are applied to align the view of uncertainty to the most up-to-date view held by the syndicate. Ultimately syndicates are required to demonstrate that current economic conditions have been reflected in the internal model and modelling of market risk is appropriate from a forward-looking perspective.

If overrides are applied to ESG assumptions these should be clearly articulated, justified and validated. If the ESG has not been overridden syndicates should also explain why this approach is appropriate. Overrides to be considered here are adjustments to any variables in the ESG, including inflation.

There should be thorough validation of the ESG, including of overrides or lack thereof, to ensure that it remains appropriate to reflect the risk profile of the forecast period. Validators should clearly demonstrate why they are comfortable with any changes in volatilities observed and correlations between economic variables. Validation should not only focus on standalone market risk, but market risk contribution to capital as well. Please signpost to your documentation/validation in the Focus Areas return.

5.3.2 Application ESG/Economic Inflation

We also require syndicates to provide information about how economic inflation from the ESG is applied to simulated losses in the model, in terms of:

- Differences in the way they are applied between premium risk, reserve risk and by class of business.

- Whether the index outputs are used as they are (with or without overrides) or blended, for example to represent the currency mix or business mix in a class of business.
- Dependency modelled between ESG/economic inflation and excess inflation.

Syndicates are required to include any relevant information to explain how the ESG indices are applied in the comment boxes and supporting documentation. If a syndicate does not model economic inflation using an ESG, the chosen approach and validation of the approach should be documented.

5.3.3 Inflation Indices in the ESG

Syndicates using an ESG must report summary statistics of the inflation indices applied in the internal model. Syndicates must report on indices which apply to at least 80% of the mean net insurance claims (as reported in LCR forms 510 for reserve risk and 503 for premium risk) in the model. For example, if one index is applied to two classes which make up 60% of mean net insurance claims exposure, another index is applied to one class which makes up 25%, and a third index is applied to the remaining 15% of exposure, syndicates should at least report on the first two indices (and preferably all three). Lloyd’s has provided space for syndicates to report on up to 10 inflation indices.

For each index syndicates must select from the drop-down the option which best describes the ESG index and provide further detail in the comments box.

Syndicates are required to report the deviation from mean inflation at various timesteps and return periods:

- Timestep 0 represents the first modelled year (i.e. 31/12/2022 to 31/12/2023), while the ultimate timestep represents the final year of the projection period for the selected index.
- Syndicates are required to report downside inflation movements only.
- If blended indices are used (e.g. between currencies or between price and wage inflation) then report the individual, unblended indices, indicating how much of the mean insurance claims exposure has informed selection of each of the indices being used in the blending.
- If overrides are used, for example to alter the volatility of an economic index, the impact of these adjustments should be included in the reported figures.

The reported inflation level should be the absolute deviation from the mean level for the timestep where the mean level is scaled, if needed, such that it represents no change to simulated claims costs.

Example:

- For the following economic inflation index:

	Year	0	1	2
Index 1	Mean	9%	7%	5%
	1 in 10	10%	8%	7%
	1 in 100	12%	11%	9%
	1 in 200	15%	13%	12%
Index 1 – deviation from mean	Mean	0%	0%	0%
	1 in 10	1%	1%	2%
	1 in 100	3%	4%	4%
	1 in 200	6%	6%	7%

- Report the figures from the bottom table in the focus areas:

Timestep	1 in 10	1 in 100	1 in 200
0	1%	3%	6%
1	1%	4%	6%
2	2%	4%	7%

5.3.4 Claims Inflation Sensitivity Test

This is a sensitivity test to remove the impact of excess inflation, economic inflation and then all claims inflation (i.e. excess and economic) volatility from the model.

The test is specific to removing inflation volatility only, any mean allowance (i.e. in terms of the expected level and path of inflation over time) should remain unchanged. The setup for this test will depend on the syndicate inflation modelling methodology (e.g. some syndicates rely on implicit allowances while others apply explicit drivers) and therefore Lloyd's will heavily rely on documentation of the approach and expect it to be clear to avoid follow-up during the capital review.

Adjustments to the model will be required in order to complete this test. Some will be approximate in nature and may involve reducing or removing the impact of uplifts and drivers which are used to model more than just inflation risk. The adjustments made and rationale for why they are appropriate should be outlined in the supporting documentation. For example, some syndicates use implicit inflation allowances in the insurance risk parameterisation approach and for the purpose of this test may re-run the parameterisation without this allowance, or artificially scale down the final volatility parameters. Any adjustments made to quantify the impact of these allowances, or not, should be explained.

With regards to this test:

- The base capital model used for all three components of the test should be the same.
- The 2023 YoA model used does not need to be the final version that is submitted to Lloyd's, however it should be representative.
- Lloyd's will accept pragmatic approaches that are clearly articulated in the supporting documents.
- If limited inflation volatility allowance is made in the model or it is largely implicit and a syndicate is not able to quantify it, the documentation must outline how the model remains appropriate to capture sufficient inflation volatility
- Syndicates should outline their approach and limitations to the testing, if there are any, in the comments box and reference any validation carried out to show that the reported inflation allowances are appropriate.

5.3.5 Catastrophe Risk Volatility

Lloyd's has asked the market in the Model Completeness questionnaire which was issued by Lloyd's Exposure Management team for inflation assumptions being made as part of assessing catastrophe exposures. The purpose is to understand how, for example increased prospective rebuild costs, are being taken into account within the syndicate's catastrophe view of risk. The question in the Focus Area Return is very similar and answers should be aligned, taking into account any additional work syndicates have carried out over the summer.

Please include detail to describe how the current environment has been factored into your catastrophe risk modelling, from external models and from other allowances that don't come from external models, separately for natural catastrophe and non-natural catastrophe losses. This should include description of how vendor models, exposure data/curves, demand surge assumptions, loss tables feeding the internal model and other catastrophe loss related modelling have been adjusted.

The response should cover how syndicates have become comfortable that the model adequately captures the potential for higher settlement costs from the 2023 accident year onwards compared to prior years.

5.3.6 Updating to the latest View of Claims Inflation

Syndicates are asked to quantify the impact to capital of updating to the latest view of economic inflation. This includes updates to economic inflation volatility applied to simulated claims in the model, which typically comes from the ESG. Other model changes which have been explicitly made to allow for changes to economic inflation uncertainty should be included in the response. We have split impacts into:

1. Updating the ESG

2. Updating natural catastrophe modelling

3. Any other model updates which are specific to allowing for economic inflation volatility.

Row 4. should be the total of rows 1. to 3., allowing for diversification between them.

For this assessment, syndicates should endeavour to provide the impact of running the 2023 YoA exposures through the 2022 YoA model (or the economic basis of the 2022 YoA model), versus the 2023 YoA model. Lloyd's would like to see the standalone capital impact of updating the economic inflation assumptions between the two models in isolation.

For the ESG step, Lloyd’s appreciates that it may be difficult to unpick the impact of inflation alone and therefore if it is more practical, the impact of updating all economic variables in the ESG can be included.

For the natural catastrophe modelling step pragmatic approaches will be accepted, such as approximating how much of any scaling to in-force exposure and demand surge changes relate to inflation uncertainty.

The ‘other’ category can include, for example, adjustments made to any risk category parameters and dependencies to reflect the current economic environment. It should include the impact of changes to the allowance made in the model where an ESG is not being used to model economic inflation volatility for liabilities. It can also include the impact of any adjustments made to reserve risk volatility to reflect changes to the best estimate reserving process.

We will accept best effort approaches to complete this question i.e. if it is particularly onerous to strip out certain model impacts because they are implicit, these may be excluded from the assessment. However, if implicit allowances are being relied on, syndicates are required to justify why these are reasonable and how they have been validated.

Syndicates should explain the impacts provided and any limitations in completing the assessment.

5.3.7 Other External Factor Impacts

Lloyd’s expects syndicates to have considered all potential impacts from uncertainty in the external environment. The response to this question should cover changes made to the model, if there are any, that are not related to high levels of economic inflation or to the Ukraine crisis. Lloyd's expects syndicates to at least consider:

- The potential for an economic downturn or recession and its impact on:
    - Forward looking exposure (including potential for impairment to the underwriting plan);
    - Volatility of and dependency between economic variables;
    - Potential for higher probability of reinsurer defaults, disputes and payment delays;
    - Reserves and losses for economically exposed classes of business;
    - Liquidity and the impact of this on cost of capital; and
    - Potential operational and control failures.
- Second order impacts from the Ukraine crisis which are not captured or considered in the UKRA and UKCL catastrophe codes. An example could be that a syndicate thinks there is a heightened risk of cyber attacks next year. This should have an impact on the cyber class and operational risk parameterisation, but there may not be any allowance for it in the best estimate losses in the UKCL catastrophe code.
- Rising interest rates: Syndicates should consider the impact this has on asset values and market risk; dependency between market risk and insurance risk; and contribution of market risk to capital.

Upon assessing these impacts, syndicates need to make a call about where they should implement changes or adjustments to their models. The capital requirement should have sufficient coverage for these impacts and this should be validated.

Syndicates should provide the detail and, where possible, the impact of the changes made. The documentation should make clear which impacts have been considered and what actions were taken to reflect them in the model.

5.3.8 Stress and Scenario Testing

Syndicates are required to carry out stress and scenario testing regarding the key uncertainties affecting the current loss. For this section of the Focus Areas syndicates should provide two scenarios used to validate how the internal model is capturing (1.) heightened economic inflation levels and uncertainty; and (2.) the potential for a recession. The scenarios provided can be those currently being used throughout the agency, for example by Risk and Validation teams, to communicate uncertainty to senior management and inform the validation process.

The loss values should be split by risk category and back-tested against the relevant distribution in your model (e.g. the total loss should be back-tested against the overall capital requirement, while risk category losses can be back-tested against the relevant risk category distributions). The total losses should be the sum of the losses by risk category.

For the inflation scenario test we expect consideration of the heightened level of economic inflation to persist for longer than currently taken into account in economic and consensus forecasts. For the recession scenario we expect consideration of the impact on asset values and economically exposed classes of business.

Lloyd's is not prescribing particular scenario definitions or probability levels that should be targeted. Syndicates should provide their own scenarios which they think are appropriate and articulate the range of impacts that have been considered.

5.4 Inflation - Reserving

The recent changes to inflation are an area of particular focus for Lloyd's from a reserving perspective, given the traditional actuarial reserving techniques implicitly assume the historical level of observed inflation in the claims data is a good proxy for future levels of claims inflation. As a result, this is typically what is allowed for in ultimate claims projections using these methods (without adjustment).

Lloyd's expect Syndicates to explicitly consider and make appropriate allowances within the best estimate reserves (i.e. the claims component, excluding ENIDs, of the earned and unearned reserves included within Solvency II technical provisions) for the recent change in inflationary environment. Considerations on economic and excess inflation (including social inflation) should be made at class of business level rather than broad brush at whole account level. Allowances should be informed by assessment of the drivers of claims costs, acknowledging that simply applying economic indices is unlikely to be appropriate since it could over-estimate (where inflation is already captured to an extent in chain ladder methods and/or economic indices are not reflective of claims cost increases) or under-estimate (where excess inflation also increases claims costs) the impact on reserves.

Lloyd's has provided further details within market guidance to Chief Actuaries issued on 6 June 2022.

Given that reserves are an important input to capital models and the level of reserves an important assumption for capital setting, Lloyd's is requesting reserving information as part of the Focus Area Return, but is expecting that this is passed on to the reserving teams to fill in. In order for Lloyd's to understand the materiality of the recent change in inflationary environment, Lloyd's has requested information by reserving class on whether economic and excess inflation have been explicitly considered as part of the Q2 2022 reserving and where an adjustment has been made, the associated quantitative impact. Additionally, a high-level mapping to Lloyd's generic classes of business from Syndicate reserving class is requested.

Further, Lloyd's has requested information on any adjustments made and associated impact to the Technical Provisions Roll-Forward process due to inflation relative to following the Syndicate's typical roll-forward process.

A third query is included in this tab to assess consistency between the SBF and capital model loss ratios for the prospective year new business. Syndicates are required to explain differences in inflation assumptions between the SBF and capital model loss ratios on a gross of reinsurance, net of acquisition cost basis.

It is noted that SBF and model classes may not align 1-1, however we still expect there to be validation performed to test the consistency of inflation assumptions used between the business plan itself and business plan inputs used in the capital model. Syndicate responses should strip out the impact arising from differences between the granularity of classes in the SBF and in the capital model, i.e. if the assumptions used are consistent but there is a difference in how they are applied due only to differences in class granularity, syndicates should select "Yes" from the drop-down menu. Syndicates are required to comment on any other differences which are relevant as well as limitations of the comparison.

5.5 Non-Natural Catastrophe Accumulation Risk

Exposure to non-natural catastrophes is increasing within the Lloyd's market and the wider insurance industry. Non-natural catastrophe risk is defined as events (i.e. an accumulation of claims with a common cause) which are not the result of the natural processes of the earth. Examples include cyber events, pandemic, terrorism and other man-made cats as well as space weather. Compared to natural catastrophes, these risks are less well understood and can evolve at an increasing pace. The November 2020 PRA Dear CRO letter also highlighted that, across the industry, exposure management frameworks for non-property classes of business are less mature than property classes, with varying degrees of progress for this risk in the market.

In order for Lloyd's to understand the materiality of the non-natural catastrophes and the exposure of the market better going forward, Form 313 has been altered to include an additional non-natural catastrophes split for the first time, as outlined in section 2.7.1. Given that this is the first time this information is collected, Lloyd's is not prescribing how this is derived and how the syndicate defines the non-natural catastrophes to be included. We are requesting information in the focus area return to understand how this additional information has been populated and any limitations associated with it.

Agents are requested to provide their definition of non-natural catastrophes. It is expected that agents will have a clear definition of non-natural catastrophes to ensure effective risk coverage, that syndicates understand their risk profile and that non-natural catastrophes receive an appropriate level of focus. It is expected that the definition will distinguish non-natural catastrophes from natural catastrophes, distinguish non-natural catastrophes from attritional claims and account for the expectation that non-natural catastrophes will cause accumulation of losses, i.e. across several policies and/or classes. Lloyd's will also use this definition to ensure consistency across the market in this area. Responses to this question are not required to be submitted with the initial LCR and Focus Areas submission but should be submitted by 1st November 2022.

5.6 Other Focus Areas for the 2023 YoA

Finally, there are some general queries. Two queries relate to previous loadings and feedback. There are two questions to assist with the modelling in the Lloyd's Internal Model. These are the back-test of the 2021 year of account; and providing the impact of non-proportional reinsurance on an ex-natural catastrophe basis. These are described in the "2023 General queries" tab of the Focus Areas return. There is also a question about the Q2 2022 to Q4 2022 TPs roll-forward process and whether any adjustments have been made to this in light of the various events outlined in the rest of the focus areas template.

6 Appendix 1: Definition of Metrics for Fast Track

Exact definitions of risk-to-exposure metrics from items on LCRs are laid out below.

#	Metric	Definition
S1	SCR(U) stress-to-exposure measure	SCR(U) stress = LCR Form 310 Row 2 Col G - LCR Form 310 Row 2 Col A Exposure measure = Mean Premium risk net claims + ½ * Mean Reserve risk net claims Mean Premium Risk Net Claims = LCR Form 502 Q1 Col B Total Mean Reserve Risk Net Claims = LCR Form 510 Q1 Col A Total
S2	Premium Risk (U) Stress-to-exposure figure	Premium Risk Stress = LCR Form 314 Table 1 Row 2 Col B Exposure Measure = Mean Premium Risk Net Claims = LCR Form 502 Q1 Col B Total
S3	Reserve Risk (U) Stress-to-exposure figure	Reserve Risk Stress = LCR Form 314 Table 1 Row 3 Col B Exposure Measure = Mean Reserve Risk Net Claims = LCR Form 510 Q1 Col A Total
S4	SCR(1) stress to SCR(U) stress	SCR(1) stress = LCR Form 310 Row 1 Col G - LCR Form 310 Row 1 Col A SCR(U) stress = LCR Form 310 Row 2 Col G - LCR Form 310 Row 2 Col A

7 Appendix 2: Definition of Claims Inflation

We define claims inflation as the change in claims cost of a like for like policy over time.

Claims cost is considered as all costs in relation to the payment and settlement of a (re)insurance claim. This includes loss adjustment expenses directly associated with the claim, such as claims handling.

Like for like means having consistent policy wording, exposure and level of coverage, such that the change in claims cost is considered after normalizing for changes in policy terms and other differences in the policy.

Our definition of claims inflation covers changes in claims cost due to trends which affect the number (frequency) and/or size (severity) of claims.

Claims inflation is the sum of economic inflation and excess inflation:

- Economic inflation: Changes in claims costs as captured through published economic indices relevant to a (re)insurer's mix of business.
    - Typically, this is inflation in the cost of a basket of selected goods and services or average wage costs, which are captured in price and wage indices (such as RPI, CPI and ASHE in the UK, which are produced by ONS).
- Excess inflation: Changes in claims costs beyond what is captured in economic indices, including factors which are specific to a (re)insurers' business.
    - Typically, this is inflation associated with resources specific to the nature of the claims costs of the (re)insurer (beyond that captured in generic inflation indices), or emerging risk from new materials, medicines and technologies.

We define social inflation as a subset of excess inflation, which more narrowly pertains to claims inflation as a result of societal trends.

This includes rising costs of claims resulting from increased litigation, broader definitions of liability (excluding those caused by changes in policy terms and conditions), more plaintiff-friendly legal decisions, larger compensatory jury awards and social movements.